



Calculating the Right Down Payment

A big consideration in getting a new home loan is the size of the down payment. This is the money you pay at the closing of a home loan toward the balance of the mortgage.

Traditionally, down payments were required to be 20% of the home value, but rising home appreciation has changed the situation today. There are many low- or no-down payment programs available to you.

If you are a first-time homebuyer and have limited cash resources, a small or no-down payment plan may be your only option. If you have recently sold a home or have greater financial reserves for a down payment, you'll have to carefully weigh the pros and cons of different down payment amounts.

Today if you don't have a 20% down payment, you'll most likely have to pay for Private Mortgage Insurance (PMI). This is insurance you to protect the lender in case you default on your mortgage. You will pay a monthly or yearly charge for PMI until your equity in the home reaches about 78% of the loan value. So if you can afford it, paying the 20% down payment could save you hundreds or thousands of dollars in insurance payments. Or if can't pay 20% but can afford something close to it, you will substantially reduce the length of your PMI payments.

If you fall into the sub-prime category of loans because of bad credit, any possible down payment could make the return on your investment very large. This is because a down payment on a sub-prime loan will generally score you a lower interest rate on the loan.

If you're leaning toward the other end of the spectrum and are considering a home loan known as a Jumbo loan, a mortgage loan over \$417,000 (the limit for 2006), you might want to contribute a down payment large enough to lower your loan amount into the conforming loan category. In this way you would net yourself a lower interest rate and greater savings over time.

Another decision involves the difference in savings based on paying more points or paying a larger down payment. If you can afford to pay one point on your loan (1% of the loan value) you will be able to lower your loan interest rate and yield a savings rate of about 20% after five years in your home. If you were to contribute the same amount of money to a larger down payment, your savings yield would only be equal to your mortgage interest rate, much less than the saving from an extra point paid.

Another case where it may not profit you most to pay a larger down payment is if you think you can invest your money elsewhere with higher returns. Other investments might include Roth IRA accounts for retirement or other diversified investment portfolios with high yields.

Be sure to take an in-depth look at your options before committing to a certain down payment amount.