Book 5
Understanding How Mortgage Insurance Works

MGIC

THE FUNDAMENTALS OF THE MORTGAGE PROCESS

Introduction

It all starts with the dream of owning a home. To turn that dream into reality, a consumer will usually turn first to a loan originator or real estate agent for help.

As a member of the mortgage industry, consumers look to you for expertise and guidance as they navigate the home-buying process. But where can *you* go for guidance?

At MGIC, we know how many steps, people, processes and rules are involved in the whole mortgage cycle. And we know that in today's constantly evolving and heavily regulated market, it's more important than ever to stay on top of changes. That's why we prepared this program: *The Fundamentals of the Mortgage Process.*

The Fundamentals of the Mortgage Process breaks down the main components of the home-buying process, and explores and explains each piece. We'll walk you through everything from closing a loan to servicing and selling it. You'll also learn how The 4 Cs of the mortgage industry — Credit, Capacity, Capital and Collateral — can help determine whether a consumer will be a successful homeowner.

Once you have completed this course, you can better position yourself as an expert to your customers. You'll have the preparation and confidence to successfully:

- Prequalify consumers
- Determine what consumers can afford
- Guide consumers through the current real estate market
- Target homes in the appropriate price ranges
- Explain to consumers how The Four Cs will affect their ability to purchase and own a home

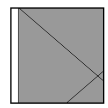
The mortgage business is a risk-based business. But the more you know and understand about the process, the more you can help minimize that risk for your company and your customers — and the more it will increase your success as a mortgage professional. We've put all the information you need in a convenient, easy-to-read package.

If you have questions about any of the information presented in *The Fundamentals of the Mortgage Process*, please contact your Account Manager, mgic.com/contact.

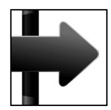
Symbol Key

We use the following icons throughout *The Fundamentals of the Mortgage Process* program to highlight details, tips and shortcuts that will help you better understand the Mortgage Cycle.

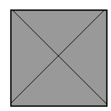
Dictionary: Industry jargon and acronyms explained in straightforward language



File It: Important documents you must include in the loan file



Take Note: Information, shortcuts or exercises that can make your job easier



Checkpoint: Helpful review points to help you ensure that you've got everything needed to complete the loan file

Check This Out: Information about MGIC resources relative to the topic at hand

Book 1
Understanding the Mortgage Cycle

Book 2
Taking the Loan Application

Book 3
Processing the Loan

Book 4
Evaluating Credit, Capacity, Capital and Collateral

Book 5
Understanding How Mortgage Insurance Works

BOOK 5

Understanding How Mortgage Insurance Works

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Although we believe the information set forth in this publication is generally accurate, the information may be outdated due to the rapidly changing nature of the residential mortgage industry, and we do not warrant the accuracy, reliability or completeness of any information contained in this publication.

The information in this publication is culled from a variety of business and mortgage industry sources. Attribution is given where deemed necessary. Opinions and insights expressed herein do not necessarily represent our views.

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How Does Mortgage Insurance Fit Into The Big Picture?

Mortgage insurance (MI) can come into play during several stages of the Mortgage Cycle:

- Most commonly, the lender orders it during the Underwriting stage
- A processor may order it while completing the loan file during the Processing stage
- An investor may order it during the Warehousing stage
- Later on in the cycle, MI serves as the passkey for low-down-payment loans from the Delivery stage into the Secondary Market, where the funds from their sale become available to fund new mortgages

For lenders that portfolio mortgages, MI serves as an added layer of protection.

Regardless of its point of entry, MI helps keep the Mortgage Cycle rolling along.

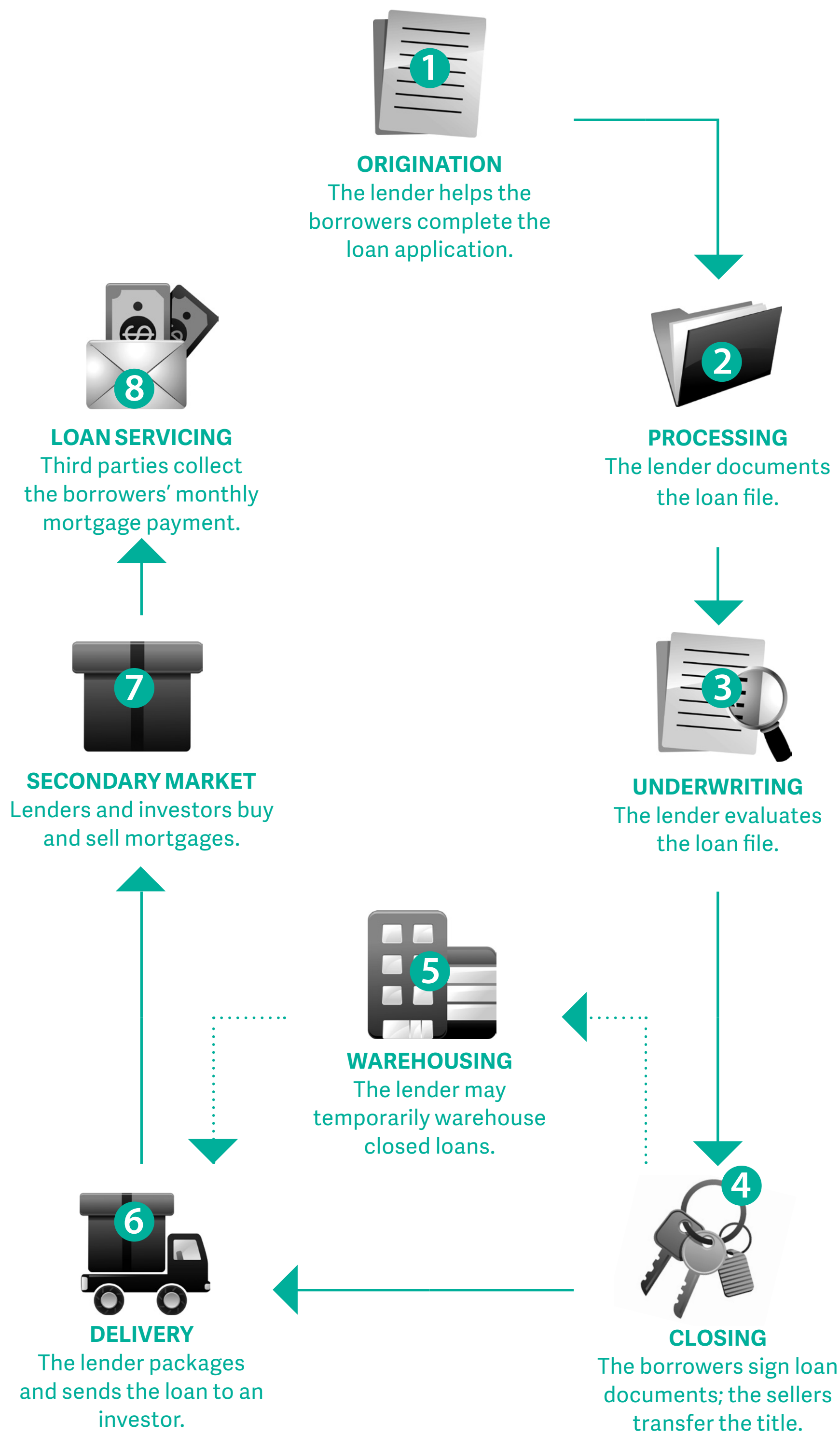
At the end of this book, you will be able to:

- Explain the purpose of MI and how it works
- Explain the advantages of MI for borrowers and lenders
- Describe 4 commonly used premium plans
- Get an MI premium

Throughout this book:

- The term "you" refers to a mortgage professional, loan officer, loan originator, underwriter or processor
- "Borrowers" refers to both multiple borrowers or a single borrower

The 8 Stages of the Mortgage Cycle



How MI Benefits Lenders and Borrowers

MI Gives You an Extra Advantage

With MI you can:

- Structure safe, high-LTV loans
- Possibly save your borrowers thousands in MI costs, compared to financing with FHA
- Broaden your customer base
- Enhance your role as Trusted Advisor and differentiate yourself from your competition by:
  - Broadening the options you provide your borrowers
  - Notifying them when they may be able to cancel MI and reduce their monthly mortgage payment

MI Benefits for Your Borrowers

Borrowers probably do not consider themselves a potential default risk, so they may be skeptical or reluctant about MI. By offering MI as a finance option, you can overcome their skepticism by showing them the opportunities that financing with MI can create for them.

Increased buying power: Say your borrowers have saved $15,000. They could use that cash to put 20% down on a $75,000 home OR they could make a smaller down payment on a more expensive home – 10% down ($15,000) on a $150,000 home or 5% down on a $300,000 home, for example (assuming they can comfortably afford the higher monthly payment that comes with a more expensive home).

Expanded cash-flow options: Using MI to finance their mortgage, your borrowers could elect to put less money down and still have funds for home-related purchases and repairs or investments. For example, rather than putting 20% down ($30,000) on a $150,000 home, they may decide to put down 10% ($15,000) and use the other $15,000 to remodel, redecorate, or fund college or retirement savings.

Lower monthly payments: Borrowers with better credit scores typically receive lower MI premium rates. That can translate to monthly MI costs and monthly mortgage payments significantly less than FHA financing.

MI may be cancelled: Private MI may be cancelled. The Homeowners Protection Act of 1998 (HPA) provides conditions for homeowners who've made all scheduled payments or extra payments ahead of schedule to request MI cancellation when their mortgage balance reaches 80% of the original property value. (Original property value is the lesser of the property sales price and the appraised value. For a refinance transaction, original value is the appraised value.) If they don't request cancellation, their lender must automatically cancel the MI policy when their mortgage balance reaches 78% of original value, and their mortgage payments are current.

- Outside of HPA, homeowners can ask their lender to cancel MI based on an increase in their property's appraised value
- In all scenarios, other requirements may apply. Homeowners should ask their lender for details. Once mortgage insurance is cancelled, the borrowers' monthly mortgage payment is reduced by the amount of their monthly MI payment
- For detailed information about cancelling MI, go to mgic.com/servicing/cancelling-mortgage-insurance and mgic.com/hpa

What is Mortgage Insurance?

In most cases, the Mortgage Cycle ends and begins again when investors such as Fannie Mae and Freddie Mac purchase mortgages from lenders, that in turn use those funds to originate more mortgages.

Investors have set parameters that loans must meet before they can be purchased. One such parameter is that the mortgage has a loan-to-value (LTV) ratio of not more than 80%, meaning that the borrowers have made at least a 20% down payment.

Historically, that 20% down payment has been a difficult hurdle to clear for many consumers.

Mortgage insurance, also called private mortgage insurance, PMI or MI, was created to help more consumers afford homeownership – to help lift them over that hurdle.

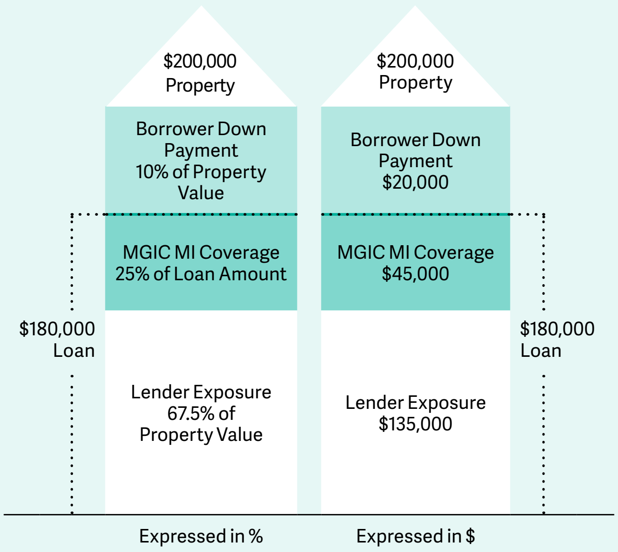
MI is a financial guaranty that reduces loss to the lender or investor in the event the borrowers do not repay their mortgage. By using MI to reduce risk, lenders and investors enhance the quality of the mortgage as an asset. It becomes a safer investment for lenders who keep their loans in portfolio and for investors looking for secure purchases. Even if the borrower fails to repay, the lender or investor will not suffer a complete loss, but rather, will share the loss with the mortgage insurer (see example at right).

Depending on the level of coverage, a loan with mortgage insurance could be considered less of a risk than a loan whose borrowers made a 20% down payment.

Mortgage insurance is NOT:

- Coverage in the event of a borrower's death. That is mortgage life insurance
- Protection against theft or damage from fire and other disasters. That type of protection is known as homeowners insurance

Example: How MI Works



The borrowers make a $20,000 down payment on the purchase of a $200,000 property. They finance a 90% LTV (90% of the home's value), fixed-rate $180,000 mortgage.

Without MI: If the borrowers fail to repay the mortgage, the lender would be at risk of losing $180,000 (90% of the property value), plus any costs associated with foreclosure.

With MI: Typically, an investor would require 25% MI coverage on a 90% LTV, fixed-rate mortgage. So in the event that the borrowers fail to repay their insured mortgage:

- The mortgage insurer would pay the lender $45,000 of the risk associated with the $180,000 loan*
- The lender's risk would be reduced to $135,000 or 67.5% of the original property value. (Original property value is the lesser of the property sales price and the appraised value. For a refinance transaction, original value is the appraised value.)

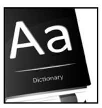
* MI coverage assumes a predetermined share of risk associated with foreclosure and the sale of the property, such as delinquent payments, attorney fees, court costs and property maintenance. For simplicity, we have not included foreclosure costs in this example.

Underwriting for MI

Loan files are underwritten for MI just as they are for lender or investor compliance. Often, MI guidelines closely align with the GSEs', allowing for ease of underwriting.

Underwriting for MI can occur simultaneously with the lender's evaluation or independently from it. The mortgage insurer's underwriting staff can underwrite files manually or its automated underwriting system can underwrite them electronically.

Generally, the principles of The 4 Cs apply: The borrowers' Credit, Capacity, Capital and Collateral are evaluated, as presented by the information on their loan application and documentation gathered to measure, support and substantiate their financial standing and the property's value.



Credit: The borrowers' willingness to repay the loan based on their prior use of credit

Capacity: The borrowers' ability to repay based on the amount and stability of their income

Capital: The borrowers' investment in the property from savings and other sources

Collateral: Whether the property's value and marketability provide adequate security for the loan

As mortgage professionals, our shared goal is to qualify as many borrowers as possible without compromising the assets of the lender or the investor – and, above all, without compromising the borrowers' ability to successfully maintain homeownership.

By carefully reviewing the borrowers' Credit, Capacity, Capital and Collateral, we can piece together a comprehensive picture of risk. The presence of a high-risk factor in any one of these categories doesn't necessarily threaten successful homeownership. But when a number of interrelated high-risk characteristics are present without sufficient offsets or compensating factors, their cumulative effect dramatically increases the likelihood of default.

For details about our underwriting requirements, see the MGIC Underwriting Guide at mgic.com/uwguide.

MGIC MI Pricing

Whether your company has opted for risk-based or rate card pricing from MGIC, you can order MI rate quotes quickly and easily through MiQ, our pricing platform.

Enter as few as 4 pieces of loan information to get an instant quote. In addition to quick, competitive pricing, you get:

- The ability to compare multiple premium plans
- Your personal rate quote queue that stores your recent quotes
- Quotes honored for 90 days

Access MiQ at mgic.com/miq or through our mobile app, mgic.com/mobileapp.

Use your MiQ Quote ID to order MGIC MI through the Loan Center to ensure your rate quote is applied. We've also integrated MiQ into many LOS systems, where you'll use your Quote ID to get the right MI price for your loan.

Contact your MGIC account representative for more information about MiQ, mgic.com/contact.

The Cost of MI

The cost of mortgage insurance is based on a variety of loan risk factors, such as:

- The premium plan you select for your borrowers
- The mortgage loan program they choose (fixed-rate, adjustable-rate, etc.)
- The loan term (15-year, 30-year, etc.)
- Whether you select a refundable or nonrefundable premium
- The ratio of the loan amount to the value of the property (loan-to-value, or LTV)
- The amount of MI coverage as determined by your institution or investor requirements
- Representative or indicator credit score
- The loan amount
- The loan purpose (e.g., cash-out refinance) or borrower occupancy status (e.g., second home)

Follow guidance from your institution, investor requirements or loan program requirements, as applicable, with regard to your selection of premium plans, loan programs, coverage levels and other loan criteria.

MGIC Premium Plans

Compare our 4 most popular premium plans to determine which best suits your borrowers' needs.

Borrower-Paid Monthly Premiums

Borrower-paid Monthly Premiums make up the most widely accepted premium plan in the industry because of their simplicity and ease of use. Other advantages include:

- **No money due at closing**
- **No upfront cost** – Borrowers avoid the decision whether to pay premium upfront or finance it, adding to their debt
- **Cancellable** – Borrowers can request cancellation based on investor requirements or under the Homeowners Protection Act of 1998 (HPA); lenders must automatically cancel under HPA terms
- **Lower monthly payment** upon cancellation – If MI is cancelled, the borrower's monthly mortgage payment is reduced by the monthly premium amount
- **Build equity faster** – With no premium financed into the loan amount and no increase to their interest rate, borrowers are able to build equity more quickly than with other premium plans

Who should consider borrower-paid Monthly Premiums?

Borrowers who want to:

- Minimize closing costs
- Qualify for MI cancellation sooner by making extra payments that reduce the mortgage balance ahead of the original amortization schedule or home improvements that result in an increase in the appraised value
- Lock in the lowest interest rate now and a lower monthly payment without refinancing
- Refinance, but whose appraised value was lower than expected and LTV is slightly above 80%

Borrower-Paid Single Premiums

Borrower-paid Single Premiums are available in both refundable and nonrefundable options. Advantages include:

- **Lower monthly payment** – The absence of a monthly MI payment often provides a lower monthly payment than Monthly or Choice Monthly Premiums afford
- **Flexibility** – The borrowers, seller, builder or other third party can pay the premium at closing. Lenders may offer a lender credit to cover the cost of the premium. The borrowers can opt to finance the premium into the loan amount. (Use the loan amount before the premium is added to determine base LTV for MI coverage requirements, but note, financing the premium into the loan amount may increase the total LTV/CLTV. Check investor guidelines.)
- **Cancellable** – Borrowers can request cancellation based on investor requirements or under the Homeowners Protection Act of 1998 (HPA); lenders must automatically cancel under HPA terms
- **Refundable** – Borrowers who select refundable single premiums may receive a refund if they cancel MI within the first 5 years of coverage. Even those who select the nonrefundable option may be eligible for a refund if they or their lender cancel MI under the HPA

Who should consider borrower-paid Single Premiums?

Borrowers who want to:

- Minimize their monthly payment, even if it means paying more at closing or increasing their debt by financing the premium into the loan amount
- Get the seller or builder to pay the premium – especially in a buyer's market
- Qualify for MI cancellation sooner by making extra payments that reduce the mortgage balance ahead of the original amortization schedule or home improvements that result in an increase in the appraised value

Borrower-Paid Choice Monthly Premiums

Borrower-paid Choice Monthly Premiums give your borrowers the option of paying part of the MI premium up front to reduce the monthly MI premium paid with their mortgage payment. Advantages include:

- **Upfront options** – With flexible upfront options, you can custom-fit the right option for your borrower
- **Flexibility** – The borrowers, seller, builder or other third party can pay the upfront portion of the premium at closing. Lenders may offer a lender credit to cover the cost. The borrowers can also opt to finance the upfront premium into the loan amount. (While base LTV is used to determine MI coverage requirements, financing the premium into the loan amount may increase the total LTV/CLTV. Check investor guidelines.)
- **Monthly portion is cancellable** – Borrowers can request cancellation on the monthly portion of the premium based on investor requirements or under the Homeowners Protection Act of 1998 (HPA); lenders must automatically cancel under HPA terms

Who should consider borrower-paid Choice Monthly Premiums?

Borrowers who want to:

- Reduce their monthly mortgage payment
- Get the seller or builder to pay the upfront portion – especially in a buyer's market
- Qualify for MI cancellation sooner by making extra payments that reduce the mortgage balance ahead of the original amortization schedule or home improvements that result in an increase in the appraised value

Lender-Paid Single Premiums

The lender pays the LPMI Single Premium at the time of insurance activation. Lenders often either increase the interest rate or charge borrowers an origination fee to cover the cost. Coverage remains in place for the life of the loan and can't be cancelled by the borrower. Advantages include:

- **Lower monthly payment** – The absence of a monthly MI payment often provides a lower monthly payment than Monthly or Choice Monthly Premiums afford
- **Ease of use** – Because the borrower pays no upfront premium and no monthly payment, it's easy to explain to the homebuyer
- **Marketing opportunity** – Many lenders market LPMI Singles as a "No MI" program or promote they're willing to pay the MI for borrowers

Who should consider lender-paid Single Premiums?

Borrowers who want to:

- Minimize their monthly payment in the short term, even if it means forfeiting MI cancellation and the chance to reduce their monthly payment in the future
- Get the seller or builder to pay origination fees – especially in a buyer's market

Use this side-by-side comparison as a quick reference to help determine the best option for your borrower.

Features	Monthly Premiums	Single Premiums	Choice Monthly Premiums	Lender-Paid MI
Refundable		●	●	
Cancellable	●	●	●	
Low Monthly Payment	●	●	●	●
Financeable		●[1]	●[1]	
Third-Party-Paid Option		●[2]	●[2]	●[2]
No Monthly MI Payment		●		●

[1] Financing the premium into the loan amount will increase the LTV. The upfront portion of a Choice Monthly premium is financeable. Check investor guidelines.

[2] The single or upfront premium may be paid by a third party, such as a builder or a seller. Check investor guidelines.

mortgage guaranty insurance corporation

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