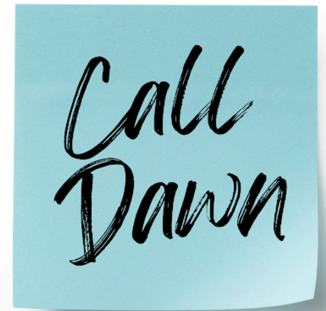
Discount Points



Discount points are the most variable among all closing costs associated with obtaining a mortgage. Specifically, one discount point equates to 1% of your loan amount. While discount points are paid as a fee at closing, it's essential to consider them part of your overall interest cost for the loan.

What Options Do You Have?

When you choose to pay discount points, you are prepaying interest at the closing table. In return for this prepayment, you receive a reduction (or discount) on your interest rate. Conversely, you can opt for a higher interest rate for lower discount points. In fact, at a sufficiently high interest rate, your discount points could drop to zero or even result in a credit paid to you, rather than an additional cost.

Typically, discount points on a conventional loan can range from a 2% cost to a 2% credit. This creates a substantial financial variability—potentially a $4,000 swing in costs for every $100,000 you borrow. Ultimately, the choice of what to pay is yours.

Should You Buy Discount Points?

Once you're eligible to lock in your interest rate, we will provide a variety of options—ranging from loans with lower rates and higher points to those with higher rates and lower points. You might have anywhere from three to six scenarios to consider, and we'll guide you through these choices.

Many people find lower rates enticing, often viewing them as the "shiny object" that's hard to resist. However, it's important to recognize that a loan with a higher rate could save you money. The ideal combination of interest rate and discount points you choose should depend on two factors: 1) how long you plan to keep the loan, and 2) your available budget for closing costs.

If you have ample funds to spend on discount points, your decision should center around the duration you intend to hold the loan. Prepaying a portion of interest at closing can be financially beneficial if you plan to keep your mortgage for an extended period. The lower rate and monthly payment can provide savings that pay off over the years.

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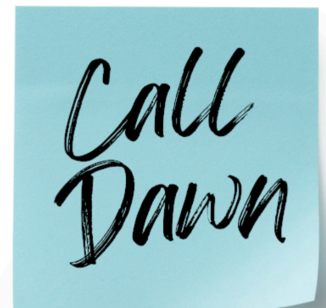
On the other hand, if you expect to sell or pay off your loan sooner, a higher interest rate may be more advantageous. Remember, a higher rate can significantly reduce your closing costs. While your monthly payment will be slightly higher, if you don't plan to make many payments, the total additional cost may be less than what you save at closing.



How to Assess Your Options?

Assessing your options is straightforward. Start by comparing two loan scenarios:

1. Determine the cash required at closing for each option.
2. Compare the differences in monthly payments.
3. Divide the difference in upfront costs by the difference in monthly payments to calculate the "break-even" point—the number of months it takes to recoup your investment in points.

If you anticipate keeping the loan longer than this break-even period, the lower rate with higher costs is likely your best choice. Conversely, if you plan to keep the loan for a shorter duration, opting for a higher rate and lower costs may be the way to go. While additional factors like time-value of money and tax considerations can complicate the analysis, this straightforward math serves most scenarios effectively.

Considering Money and Discount Points

For many of us working within a budget, managing costs is crucial. After all, you can't spend what you don't have. That's where **discount points** come into play as a valuable tool for managing your cash due at closing.

The extent to which a certain number of discount points will lower your interest rate can vary significantly based on market conditions, your specific loan type, and even the rate you select. For example, the cost of buying a rate that is just 0.125% lower can range from as little as 0.25% of your loan amount to as much as 1% or more, making it difficult to define what's "normal." Generally, for a 30-year fixed-rate loan, a 0.125% reduction in your note rate should typically cost around 0.5% in discount points. In such cases, your break-even point—calculated as mentioned earlier—falls between 5 and 6 years. This means you would need to make 60 to 70 months of payments at the lower rate to recoup the upfront cost of the discount points.

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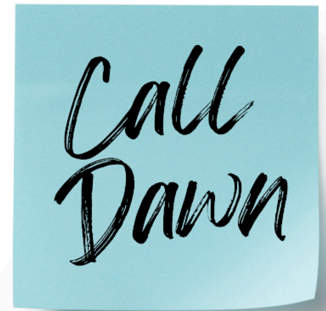
Additional Considerations



While much of our discussion about discount points centers on finding the right balance between discount points and interest rates, there's another important factor to consider: risk. Lenders have become increasingly sophisticated in assessing the risk of default associated with different loan types. Your credit score, loan amount, down payment percentage, the type of property being purchased, your occupancy status, and the type and term of your loan all contribute to your overall risk profile.

When lenders perceive increased risk, they often compensate by charging additional fees in the form of discount points. If you face any risk premiums, we'll inform you of these charges and work together to strategize ways to minimize them.

It's important to note that not every loan includes variable discount points or risk premiums. Notable exceptions to this include the Oregon Bond loan, the Oregon VA home loan, and some jumbo loans.

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