



Should You Borrow Money for a Down Payment?

Many people dream of owning a home but feel overwhelmed by the idea of saving tens of thousands of dollars for a down payment. In some cases, borrowing money for a down payment can be a smart move, but there are some important caveats to consider.

When Does It Make Sense to Borrow for a Down Payment?

Many lenders require buyers who put down less than 20 percent of a home's purchase price to obtain private mortgage insurance (PMI) to protect the lender if the buyer defaults. PMI can cost hundreds of dollars per month, on top of mortgage payments, and needs to be paid until the homeowner has 20 percent equity. If you put down 20 percent, you'll be able to avoid PMI. If loan payments would cost less than PMI, borrowing to make a large down payment might make sense. Additionally, most lenders will require any funds for a loan to be "seasoned" which means the money has to be in your bank account for at least 60 days.

Potential Sources of Funds

If you own another property, you might be able to use a home equity loan or a home equity line of credit to finance a down payment. The interest rate would probably be relatively low, but using your current home as collateral to buy a new one would mean you could lose both houses if you were unable to afford all your payments.

Another option is to take a loan from your 401(k). You could get a low interest rate, but you could also lose a substantial amount of potential savings since any money you withdrew would not be able to accumulate compounded interest.

A personal loan could be quick and easy to obtain and could have a much lower interest rate than credit cards, but it would raise your debt-to-income ratio. That could make a lender reluctant to give you a mortgage.

A variety of federal, state and local programs can help homebuyers secure loans with favorable terms, as well as down payment assistance. Since many of those programs require low down payments, you could buy a house, but you would have to pay for PMI since your down payment would be less than 20 percent. Depending on your circumstances, you might or might not be better off borrowing money from another source to put down 20 percent.

Borrowing money from family or friends could help you avoid high interest rates and have a flexible repayment schedule. Before you take a loan from family or friends, make sure you can repay it. Failing to meet your obligations could cause irreparable harm to your personal relationship.

Weigh Your Options

PMI can significantly increase monthly housing costs for years. If you can put down 20 percent and avoid PMI, you may save thousands of dollars in the long run. You might be able to borrow money from several sources, but think carefully about the pros and cons. Discuss your options with a financial advisor and your real estate agent.

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