

Restricting PMI Premiums: Who Will Suffer?

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When a home buyer lacks the cash to provide a 20% downpayment, the lender seeks protection against default through insurance from a government agency or a private insurance company. Consumer advocates have long complained of the practice, seemingly widespread among private mortgage insurance (PMI) underwriters, of continuing to collect premium payments long after the borrower's equity has reached 20%. A Senate committee has discussed federal legislation to force insurers to inform borrowers when they can stop paying PMI premiums.

It is difficult to find fault with laws that serve to inform people. A compelling question, however, is whether the well-intended efforts of consumerists and lawmakers will actually reduce the cost of mortgage insurance for borrowers. Their belief appears to be that if borrowers pay fewer premiums, PMI (and thus housing) will become more affordable. While such a view may appear correct at first glance, it reflects some errors of logic.

Pay Later, or Pay Now

An underlying premise seems to be that the market for PMI is not competitive, such that bloated mortgage insurers could cover their operating costs even if their revenues were seriously curtailed. But arguments that the market for PMI

lacks competition are unconvincing, both because borrowers can compare total loan costs (which include PMI) across lenders and because FHA insurance provides an alternative for many affected borrowers.

An insurer sets its rates based on actuarial expectations. The present value of expected revenues (net of costs, which would differ slightly with the servicing period) therefore should be essentially the same regardless of the time over which the firm expects to receive premiums. If the PMI market is at all competitive, then premium rates reflect overpayments that some borrowers are expected to make (a situation with admittedly unfair aspects), and attempts at curtailing the collection period would simply result in higher annual premiums for all insured borrowers.

Exacerbating the Tilt Problem

An accompanying dilemma is that, by imposing higher PMI outlays early in the borrowing period, we would increase the *tilt problem* that borrowers face with most types of mortgage loans. High early payments are particularly onerous for households whose incomes will rise with inflation (or with career advancement). We must recognize, in fact, that concentrating PMI premiums over a shorter time period could actually price some marginal buyers out of the housing market. ■

“**Market Analysis: Illinois Housing Prices**” (page 1) compares the recent history, as outlined in graphs and supporting text, of home prices in seven Illinois communities with those for the state, region, and nation over the past two decades. The article also provides insights on the use of repeat sales indices in analyzing housing markets. The two articles that follow discuss aspects of the Real Estate Settlement Procedures Act (RESPA), still controversial long after its 1974 passage. In “**The Economics and Politics of RESPA**” (page 6), a former top HUD policy maker asks whether referrals among affiliated firms that provide services to home buyers bring about efficiencies that lead to lower costs for consumers, or simply pad the pockets of referring agents. “**Issues in Settlement Regulation: RESPA at 23**” (page 10) offers a current HUD economist's discussion of referral fees; the author describes a relevant study of FHA loans and offers recommendations on creating a more effective structure for regulating the mortgage loan settlement process. “**Restricting PMI Premiums: Who Will Suffer?**” (page 16) contains thoughts on proposals to force mortgage insurers to better assist families in terminating their coverage; an unintended result could be higher premiums and a worsening of affordability problems for marginal households.

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