

Private Mortgage Insurance

Private Mortgage Insurance, or PMI, is extra insurance designed to protect a lender against default on a loan (though the home is the primary safety net for the lender). Most lenders require PMI if you make a down payment of less than 20 percent of the purchase price. Cost varies from one mortgage insurance firm to another. When your equity (the amount you have invested in the house) reaches 20 percent, lenders are required to remove PMI and you can look forward to a lower monthly payment. If you have bought into a rapidly appreciating area, you may also qualify to have PMI removed much sooner because a higher appraisal value creates more equity.

Private Mortgage Insurance vs. Second Mortgage Loans

Purchasing a home has never been easier. Diverse products have evolved to help so many individuals, yet the problem of achieving a 20% down payment eludes nearly 1/2 of all homebuyers. Without a 20% down payment, purchasers are required to pay Private Mortgage Insurance (PMI). Lately there has been a lot of focus on 80-10-10 loans as an alternative to paying MI. An 80-10-10 avoids MI by using an 80% first mortgage, a 10% second mortgage and a 10% down payment from the borrower. Buyers have been programmed to avoid MI but are the alternatives really better?

When comparing the differences between paying PMI or choosing the 80-10-10, the monthly payment usually ranks as the borrowers highest priority. Since PMI is an extra fee, most buyers assume it will result in a higher monthly payment. That is not necessarily the case since the second mortgage portion of the 80-10-10 is usually at a higher rate. Additionally, the rate may be variable on that 2nd mortgage loan and may have a shorter amortization period. The result is that total payments between PMI and the 80-10-10 are very close, with the possibility of either program being slightly less expensive on a monthly basis. However, there are a few additional factors to consider:

1. One major benefit of paying PMI is that you may be able to have it removed from your loan if your home appreciates in value. While lenders are not required to drop the MI coverage even if you can demonstrate greater than 20% equity in your home (based upon appreciation), you do stand a reasonable chance of having the MI removed.
2. Another benefit from PMI for some borrowers is the fact that the lender will be more accommodating when it comes to approving your loan. With the extra insurance on the loan that MI offers, lenders can overlook some borrower shortcomings or make more exceptions since the loan is safer to approve.
3. The payment for PMI is not tax deductible. This should be checked out with your tax preparer.
4. A minor consideration is that the 80-10-10 is really 2 different loans so there are 2 separate sets of papers, closings and payments resulting in more hassles.
5. A major consideration is the current Jumbo limit is \$322,000 and loans above this amount are charged a higher interest rate. The increase is typically between 0.25% and 0.5%. If you can use the 80-10-10 to avoid both the Jumbo limit on the first mortgage and MI, then it would really benefit you to select the 80-10-10.



Some borrowers are so intent on making a 20% down payment in order to avoid either option that they liquidate their retirement funds to do so. Cashing in your IRA or 401K is a terrible mistake. Tax deferred retirement plans are one of the best tools individuals have for a secure future.

