Have a Home Loan?
Pay Less to Uncle Sam

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From MarketWatch
(As reported on RealEstateJournal.com, 4/19/07)

This time next year, some homeowners who pay mortgage insurance will have an extra deduction on their federal income tax returns.

Under a new law, certain borrowers who take out a mortgage for purchase or refinance in 2007 are eligible to write off all or a portion of their mortgage insurance premiums for the year. It's a tax break many in the industry have sought for years because the insurance is often regarded as a cost akin to mortgage interest or points.

Mortgage insurance is required for borrowers who make less than a 20% down payment; its purpose is to protect lenders from losses if the borrower defaults on the loan. The insurance is cancelled when there is enough equity built up in the home.

But premium deductibility aside, mortgage insurance has been gaining in popularity these days, some in the industry say.

According to the Mortgage Insurance Companies of America, 118,214 borrowers used private mortgage insurance while buying or refinancing a loan in February, an 8.5% increase compared with January's 108,980 borrowers. In February 2006, 104,146 borrowers used PMI, the group reported.

"The mortgage-insurance industry has had a very, very good first quarter," said David H. Katkov, president and chief operating officer of PMI Mortgage Insurance Co. "People are looking at mortgage insurance today as they haven't in previous years."

Katkov calls the tax break a "bonus" benefit to homeowners, adding that there have been other factors fueling the growth in the mortgage-insurance industry.

In recent years, many borrowers have opted to get around using the insurance by taking two loans: a primary mortgage as well as a second, "piggyback" loan in the form of a home equity loan or line of credit. The equity from the second loan fulfills the down payment of the first, and there are tax breaks on the interest of both loans.

But many piggyback mortgages have variable rates that fluctuate based on the prime rate, which has risen over the last year. The set rate for mortgage insurance has become attractive to homeowners aiming for predictable loan costs, Katkov said. There's also the lure of simplicity that the mortgage insurance offers, since borrowers only need to deal with one set of loan documents in that option, he added.

Tightened lending standards might also contribute to additional popularity of mortgage insurance; as lenders get more conservative in the aftermath of problems in the subprime market, the risk associated with a piggyback loan probably isn't as attractive, said Corey Carlisle, senior director for government affairs at the Mortgage Bankers Association. The cost of the second loan, along with the hard look at underwriting standards, could have a "double whammy effect" on piggyback loans, he said.

That said, piggyback loans are certainly not going away, he added. For some borrowers, the dual loan structure might still make sense, he said, adding "everyone needs to weigh their own financial needs separately and do what's best for them."

To help in the decision, PMI Mortgage Insurance Co. has an online calculator for determining which option is best suited to an individual borrower. Visit the calculator.

Deduction details

To qualify for the full mortgage insurance premium deduction in 2007, a homeowner needs an adjusted gross income of $100,000 or less; those with adjusted gross incomes of $109,000 or less are eligible for partial breaks. Currently, the deduction is limited to the 2007 calendar year, although there are efforts to extend it.

The tax deduction applies to coverage provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration in addition to private mortgage insurance, according to the Internal Revenue Service's Web site.

Some tax and consumer advocates, including Bruce Hahn, president of the American Homeowners Grassroots Alliance, think the deduction should have been available years ago.

"Finally, enough legislators came to recognize this is truly a cost of lending," he said. Low- and moderate-income homeowners stand to benefit the most, he added.

The cost of mortgage insurance varies based on the size of the down payment, type of mortgage and the amount of coverage. But insurance on a $224,500 home typically costs about $50 to $100 per month, according to Mortgage Insurance Companies of America. Annual tax savings for those using the deduction will range between $300 and $350, according to the group's estimates.

But is it enough?

Some argue, however, that the qualifications for the deduction are too restrictive.

While middle-class homeowners in the middle of the country will benefit from the deduction, those living in areas where housing is more expensive might not, said Pete Sepp, vice president for communications for the National Taxpayers Union.

"Clearly this has to be made available to more homeowners," he said, adding that lawmakers need to "recognize the reality that $100,000 of income doesn't necessarily support a mansion." On the coasts, for example, homeowners' income doesn't stretch as far as it does in the Midwest, he said.

In addition, Sepp criticized the phase-out of the deduction for being too steep: Those with adjusted gross incomes up to $100,000 receive the full break, but the deduction reduces 10% for every $1,000 over $100,000 until it reaches zero at an adjusted gross income of $110,000.

"Congress has taken perhaps the toes of one foot through the door, and now we need to see them follow through and walk through all the way," he said.

If enough homeowners benefit from the deduction, there's a good chance lawmakers could move to extend it into future tax years, Sepp said. Carlisle has noticed a general support of extending the benefit on Capitol Hill; making it permanent is another issue, he said.