

What They Don't Want You To Know About Interest Rates!



Is 5.25% better than 6.00%?

What exactly IS a “point”?

On the face of it, 5.25% DOES sound better than 6.00% - but that doesn't begin to tell the whole story!

Interest Rates – How They Work

Yes, of course the interest rate is important, but not quite in the same way most people think it is. Although, that is the one and only thing many first-time homebuyers look at! Interest rates by themselves never change; it is actually the price of that interest rate that changes – let me explain:

The money provided for mortgages is primarily provided through the sale of securities to investors on Wall Street. These investors expect a certain return on their money, called a “*yield*” – that is to say that if they invest \$1000, they expect to make “xxx” number of dollars in return per year for that investment. The interest that you as a homeowner pay on your loan is used to pay that *yield* to the investor.

But the interest rate on the actual securities doesn't change! If I were to offer you a mortgage today at a 5.00% interest rate, you would still be able to get that same rate tomorrow, and the next day, and next week – but the cost to get that rate might be different because of ever-changing market conditions, and the “price” of the money on Wall Street.

So for example, a 5.00% interest rate today that includes closing costs of \$2000 – could be a 5.00% interest rate next week, with closing costs of \$2300. While the interest rate is the same, the cost of the loan is obviously not.

Interest Rates vs. Points

Another common question that first-time homebuyers often ask is about “points”. Points are a way of differentiating between the relationship of the interest rate and that ever-changing “cost” we just talked about.

First, the definition of a “point” is nothing more than a percentage of the loan amount. For example, **on a \$75,000 loan:**

1 point = \$750 (or 1% of the loan amount)
2 points = \$1500 (or 2% of the loan amount)

Points can be quoted in any number of fractions or decimals, such as ½, ¾, or .125 which would be 1/8th of a point.

So, is 5.25% better than 6.00%??

That’s where the tricky part comes in – if the costs for the two interest rates were the same, then yes – but that’s not what you will see in the marketplace. Instead, you will see the following:

5.25% **1 Point Origination + ½ Discount Point**
or
6.00% **0 Points Origination + 0 Discount Points**

So which one is better? The 5.25% rate might look more attractive, but the costs associated with getting that interest rate might make the *effective* rate much higher than the 6.00% rate! There are many other factors to consider as well, such as the actual loan program terms, and other costs involved in the transaction that may include higher fees associated with certain programs – even if the interest rate is lower!

Lower is not always better. That’s why we will take the time to compare dozens of different interest rate and program combinations to come up with the best fit for **YOUR** circumstances! This is one area where you can’t afford to deal with someone who’s inexperienced – there’s too much at stake!

Mortgage Insurance

Mortgage insurance is also another cost that can drastically affect the “*real*” interest rate of you loan. Typically, mortgage insurance is required on any loan that has an LTV (Loan-To-Value) of greater than 80%. That means if you put less than 20% down on a purchase, you will need this insurance to protect the lender against possible default on the loan. This insurance allows interest rates to remain competitive on higher LTV loans, where the risks of non-payment increase.

Mortgage insurance can be paid monthly, all at once, or even financed as part of the loan on certain loan programs. Whichever way it is paid, it still has an effect on the cost of the loan – over and above the interest rate. For example, a 5.50% interest rate on an 80% LTV loan would not be the same as a 5.50% interest rate on a 90% LTV loan that required an additional .50% mortgage insurance payment per year!

Annual Percentage Rate – APR

The Annual Percentage Rate or APR can be another confusing concept to most new homebuyers. This system was developed to allow consumers to shop around based upon the *TRUE* cost of the credit being obtained. This will give you an idea how it works:

If I were to offer you a loan today at 5.00% interest, with \$1200 in closing costs, and you were to go down the street and talk to another lender that offered you a 5.00% loan with \$3600 in closing costs – their loan is obviously more expensive than the one I am offering.

In an attempt to illustrate the cost of the credit to the consumer, the federal government came up with a system that calculates the “*effective*” interest rate of the loan reflective of the costs involved – in other words, if your were to *finance* those costs as part of the loan, that would be the true interest rate paid. The higher the costs, the higher the APR. In theory, this will help you distinguish the difference between the actual rate and the *cost* of that rate as we discussed on page 1!

Again, while this may assist in understanding the general concept of interest rate comparison, there are many factors to consider when selecting the right combination of rate, terms, and costs.

I look forward to the opportunity of showing you the various options available to get YOU into the home of your dreams – call me today, and I will gladly fax or e-mail you some additional information regarding interest rates and costs. Better yet, I would welcome the chance to meet you personally and show you how these factors can be used to your advantage to build wealth in a relatively short period of time.

I’ve recently helped hundreds of other people just like you get into their first home and start building their dreams – isn’t about time we talked about *your* future?