Permanent vs. Temporary Interest Rate Buydown: Which One Is Right For You?

As the housing market continues to balance, we are seeing more sellers reduce the list prices of their homes to attract more buyers. But did you know that for most buyers, a list price reduction does much less to help with affordability than a rate buydown strategy does?

As a buyer, it's important for you to understand the different rate buydown options available to you, because it can make a big difference in your buying power. Understanding these strategies can help put you on track to meet your homebuying and financial goals.

What Is An Interest Rate Buydown?

If you are looking to buy a home but find that you can't afford the house you'd like due to rising interest rates, there are options available to lower your rate. Depending on how much money you have available for a down payment and closing costs, your lender can work with you to implement an interest rate buydown.

"Buying your rate down" (or paying points) means that you're paying an extra fee to get a lower rate for either the entire life of your loan or just the first two or three years (more on that below). This fee is based on a percentage of your loan amount.

There are multiple rate buydown strategies available to you, and the one you choose will depend on your financial goals and how long you expect to stay in your home. Let's walk through what each type of buydown is, when you can use them, and what loan programs they are specific to.

Temporary vs. Permanent Interest Rate Buydown

There are two main types of rate buydown strategies you can implement to help you qualify for a mortgage:

Temporary Buydown

Often referred to as a 2/1 or 3/2/1 buydown – this is a temporary reduction in the interest rate of your mortgage during the first 1, 2 or 3 years. When the temporary buydown period is over, the interest rate reverts back to the original note rate that you initially qualified for.

There are few things to keep in mind when considering a temporary interest rate buydown:

1. A temporary buydown **can only be funded by the seller.** A buyer cannot use their own funds to purchase a temporary buydown.
2. A temporary buydown **can only be used on a conventional or government loan (Fannie Mae or Freddie Mac, FHA, VA or USDA).** This strategy will not work with jumbo or non-traditional mortgage programs.
3. You must be able to qualify for the mortgage **at the permanent rate.** The temporarily reduced rate cannot

4. If you refinance your loan before the temporary buydown expires, the remaining funds in the escrow account used for the buydown go towards **a principal pay down on the existing mortgage.**
5. A temporary buydown **creates the highest amount of buying power and upfront savings** compared to a permanent buydown.

Permanent Buydown

Rather than a temporary reduction in your interest rate, you also have the option to permanently buy down the rate for the entire life of your loan.

1. A permanent rate buydown **can be funded by the seller or the buyer** (or a combination of the two).
2. A permanent rate buydown **can be used with any loan investor,** not just conventional or government loans.
3. Because the interest rate reduction is permanent, **you can qualify for the mortgage at the lower rate.**

When Should You Use a Permanent vs. A Temporary Rate Buydown?

The buydown strategy you choose will depend on your ability to qualify for the mortgage, what loan program you choose, how much you can negotiate with the seller, and your financial goals.

When To Choose A Temporary Rate Buydown

1. You can qualify at the initial (higher) rate, but you would like a large amount of upfront savings for the first couple years.
2. The seller is willing to fully fund the entire rate buydown.
3. You are applying for a conventional or government-funded mortgage loan.

When To Choose A Permanent Rate Buydown

You are unable to qualify at the initial (higher) rate, and you need a lower rate for your debt-to-income ratio.
The seller cannot fund the buydown or can only fund part of the buydown.
You are applying for a jumbo or non-traditional mortgage loan.

The Bottom Line

Utilizing an interest rate buydown strategy is a great way for you to get into a home sooner and benefit from price appreciation immediately, rather than waiting to buy in hope that rates drop in the future. It can also allow you qualify for a mortgage when you otherwise would not be able to, and help you ease into your new mortgage payment if you are worried about your finances.

Want to learn more? Please schedule a call today!

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