What is PMI? Home buyer's guide to private mortgage insurance

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Private mortgage insurance (PMI) is a type of insurance that's required when you buy a house with less than 20% down. PMI is paid by the homeowner but protects the lender in the event of foreclosure.

Why would anyone pay PMI when it protects only their lender? Because PMI allows you to buy a house with as little as 3% down. To avoid PMI, you typically need at least 20% down — which can take years to save for.

It's important to remember that PMI is not forever. Many people **buy a house with a low down payment**, pay PMI at the outset, and are able to remove it after a few years. Since PMI helps you buy a home and start building equity sooner, it often pays for itself in the long run.

What's the purpose of private mortgage insurance?

Private mortgage insurance protects your lender from financial losses it might sustain if you default on your mortgage, and it has to foreclose. The general rule of thumb is that if you put 20% down, your lender won't lose much money in a foreclosure. That's why loans with *less* than 20% down require PMI as added security.

Once you've built up 20% equity in your home, you'll have the same financial 'cushion' as if you'd made a 20% down payment. At that point, PMI can be removed, and you no longer have to pay the monthly fee.

How much does PMI cost?

PMI rates vary depending on credit score and down payment amount but often cost between 0.5% and 1.5% of the mortgage balance each year. Borrowers with a 620-credit score and 3% down (the minimum requirements for a **conforming loan**) will pay the highest PMI rates, while borrowers with higher FICO scores and/or more money down will see reduced rates. A high **debt-to-income ratio** (DTI) can also push up your mortgage insurance rate.

The annual PMI cost is broken into monthly installments and added to your regular mortgage payments. For example, say you have a $300,000 mortgage. A 0.5% PMI rate means you'd pay $1,500 annually or $125 each month. A 1.5% rate on the same loan amount would cost $4,500 annually or $375 each month.

Keep in mind that PMI costs will go down each year as you pay off your mortgage balance because the PMI rate will be charged on a smaller loan amount. Eventually, once the loan is paid down to 80% of your home's value, PMI can be removed altogether.

When is PMI required?

Almost every type of home loan requires mortgage insurance if you put less than 20% down. Only conventional loans with 20% down or more are automatically exempt from PMI.

Conventional loans are mortgages not backed by the federal government. Most U.S. mortgages are conventional "conforming" loans, meaning they conform to lending guidelines set by Fannie Mae and Freddie Mac. Conventional loans with less than 20% down almost always require PMI, aside from a **few niche programs** that usually have higher interest rates.

Government-backed loans aren't off the hook, though. In place of PMI, they charge their own insurance fees. With an FHA, VA, or USDA loan, you'll pay some sort of insurance fee regardless of your down payment amount.

- **FHA loans** charge mortgage insurance premiums (MIP). There's both an upfront fee and a monthly fee

- **USDA loans** charge mortgage insurance (MI). There's both an upfront fee and a monthly fee
- **VA loans** charge only an upfront guarantee fee, called the VA funding fee. There is no monthly PMI

The main difference between conventional PMI and **FHA mortgage** insurance is that FHA mortgage insurance typically lasts the entire life of the loan. The same goes for **USDA mortgage** insurance. By comparison, conventional PMI can be removed once you have enough equity in the home.

VA loans are the only mainstream home loan that does not charge monthly mortgage insurance with less than 20% down. There's just a one-time fee (the "**VA funding fee**") which most people roll into their loan amount. Only veterans, service members, and a few closely related groups qualify for VA loans.

Is PMI bad?

PMI does not protect the borrower, and yet they're the ones who must pay for it. Because of this, PMI often gets a bad rap and many home buyers want to avoid it if they can.

But there's a major upside to PMI, too. If you're willing to pay PMI, you may be able to buy a house with just 3-5% down. That can put you in a home a few years sooner than if you waited to save a 20% down payment. And, when home values are rising rapidly, homeowners typically earn far more in equity than they spent on PMI. So, the added fee can easily pay for itself (and then some).

Remember that when you have 20% home equity — meaning your loan amount is down to 80% of your home value — you can stop paying PMI. Those monthly fees will be removed for good. So you can think of PMI as a temporary cost that brings long-term benefits.

For more information, read: **How much is mortgage insurance? PMI cost vs. benefit**.

When can I stop paying PMI?

You can stop paying private mortgage insurance when your mortgage balance drops to 80% of your home's current appraised value. When home prices are rising quickly, that can be quite soon — maybe even a year or two — after you bought your property.

If you want to stop PMI payments when you reach that 80% **loan-to-value** mark, you'll have to ask your lender to remove it. A new appraisal may be required if your assessment is based on rapidly rising home values. Otherwise, PMI will automatically be canceled when your mortgage balance is paid down to 78% of your home's value.

To be clear, this applies only to conventional loans. If you have a government-backed loan from the FHA or USDA, mortgage insurance is typically permanent. To remove it, you'd need to refinance out of your government loan and into a conventional loan once you have at least 20% equity. At that point, you could qualify for a conforming loan with no PMI.

Can I avoid PMI?

You might be able to **avoid private mortgage insurance with less than 20% down**. But, unless you qualify for a VA loan, it won't be straightforward.

For example, you can get Lender-Paid Mortgage Insurance (LPMI) from some lenders. That may sound great, but there's a catch. Mortgage lenders charge higher interest rates on no-PMI loans. And that higher rate is with you for the life of the loan — unlike PMI, which can be removed after a few years.

Piggyback loans are another alternative to mortgage insurance. With a piggyback mortgage, you make a 10% down payment, use a standard mortgage for 80% of the home price, and cover the remaining 10% with a second mortgage (usually a HELOC). A piggyback loan could save you money in the long run, but it's tougher to qualify and the arrangement is more complex. So have a lender walk you through your options if you're considering this.

Note that some programs for first-time home buyers offer special, low PMI rates. Check out **Fannie Mae's HomeReady** loan and **Freddie Mac's Home Possible** loan. Some individual lenders also offer their own proprietary programs that are PMI-free. But these are typically aimed at tightly defined groups, such as first-time buyers with below-average incomes, doctors, teachers, first responders, and so on.

Your next steps

PMI might seem unappealing, but it's actually a very useful tool for home buyers. Using a low-down-payment loan with PMI can put you in a home much sooner than you thought possible. And remember that PMI isn't forever; you'll eventually be able to remove it.

So, before you write off PMI, explore your options. Have a lender walk you through the costs and longer-term benefits of using PMI. You may find that it's ultimately a wise decision.