How PMI and Credit Scores Are Linked

If you're thinking about buying a home, you've probably realized that your credit score plays a big role in the process. Credit scores affect things like interest rates and eligibility for certain types of loans. But you may not realize that credit scores can affect other parts of the transaction, specifically the cost of private mortgage insurance.

Private mortgage insurance, known as PMI, protects the lender's investment when the borrower pays less than 20 percent down. When you reach 20 percent equity, PMI is not required and there are several ways to get rid of it. Until then, you must pay a monthly insurance premium, in addition to the mortgage. (For simplicity, we're only talking about PMI on conventional loans here; there are other types of mortgage insurance for other loans types).

Credit Scores Can Affect the Cost of PMI

Mortgage insurance companies, like lenders, look at credit scores when determining PMI eligibility and cost.

"I would say credit scores are one of the bigger drivers of how mortgage insurers tend to price," said Steve Keleher, vice president of portfolio management at Radian, a leading provider of mortgage insurance. "We protect the lender and investor; anything that increases the likelihood of delinquency and foreclosure increases the cost."

An example scenario

The PMI premium typically goes up as the credit score goes down. Here is an example:

Imagine three borrowers with three different credit scores:

- **Borrower 1 has a "very good" FICO credit score of 740 or higher.**
- **Borrower 2 has a "good" FICO credit score of 670-739.**
- **Borrower 3 has a "fair" FICO credit score of 620-660.**

Each borrower buys a house for $300,000 and puts 10 percent down, leaving them with a balance of $270,000 with a 30-year mortgage. Because they are not at the 20 percent equity threshold, each borrower will need to pay PMI. As a result:

- **Borrower 1's PMI payment might be 0.20 to 0.30 percent of the loan balance, or $45 to $68 a month.**
- **Borrower 2's PMI payment might be 0.35 to 0.40 percent of the loan balance, or about $79 to $90 a month.**
- **Borrower 3's PMI payment might be 0.75 to 1.5 percent of the loan balance, or about $169 to $338 a month.**

As you can see, someone with a fair credit score might end up paying three or four times as much in PMI as someone with a very good credit score.

PMI Opens the Doors to Home Ownership for Many

Private mortgage insurance is an added cost of homeownership and you certainly don't want to pay it if you don't have to. But the good part about PMI is that it opens doors for borrowers who can't get over one of the biggest hurdles to homeownership: the 20 percent down payment. Without the PMI option, many people wouldn't be able to buy a home.

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