



## Don't Pay Points, Please!

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So you're in the market for a mortgage. After hearing about all the options and products, your head is probably spinning. If that weren't enough, after you pick your mortgage you then have to decide whether to pay points, and how many.

What is a point anyway? Points are prepaid interest. One point equals one percent of the mortgage amount. One point on a \$200,000 mortgage is \$2,000.

People are often tempted to pay points because it will reduce their interest rate. And why not? If it saves you money in the long run, then it must be good. But in the real world, it usually doesn't work out that way.

Let's look at an example: You take on a \$200,000 mortgage with a 30-year fixed-rate. Your lender offers 8 percent with no points, or 7.75 percent with one point, or 7.50 percent with two points, and so on.

Generally one point equals a quarter of a percentage point. It's not a hard and fast rule, but it usually works out that way.

- The 8-percent/zero point option equates to a monthly mortgage payment of \$1,467.
- The 7.75-percent/one point option equates to a \$1,433 monthly payment, but with \$2,000 paid up front.

So your choice is: save \$2,000 now, or save \$34 each month going forward.

It's quite natural for you to make a few quick math calculations: \$2,000 divided by \$34 equals roughly 59. So 59 months (nearly five years) from now, the point you paid will pay for itself.

This is probably how some mortgage bankers will explain it to you. In turn, you might respond by saying: I plan to live here more than five years so

the point makes sense. That can be a big mistake. Worse yet, it's the kind of mistake that goes unnoticed. The simple calculation is flawed; that's the whole problem. This is one case where simplicity isn't good.

Here's why. The question really boils down to how you can best use that \$2,000. You can pay a point, you can invest it, you can pay down other debt, or you can put it toward a bigger down payment on your house. If you plow it into the down payment, now you have a mortgage balance of \$198,000. This changes the original choice you were faced with above. Now the choice is:

- The 8-percent/zero point option gets a monthly mortgage payment of \$1,452 with the lower starting balance.
- The 7.75-percent/one point option equates to a \$1,433 monthly payment, but with \$2,000 paid up front.

So now your choice is: put the \$2,000 toward the down payment, or pay the point and save \$19 each month going forward. Now when you do the quick math: you will divide \$2,000 by \$19 and come up with about 105 months or nearly nine years. This isn't quite the no-brainer the previous decision was.

The average family changes residences about every nine years, according to the National Association of Realtors. And first-time homebuyers move frequently. The Mortgage Bankers Association says the typical homeowner refinances once in nine years. All this brings us to the average life of a mortgage, which is less than five years. So more often than not, borrowers will find themselves with a new mortgage before one point pays off.

The case for avoiding points is even more compelling when you refinance a mortgage. That's because the tax treatment is less favorable. The points paid on a first mortgage when you purchase a home are fully deductible on your federal taxes that year. That's one of the selling points of points to begin with. But on a refinance, you must amortize those points over the life of the loan. This leaves you with slim pickings at best, on the tax benefit side of the equation. On a refinancing with \$3,000 of points paid, you get to deduct just \$100 per year on a 30-year loan.

Lenders love to take your point money. But you should keep it and put it toward a sure thing, like cutting your loan size.