Understanding Mortgage Insurance

If you put down less than 20% when you buy your home, you'll have to pay mortgage insurance. Let's take a closer look at how mortgage insurance works.

WHAT IS MORTGAGE INSURANCE?

Mortgage Insurance (MI) protects the lender in the event that you fall behind on your mortgage payments. If you put down less than 20% when you buy your home, you'll have to pay MI (also referred to as private mortgage insurance [PMI] or a mortgage insurance premium [MIP], depending on the type of loan product you choose).

Some loan programs, like VA loans, don't require MI, no matter how big or small your down payment.

Understanding Equity

Equity is the amount of home you actually own. Equity builds gradually as you pay down your mortgage and can also increase as your home's value appreciates over time. You can get rid of MI once you have 20% equity in your home.

HOW MORTGAGE INSURANCE CAN BENEFIT YOU

While MI places an added expense on your monthly mortgage payment, it can be worth it by helping you purchase a home sooner. For example, let's say you only have 5% saved up for a down payment. Rather than waiting to save up for a full 20% down payment, which could take years, you could purchase a home now with your 5% down payment and pay MI as a tradeoff. Once you have enough equity built up, you may be able to cancel your MI. That's because as you build equity, your LTV decreases. Remember in an earlier section how we said borrowing $90,000 to purchase a $100,000 home would equal a 90% LTV? In that scenario, once you've built up enough equity and your LTV reaches 80% (i.e., once you owe $80,000), you can request to have your MI canceled.

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