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What Are Points and When Should You Pay Them?

Points are up-front fees paid by the borrower to obtain a better interest rate on a loan. One point equals one percent of the loan amount. And while a lower interest rate may result in a lower monthly payment, it is important to consider how long you intend to be in the loan and to compare current interest rates to historical market trends. This will help you to determine whether paying points is a worthwhile investment.

Let's look at a sample scenario. If you take out a \$300,000 mortgage and decide to pay one point in order to lower your interest rate, this would translate into an up-front cost of \$3,000. To keep things simple, we'll assume that paying this one point will save you \$50 a month. This means it will take you 60 months to recoup the cost of that point. If you decide to refinance or sell the home before the 60-month mark, your money is lost not to mention the opportunity cost of not having this money invested elsewhere. In this scenario, you would only benefit financially from paying points if you were to remain in the home for no less than 60 months.



It's also important to remember that interest rates run in cycles. When rates are at historical lows, it makes more sense to pay points if you plan to live in the home for an extended period of time. If it's unlikely that rates will go down in the near future, then there will be no need to refinance.

When interest rates are high, however, there is a strong likelihood that they will come down again before too long. Therefore, this is not a good time to pay points. The chances of refinancing in the near future are extremely high, and you will likely not be in the loan long enough to recoup the up-front cost of the points.

Tax deductibility is another thing to consider when choosing whether or not to pay points. For new purchases, interest from both points paid and your mortgage are tax deductible up front. For refinances, however, points are not deductible up front. Instead the deductions are spread out over the term of the loan (unless the entire loan is paid off early), making points more costly in comparison.

Ultimately, there's a lot to consider when it comes to points and whether or not they are a worthwhile investment. An experienced mortgage professional will work with you to determine the best course of action based upon your specific situation. Request a comprehensive cost comparison to see whether paying points could be financially beneficial to you.

If you or someone you know would like to learn more about points and whether they should be a part of your mortgage plan, give me a call. I would be happy to assist you!

