

How Low Can Your Monthly Payments Go?

*By David Reed
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For the past several years, buyers have used a common loan program called an 80-10-10. An 80-10-10 is two mortgages; a first mortgage at 80 percent of the sales price and a second at 10 percent of the sales price. The final 10 percent is down payment from the buyer. There is also an 80-15-5 program that is structured the same way, only the buyer puts 5 percent down and not 10 percent.

Since interest rates have been as low as they have for as long as they have, this combination of loans has been the product of choice for those who want to avoid private mortgage insurance, or PMI, which is typically required on all loans when the first mortgage exceeds 80 percent of the sales price.

The math works out because the total monthly payments between an 80-10-10 and a regular 10 percent down loan with PMI are lower with the 80-10-10.

For instance, on a \$300,000 sales price, 30 year, 6.25 percent first and an 8.00 percent second, the monthly payments are \$1,470 for the first on a loan amount \$240,000 while the second note comes out to \$218 and a \$30,000 loan.

Add those together and the monthly payment is \$1,688.

If you put 10 percent down and used that same 6.25 percent rate on 90 percent of the sales price, or \$270,000, the payment is \$1,610. Now add the PMI payment of \$117 per month and the total payment is \$1,770. Certainly a difference you can feel in your wallet each month.

However the second note stays with you for a long, long time. In this case at least 15 years. With PMI removed, the payment stays at \$1,610. For a long, long time.

PMI is not a lifetime thing, and can be removed typically after 24 months have passed and the home has appreciated to provide a 20 percent equity position by appreciation, principal paydown or a combination of both.

That's a strong consideration for avoiding 80-10-10 loan for the sake of avoiding PMI. Especially since PMI is now tax-deductible in most cases.

The second mortgage will stay there for a long, long time while the PMI policy is only short term. It's been pretty much of a mortgage mantra to avoid the "dreaded PMI" by constructing an 80-10-10 loan. In fact, lenders and loan officers can make themselves appear to be financial wizards by "saving their borrowers" from the throes of PMI.

I suggest that idea may not hold as much water any longer, especially with new mortgage insurance rules. I say that it might be better to go ahead and put 10 percent down, let the property appreciate then get rid of PMI a couple of years down the road and enjoy lower monthly payments for the rest of the loan term.

Much longer than an 80-10-10 structure.

When pressed with 5 percent or 10 percent down don't automatically think 80-15-5 or 80-10-10,

but also look at current PMI offerings. Your lender or mortgage broker can have both, but don't fall for the notion that PMI is a bad thing. It's not.

In fact, it could very well be the better thing.

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