

December 23, 2006

GREEN THUMB
 By RON LIEBER



Deciphering Mortgage Points

**Research Shows Few Do It Right;
 Calculating the Unknown**
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An offer to pay more now in order to pay less later can be a real head-scratcher. But it's a key part of mortgage negotiations -- and there's evidence that people often make the wrong choice.

Lenders frequently let borrowers pay "points" to lower the interest rate on their mortgage. Each point costs one percent of the mortgage amount, and you pay up front (or roll the points into the loan and pay over time). In return, the loan's interest rate drops permanently, often from one-eighth to one-quarter of a percentage point for every "point" paid.

Points were popular in the 1970s, when interest rates were high. As rates have fallen to historic lows recently, fewer people have bothered. Buying points can still make sense, however, if you play the numbers right.



Extra Points

A primer on points, the discount that lenders often offer people applying for mortgages:

- **Each point** costs 1% of the mortgage amount
- **You get** a discount on your interest rate, often from one eighth to one fourth of a percentage point
- **Various tax** deductions are available to people who buy points

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Start with a basic question: How long do you think you will hold the loan? If you hold it long enough, the savings on the monthly payments from the lower interest rate will more than cover the cost of the points. Most of the time, it takes years to get there.

Doing the math involves other issues, too, such as whether you intend to invest any savings, like the money not spent on points. Plus, there are tax breaks for points buyers. There's a good calculator for figuring it all out at mtgprofessor.com¹. Scroll down, click on "Mortgage Calculators," then scroll to the points calculators.

Say you seek a \$500,000, 30-year, fixed-rate mortgage and can get a 6% rate with one point or a 6.25% rate with no points. You would have to keep that loan for 57 months to break even on the points (assuming you are in the 33% tax bracket and your savings earn 7%).

To see how points have worked out for borrowers, Penn State professor Abdullah Yavas and one of his graduate students, Yan Chang, who is now a senior

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economist at mortgage giant Freddie Mac, tracked 3,785 fixed-rate mortgages between 1996 and 2003. The two researchers obtained their data from Freddie, but the company didn't fund the research or assist in any other way, says Mr. Yavas.

The pair found that just 1.4% of borrowers held their mortgages long enough to break even on the points they paid. The rest paid off their loans more than three years, on average, before they would have hit that break-even point.

How could so many people get it wrong? Interest rates fell during the period, and home values rose, so those who refinanced had good reason to seek a new deal.

But that highlights the risk in paying points in the first place: No one can predict which way interest rates are headed. That said, rates remain low, which means that people currently paying points are somewhat less likely to need to refinance later just to obtain a lower rate.

Other unknowns are closer to home: Maybe you unexpectedly have twins, or your aging parents need to move in, necessitating more space. Or a big promotion enables you to upgrade your suburb.

If you hold the loan for a decade or more, paying points can pay off big time. But throwing thousands of dollars at them doesn't seem wise, given our proven inability to predict the future.

- Make your points to ron.lieber@wsj.com²

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