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Lenders resurrect interest-rate buy-downs as buyer incentives

Extra points can provide same cost savings as reducing home's list price

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By Matt Carter
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With housing inventories in many markets on the rise, it's not unusual for sellers to offer buyers incentives ranging from paying their closing costs or homeowners association dues to free gardening and pool cleaning services.

Many buyers aren't swayed by such offers. What they are looking for is a reduction in asking price.

So sellers are dusting off an old tool from the days of high interest rates that can give buyers a break on their mortgage payments: the interest-rate buy-down.

By agreeing to pay lenders extra points up front, sellers can secure thousands of dollars in savings for buyers, equivalent to a much larger reduction in asking price.

For about $18,000, a seller can permanently buy down the interest rate of a $450,000, 30-year loan a full percentage point, shaving $289 a month off the buyer's mortgage payments, said Joe Carroll, of Metrocities Mortgage.

That assumes a 10 percent down payment on a $500,000 home, with a 6.5 percent interest rate before the buy-down. In order to give the buyer the equivalent savings through a price reduction, the seller would have to cut his/her price by $45,800, Carroll said.

"As a rule of thumb, you basically need twice the price reduction to equal the buy-down's advantage," said Carroll, Metrocities' Southern California region first vice president.

Once fairly commonplace, buy-downs all but disappeared during the boom years in the housing market, when interest rates were falling, prices were climbing, and sellers in many regions could count on receiving multiple offers.

"If you mention buy-downs to a group of Realtors or loan officers, half of them won't know what you're talking about," Carroll said. "It's something we've had to dust off because the market dictates it. Now that the buyers are more in control, we use it as a tool prior to a price reduction."

Loan consultant Jillie Diane of Cal Metro Mortgage Services in Palm Desert, Calif., recently used an interest-rate buy-down on the sale of a $309,000 home. The seller paid 2 points -- about $5,000 -- for a 75 basis-point interest-rate reduction on a 30-year fixed-rate loan that will save the buyer $121 a month, she said. Cal Metro is a joint venture of Metrocities and Windermere Real Estate.

"I think this is the best tool out there for agents and sellers, because it's costing the seller less money to do a buy-down than it would for a price reduction, and it can make a huge difference for the buyer," Diane said. "The buyer can buy more house, because it moves the buyer into a higher price range."

Realtor Michael Weitzel of Windermere Real Estate represented the buyer. Weitzel said he'd never used a buy-down as a negotiating tool.

"I wrote it into the contract and they (the sellers) didn't even blink an eye or ask about it," Weitzel said. "I was surprised they went ahead and did it without a problem," especially because the seller also agreed to connect the house to the local sewer system at a cost of about $15,000.

"It was a bit of a stretch for my buyer to get into the house, so it was good for him to get a buy-down," Weitzel said.

Quicken Loans, which claims to be the nation's largest online lender, is among a number of other lenders marketing interest-rate buy-downs.

"Sellers' concessions of this variety are something we have been recommending to people since the housing pendulum began swinging from the seller's to the buyer's market," said Quicken spokesman Michael J. Dunklee. "It is a win-win situation."

But interest-rate buy-downs can be difficult to explain, said Anthony Marguleas, the broker-owner of Los Angeles-based Amalfi Estates and Amalfi Mortgage.

"Most lenders probably won't go for it," Marguleas said. "Of those who have offered it, who has actually done it? It's too difficult a concept for most people to grasp, whether agents, buyers or sellers."

It's hard to explain an interest-rate buy-down in an MLS listing, Marguleas said, noting that agents will instantly see a reduction in asking price, but only those already interested in buying a property will notice an offer of an interest-rate buy-down as an incentive.

A seller's offer to consider an interest-rate buy-down smacks of "desperation … similar to offering a free Hawaii vacation or a bonus to the buyer or their agent if the home sells by a certain date," Marguleas said. The concept has to be explained to individual buyers at settings like open houses, he said.

Carroll and Diane acknowledged they do have to educate buyers, sellers and agents, but said the interest-rate buy-down is not a difficult concept for most people to grasp.

Metrocities produces brochures for distribution at open houses and provides agents with riders for yard signs that inform buyers that special financing is available, Carroll said.

"For the last few months, I've been educating agents I work with about buy-downs," Diane said. "In this case, the agent educated the buyer on how a buy-down works, then wrote it into the offer to the seller."

A good time to raise the issue of buy-downs is when prequalifying buyers, Diane said, when loan consultants can "show not only the agent but the buyer the difference this might make to them."

Interest-rate buy-downs can be permanent or temporary (a buy-down that's phased out over three years is common). Diane said she doesn't believe in temporary buy-downs because they require buyers to "bank on unknowns."

For now, interest-rate buy-downs are used on less than 5 percent of the loans Metrocities and its partners make, Carroll said.

"You can count the number of buy-downs going through the shop right now on two hands," Carroll said. "But the astute agent is using them to keep more money in the seller's pocket, and get something for the buyer when they don't think the seller is ready to make a heavy price reduction."

American Home Bank has a number of mortgage lending joint ventures with builders who have been using temporary 3-2-1 and 2-1 interest-rate buy-downs as incentives. In a 3-2-1 buy-down, the interest rate is reduced by 3 percent the first year, 2 percent the second year, and 1 percent the third year. A 2-1 buy-down lasts for two years, with a 2 percent reduction the first year and a 1 percent the second.

"The lower rate really sparked in interest and helped our builders sell a lot of homes" in Virginia, Delaware, Pennsylvania and Maryland, said Paul Fazzini, vice president of joint venture development at American Home Bank. The builders purchased a "forward," a block of money that's used to secure multiple buy-downs at a discounted rate, Fazzini said.

"It was extremely popular when first offered in July, and has tapered off a little bit," Fazzini said. But interest-rate buy-downs remain a good tool for builders or any seller looking for ways to help their properties stand apart from similar listings, he said.

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