

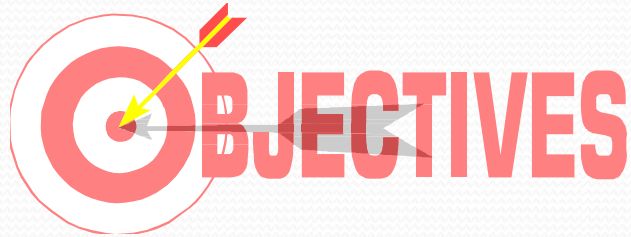
# LESSON NINE

## POINTS & DISCOUNTS IN THE MORTGAGE MARKETS



# STUDENT LEARNING OUTCOMES

(SLOs):



1. *Describe the role of investment bankers in the secondary market.*
2. *Differentiate between "points" and "discounts".*
3. *Describe the relationship of "price" and "yield".*
4. *Illustrate the use of points for government, conventional and junior loans.*

# Points and Discounts

## I. What are points & discount points?

- A. Loan Fee
  - Seller will want to know the cost of points or loan fee
- B. Inter-relationship of the terms
  - **One** point = 1% of the loan amount
- C. Equivalency

## II. Why are points used?

- A. Discount increases effective return, or yield.
- B. Example
  - On purchase
    - Point charged up-front
  - On refinance
    - Subtracted from total loan
- C. Simplifying computations
  - Lenders use tables or financial calculators
- D. Effective Rate

## III. Price and Yield

- Licensees use: points and discounts
- Lenders use: price and yield
- Price is another way of quoting the discount
- Price and discount added together always equal 100.
- To determine price, subtract the **discount** from 100.
- At zero points, the discount is zero and the price is 100.
- The effective interest rate is called **yield**.
- A loan with no discount sells **at par**.
- A loan sold at a price in excess of interest rate is sold at a **premium**.
- A loan sold at a price below the interest rate is sold at a discount.

## IV. How & When are Discounts Used?

- A. FHA and DVA loans
  - The loan interest rate is **negotiated** directly between the lender and the borrower.
  - A lender could be persuaded to make a loan at a **lower** interest rate if a **higher** yield could be obtained.
  - **One** discount point = 1/8% **increase** in yield
- B. Conventional loans
  - 1. Discounts are used to **adjust** yields
  - 2. **Increase** effective yield
- C. Junior Liens
  - Junior are bought & sold by investors in the secondary market the same as senior liens.



## V. SO WHERE ARE WE?

- 1. Points and discounts is a relatively complicated subject, but understanding them will help **licensees** to **explain** to buyers and sellers the importance of points and discounts in the financing process.
- 2. Few transactions involving **third party** loans would ever be consummated without the use of discounts.