09/29/2006

Getting the Best Rates and Points Combination on Your Home Loan

Two terms you'll frequently encounter when applying for a mortgage loan are "points" and "rates." Knowing as much as possible about these before signing a contract will help you get the best loan for your situation.

The term "rates" refers to the interest rate you will receive on your loan. It will determine how much interest you will pay over the course of the loan. "Points" are the fees paid to the lender at the close of the loan. One point is 1% of the loan total. For example, one point on a $100,000 loan would be $1,000.

Most people only think about getting the best interest rate possible for their home investment. However, depending on the amount of points you pay, almost any rate is available to you.

Generally the more points you pay, the lower your interest rate will be. The reverse is also true: the higher your interest rate, the fewer points you'll pay. This is because both points and the interest rate help insure the lender against any payment delinquencies or foreclosure on your part. If you pay more points initially, your rate can be lower in the future since you have given a sizable contribution to the loan. If you do not pay points at the beginning, your rate will be higher to get that contribution through interest payments.

Keep in mind that points are a one-time fee similar to a down payment, but the interest rate will affect the your payments for the rest of the loan term. Many first-time buyers do not have much choice in picking their ideal rate, as they have little cash to contribute to as points. Homebuyers who have been down the mortgage path before can often bring money to the bargaining table after selling a previous home. Getting a lower interest rate this way will save you money from month to month, but it will cost you more out-of-pocket cash at the beginning. It is very important to consider the costs and benefits to you of any given points/rate combination.

The amount of points you'll be required to pay will differ greatly among lenders. Some may even pay you points if you pay a very high interest rate. (These are called negative points and will cost you much more in the end if you stay in your home longer than 3 years.) Some lenders will allow you to pay no points and some may ask for several up front. Your best strategy is to determine how many points you can afford or want to pay when you close the loan, and then you can look around for possible lenders based on their point and rate schedules.

Usually, it is a better idea to pay some points rather than get a higher interest rate if you plan to stay in your home for three or four years. That is true whether you have a fixed rate mortgage or adjustable rate mortgage.

You can use a simple formula to determine how long you'll have to stay in your home to break even in savings between points and interest rate. Just divide the cost of the closing points by the potential monthly savings with the corresponding interest rate. The answer will be the number of months you'll need to stay in your home to "break even" between closing costs and savings.

A chat with a trusted mortgage lender or two will help you figure out just what combination will

Copyright © 1999-2008 Homeloanbasics.com, Etrafficers, Inc., or its affiliates

best fit your home-owning needs.

Copyright © 1999-2008 Homeloanbasics.com, Etrafficers, Inc., or its affiliates