PMI 101: Understanding Private Mortgage Insurance

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If you're like many first-time homebuyers, you encountered an unfamiliar term as you prepared to close your mortgage transaction: **private mortgage insurance** (**PMI**). We created this document to provide basic answers to some of the common questions homeowners ask about PMI.

What is PMI?

PMI is an insurance policy *you pay for* that protects *your mortgage lender* from financial loss if you stop making your mortgage payments. And depending on your credit score, your down payment, and several other factors, your lender may **require** you to have PMI coverage on your mortgage. Here's how it works:

- If you stop paying your mortgage and your lender is forced to take possession of your property, the lender can usually recover most of your property's appraised value (about 80%) in a foreclosure auction. Your PMI policy then pays your lender the remaining value of the property.
- If you consistently pay your mortgage on time, it may be possible to have your PMI policy *canceled* after you pay down your loan's principal balance to a point where you achieve 20% equity in your home (based on its original appraised value). *Read on for more information about canceling PMI.*

Does PMI pay my mortgage payment for me if I can't?

No, it doesn't. Your PMI policy insures *only your lender* against loss; it does *not* make mortgage payments for you if you're injured or unemployed. So don't be confused: Some mortgage companies also sell "mortgage insurance," which makes your mortgage payment for you if you can't pay due to job loss, sickness, or other causes—but that's *not* PMI. A "mortgage insurance" policy protects *you*, but a PMI policy protects *only* your lender.

What does PMI cost?

Too many homebuyers don't realize how much PMI can increase their mortgage payments. Also, PMI requirements can vary depending on the size of your down payment, your credit score, the type of mortgage you have, and some other factors. For example, on most FHA/VA loans and some other "non-traditional" loans, PMI is *required*—and it can significantly increase your regular mortgage payment.

For a "traditional" mortgage loan from a bank or a reputable mortgage company, the cost of your annual PMI premium is calculated based on the total amount you borrow; it's often between 0.5% (one-half) and 1.5% (one-and-a-half) of your loan amount. While some lenders allow you to pay PMI "up front" when you close your mortgage transaction, most homeowners choose to "roll" their PMI costs into their mortgage payments and extend them over several years of their mortgage term.

But even if you spread your PMI costs over years and include them in your mortgage payments, PMI can still be a significant expense. For example: If you buy a $200,000 house and you put $20,000 down (10%), the amount of money you're borrowing (the *principal*) is $180,000. If your PMI premium rate is 1% of the principal, your annual PMI policy costs $1,800 (**$150** per month). That's a real stretch for some homeowners!

How can I reduce my PMI costs?

The easiest way to reduce PMI costs is to *put more money down* when you buy a house. For example, a down payment of 15% could help reduce your PMI premium rate (compared with a down payment of 10%). And in most cases, if you make a 20% down payment, your lender will *not require PMI at all*.

Can I cancel my PMI?

Yes, it's possible to cancel PMI—but based on the kind of loan you have, you must satisfy certain requirements:

- **"Conventional" loans.** If you have a "conventional," single-family mortgage (*not* one from Fannie Mae, Freddie Mac, the FHA, or the VA) and your loan closed on or after July 29, 1999, government regulations allow your lender to cancel your PMI after you've paid your mortgage down to 80% of the property's original appraised value (that is, the value of your house on the day it was appraised for your current mortgage; also called the loan-to-value, or **LTV** ratio). To cancel PMI, you must meet these criteria:

- ✓ Your house must have been your primary residence for over 24 months.
- ✓ You must have a continuous 12-month history of on-time payments before you request cancellation.
- ✓ You cannot have made a payment over 60 days late in the 24 months before your request.
- ✓ You must submit your request in writing.

Remember the $200,000 house you bought with 10% down? You'll need to make about 26 monthly payments to bring your LTV ratio down to 80%.

But what if you're unable to get your PMI canceled when your LTV ratio hits 80%? Hang in there a bit longer, because your lender is required by law to *automatically cancel your PMI policy when your LTV ratio reaches 78%*—provided your home is your primary residence and your payments are current.

- **Fannie Mae/Freddie Mac loans**. If your mortgage is underwritten by "Fannie" or "Freddie," your cancellation options are about the same as those of a conventional mortgage. Fannie and Freddie also allow you to cancel PMI on second-home mortgages and even some mortgages on investment properties. However, some of the details around Fannie/Freddie PMI cancellation are rather complex. So please contact us for all the details about canceling PMI on your Fannie Mae or Freddie Mac loan.
- **FHA/VA loans.** The rules are very different if you have an FHA/VA (Federal Housing Administration/Veterans Administration) mortgage, which often requires *no* (or very little) money down. For example, if your LTV ratio is over 90%, the FHA will *not* cancel your PMI under any circumstances. But even if your LTV ratio is less than 90%, the FHA will *not* cancel your PMI for *at least 11 years*. There are other detailed requirements for canceling PMI on FHA/VA loans, so contact us to discuss your options.

Is PMI tax-deductible?

Yes—for tax year 2018, but nothing is guaranteed after that. The PMI deduction has expired and has been brought back by Congress several times in recent years, so who knows what the future may hold?

Are there other strategies I can use to pay less PMI?

Yes. It's possible to pay off your PMI sooner than you may have originally expected by using two strategies: Prepaying your mortgage principal and monitoring your home's value:

- **Prepaying principal.** Your mortgage principal balance is the amount you owe on your home—*not* including the interest your lender charges you. So if you pay extra against your principal, you'll reach an 80% LTV ratio sooner, and you'll be able to pay off your PMI sooner.
- **Monitoring home value.** The other way you may be able to pay less PMI is to carefully monitor your home's market value. If you've made a wise home purchase, chances are good (especially in today's market) that your home will be worth a bit more than you paid for it every month you live in it. So if you're confident your home's value has significantly increased (beyond the principal payments you've made), talk with us and request a new appraisal. *Note*: You'll have to pay for the appraisal, and it could cost as much as $500. But if the new appraisal reveals your LTV ratio is 80% or less, you can ask us to cancel your PMI.

What else do I need to know?

Depending on the kind of loan you have and the amount of equity you have in your home, canceling your PMI might be easy, not so easy, or impossible. This brief document is intended to give you a basic understanding of PMI; it is *not* designed to cover every detail of every possible PMI scenario. If you still have questions, *please contact us* to get the specific answers you need in your unique situation.

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