How much is mortgage insurance? PMI cost vs. benefit

Is mortgage insurance a bad thing?

Private mortgage insurance (PMI) is usually required if you put less than 20% down on a conventional loan.

Many homebuyers try to avoid PMI at all costs. Why? Because unlike homeowners insurance, mortgage insurance protects the lender rather than the borrower.

But there's another way to look at it. Mortgage insurance can help you buy a house sooner. You might pay more than $100 per month for PMI. But you could start gaining tens of thousands per year in home equity.

For many people, PMI is worth it. It's a ticket out of renting and into equity wealth.

How much is private mortgage insurance?

Mortgage insurance costs vary by loan program (see the table below). But in general, the cost of **private mortgage insurance**, or PMI, is about 0.5 to 1.5% of the loan amount per year.

This annual premium is broken into monthly installments, which are added to your monthly mortgage payment.

So, a $300,000 loan would cost around $1,500 to $4,500 annually — or $125 to $375 per month. Your PMI rate will depend on your loan size, credit score, down payment amount, and debt-to-income ratio.

Some home loan types also charge an upfront mortgage insurance fee, which can often be rolled into the loan balance, so you do not have to pay it at closing.

Types of mortgage insurance rates

For most loan types, there are two mortgage insurance rates: An annual rate and an initial rate or "fee."

The initial fee is usually higher, but it's paid only once — when the loan closes.

Costs for both types vary by loan program:

	Conventional Loans	FHA Loans	USDA Loans	VA Loans
Initial Mortgage Insurance	n/a	Upfront Mortgage Insurance Premium	Upfront Guarantee Fee	VA Funding Fee
Rate*	n/a	1.75%	1.0%	2.3%**
Annual Mortgage Insurance	PMI Annual Premium	Mortgage Insurance Premium	Annual Fee	n/a
Rate*	0.19-1.86%	0.55%	0.35%	n/a

**Mortgage insurance rates are shown as a percentage of the loan amount*

***VA funding fee is 2.3% for a first-time home buyer purchase zero down and up to 3.6% for subsequent uses*

Cost of mortgage insurance by loan type

Each loan type has a different mortgage insurance rate, even for the exact same loan size. Costs could differ depending on whether you got a conventional mortgage, FHA, VA, or USDA mortgage.

For example, you buy a $300,000 home with 3.5% down. Here's how mortgage insurance costs would compare for the four major loan types:

	Conventional Loan	FHA Loan	USDA Loan	VA Loan
Initial Mortgage Insurance Cost	$0	$5,000	$2,900	$6,700
Annual Mortgage Insurance Cost*	$3,500	$2,500	$1,000	$0
Monthly Premium	$292	$208	$84	$0

The above example assumes a $300,000 home purchase price with 3.5% down, and a 30-year fixed-rate of 6.75%. Your own interest rate and mortgage insurance costs will vary

**Annual mortgage insurance cost is calculated based on the first year's mortgage balance. Annual costs will go down each year as the loan balance is reduced*

How is mortgage insurance calculated?

Mortgage insurance is always calculated as a percentage of the mortgage loan amount. It is not based on the home's appraised value or purchase price.

For example: If your loan is $200,000, and your annual mortgage insurance is 1.0%, you'd pay $2,000 for mortgage insurance that year. That breaks down to a payment of $166 per month.

Since annual mortgage insurance is re-calculated each year, your PMI cost will go down every year as you pay off the loan. So, if your loan balance fell to $190,000 in the second year of the loan, your PMI would go down to $1,900 a year, which would be about $158 a month.

Calculating mortgage insurance by loan type

Your **down payment amount** and credit score affect your PMI rate on a conventional loan. Rates can vary a lot by borrower but often range from 0.5% to 1.5% of the loan amount per year (paid in monthly installments).

Government-backed loans work differently. For these loans, the mortgage insurance rate is pre-set. It's the same for just about every customer.

- **FHA:** 1.75% of loan amount upfront and 0.85% annually
- **USDA:** 1% of the loan amount upfront and 0.35% annually
- **VA:** Between 0.5% and 3.6% upfront, depending on borrower and loan purpose

Typically, the ongoing annual premiums for mortgage insurance are spread across 12 monthly installments. You simply pay it each month as part of your regular mortgage payment.

Calculating mortgage insurance by credit score

Borrowers with **lower credit scores** tend to pay higher PMI rates on conventional loans, but this isn't true for government-backed mortgages. That's why borrowers with lower credit scores can often save with a government-backed loan such as **an FHA loan.**

The following chart shows cost differences between the three major types of mortgage insurance, based on a $250,000 loan amount, and varying credit levels.

	660 FICO Score	700 FICO Score	740 FICO Score
Conventional 5% Down	$295	$180	$120
Conventional 10% Down	$210	$125	$85
FHA 3.5% Down	$177	$177	$177
USDA 0% Down	$66	$66	$66

You can use a **mortgage calculator** to better understand the impact PMI payments will have on your home buying budget. Experiment with down payment percentages, loan terms, home purchase prices, and other variables to get an idea of how much PMI may cost.

Additionally, mortgage calculators help you understand your total estimated monthly mortgage payment, including homeowners insurance, property taxes, and principal and interest.

What is mortgage insurance?

Mortgage insurance protects the lender in case the borrower defaults on the mortgage.

Lenders can lose money during a foreclosure. They're at more risk of losing money when the home loan is almost as big as the home's value. Also, foreclosures are more likely on larger loans since borrowers have less of their own money invested in the home.

Mortgage insurance provides an extra layer of protection for the lender. If they had to foreclosure, the insurance would compensate them for some, or all, of their losses. This extra security helps the lender offer lower mortgage rates to the borrower.

Private mortgage insurance (PMI) is one type of policy that protects conventional mortgage lenders. Government mortgage insurance protects lenders who underwrite FHA, USDA, and VA loans.

When is PMI required?

If a borrower defaults on their home loan, it's assumed the lender will be set back about 20% of the home's purchase price.

As a result, you'll usually be required to pay for PMI if you make a down payment smaller than 20% on a conventional loan.

If you put down 20%, that makes up for the lender's potential loss if your loan defaults and goes into foreclosure. Put down less than 20%, and the lender will likely lose money if the loan goes bad.

The cost of PMI covers that extra loss margin for the lender. If you ever default on your loan, the lender will receive a lump sum from the mortgage insurer to cover its losses.

When is government mortgage insurance required?

Paying 20% down eliminates PMI for **conventional loans.** But the same is not true for federally backed loan programs. These programs require mortgage insurance premiums regardless of your down payment.

That said, there are other advantages to making a larger down payment on a government-backed loan. For example, an FHA loan with 10% or more down charges lower mortgage insurance premiums, and the insurance will expire after 11 years.

Also, a larger down payment means more home equity from the start. Having more equity can help you refinance into a conventional loan with no PMI sooner.

Is mortgage insurance bad for homeowners?

Paying monthly mortgage insurance premiums might sound like a tough deal. But the upside is, it gives you a faster track to homeownership.

Without it, many people would have to wait years to save up for a bigger down payment before buying a house. Those are years they could have spent investing in their home and building equity, rather than paying rent to a landlord each month.

Without mortgage insurance, home buyers would also face higher interest rates which raise monthly costs as much, or more than, PMI.

Keep in mind that most borrowers can eventually cancel their PMI. So, you're not stuck with the added fee forever. It's a temporary cost that can have very long-term rewards.

Cost versus benefit of private mortgage insurance

Many home buyers only think about the upfront cost of PMI. But they don't realize that PMI can have a great return on investment. That's because PMI can help you buy a home much sooner. And

typically, the amount you pay for PMI is far less than the wealth you'll gain via home equity.

PMI and home price appreciation

There's no guarantee that homes will increase in value every year. Sometimes, and in some places, real estate values go down. But, in most cases, if you keep the home long enough, it should increase in value.

In recent years, values have risen quickly. According to the Federal Housing Finance Agency (FHFA), **U.S. home prices** rose from $280,000 in January of 2020 to $392,000 in January of 2023. That was an increase of about 40%.

Median prices started to slip toward the end of 2022 as the Fed raised interest rates, cooling the demand for homes in many markets. The FHFA projects more slight declines throughout 2023.

Even if the median home price falls to $340,000 by year's end, it would still be about 21% higher than it was in January of 2020.

For buyers who can afford only **a small down payment**, PMI can serve as an admission ticket into the real estate market.

PMI return on investment (ROI)

Home buyers often try to avoid PMI because they feel it's a waste of money. In fact, some forgo buying a home altogether because they don't want to pay PMI premiums.

That could be a mistake. Data from the housing market indicates that PMI yields a surprising return on investment.

Imagine you buy a house worth $333,000 with 5% down.

The 1% PMI cost is $268 per month. Over the first five years of the loan, you'd pay about $15,000 in private mortgage insurance premiums.

If the home appreciated at a relatively modest rate of 3%, the property would be worth about $386,000 in five years. That's a gain in property value of $53,000.

In other words, the $15,000 invested in PMI opened the door to a $53,000 gain in equity.

Use PMI as a wealth-building tool

Homeownership is the primary means of wealth building in the U.S. Each monthly mortgage payment can be considered an investment in the future.

Owning a home is no guaranteed path to quick riches. Rather, it's an investment that can pay off gradually over time, even considering cyclical downturns.

Ultimately, a house is a forced savings account. Housing expenses are required whether you rent or own. But when you own, you deposit a small chunk toward your future wealth each month. When you rent, you deposit money toward your landlord's future wealth.

So what does PMI have to do with this?

Well, PMI starts the wealth-building process sooner. You can get into a home without waiting years and years to save for 20% down. And you could be on the winning side of rising home values.

What about lender-paid PMI offers?

Can't afford to put 20% down and avoid PMI? You might be attracted to lenders who say they'll waive PMI for you.

It's possible to find these kinds of deals, but they aren't always what they seem. When lenders waive PMI, they usually charge higher mortgage rates. So, you'd still be paying extra — and you might even pay more — to avoid PMI.

The same tends to be true for lenders who cover **closing costs**. You'd still be paying closing costs in the form of more interest over the life of the loan.

This can be a good deal if you're short on upfront cash and don't mind paying more over time. But it's a deal you should enter knowingly. Be sure to compare the costs of several loan scenarios to find the plan that works best for you.

How can I pay lower monthly PMI?

Like most types of insurance, PMI prices its rates on risk. Riskier borrowers usually face higher monthly PMI rates. So, you could get a lower PMI rate by becoming 'less risky' to your lender.

Your FICO score is one of the main ways lenders assess your risk level. Paying down credit card balances and making on-time payments on your other loans can raise your score. Also, **checking your credit reports** for errors and disputing them should help.

Another big piece of the puzzle is **debt-to-income ratio**, or DTI. Lower DTIs look better to lenders. You can lower yours by paying down debts or asking for a raise.

Your down payment size matters. Even if you can't put down 20%, putting down 7% instead of 5% makes you a stronger borrower — one who might qualify for lower PMI rates.

For the most part, the risk doesn't affect mortgage insurance rates on government-backed loans. Eligible borrowers pay the same rates.

When can I cancel PMI?

If you have a conventional mortgage loan (not a government-insured loan), PMI cancellation happens automatically when your loan-to-value ratio (LTV) falls to 78% of your original balance.

As an example, when the principal on a $300,000 loan drops to $234,000, your LTV ratio is 78% and your mortgage servicer will automatically cancel PMI.

You can also cancel PMI once your LTV ratio drops to 80%.

Keep in mind that these rules apply only to conventional loans (those backed by Fannie Mae and Freddie Mac). Mortgage insurance works differently for government-backed loans such as **USDA** and **FHA mortgages.**

FHA mortgage insurance premium (MIP)

FHA loans, backed by the Federal Housing Administration, require their own type of mortgage insurance. This is known as mortgage insurance premium or MIP.

As discussed above, MIP charges two separate fees: an upfront payment and an annual one:

- **Upfront mortgage Insurance premium** (UFMIP) costs 1.75% of the loan amount. It can be paid at closing, but most home buyers roll it into the loan balance
- **Annual mortgage insurance premium** (MIP) costs 0.55% of the loan amount per year, split up into 12 installments and paid monthly with the mortgage payment. This continues for the life of the loan unless you put at least 10% down. In that case, the MIP payments will cancel after 11 years

Of course, a homeowner could refinance out of an FHA mortgage to eliminate their MIP payments. If the home's loan-to-value ratio has fallen below 80%, refinancing into a conventional loan would not require paying PMI.

USDA and VA loans

USDA loans also charge both an upfront and ongoing mortgage insurance fee. However, USDA rates are slightly lower, with a 1% upfront fee and 0.35% annual charge.

VA Loans, backed by the federal Department of Veterans Affairs, do not require ongoing mortgage insurance payments. The VA charges a funding fee upfront to help insure lenders, but there's no added monthly charge for the borrower.

How do I know if PMI is right for me?

Private mortgage insurance isn't for everyone, but, depending on your financial situation, consider checking the potential returns on the costs of PMI before automatically refusing to pay it.

Check your home loan options to see what you can afford and how much mortgage insurance would cost you.