What is PMI?

If you make a down payment of less than 20% of the purchase price of the home, mortgage lenders generally require that you take out Private Mortgage Insurance (PMI) that protects the lender incase you default on your mortgage. You may need to pay up to a year’s worth of premium for this coverage at closing, which can amount to as much as several hundred dollars. One obvious way to avoid this extra cost is to make a 20% down payment. There are also other ways to eliminate PMI such as 80-10-10 financing which is further described in this section.

How does PMI work?

PMI companies write insurance protecting approximately the top 20% of the mortgage against default, depending on the lender’s and investor’s requirements, the loan-to-value ratio, and the particular loan program involved. Should a default occur, the lender sells the property to liquidate the debt, and is reimbursed by the PMI company for any remaining amount up to the policy value.

Could obtaining PMI help me qualify for a larger loan?

Yes. Let’s say that you are a family with $42,000 annual gross income and monthly revolving debts of $800 (car payment and credit cards) and have $10,000 for a down payment and closing costs on a mortgage at 7% interest. Without PMI, the maximum price you can afford is $44,600. But with private mortgage insurance covering the lender’s risk, you can buy a house worth $62,300. PMI has afforded you 39% more house.

What does PMI cost?

Costs vary from insurer to insurer, as well as from plan to plan. For example, a highly leveraged adjustable rate mortgage would require the borrower to pay a higher premium to obtain coverage. Buyers with 5% down payment can expect to pay a premium of approximately 0.78% times the annual loan amount ($92.67 monthly for a $150,000 purchase price). But the PMI premium would drop to around 0.52% times the annual loan amount ($58.50 monthly) if a 10% down payment was made on the loan.

How is PMI paid?

PMI fees can be paid in several ways, depending on the PMI company used. Borrowers can choose to pay the first-year premium at closing; then an annual renewal premium is collected monthly as part of the house payment. Or the borrower can choose to pay no premium at closing, but add on a slightly higher premium monthly to the principal, interest, tax, and insurance payment. Buyers who want to sidestep paying PMI at closing but not increase their monthly house payment can finance a lump-sum PMI premium into their loan. With this type of payment plan, should the PMI be canceled before the loan term expires (through refinancing, paying off the loan, or removal by the loan servicer), the buyers may obtain the rebate of the premium.

How does the buyer apply for PMI?

Although the buyer typically bears the cost of PMI, the lender is the PMI company’s client, and shops for the PMI on behalf of the borrower. Many lenders deal with only a few PMI companies because they know the guidelines for those insurers. This can be a problem when one of the lender’s prime companies turns down a loan because the borrower doesn’t fit its risk parameters. An uneneterprising lender might follow suit and deny approval on the loan application without consulting even a second PMI company. This obviously could leave all the parties involved in an undesirable position.

The lender has an increasingly difficult task to be fair to the borrower while shopping for the most effective method to soften liability. Sometimes, it may appear that a lender has no justification for doing what he or she does – but if we look deeper, it is undoubtedly there.

What is 80-10-10 financing?

Surprising as it may seem, some folks with hefty incomes find that it’s mighty tough for them to save enough money to make a 20% cash down payment on their dream homes. Using conventional financing, such buyers must purchase Private Mortgage Insurance (PMI) which increases the cost of home ownership and, ironically, makes it even more difficult to qualify for the mortgage. However, if you’re a dues-paying member of the cash-challenged class, don’t despair. Given that your income is sufficiently high, it’s eminently possible to avoid getting stuck with PMI. That is why 80-10-10 financing was invented. It is called 80-10-10 because a savings and loan association, bank, or other institutional lender provides a traditional 80% first mortgage, you get a 10% second mortgage, and make a cash down payment equal to 10% of the home’s purchase price. By using this method, you are no longer obligated to take out PMI on your property.

The same principle applies if you can only afford to make a 5% down, 80-15-5 financing is also available. However, because a smaller cash down payment increases the lender’s risk of default, do not be surprised when you are asked to pay higher loan fees and a higher mortgage interest rate for 80-15-5 than you pay for 80-10-10.

Cancellation of PMI

The Homeowners Protection Act of 1998 - which became effective in 1999 - establishes rules for automatic termination and borrower cancellation of PMI on home mortgages. These protections apply to certain home mortgages signed on or after July 29, 1999 for the purchase, initial construction, or refinance of a single-family home. These protections do not apply to government-insured FHA or VA loans or to loans with lender-paid PMI.

For home mortgages signed on or after July 29, 1999, your PMI must - with certain exceptions - be terminated automatically when you reach 22 percent equity in your home based on the original property value, if your mortgage payments are current. Your PMI also can be canceled, when you request - with certain exceptions - when you reach 20 percent equity in your home based on the original property value, if your mortgage payments are current.

One exception is if your loan is "high-risk." Another is if you have not been current on your payments within the year prior to the time for termination or cancellation. A third is if you have other liens on your property. For these loans, your PMI may continue. Ask your lender or mortgage servicer (a company that collects your payments) for more information about these requirements.

If you signed your mortgage before July 29, 1999, you can ask to have the PMI canceled once you exceed 20 percent equity in your home. But federal law does not require your lender or mortgage servicer to cancel the insurance

History of PMI

Private Mortgage Insurance originated in the 1950s with the first large carrier, Mortgage Guaranty Insurance Corporation (MGIC), referred to as “magic”. For this reason, early PMI methods were deemed to “magically” assist in getting lender approval on an otherwise unacceptable loan package. Today, there are eight PMI insurance underwriting companies in the United States.

PMI Companies

Amerin Guaranty Corporation

303 East Wacker Drive, Suite 900

Chicago, IL 60601

Tel: 800-257-7643

Fax: 312-540-0564

PMI Mortgage Insurance Company

601 Mongomery Street

San Francisco, CA 94111

Tel: 800-288-1970

Fax: 415-291-6175

Commonwealth Mortgage Assurance Company

1601 Market Street

Philadelphia, PA 19103-2197

Tel: 800-523-1988

Fax: 215-496-0346

Republic Mortgage Insurance Co.

P.O. Box 2514

Winston-Salem, NC 27102-9954

Tel: 800-999-7642

Fax: 919-661-0049

G.E. Capital Mortgage Insurance Corporation

P.O. Box 177800

Raleigh, NC 27615

Tel: 800-334-9270

Fax: 919-846-4260

Triad Guaranty Insurance Corp.

P.O. Box 25623

Winston-Salem, NC 27114

Tel: 800-451-4872

Fax: 919-723-0343

Mortgage Guaranty Insurance Corporation

P.O. Box 488

Milwaukee, WI 53201

Tel: 800-558-9900

Fax: 414-347-6802

United Guaranty Corporation

P.O. Box 21567

Greensboro, NC 27420

Tel: 800-334-8966

Fax: 919-230-1946