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Private mortgage insurance: What it is and how it works

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Private mortgage insurance (PMI) is an extra expense for conventional mortgage borrowers who make a down payment of less than 20%. Although the borrower pays for it, PMI actually protects the lender since the lender takes on more risk for lending a larger loan with a lower down payment.

However, you won't pay PMI forever. Lenders are required to cancel it when your mortgage balance drops to 78% of your home's original value (its worth when you bought it), or once you are halfway through your loan term, whichever comes first.

The average monthly cost of PMI is 0.46% to 1.5% of the loan amount, according to the Urban Institute.

Factors that influence the cost of PMI include:

- Your credit score: Your credit score plays a major role in the cost of PMI. In general, the higher your score, the lower your PMI cost.
- Your loan-to-value (LTV) ratio:

The LTV ratio is the percentage of the home's value you're financing. The higher your LTV ratio, the higher your PMI payment.

- Your loan type: Adjustable-rate mortgages (ARMs) are generally considered riskier, so your PMI might be more expensive with an ARM than with a fixed-rate loan.
- Your down payment amount: The closer your down payment is to 20%,

the less your PMI. There are three main ways to make PMI payments. Your options could vary depending on your lender:

• Monthly: The most common method is paying PMI premiums monthly with your mortgage payment. This boosts the size of your monthly bill, but allows you to spread out the premiums over the year.
• Upfront: Another option is an upfront PMI payment, meaning you pay the full premium amount for the year all at once. Your monthly mortgage payment will be lower, but you'll need to have the money set aside for that larger annual expense. Also, if you move sometime in the year, you might not be able to get part of your PMI refunded.
• Hybrid: The third option is a hybrid one — paying some upfront and some each month. This can be useful if you have extra cash early in the year and want to lower your monthly housing costs.
Types of PMI
• Borrower-paid PMI is what most people are referring to when they talk about mortgage insurance. With borrower-paid PMI, the premiums are part of your monthly mortgage payment. You'll be able to request to cancel these when you reach 20% equity in your home.
• Lender-paid mortgage insurance, sometimes called a no-PMI loan, isn't exactly what it sounds like. With lender-paid PMI, the lender pays the premiums, but you'll pay, too, by way of a higher interest rate on the loan. Often, that higher rate costs you more over time than the extra amount you'd pay monthly with borrower-paid PMI. You can't get lender-paid PMI canceled in the same way you can with borrower-paid insurance, either. The main path to getting out of lender-paid PMI is to refinance.
• Single-premium PMI: Instead of dividing up payments into regular installments each month, single-premium PMI bundles the entire cost of the premiums into one lump payment. Depending on the loan terms, you can either pay this in full at closing or roll the amount into the loan for a higher balance. I
If you pay it upfront, you'll get the benefit of lower monthly mortgage payments. However, you might not have the funds to make this happen. Plus, if you sell your home before you would have stopped paying PMI, you paid premiums in advance for no benefit.
• In a split-premium PMI arrangement, you'll pay a larger upfront fee that covers part of the overall insurance costs. You'll pay the remainder with your monthly mortgage payment. This strategy combines the pros and cons of single-premium and borrower-paid PMI. You'll need some cash — but not as much — to pay the upfront premium, and your monthly payments won't be as high.
Split-premium mortgage insurance can also be helpful if you have a higher debt-to-income (DTI) ratio: It allows you to lower your estimated mortgage payment and avoid pushing your DTI so high that you'd be ineligible for the loan.
It's possible to avoid paying PMI. Here's how:
• Put 20% down: If you put 20% down on a home, you'll avoid the PMI expense altogether. That can be tough to save for, though down payment assistance might help.
• See if your lender offers piggyback loans and compare the costs: A piggyback loan, also known as an 80/10/10 or combination mortgage, takes the form of two loans: one for 80% of the home's price and the other for 10% of the home's price. You'll then pay 10% as a down payment. The upside: You won't pay PMI. The downside: The two loans could end up costing more than PMI in interest and closing costs.
• Get a VA loan: Mortgages guaranteed by the Department of Veterans Affairs don't require PMI or a down payment. If you're a military veteran, active-duty service member or surviving spouse, you might qualify for a VA loan. You'll need to pay a funding fee, however.

There are a few ways to get rid of PMI:

- Request PMI cancellation. By law, you can request to cancel PMI when your LTV ratio drops to 80%. You'll likely need to submit your request in writing to your lender or loan servicer. Additionally, you might need to get an appraisal or broker price opinion.
- Wait until it's automatically canceled. Your mortgage lender must automatically end your PMI when your LTV ratio drops to 78%, or when you're halfway through your loan's term.
- Have your home reappraised. With home prices rising, you might have 20% equity in your home even if you haven't owned it long. To prove this, you'll need to get your home reappraised, either by a professional appraiser or a broker.

Should you pay PMI?

If you're wondering whether or not you should put 20% down on a home to avoid PMI, here are some questions to consider:

- Is your goal to buy a house as soon as possible? If you need to buy a home sooner rather than later, instead of waiting to save a 20% down payment, you can contribute what you have now and eventually cancel PMI once you build enough equity.
- Will a 20% down payment drain your savings? Owning a home comes with lots of additional expenses — some unexpected — for repairs and maintenance. Rather than spending every dollar you have on a down payment to avoid PMI, it may be wise to make a smaller down payment and keep a healthy reserve of cash for emergencies.
- Can you look for a more affordable property? If you're focused on avoiding PMI, you may want to consider a smaller home, or look in a less desirable area where housing prices are more affordable for your budget.

"The typical U.S. home sells for close to $400,000, and coming up with a 20% down payment means writing a check for $80,000," says Jeff Ostrowksi, housing market analyst at Bankrate. "Many first-time buyers don't have that much money. So even though paying private mortgage insurance isn't anyone's favorite thing to do, the upside is that PMI lets buyers get into a challenging housing market even if they haven't amassed a stash of cash."

Pros of PMI

- It allows you to buy a home with 3%-5% down instead of 20%.
- It lets you start building equity sooner.
- It helps you preserve money for emergencies or other financial goals.
- You can remove it as soon as you hit 20% equity in your home. Cons of PMI
- It increases your total monthly payment, often by hundreds of dollars.
- It's designed to protect the lender, not the homeowner.
- Putting less money down means paying more in interest over the life of the loan.
- Getting to 20% equity can take years.

Frequently asked questions

Is PMI tax-deductible?

For now, no. PMI isn't tax-deductible for tax year 2025, but the deduction will be renewed starting tax year 2026.

What's the difference between mortgage insurance and homeowners insurance?

Mortgage insurance protects your mortgage lender in the event you don't pay back your loan. Homeowners insurance protects your home from damage against certain covered events. Lenders require mortgage insurance if you're getting a conventional or FHA loan and putting less than 20% down. They also typically require homeowners insurance for any type of mortgage. Is PMI based on credit score? Yes. The amount you pay for PMI depends largely on your credit score. For those with a score of 620 to 639, PMI can be as high as 1.5% of the loan amount, according to the Urban Institute. By comparison, those with a credit score of 760 or greater might pay as low as 0.46%.

How much does PMI cost on a $300,000 mortgage?

How much you'll pay for PMI depends on factors such as your credit score, down payment, loan type and lender. PMI typically ranges from 0.46% to 1.5% of the original loan amount per year. On a $300,000 mortgage, that works out to around $115 to $375 per month.

How long do you have to pay PMI? You pay PMI until your loan balance reaches 80% of your home's value. At that point, you can request that your lender remove it. If you don't, your lender must automatically cancel it when your balance reaches 78% of the home's value.