Lender credits: How mortgage lenders can pay your closing costs

What are lender credits?

Lender credits are an arrangement where the lender agrees to cover part or all a borrower's closing costs. In exchange, the borrower pays a higher interest rate. This is also known as "lender-paid closing costs."

Lender credits can be a smart way to avoid the upfront costs of buying a house or refinancing. They can also help you put more of your savings toward a down payment.

But lender credits aren't always the right choice. For some borrowers, it makes sense to pay *more* upfront and get a lower interest rate. Here's how to negotiate the best mortgage deal for you.

How do lender credits work?

Lender credits are a type of "**no-closing-cost mortgage**" where a mortgage lender covers all or part of a borrower's closing costs. Of course, lenders don't pay borrowers' fees out of generosity. In exchange for absorbing closing costs, the lender charges a higher interest rate. The "extra" interest paid by the homeowner over time eventually repays any fees covered by the lender.

For buyers who plan to stay in their homes indefinitely and those who have sufficient cash upfront, lender credits usually aren't ideal because the higher long-term interest cost outweighs the initial savings. But certain home buyers may find lender credits advantageous.

Benefits of lender credits

While lender credits mean you could pay thousands more in interest over the life of the loan, there are several valuable benefits for some borrowers.

- **Purchase a home sooner**: In some cases, the increased amount you'll pay in interest may be offset by what you'd be paying for rent while you continue to save for a home. Lender credits can help buyers get into homes faster and start building equity wealth
- **Increased savings when selling shortly after buying:** Higher interest rates mean you'll pay more over the loan term. But those who sell their properties within a few years will benefit from saving thousands in closing costs that only cost them a couple of hundred dollars in extra interest
- **Avoid paying private mortgage insurance**: Buyers with conventional loans who are near the edge of 20% down can apply what they would have paid for closing costs toward their down payment and avoid PMI
- **Lower mortgage insurance premiums**: Since the amount conventional borrowers pay for mortgage insurance is loosely based on the size of the down payment, offering more money down can lower your premiums

If lender-paid closing costs will help you afford a home when you couldn't otherwise, they can be a great idea. Keep in mind that you can refinance out of that higher interest rate later if rates fall.

What can lender credits be applied to?

Lender credits can work in a few different ways, depending on what the lender agrees to cover and how much the borrower is willing to increase their mortgage rate. For example:

- The lender might cover *all* the borrower's closing costs
- The lender might cover its own fees and third-party services (like the appraisal) but not prepaid items (like property taxes and homeowners insurance)
- The lender might cover *only* its own fees and none of the third-party services or prepaid items

The more of your **closing costs** a lender pays via lender credits, the higher your mortgage interest rate will be, and vice versa. Mortgage pricing is flexible, and you can take advantage of tools like lender credits to negotiate a rate and fee structure that works well for you.

How to compare mortgages with lender credits

If you're considering a home loan with lender credits, it's important to weigh the short-term savings versus the long-term cost. You might eliminate your upfront fees with lender credits. But the tradeoff of accepting a higher interest rate means you'll pay more in the long run. You'll also have a higher monthly payment.

Consider your loan term

If you keep your loan for its full term — typically 30 years — the amount of extra interest, you pay could far exceed the amount you would have spent on upfront closing costs.

However, most home buyers don't keep their mortgages for the full loan term. They sell or refinance within a decade or so. If you only keep your loan for a few years, having a slightly higher interest rate might not matter as much. So, you need to consider how long you plan to keep the mortgage before selling or refinancing it to decide if lender credits are worth it.

Compare mortgage offers

Be sure to **compare mortgage offers** on equal footing. If you look at one lender quoting a zero-cost mortgage, and another that's only covers origination fees, you're going to see very different rates. So, make sure all the lenders you compare are covering the same amount and types of closing costs.

You can find your total closing costs and how many lender credits are included in the standard **Loan Estimate** you'll receive after applying with any lender. These documents make it easy to compare home loan offers side-by-side to find the better deal.

Compare mortgage companies

You should also compare no-closing-cost loans from a few different mortgage lenders. Each lender structures lender credits differently — so you might find one that covers the same amount of closing costs but charges a lower interest rate than another.

Are lender credits worth it? An example

Typically, the less time you keep your mortgage, the more you'll benefit from lender credits. Here's an example:

	No Lender Credits	With Lender Credits
Loan Amount	$250,000	$250,000
Interest Rate*	3.00%	3.75%
Upfront Closing Costs	$9,000	$0
Interest Paid In 5 Years	$35,500	$44,500
Interest Paid In 30 Years	$129,500	$166,800

**Interest rates are for sample purposes only. Your own interest rate with or without lender credits will vary.*

This home buyer can take a 3% interest rate on a 30-year fixed-rate mortgage with $9,000 in closing costs (3.6% of the loan amount), or they can accept a 3.75% interest rate with $0 in upfront closing costs. If the homeowner keeps the mortgage for five years or less, lender credits are likely worth it.

At the end of year five, they will have paid $9,000 in extra interest due to their higher rate. But they saved $9,000 upfront. So, if they sell or refinance any time before the end of year five, the savings from lender credits outweigh the added cost. This point — where the upfront savings level out with the long-term cost — is known as the "break-even point."

If this homeowner stays *beyond* the break-even point, they end up paying their lender more in added interest than they saved upfront. So, it’s easy to see how lender credits don’t make as much sense if you plan to keep your loan for a long time.

What is the difference between lender credits and discount points?

Lender credits can work the opposite way, too. Instead of paying less upfront and taking a higher rate, you can pay *more* upfront and get a *lower* interest rate. This strategy is known as points, mortgage points, or discount points.

Whereas lender credits save you money upfront but increase your long-term cost, **discount points** cost you more at closing but can save you a huge amount of money over the life of the loan. Having a lower interest rate also reduces your monthly mortgage payments. Look at an example:

	With 1 Discount Point	No Points or Credits	With Lender Credits
Loan Amount	$250,000	$250,000	$250,000
Interest Rate*	2.75%	3.0%	3.75%
Upfront Closing Costs	$11,500	$9,000	$0
Interest Paid In 5 Years	$32,500	$35,500	$44,500
Interest Paid In 30 Years	$117,500	$129,500	$166,800

**Mortgage interest rates are for sample purposes only. Your own interest rate with or without points or credits will vary.*

One discount point typically costs 1% of the loan balance and lowers your rate by about 0.25 percent. In this case, one-point costs the borrower an extra $2,500 at closing and lowers their rate from 3% to 2.75 percent.

- **By the end of year five:** The homeowner has already saved $3,000 in interest compared to the original rate quote. The longer they keep their mortgage, the more that discount point will pay off
- **By the end of the 30-year loan term:** They've saved $12,000 compared to the original rate — and nearly $50,0000 compared to the no-closing-cost mortgage

This is just another example of how borrowers can use mortgage pricing to their advantage.

The homeowner staying long-term can pay for discount points and save themself tens of thousands of dollars over 30 years. The person buying a starter home, or a fix-and-flip can eliminate their upfront cost and sell before the higher interest rate starts to matter.

It's up to you to decide what makes the most sense based on your home buying or refi goals, and your personal finances. Your loan officer or mortgage broker can help you compare options and choose the right pricing structure.

Negotiating your mortgage interest rate

Both lender credits and discount points involve **negotiating with your mortgage lender** for the deal you want. You'll be in a better position to negotiate low closing costs and a low rate if lenders want your business. That means presenting yourself as a creditworthy borrower in as many areas as you can. Lenders typically give the best rates to borrowers with a:

- Credit score above 720
- Down payment of 10-20% or more
- Debt-to-income ratio below 43%
- Clean credit report with no late payments
- Loan balance within conforming loan limits

Of course, you don't need to be perfect in all these areas to qualify for a mortgage. Some types of loans offer buyers a more flexible home purchase experience, including:

- FHA loans: This loan program allows credit scores as low as 580 and a down payment of only 3.5%. Keep in mind that the tradeoff for this flexibility is that you'll pay mortgage insurance premiums until the loan is paid off or refinanced
- USDA or VA loans: These loan types let you buy with 0% down and no ongoing mortgage insurance premiums. But each program has its own specific guidelines

Making improvements where you can — for instance, raising your credit score or paying down debts before applying — can make a big difference in the rate you're offered.

Lender credits FAQ

Why do lenders give credit?

Mortgage lenders offer credits to pay closing costs for borrowers who are short on cash. While lender credits provide a short-term benefit for home buyers, the tradeoff is a higher interest rate over the life of the loan. Lenders offer these credits because they get borrowers in the door and ultimately generate more revenue for the lender.

How much are lender credits?

There is no fixed cost for lender credits. Instead, a lender's credit is calculated depending on how many of the closing costs the credit will cover. If your lender is just paying for origination fees and title insurance, then the credit would require a lower interest rate than, say, one that covers all your closing costs.

Can you negotiate lender credits?

Borrowers can typically negotiate lender credits during the mortgage application process. You stand a better chance of negotiating a lower rate increase with a sizable down payment, a low debt-to-income ratio, and a good credit score.

When will you receive lender credits?

You will receive your lender credit at closing to cover all or some of your upfront mortgage costs. The lender credit is a cash credit applied to your loan fees in exchange for a higher mortgage interest rate.

Today's mortgage rates with lender credits

Although today's rates are generally higher than they were a year or two ago, it doesn't mean there aren't still deals to be had. Many borrowers can get their closing costs paid for and still walk away with a competitive rate on their mortgage. This is because the mortgage interest rate you receive will be determined by your lender, the type of loan you apply for, and real estate trends in your area, among other factors.

The trick is to compare mortgage loans from a few different lenders. And, if you want a zero-cost mortgage, make sure you ask specifically for quotes with lender credits so you can find the lowest rate on the mortgage you want.