



Private Mortgage Insurance

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Simply stated, Private Mortgage Insurance (PMI) is a guaranty that protects the lender against loss in the event that a borrower defaults. But what it means to homebuyers is that they can afford more house than they would otherwise.

How does this work? Without PMI, lenders typically require a 20 percent down payment. Wages have not kept pace with the rise in home prices in the past 25 years, which translates to lower earnings and, inevitably, lower savings. This means that people are having to rent longer while saving up for a down payment. According to a Chicago Title and Trust study, the average first-time homebuyer is required to save for a down payment for about seven and a half years. However, if buyers purchase Private Mortgage Insurance, they can realize their homeownership in just over a year of saving, because a five percent down payment is all that's necessary. In other words, Private Mortgage Insurance increases a purchaser's buying power.

The bad news: Buyers can't shop around for the best PMI rate. There are only eight PMI insurers in the U.S., and the lender—the at-risk party—is the one who chooses which one to use. And even though the buyer pays the premiums, he is not allowed a copy of the PMI policy.

Homeowners Protection Act of 1998

For these reasons as well as reports of abuse and vague disclosure practices, PMI has been given a bad rap in recent years. The result is the Homeowners Protection Act of 1998, which gives homeowners the ability

to cancel the insurance once they've built up 20 percent equity in their home. The Act actually requires that PMI policies written on or after July 29, 1999, be automatically cancelled once equity rises to 22 percent. Insurers are assessed fines and legal fees if they don't cancel, and they must refund whatever payments are made beyond the 22 percent point.

The fact is that, over the years, many homeowners didn't even know that they were paying a monthly PMI premium to begin with, since it's one of the "hidden" costs rolled into a borrower's monthly mortgage payment. Now, under the Homeowners Protection Act, borrowers must be informed in writing when they close on their house 1) that they have private mortgage insurance, 2) what it is, and 3) how and when they can cancel it. The policy writer then must remind the borrower annually when he can cancel.

Often confused with mortgage life insurance, which pays all or a portion of the mortgage in the event of the owner's death, PMI is required by lenders because they understand that there's a strong correlation between borrower equity and default. The more borrowers have invested in their home, the less likely they are to default. Therefore, since a homebuyer can invest as little as five percent in the beginning, lenders want insurance that they're going to get their money back.

Following the Homeowners Protection Act, a flurry of publicity let consumers know that they could demand a refund from their insurers. Since these articles often failed to

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mention that PMI is legal and helpful, the media tended to stir up controversy and panic instead of educate consumers. Some companies have even sprung up to help homeowners recover refunds from overpaid private mortgage insurance. (Many of these use inflammatory messages such as “A legal ‘conspiracy of silence’ continues to cost us billions! If you purchased your home with less than 20 percent down payment, odds are you are, or will be, a victim!”) But buyers don’t need to give money to one of these third parties to find out how to stop paying PMI.

Requirements for PMI Cancellation

There are no hard and fast rules for PMI cancellation, since there are many different property types, loan servicers, and loan types. To find out the specific requirements for a given PMI, buyers should contact their loan servicer. However, typical requirements may include one or more of the following:

- Private Mortgage Insurance payments have been made for a specified minimum period of time.
- The outstanding mortgage balance is below 75-80 percent, due to paying down of the principal through regular payments, added value because of structural improvements, sharply increased property values in a neighborhood, or other conditions.
- The borrower’s payment history is good, with current payments, no payments more than 30 days past due in the past 12 months, no more than one late payment penalty in the past 12 months, and no notice of default recorded against the property.

“Do-It-Yourself” Private Mortgage Insurance Cancellation

The first step borrowers should take to cancel their own Private Mortgage Insurance is to figure out if they qualify for PMI cancellation. The mortgage needs to be paid down

to 80 percent LTV (loan-to-value—the ratio of the amount of the loan to the appraised value or sales price, whichever is less, expressed as a percentage, figured by dividing the loan amount by the appraised value). Structural improvements increasing the value of the home should be factored in, and if homes in the area have increased dramatically in value, that should play a role in the home’s current value as well. If the LTV is 80%, or if the home has gone up markedly in value, it may be time for the borrower to get in touch with the loan servicer with the following information: name, social security number, property address, and loan number. This information can be found on the most recent monthly payment coupon or invoice.

While most loan servicers require PMI cancellation requests in writing, the borrower will want to call on the phone to request the servicer’s specific instructions to cancel. There may be added requirements, such as supplying additional information about the home or loan or having an appraisal, Broker’s Price Opinion (BPO—a less-detailed appraisal, also performed by a licensed professional), or Comparative Market Analysis (CMA—a property value established for listing a home for sale based on comparative prices by a licensed professional).

Once all requirements are met, the borrower can send a written cancellation request. Items to include in the cancellation request letter include the loan number, property address, borrower’s name and phone number, and the borrower’s intention to cancel PMI. It’s also a good idea to request that the loan servicer follow up with the details and status of the cancellation request.

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