

## Smaller Down Payments Help Qualify More Home Buyers

The advantages of mortgage insurance are not always immediately evident to a borrower. Many prospective borrowers believe they need to provide at least a 20% down payment to avoid paying for mortgage insurance. However, there are many situations in which borrowers can benefit by using mortgage insurance. The following illustrates several of these:

1. Mortgage insurance increases the price of the house a borrower can afford. For example, a borrower with a \$20,000 down payment can buy a \$100,000 home without mortgage insurance. But by using mortgage insurance, the borrower may be able to buy a much larger home.
2. Mortgage insurance can help home buyers consolidate debt and save on income taxes. Even if borrowers can come up with a 20% down payment, it may be more beneficial for them to put less down and apply the balance of their available funds to other debts or opportunities. Below is an example.

Charles and Angela Brown have a combined income of \$50,000 per year (\$4,167 per month). They've picked out a beautiful home and negotiated a purchase price of \$125,000. The Browns have saved \$25,000 for use as a down payment, and they have \$12,500 in debt, as detailed below:

Debt	Original Balance	Original Term	Interest Rate	Monthly Payment	Balance Due
Credit Cards	N/A	N/A	18%	\$200.00	\$ 4,000
Car Loan	\$18,000	5 yrs	10%	\$382.45	\$ 8,500
Total				\$582.45	\$12,500

The Browns had planned to use the entire \$25,000 to make a 20% down payment. However, their loan officer points out that they should consider using half of that money to pay off their existing debts, and use the balance to make a 10% down payment. Although they'll need to obtain mortgage insurance, their total monthly payments will be significantly lower.

	20% Down Payment	10% Down Payment
Home Purchase Price	\$125,000	\$125,000
Down Payment	\$25,000	\$12,500
Loan Amount	\$100,000	\$112,500
Monthly P&I*	\$722.76	\$825.49
Monthly MI Premium**	\$0.00	\$48.75
Other Debt Payments	\$582.45	\$0.00
Total Monthly Payments	\$1,316.21	\$874.24

Monthly Savings with MI	N/A	\$411.97
Housing Debt Ratio***	22.4%	25.8%
Total Debt Ratio	36.4%	25.8%

\* Assumes 30-year fixed-rate fixed-payment mortgage at 8.0% interest.

\*\* Assumes monthly premium no-refund payment plan option with 25% coverage.

\*\*\* Includes \$200 per month for taxes and hazard insurance.

The Browns are able to save hundreds of dollars a month while consolidating their debts into one payment at a lower interest rate. And, this doesn't even take into account that financing a higher loan amount may increase their mortgage interest income tax deduction, one of the last tax breaks available. With MI, they may be able to convert non-deductible debt into deductible debt.

3. Even if borrowers don't have a lot of debt to pay off, they may have alternative opportunities for investing their money. Let's look at the situation of another couple, Andy and Jan Green. The Greens also have a combined income of \$50,000 per year (\$4,167 per month), and have planned to make a 20% down payment on a \$125,000 home. However, the Greens are debt-free. Their loan officer explains that the return on the equity they use to make a down payment is much higher with a smaller down payment, as shown below. This illustration assumes the home appreciates at 15% per year.

Down Payment	Initial Equity	First-Year Appreciation	Return on Equity
10%	\$12,500	\$6,250	50%
20%	\$25,000	\$6,250	25%

The home appreciates the same amount regardless of the down payment amount. And, the Greens can invest the balance of the down payment to increase their wealth. Investing \$12,500 in a mutual fund that returns 8% will earn \$1,000 in the first year. In an emergency, the money is also much easier to access in a mutual fund than it would be if it was tied up in the home's equity. In addition, the higher loan amount may increase their mortgage income tax deduction!