# What Is a 2-1 Buydown Loan and How Do They Work?

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A 2-1 buydown is a mortgage agreement that provides a low interest rate for the first year of the loan, a somewhat higher rate for the second year, and then the full rate for the third and later years. Borrowers or home sellers pay additional money upfront to earn the lower rate for those first two years.

KEY TAKEAWAYS

- A 2-1 buydown is a type of financing that lowers the interest rate on a mortgage for the first two years before it rises to the regular, permanent rate.
- The rate is typically two percentage points lower during the first year and one percentage point lower in the second year.
- Sellers, including home builders, may offer a 2-1 buydown to make a property more attractive to buyers.
- 2-1 buydowns can be a good deal for homebuyers, provided that they will be able to afford the higher monthly payments once those begin.

## How 2-1 Buydowns Work

A buydown is a real estate financing technique that makes it easier for a borrower to qualify for a mortgage with a lower interest rate. That lower rate can last for the duration of the mortgage (as

is often the case when borrowers pay extra point up front to the lender) or for a particular period of time. A 2-1 buydown is one kind of temporary buydown, in this case lasting for two years.

In a 2-1 buydown, the interest rate will increase from one year to the next until it settles into its permanent rate in year three. To make up for the interest that they won't be receiving in those early years, lenders will charge an additional fee.

Either a homebuyer or a home seller can pay for a buydown. That payment may be in the form of mortgage points or a lump sum deposited in an escrow account with the lender and used to subsidize the borrower's reduced monthly payments.

Sellers, including home builders, often use 2-1 buydowns as an incentive for potential purchasers.

## Example of a 2-1 Buydown Mortgage

Suppose a real estate developer is offering a 2-1 buydown on its new homes. If the prevailing interest rate on 30-year mortgages is 5%, a homebuyer could get a mortgage that charged just 3% in the first year, then 4% in the second year, and 5% after that.

If the homebuyer took out a $200,000, 30-year mortgage, for example, then their monthly payments during the first year would be $843. In the second year, they would pay $995. After the end of the second year, their monthly payment would rise to $1,074, where it would stay for the remainder of the mortgage.

## 2-1 Buydown Pros and Cons

For home sellers, a 2-1 buydown can help them by making it easier and sometimes faster for them to sell their homes for a good price. The downside, of course, is that it comes at a cost, which ultimately reduces how much they will net from the sale.

For homebuyers, a 2-1 buydown has several potential benefits. For one thing, it can help them afford a larger mortgage and a more expensive home than they might otherwise qualify for. For another, it buys them some time before their mortgage payments rise to the full amount, which can be helpful if their income is also rising from year to year.

The downside for homebuyers is the risk that their income won't keep pace with those increasing mortgage payments. In that case, they might find themselves stretched too thin and even have to sell the home.

## When to Use a 2-1 Buydown

Home sellers may want to consider offering (and paying for) a 2-1 buydown if they're having difficulty selling and need to provide an incentive to find a buyer.

Borrowers may benefit from a buydown if it allows them to buy the home they want at a price they can afford. However, they will also want to consider what would happen if their income doesn't rise fast enough to keep up with their future monthly payments.

Buyers should also make sure that they are getting a fair deal on the home in the first place. That's because some sellers might increase the home's price to make up for the cost of the 2-1 buydown.

Note that buydowns may not be available under some state and federal mortgage programs or from all lenders. A 2-1 buydown is available on fixed-rate Federal Housing Administration (FHA) loans, but only for new mortgages and not for refinancing. Terms can also vary from lender to lender.

## What Is a Buydown?

A buydown is a means of paying for a lower interest rate, often on a mortgage. A 2-1 buydown is just one example of this type of transaction. There also are buydowns that will lower rates for different periods of time or even for the duration of the mortgage.

## Is a Buydown a Good Deal?

It depends on the circumstances. The most important factor with a 2-1 buydown is to be prepared for what mortgage payments will be after the first two years. That's the payment you'll be responsible for making for the bulk of the mortgage. If you plan for that it definitely can be a good deal.

## Who Pays for a 2-1 Buydown?

Either the buyer or the seller can pay for the buydown. Buyers might be willing to pay for it to save on interest payments. Sellers might be willing to pay for it to make a home easier to sell.

# The Bottom Line

A 2-1 buydown lowers the interest rate on a mortgage for the first two years before it rises to the regular, permanent rate for the third year and beyond. A typical 2-1 buydown offers a reduction of two percentage points the first year and one percentage point the second year.

Borrowers can pay for a 2-1 buydown, but sellers, including home builders, also may offer a 2-1 buydown to make a property more attractive. These transactions can be a good deal for homebuyers if they can afford the higher monthly payments that will begin in year three.