How To Beat High Rates With A 2-1 Buydown

As we enter the last few months of 2022, we're starting to see the housing market transition into a more balanced market, pulling some of the leverage from sellers and giving power back to buyers. This is great news for you if you have been struggling to find a home in your price range, because it means sellers are now more willing to give some concessions to facilitate the sale of their home.

This movement in the market is creating a lot of discussion around interest rate buydown strategies. One particular strategy that is getting a lot of attention is called a 2-1 buydown.

Here's everything you need to know about using a 2-1 buydown strategy to lower your interest rate and save money on your monthly mortgage payment.

What Is A 2-1 Buydown?

A 2-1 buydown is when you apply credits from the seller or builder to temporarily lower the interest rate on your mortgage by 2% in the first year and 1% in the second year. This can make the home more affordable by saving you quite a bit of money on your monthly payment.

For example, say the quoted rate for your mortgage is 5.5%. With a 2-1 buydown strategy, you would subtract 2% from your interest rate for the first year – giving you a rate of 3.5% and dropping your payment substantially.

In year two, that rate would go up to 4.5%. After that, your rate would return to the original note rate of 5.5% and remain there for the remainder of the life of your loan (years 3-30).

These buydown funds are prepaid by the seller or builder and applied at the time of closing.

What Happens When The 2-1 Buydown Period Is Over?

After year 2, your interest rate adjusts back to its normal "note" rate. Your rate does not adjust according to market rates at that time; even if rates are higher, you would only pay the rate you initially qualified for.

However, if something happens that causes rates to decrease (like a recession, which we believe will happen sometime next year), you may be able to refinance and get a permanently low rate for the rest of your loan.

What Are The Benefits Of A 2-1 Buydown?

A 2-1 buydown strategy reduces your interest rate and your monthly payment for the first few years of your mortgage, making the home more affordable. A lower monthly payment can also make the transition from renting to owning a bit easier and allow you to start to building equity and investing in your future much sooner.

What many people do not realize is that a 2-1 buydown is much more effective at lowering your monthly payment than a price reduction would be. This could be a great negotiating tool because we are starting to see more price reductions hit the market, which sellers obviously want to avoid.

Finally, a 2-1 buydown strategy can give you some breathing room if you want to make any home repairs or save money before the rate returns to its initial point.

How Is A 2-1 Buydown Different From A Traditional Rate Buydown?

The main difference is the time period. A 2-1 buydown reduces your interest rate for the first two years, while a traditional buydown uses discount points to reduce the rate for the entire life of your loan.

A traditional buydown will not reduce the rate as much as a 2-1 buydown, but the savings will be greater if you plan on keeping your mortgage for a long period of time and not refinancing or selling.

Is A 2-1 Buydown Right For You?

In an environment where mortgage rates are rising, a 2-1 buydown can help you afford a larger mortgage payment and a more expensive home. This strategy can be especially helpful to first-time homebuyers who may be having trouble purchasing a home in the current market.

Understanding your different options will help you determine the right loan product for you. Whether a 2/1 buydown makes sense for you will depend on a variety of factors such as your current financial situation, the market you are buying a home in, and your financial and homeownership goals.

Want to learn more? Please schedule a call today!

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