

FHA Loan Programs

FHA or Federal Housing Administration loans are insured by the full faith of the Department of Housing and Urban Development. This means that it is the FHA who reimburses a lender if a loan goes into non-payment. FHA loans require a lower down payment (minimum 3.5% of the sales price), but do carry higher mortgage insurance amounts. Mortgage insurance is collected on FHA loans in the form of (upfront and monthly premiums) put aside (in reserve) to reimburse lenders. Depending on the loan program, anyone can apply for a FHA loan (Some FHA programs with down payment assistance may require the borrowers to meet annual cap restrictions on income). FHA loan guidelines are considered to be more lenient compared to conforming loans. Main difference: Debts to income ratio guidelines are higher, meaning that borrowers can carry slightly more debt than a conforming or conventional loan. Also, FHA loans carry lower penalties if a borrower is more than 15 days late on a monthly payment (4% vs. 5% on conforming).

30 year fixed FHA loan: a loan where the interest rate has no fluctuation (change) for the term of 30 years. The interest rate is “fixed” for 30 years. This loan has no pre-payment penalty whatsoever.

Pros:

- Borrower’s can take advantage of a long term fixed rate of interest with no worry about fluctuation in interest rate.
- If the monthly payment will fit your specific goals, this would be considered the most conservative loan program available.
- Borrowers can budget their principal and interest payments for the 30 year period.

Cons:

- Other programs with shorter terms such as: 15 year fixed mortgage may carry a lower interest rate due to shorter fixed term of the mortgage, but carry a higher required payment.
- Adjustable Rate Mortgages will also carry lower “start” rates.

15 Year Fixed: This is also a loan where the interest rate has no fluctuation for the specific term of the loan. The interest rate is “fixed” for the 15 period.

Pros:

- Borrower’s take advantage of a fixed rate of interest for the term of the loan with no possibility of change.
- Borrowers can budget their principal and interest payments for the specific term.
- These loans may carry a lower interest rate than a 30 year fixed.
- These loans will be paid off sooner than a 30 year fixed.

Cons:

- Other programs may carry lower interest rates due to their shorter term periods, such as Adjustable Rate Mortgages (ARM’s).
- Required Principal and Interest payments are higher than a 30 year fixed.

FHA ARM – Federal Housing Administration ARM

FHA adjustable rate mortgages are similar to conforming ARMS, having different fixed periods, and using similar margin amounts - but do carry lower required caps. The caps on FHA ARMS are 1/5 respectively. This means that at the first adjustment of the ARM, the loan cannot go up any more than 1% (1/5) based on the original interest rate. The next number in the cap is called the “lifetime cap”. This means exactly that. The original interest rate cannot exceed more than 5% of the original interest rate amount at any time during the loan (1/5) after.

1 Year FHA ARM: this is a loan that is fixed for a 12 month period (1 year) and per loan program guidelines - is set to adjust on the 1 year anniversary of the loan and every 12 month period thereafter. This loan is a 30 year loan. This loan carries 1/5 Caps and a 2.25% margin.

3 Year FHA ARM: This loan is fixed at the original rate for a 3 year period (3/1) and then will adjust annually (3/1) after that period. This loan payment is based on a 30 year loan. This loan carries 1/5 Caps and a 2.25% margin.

5 year FHA ARM: This loan is fixed at its original rate for a 5 year period (5/1) and then adjusts every 1 year (3/1) thereafter. This loan payment can be based on a shorter amortization (payment) after the original 5 year period. This is depending on investor’s guidelines. This loan is a 30 year loan. This loan carries 1/5 Caps and a 2.25% margin.

REAL WORLD: If you are buying your “forever house” do not use an ARM! We feel that the only reason you should get a FHA ARM is if you are positive that you will only be in a home for a short period of time. The advantage of a FHA ARM is the lower original (start) rate for sure. BUT: Make sure you check the specific ARM rate versus a 30 year fixed at the time of purchase. Do the math and see if it is worth the savings monthly (and possible downside) and fixed term of the ARM. Example: 5/1 ARM, \$200,000.00 loan amount, 30 year term @ 4.5% = P&I payment of \$1013.37 per month. Take the same 30 year fixed @ 5.0% (same loan amount) = P&I payment of \$1073.64 per month. The savings monthly by using the 5/1 ARM is \$60.27 monthly or \$723.24 or \$3616.20 over the 5 year period. Analyze: If you know that you will be in the home for only 5 years, this is an excellent financial decision. If you stay in the home for a period longer than the 5 years, you will face an adjustment either way - up or down in interest rate. If your rate does go up at adjustment, you will then be “giving back” what you saved over the 5 year period...it’s actually pretty simple...” If you are going to be living (and staying) in the particular home longer than the original fixed rate period of the ARM, think about using a longer term loan to guard against interest rate fluctuations.”