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Mortgage points and how they can cut your interest costs

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Buying a house is the most expensive purchase most of us will ever make, so naturally, anything that can reduce the cost of a mortgage is worth looking at. Besides negotiating a good price and shopping for the best mortgage rates, some savvy homebuyers buy mortgage points, also called "discount points," to lower the amount of interest they pay.

What are points on a mortgage?

Mortgage points are the fees a borrower pays a mortgage lender in order to trim the interest rate on the loan. This is sometimes called "buying down the rate." Each point the borrower buys costs 1 percent of the mortgage amount. So, one point on a $300,000 mortgage would cost $3,000.

Each point typically lowers the rate by 0.25 percent, so one point would lower a mortgage rate of 4 percent to 3.75 percent for the life of the loan. How much each point lowers the rate varies among lenders, however. The rate-reducing power of mortgage points also depends on the type of mortgage loan and the overall interest rate environment.

Borrowers can buy more than one point, and even fractions of a point. A half-point on a $300,000 mortgage, for example, would cost $1,500 and lower the mortgage rate by about 0.125 percent.

The points are paid at closing and listed on the loan estimate document, which borrowers receive after they apply for a mortgage, and the closing disclosure, which borrowers receive before the closing of the loan.

Mortgage discount points vs. APR

Buying discount points on your mortgage is effectively a way of prepaying some of your interest, and looking at the annual percentage rate (APR) can help you compare loans with different rate and point combinations. The APR incorporates not just the interest rate, but also the points you pay and any fees the lender will charge. Check out a quick explanation from Greg McBride, CFA, Bankrate chief financial analyst:

Example of how mortgage points can cut interest costs

If you can afford to buy discount points on top of the down payment and closing costs, you will lower your monthly mortgage payments and could save lots of money. The key is staying in the home long enough to recoup the prepaid interest. If you sell the home after only a few years, or refinance the mortgage or pay it off, buying discount points could be a money-loser.

Here is an example of how discount points can reduce costs on a $200,000, 30-year, fixed-rate mortgage:

LOAN PRINCIPAL	$200,000
Interest rate	4%
Discount points	None
Monthly payment	$954
Interest total	$144,016
Lifetime savings	None

In this example, the borrower bought two discount points, with each costing 1 percent of the loan principal, or $2,000. By buying two points for $4,000 upfront, the borrower’s interest rate shrank to 3.5 percent, lowering their monthly payment by $56, and saving them $20,680 in interest over the life of the loan. (However, to save the full $20,680, the borrower would have to live in the home for the full term of the loan, 30 years, and never refinance.)

What is the breakeven point?

To calculate the “breakeven point” at which this borrower will recover what was spent on prepaid interest, divide the cost of the mortgage points by the amount the reduced rate saves each month:

$4,000 / $56 = 71 months

This shows that the borrower would have to stay in the home 71 months, or almost six years, to recover the cost of the discount points.

“The added cost of mortgage points to lower your interest rate makes sense if you plan to keep the home for a long period of time,” says Jackie Boies, a senior director of Partner Relations for Money Management International, a nonprofit debt counseling organization based in Sugar Land, Texas. “If not, the likelihood of recouping this cost is slim.”

You can use Bankrate’s mortgage points calculator and amortization calculator to figure out whether buying mortgage points will save you money.

Mortgage origination points

Mortgage origination points are another type of mortgage points. They are fees paid to lenders to originate, review and process the loan. Origination points typically cost 1 percent of the total mortgage. So, if a lender charges 1.5 origination points on a $250,000 mortgage, the borrower must pay $4,125.

Origination points differ from discount points in that they do not directly reduce the interest rate of the loan. Some lenders allow borrowers get a loan with no or reduced closing costs or origination points, but compensate for that with higher interest rates or other fees.

Mortgage points FAQs

Should you buy down your rate as mortgage interest rates rise?

Since the start of 2022, mortgage rates have risen sharply, and that might make mortgage points seem more attractive to many borrowers. The calculation is a little more complicated, however, than just figuring out how to get the lowest possible rate in the current market, McBride says.

“While borrowers may give greater consideration to paying points when rates have been on the rise, the breakeven point is still nearly six years,” McBride says. “The benefits of paying points only truly accrue if you expect to have the loan longer than that, which might be very plausible when rates were at all-time lows near 2.5 percent, but with rates at 4.5 percent, you’re more likely to be looking to refinance if we see a drop in rates.”

Basically: Points could be a good way to go if you want to set and forget your mortgage, but if you plan to manage the account more actively and refi into a lower rate if the market recedes, it might not be worthwhile to buy them now.

How are mortgage points factored into advertised rates?

Whether you find a rate on a mortgage lender's website or through a third party, the mortgage rates you see advertised might or might not include points. One rate might even seem attractively low, but that could be due to points already factored in that you might not want to pay. On Bankrate, we specify whether advertised mortgage rates include points so you can make a fair comparison between lenders.

How do mortgage points work with ARM loans?

Mortgage points on an adjustable-rate mortgage (ARM) work like points for a fixed-rate mortgage, but most ARMs adjust at five years or seven years, so it's even more important to know the breakeven point before buying points.

"Factor in the likelihood that you'll eventually refinance that adjustable rate because you may not have the loan long enough to benefit from the lower rate you secured by paying points," says McBride.

Because the points only apply to the fixed period of an ARM, most adjustable-rate borrowers do not use them, according to U.S. Bank.

Can you negotiate points on a mortgage?

You can decide whether or not to pay points on a mortgage based on whether this strategy makes sense for your specific situation. Once you get a quote from a lender, run the numbers to see if it's worth paying points to lower the rate for the length of your loan.

Sometimes, origination points can also be negotiated. Homebuyers who put 20 percent down and have strong credit have the most negotiating power, says Boies.

"A terrific credit score and excellent income will put you in the best position," Boies says, noting that lenders can reduce origination points to entice the most qualified borrowers.

Are mortgage points tax-deductible?

Mortgage discount points, which are prepaid interest, are tax-deductible on up to $750,000 of mortgage debt for homeowners who bought property after Dec. 5, 2017, or up to $1 million for those who purchased before that date. Taxpayers who claim a deduction for mortgage interest and discount points must list the deduction on Schedule A of Form 1040.

“That generally isn’t a problem for homebuyers, as interest on your mortgage often is enough to make it more beneficial to itemize your deductions rather than taking the standard deduction,” says Boies.

However, unless you can meet a host of IRS requirements, you can’t take a deduction for all of the points you paid in the same tax year. Each year, you can deduct only the amount of interest that applies as mortgage interest for that year. The points are deducted over the life of the loan, rather than all in one year.

Origination points, on the other hand, are not tax-deductible.

“Points that are not interest but are charges for services such as preparing the mortgage, your appraisal fee or notary fees can’t be deducted,” says Boies.

Consult a tax professional if you’re not sure what home-buying expenses are tax-deductible.

Are mortgage points right for you?

Buying mortgage points is a way to pay upfront to lower the overall cost of your loan. It makes the most sense if you plan to be in the home for a long period of time. The amount you’ll save each month is likely to make the upfront cost worth it.

For many borrowers, however, paying for discount points on top of the other costs of buying a home is too big of a financial stretch, and buying points might not always be the best strategy for lowering interest costs.

“It may make financial sense to apply these funds to a larger down payment,” says Boies.

A bigger down payment can get you a better interest rate because it lowers your loan-to-value ratio, or LTV, which is the size of your mortgage compared with the value of the home.

Borrowers should consider all the factors that could determine how long they plan to stay in the home, such as the size and location of the property and their job situation, then figure out how long it would take them to break even before buying mortgage points.