

Beware of the Smoke and Mirrors of the “2-1 Buydown”



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Here is how it is being sold to buyers - The seller will “buydown” your interest rate 2% in the first year and 1% in the second year. Instead of a rate of 7%, your first year will be 5% and your second year will be 6%. After that you will pay 7% for the life of your loan.

Here's what is actually happening – The seller is contributing to reduce your payments for the first two years AS IF the interest rate was reduced for the first two years..

Let's look at the math based on a current rate of 7% on a \$550,000 loan amount –

Loan Summary	
Loan amount	\$550,000
Purchase Price	\$650,000
Interest Rate (Annual)	7.000%
Loan period in years	30
Number of payments per year	12
Monthly Payment	\$3,659.16
Total Payments	360

2-1 BUY DOWN						
	Interest Rate	Note Rate Payment	Buydown Payment	Monthly Savings	# of Payments	Annual Monthly Savings
Year 1	5.000%	\$3,659.16	\$2,952.52	\$706.64	12	\$8,479.68
Year 2	6.000%	\$3,659.16	\$3,297.53	\$361.63	12	\$4,339.56
2/1 Buydown Cost						\$12,819.24
Concession Required						1.972%

What is REALLY happening is that the seller is contributing \$12,819.24 (almost 2% of the sales price) to pay for a two-year monthly savings AS-IF your interest rate was 5% for the first year and 6% for the second. Thinking you have a lower interest rate makes you feel good, right!

From a marketing standpoint that sounds a lot better than a 2% sales price reduction, doesn't it?

BUT, since that money seems to be available from the seller, let's see how else it could be applied.

1. Take the money as a price reduction and borrow \$12,819.24 less and save about \$85/mo. So, you would owe \$12,819.24 less to the bank AND save an additional \$10,200 in payments in the next ten years. Clearly, that does not sound as exciting as 5% and 6% rates for two years!
2. Take it as a closing cost credit and reduce your cash-to-close by \$12,819.24. Why should you wait two years to save that money when you can have it all now?! You can apply it to your payments on your own if you like rather than have it be dictated by the seller.
3. Use the money to PERMANENTLY buydown your rate to 6.375% for the life of the loan. You would DOUBLE your savings in under 10 years and continue to save over \$225/mo for the life of the loan!

Clearly those options might not SOUND as good to you but the REAL benefits are more advantageous than the marketing “sizzle” of the “2-1 buydown”.

For 30 years I have been providing real life, reliable mortgage advice to my clients based on their personal situation and mortgage math. Call to find out what the best path to home ownership is for YOU.