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Private Mortgage Insurance Might Not Be So Bad

During the recent housing boom, mortgage lender standards were loose and homebuyers took advantage of all sorts of “exotic” loan programs in order to get into the red hot real estate market. Borrowers discarded traditional loans with private mortgage insurance (PMI) en masse and looked to 80-10-10, or piggyback loans, to solve their mortgage needs. Now that the boom has almost slowed into a slump, the use of loans with PMI is coming back into fashion. If you are considering a home purchase in the near future, you may want to explore the benefits of this more traditional route.

PMI is insurance for the mortgage lender. A borrower with a traditional mortgage loan will be required to pay PMI if he does not make a full 20 percent down payment at the beginning. This insurance reduces the risk to the lender that she will loose money in the even that you, the borrower, should default and go into foreclosure. The money you pay to an insurance company such as major PMI underwriters Milwaukee-based MGIC Investment Corp, PMI Group Inc. in Walnut Creek, Calif., or Triad Guaranty Inc. in Winston-Salem, N.C., will provide a policy that will guarantee the lender reimbursement up to 20 percent if you do foreclose.

The alternative, the 80-10-10, actually creates two home loans to get around the PMI requirement. In this scenario, the borrower makes a 10 percent down payment, gets a traditional home loan to cover 80 percent of the home price, and also takes out a second mortgage to make up for the remaining 10 percent. The borrower does not have to make any PMI payments, but the interest rate on the second mortgage is usually an adjustable rate that can rise with the market changes and runs at least 2 percent higher than the first mortgage.

In the past few months foreclosure rates have been rising significantly among those who got non-traditional loans in the past few years, especially among those in the sub-prime or poor credit category. Accordingly mortgage lenders are becoming more cautious in their standards and are encouraging more and more homeowners to stick with the conventional PMI method. In fact, recent data from the Mortgage Insurance Companies of America in Washington D.C. proves that PMI-backed loans are returning to popularity. There were 118,214 purchase and refinance loans with PMI in February 2007, compares with 104,146 such loans in the same month of 2006.

And this change may not be a bad thing for borrowers either. The truth is, while making PMI payments is annoying, it may be a much less risky venture than taking out two home loans initially. Plus, borrowers can stop PMI payments as soon as their equity in the home reaches 20 percent, either through paying down the principal or appreciation in the home’s value or a combination of the two. Some estimates indicate that it takes the average homeowner only about four or five years to reach that 20 percent equity mark.

This year may be especially profitable for PMI-paying homeowners as the government is allowing a one-year tax break for PMI. Those couples with a combined salary of less than $109,000 per year are eligible to deduct all or part of their PMI payments.

If you are starting your home mortgage search, you may find that making PMI payments for a few years will be well worth the decreased risk and better loan terms you will enjoy.

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