

Homebuyers Paying Too Much in Points, Says New Statistical Study.

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Do mortgage applicants seeking lower interest rates end up paying too much in upfront points? A new statistical analysis suggests that only a small fraction of consumers who opt to pay points hold onto their mortgages long enough to actually recoup the costs.

In fact, according to first-of-its-kind research by Penn State business professor Abdullah Yavas and Yan Chang, a senior economist at mortgage investor Freddie Mac, home buyers who paid points with their loans tended to pay off their loans 37.5 months before the "break even" point.

"The average mortgagor with points ended up defaulting, moving or refinancing more than three years before" they recouped the upfront cash outlays on those points, according to the authors. Yavas and Chang examined detailed data on 3,785 loans closed between 1996 and 2003 that were funded or securitized by Freddie Mac.

Of the borrowers who paid points to lower their rates, only 1.4 percent stayed in their mortgages long enough to financially justify the payments. Conversely, of the home buyers in the study who chose not to pay points, only 1.5 percent of them would have been better off by paying points to lower their rates.

Points represent lump-sum upfront interest paid in advance, typically in connection with a discount on the note rate charged the borrower. Though the conventional assumption in the real estate industry is that each point paid cuts a borrower's interest rate charges by 0.25 percent, the study documents that the actual rate reduction was much less. Using regression analysis, Yavas and Chang estimated the effective rate decreases per point at anywhere from 0.034 percent to 0.096 percent. Equally significant, said the authors, "Our results also indicate that the reduction in the interest rate is not proportional to the increase in points."

With a lower rate impact than generally assumed, the break-even period for people who paid points was considerably longer than they may have believed -- or perhaps had been led to believe.

The authors note that the period of time covered by the loans studied coincided with generally declining mortgage interest rates and a rising propensity by home owners to refinance. That, in turn, often vitiated the value of the points they paid on their mortgages up front. The time span of the study also coincided with the early phase of the housing price boom, which stimulated record levels of resales and purchases.

The net effect was that many people moved sooner than they apparently expected -- again eliminating the financial advantage they might have sought in rate savings by paying substantial points up front.

The bottom line for home buyers, refiners and their professional advisers: Before sinking thousands of dollars into points, make absolutely certain that your rate and interest payment savings are worth the upfront outlay, especially given other investment uses you might have for that money. And try to be reasonably certain that you'll stay in the property long enough to break even ... or better.