Mortgage discount points explained

What are mortgage points?

Mortgage points offer a trade-off: They let you pay more money upfront in exchange for a lower mortgage interest rate.

This means you'd pay more in closing costs for smaller monthly payments over the life of your loan.

And, if you keep your mortgage long enough, those discount points could equal huge savings over time.

How mortgage points work

When you check current interest rates from mortgage lenders, you'll often see three different numbers listed: mortgage interest rate, APR, and 'points.'

Points — also called 'mortgage points' or 'discount points' — are fees used to buy down your rate. Each discount point costs 1% of your loan size, and it typically lowers your mortgage rate by about 0.25%.

How to shop for a mortgage with points

When you're looking at a rate quote that includes points, you'd have to pay extra money upfront to get the rate shown.

For example, imagine you're taking out a $300,000 mortgage loan. Here's how your interest rate *might* look with and without mortgage points:

Mortgage Points	Upfront Cost to Buy Points	Interest Rate	Total Interest Paid Over 30 Years
0	$0	3.50%	$185,000
0.5	$1,500	3.375%	$177,500
1	$3,000	3.25%	$170,000
2	$6,000	3.0%	$155,300

The interest rates shown are for sample purposes only. Your own mortgage rate and fees will vary. KeyFactor_MLO will pair you up with a preferred lender to get a custom rate.

The cost of buying mortgage points adds up quickly. But as you can see in the example above, the long-term savings built into your monthly mortgage payment can be substantial.

How discount points affect your mortgage rate

When discount points are paid, the bank collects a one-time fee at closing in exchange for a lower interest rate over the life of the loan.

However, the size of your interest rate reduction will vary by bank.

This is one of the reasons why it's important to shop for your best mortgage rate. Different banks will offer different rate reductions in exchange for paying points.

As a rule of thumb, paying one discount point lowers a quoted mortgage rate by 25 basis points (0.25%).

Different banks will offer different rate reductions in exchange for paying points. So, shop around carefully.

However, paying two discount points will not always lower your rate by exactly 50 basis points (0.50%), as you would expect. Nor will paying three discount points necessarily lower your rate by 75 basis points (0.75%).

In addition, banks consider discount points to be a form of "prepaid interest," which is **tax-deductible for eligible tax filers**.

So, for some mortgage borrowers, there's an added tax advantage to buying points, as we'll discuss more below.

However, you don't pay for discount points to get the IRS tax break. You pay to get the mortgage rate break.

For more information about the discount point mortgage tax deduction, speak with a professional tax advisor.

Are mortgage discount points worth it?

Discount points can save you money if you stay in the home loan long enough to make them worthwhile.

The following example will show the impact of discount points on the monthly payments for a $300,000 home loan financed over 30 years:

Discount Points	Mortgage Rate	Monthly Payment	Monthly Savings
0	3.5%	$1,347	0
1 ($3,000 upfront)	3.25%	$1,305	$42
2 ($6,000 upfront)	3%	$1,265	$82
3 ($9,000 upfront)	2.75%	$1,225	$122

Payment estimates do not include real estate property taxes or homeowners insurance. They include mortgage principal and interest only.

In the above example, the mortgage applicant saves $42 a month by spending $3,000 on discount points upfront.

To reclaim the full $3,000 cost of the point, the homebuyer would need to make 72 regular monthly payments. That would take six years of making the loan's regularly scheduled payments.

Finding your break-even point

Home finance experts call this period of time needed to recover your upfront cost the "break-even point."

Every mortgage loan will have its own break-even point for buying points.

If you plan to stay in your home beyond the break even point and — this is key! — if you don't think you'll refinance before the break-even hits, **paying points may be a good idea**.

The longer you stay in the home beyond the break-even point, the more you'll save because the interest rate reduction continues generating monthly savings as long as you have the loan.

When are discount points a waste of money?

Selling your home or refinancing the mortgage before its breakeven point can make discount points a waste of money. In this case, you'd do better to put the money toward your down payment to increase your home equity.

According to **Freddie Mac**, the typical 30-year fixed-rate mortgage loan carries between 0.5 and 0.7 discount points. Adjustable-rate mortgages tend to carry fewer points because ARM homebuyers intend to sell or refinance sooner. Points pay off only if you keep the loan long enough to realize savings from the reduced interest rate.

How mortgage points affect APR

Banks will sometimes use a mortgage shopping tool known as "APR" to make a loan with discount points look more attractive than it really is.

APR, which stands for **Annual Percentage Rate**, is a calculation that shows the long-term cost of holding a mortgage.

APR includes the cost of mortgage insurance, which is required for most types of mortgages. APR also reflects the effect of discount points on your rate.

But APR also assumes you'll hold your loan for 30 years and pay off the total loan amount on schedule. Very often, you will not, which nullifies the APR math.

This is why it's important to remember that **your APR is not your mortgage rate**.

Comparing loan estimates using the "lowest APR" method is rarely a good plan. It uses discount points against you. If you're not clear how much you'll pay to borrow, ask your loan officer to walk you through your **Loan Estimate** or a truth-in-lending disclaimer.

“Negative” discount points (zero-closing cost loans)

Another helpful aspect of discount points is that lenders will sometimes offer them in reverse.

Instead of paying discount points to get access to lower mortgage rates, you can *receive* points from your lender and use the cash to pay for closing costs and fees associated with your home loan.

The technical term for reverse points is a “rebate.”

Mortgage applicants can typically receive up to 5 points in rebate. However, higher rebates create higher interest rate loans.

Here is an example of how rebate points may work on a $300,000 mortgage with a 30-year loan term:

Rebate points	Mortgage rate	Monthly payment	Added monthly cost
0	3.5%	$1,347	0
1 ($3,000 rebate)	3.75%	$1,389	$42
2 ($6,000 rebate)	4%	$1,432	$85
3 ($9,000 rebate)	4.25%	$1,476	$129

Payment estimates do not include real estate property taxes or homeowners insurance. They include mortgage principal and interest only.

Homeowners can use rebates to pay for some, or all, of their loan’s closing costs. When you use a rebate to pay for all your closing costs, it’s known as a zero-closing cost mortgage loan.

Zero-closing cost mortgages reduce the amount of cash required at your closing. The lender rebates can cover bank charges, like the loan origination fee, along with closing costs charged by third parties such as the attorney or appraiser.

Buyers who are using **low-or no-down payment mortgages** may find this option appealing — especially if they're worried about keeping money in savings for emergencies or other life events.

When you do a zero-closing cost refinance, you can stay as liquid as possible with all your cash in the bank.

Rebates can be good for refinancing, too

Using rebates, a loan's complete closing costs can be 'waived,' allowing the homeowner to refinance without increasing their mortgage amount.

When mortgage rates are falling, zero-closing cost mortgages are an excellent way to lower your rate without paying fees repeatedly.

You could potentially refinance three times in a year or more and never pay fees to the bank.

Are mortgage points tax-deductible?

Discount points can be tax-deductible, depending on which deductions you claim on your federal income taxes.

To write off discount points, or any other qualifying mortgage interest payments, you'd need to itemize your deductions using Schedule A of IRS Form 1040.

If you take the standard deduction, you will not be able to deduct mortgage interest or mortgage points.

Discount points paid on a home purchase mortgage loan can be 100% deductible in the year in which they're paid. Discount points on a **home refinance mortgage loan** cannot.

The tax deduction for points paid on a refinance loan is spread over the life of the loan. A homeowner paying points on a 30-year mortgage loan can claim 1/30 of the points paid as a deduction annually.

Always consult a professional before filing. This website doesn't give tax advice. Let your tax preparer know if you'd like to write off mortgage interest payments and discount points.

What are today's mortgage rates?

Today's mortgage rates are at historic lows. Mortgage points allow borrowers to buy down their interest rate even further, which can generate huge savings.

However, mortgage points aren't always worth it. And if you opt not to pay for them, you're still likely to get a great deal in today's ultra-low rate environment.