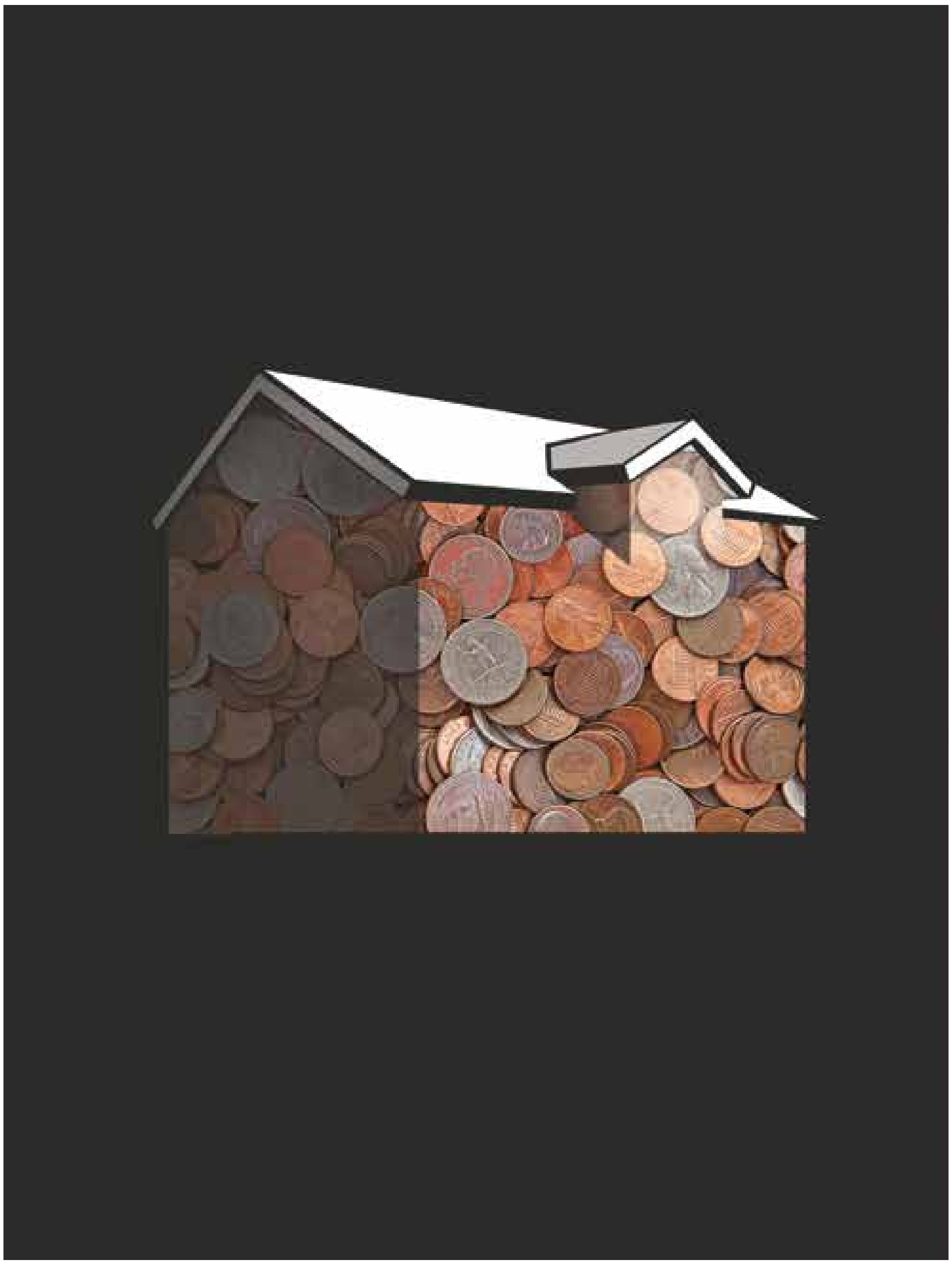
More than a Small Change in Downpayments

Several financing programs are available for homebuyers who are tight on cash

By John Wiseman



They're back. Although buyers with less than 20 percent to put down on a home have never truly gone away, there has been a notable uptick in low-downpayment lending this year.

Finding the right loan for these buyers can be tricky because each person's situation is different. But by knowing the ins and outs of the most broadly available loans — conventional, with private mortgage insurance (PMI), and those through the Federal Housing Administration (FHA) — you can make sure these low-downpayment homebuyers get the most bang for their buck.

A June report from RealtyTrac clearly showed that low-downpayment homebuyers are on the rise. According to the study, 51 percent of homebuyers with non-jumbo mortgages put 10 percent or less down on a home in first-quarter 2015. That number

Continued >>

John Wiseman is the vice president and managing director of sales and business development in the East Central Region for Mortgage Guaranty Insurance Corp. (MGIC). He has more than 38 years of experience in the mortgage insurance industry. In addition, Wiseman serves on the board of the Ohio State Center for Real Estate and is a past president of the Ohio Mortgage Bankers Association. Reach Wiseman at john_wiseman@mgic.com.

<< Continued

was just 48 percent for the same quarter of 2014. RealtyTrac also found that 40 percent of homebuyers put 5 percent or less down in first-quarter 2015, compared to 38 percent the prior year.

Multiple factors are responsible for this increase, including the improving economy, a stabilized housing market and changes in housing policy. Fannie Mae and Freddie Mac, for example, re-introduced mortgage programs that allow as little as 3 percent down, and FHA loans have seen a reduction in fees.

Homebuyers with low downpayments have many factors to consider when choosing a mortgage, including their credit standing, the amount of cash they have on hand and the price of the home they're looking to buy. They'll want to determine which option will give them the lowest monthly payment, how quickly they'll be able to build equity and whether they'll be able to cancel the mortgage insurance product. By finding out what is most important to your clients, you can help match them with the right product for their specific needs.

The U.S. Department of Veterans Affairs and the U.S. Department of Agriculture have low-downpayment products on the market, but they are targeted at specific groups. FHA loans and conventional loans with PMI are widely available and are worth exploring more deeply.

Money down

At first glance, the downpayment requirements for these two options don't seem much different. The FHA requires a minimum of 3.5 percent down, and Fannie Mae and Freddie Mac offer borrowers options for putting just 3 percent down. Although half a percent may seem like a small amount, it adds up to $1,250 on a $250,000 purchase. For a first-time homebuyer, who will likely have numerous out-of-pocket expenses in the near future, the ability to keep those additional funds to spend on appliances or furniture could be a deciding factor.

FHA vs. Conventional Loans with PMI

$250,000 purchase, 760 FICO Credit Score	FHA 3.5% Down	PMI Conventional 3% Down	PMI MCM/HPA* 3% Down	PMI Conventional 5% Down
Downpayment	$8,750	$7,500	$7,500	$12,500
Base Loan Amount	$241,250	$242,500	$242,500	$237,500
Upfront Premium *(financed into loan amount)*	$4,222	$0	$0	$0
Total Amount Borrowed	$245,472	$242,500	$242,500	$237,500
Interest Rate	3.75%	4.00%	4.00%	3.875%
Monthly MI Payment	$169	$212	$115	$107
Monthly Loan Payment *(P&I plus MI)*	$1,306	$1,370	$1,273	$1,224
	Assuming 3% annual appreciation			
Est. MI Cancellation *(in years)*	Not Cancellable	5.1	5.1	4.8
Est. Payment in 5 Years *(assuming MI cancellation)*	$1,289	$1,158	$1,158	$1,117
Est. Equity in 5 Years	$68,704	$70,483	$70,483	$75,442

*HPA: Homeownership Preservation Advance credit   *MCM: Fannie Mae's My Community Mortgage loan program

Source: Mortgage Guaranty Insurance Corp. PMI are as of July 2015.

Additionally, FHA and conventional loans with PMI allow the borrower to use a gift for the downpayment. If the buyers have family members willing to help with the downpayment, or are eligible for grants, they may want to consider this option.

Credit scores and DTI ratios

FHA offers some benefits over conventional lending for certain borrowers who have lower credit scores and higher debt-to-income (DTI) ratios. PMI, however, covers borrowers with credit scores as low as 620. Fannie Mae and Freddie Mac currently have a Qualified Mortgage (QM) exception to DTI.

Nonetheless, borrowers with lower credit scores and higher debt obligations may find that FHA is their best option.

Monthly payment

FHA's upfront and annual premiums are priced independently of credit score. Pricing for conventional loans, however, is usually tiered based on credit-score buckets. So ultimately credit scores also matter, because they will affect the borrower's monthly payment on a conventional loan. But that doesn't mean an FHA loan will always offer the lowest monthly payment. Even with FHA's recent fee reduction, a conventional loan with PMI will still be a more affordable option for many borrowers.

If your potential borrowers show concern about the monthly payment, it's worth running a quick calculation to see what the monthly payment would be with FHA and a conventional loan with PMI. Maybe even bump the downpayment as high as 5 percent to show them how coming up with a slightly higher amount upfront (through savings or a gift) will help reduce their monthly expense.

More equity

Speaking of the FHA's upfront premium, most often that 1.75 percent fee is financed into the loan. By financing the premium, the borrower is sacrificing equity and, in a way, giving back half of the downpayment they worked so hard to save.

Conventional lending with PMI offers a variety of premium plans to choose from, with the most common being monthly PMI.

Continued >>

<< Continued
This option features no upfront premium and no additional cost to the borrower at closing. Choosing a conventional loan with PMI allows the borrowers to enter into homeownership with more equity in their home and to continue building equity at a faster rate.

Cancellation

FHA insurance can only be canceled if the buyer puts 10 percent or more down. Borrowers who don't meet that threshold will maintain the insurance premium for the life of their FHA loan.

On the other hand, PMI automatically cancels when the home reaches 78 percent loan-to-value (LTV) ratio based on the original value of the home. In addition, Fannie Mae and Freddie Mac allow a new appraised value to be used in cases where the borrower requests cancellation.

This is another scenario where running the numbers for a borrower is a useful exercise. Although an FHA loan may provide a lower initial monthly payment compared to a conventional loan, being able to cancel PMI may offer the borrower more savings over the long term.

■ ■ ■

FHA loans and conventional loans backed by PMI are often portrayed as competing products, but the truth of the matter is they work in concert to fuel a healthy, sustainable low-downpayment market. By understanding what is most important to your borrowers, you can better present their options to them and help them choose the right mortgage for their situation. You will ultimately end up with satisfied customers — and happy customers make the best referral sources ■