Private Mortgage Insurance (PMI)

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What is private mortgage insurance (PMI) and why do you need it?

Most lenders feel that borrowers who make low down payments (and therefore have little equity in the property) are more likely to default on mortgage loans. When a default does occur, a lender must foreclose on the home and sell it to satisfy the debt. The lender pays the foreclosure costs out of the sale proceeds before applying any money to the outstanding loan balance, often losing money on the transaction.

As a result, lenders generally require you to purchase private mortgage insurance (PMI) if you are borrowing more than 80 percent of the value of the home you are purchasing (i.e., your down payment is less than 20 percent). PMI guarantees that your lender will be paid if you default on your mortgage.

> **Caution:** PMI protects the lender's financial interest in your home. PMI does not protect you against losing your house in the event of a default on your mortgage. In fact, the private mortgage insurance company may seek recourse against you for any amount it pays to your mortgage lender if you default on your mortgage.

Government loan programs that offer low down payment mortgages may not require PMI. For example, VA loans don't require PMI because the federal government guarantees a portion of the total mortgage. FHA loans don't require PMI because they are insured by the federal government. However, the insurance cost is passed on to the borrower through an initial mortgage insurance premium (MIP) that often is financed as part of the loan amount, and through annual MIP charges that become part of the monthly mortgage payments.

> **Caution:** PMI premiums are not tax deductible.

How much does PMI cost?

PMI premiums vary depending on the insurance company, but they are usually based on factors such as the type of mortgage loan and the loan amount. PMI premiums are often paid to your loan servicer along with your monthly housing payment (principal, interest, taxes, and insurance). Although PMI can be expensive, you may be unable to qualify for a mortgage without it.

Can PMI ever be removed?

The good news is that you won't have to pay PMI forever. If you have a good payment history and reach 20 percent equity in your home, you can petition your lender to remove the PMI. For loans that originated after July 29, 1999, your lender is obligated to remove PMI once you have reached

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22 percent equity in your home, provided you have a good payment history. However, you may be required to obtain a home appraisal from an appraiser approved by the lender; the appraisal fee will be an expense you'll have to pay.

Are there any alternatives to paying PMI?

If you don't have at least 20 percent for a down payment, there are a couple of alternatives to paying PMI. Consider asking if your lender is willing to increase your mortgage interest rate rather than require PMI coverage. Your monthly payment will increase by roughly the same amount as the monthly insurance premium. However, mortgage interest is generally tax deductible, whereas PMI payments are not. Moreover, if you're able to make prepayments against your mortgage principal, you'll save on the total interest charge you'll pay over the term of your mortgage. For more information, see Prepayment and Biweekly Mortgage Payments .

> **Caution:** With this arrangement, you'll pay the interest for the life of the loan. In contrast, you can generally remove PMI once you obtain a certain amount of equity in your home.

Another alternative to paying PMI is 80−10−10 financing (also known as piggyback financing). With this type of financing, a lender provides a traditional 80 percent first mortgage. You then obtain a 10 percent second mortgage and make a 10 percent down payment. Keep in mind that 80−10−10 financing can be altered to accommodate the size of your down payment (e.g., you could put 8 percent down and obtain 80−12−8 financing). However, the lower your down payment, the higher the loan fees and interest rate may be.

> **Caution:** Although the mortgage interest you pay is generally tax deductible, the initial and ongoing costs of these arrangements may be higher than your PMI payments would be, particularly if you put less than 10 percent down.