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## FHA Mortgages For Millennials Who May Not Think They Have Enough Cash Or High Enough Credit Score To Purchase Real Estate



An FHA loan is mortgage loan insured by the Federal Housing Administration (FHA). FHA loans have been around since the 1930s to enable home buyers who might not qualify for typical mortgages to obtain loans to buy homes or condominiums.

### **What are the Advantages and Opportunities Provided by FHA Loans?**

- Borrowers can qualify for an FHA loan with a down payment as little as 3.5% (Loan to Value (LTV) ratio up to 96.5 %) and a credit score of 580 or higher. (Less than 11% of all mortgage loans issued in 2014 were to borrowers with credit scores under 660).
- If a 10% down payment is made, an FHA borrower's credit score can be as low as between 500 and 579. However, the lower the credit score, the higher the interest rate the borrower will receive.
- 100% of a down payment and other closing costs may be gifted by a family member.
- An FHA loan is assumable, which means if you want to sell your home, the buyer can "assume" the loan that you have on the property.
- FHA loans are available to investors in properties with up to 4 units, as long as the **borrower's primary residence** will be one of the apartment units. A borrower may qualify for an FHA loan of as much as \$1.2 million for purchase of a 4-family building, depending on the area's median housing price.

- FHA loans can have fixed 15-30 year terms and interest rates are generally consistent with non-FHA loans.

## What Challenges Do Potential FHA Borrowers Face?

### Additional Mortgage Insurance

Typically any mortgage loan for which a down payment is made of less than 20% of the purchase price requires private mortgage insurance (PMI), typically rolled into the mortgage payment each month and runs between .5% and 1% of the loan amount annually. With an FHA loan, the mortgage insurance is called MIP and *in addition* to a monthly premium rolled into the mortgage of between .5 and 1.05% of the loan amount (depending on loan to value ratio and loan term), a mortgage insurance premium of 1.75% of the loan amount is paid one-time up front and is part of the settlement charges or can be rolled into the mortgage.

For a conventional loan, once a borrower has paid enough of the principal so that the loan to value based on the purchase property is 80% or less, they no longer have to pay PMI. But with an FHA loan, borrowers will have to continue to pay mortgage insurance for the entire loan term if the LTV is great than 90% when the loan was originated.

### Cap on the Size of an FHA Loan

The size of an FHA loan is generally capped at \$625,500 for single family homes (or condominiums) and may be lower depending on the median home price in the metropolitan area.

### What else do I need to know about FHA loans?

Aside from the basics like borrowers having lawful residency in the US and the property meeting certain minimum appraisal standards, FHA borrowers must have a steady employment history or have worked for the same employer for the past two years.

The total of carrying costs (mortgage payment, property taxes, mortgage insurance, and homeowners insurance) needs to be less than 31% of the borrower's gross income. In some cases, a loan may be approved if this "front-end ratio" is as high as 40%, if the lender can provide justification that the mortgage still presents an acceptable risk.

The total of all debt and mortgage related costs, including credit card and student loan payments, needs to be less than 43% of the borrower's gross income, but in some cases this "back-end ratio" may be as high as 50% if the lender can show what compensating factors justify the loan's approval.

For a multi-family investment, the actual or projected rental income must meet a *self-sufficiency test*, which means the mortgage payment cannot exceed 75% of the actual or projected rent less property taxes, mortgage insurance and property insurance. The borrower must have three months mortgage payments in reserve after closing and this reserve cannot be from a gift.

A typical on-line mortgage loan search engine will identify whether a lender is FHA-eligible.

Just like for conventional mortgages, FHA loan interest payments are subject to tax deductibility (See <http://centsai.com/if-everyone-is-renting-or-sharing-why-should-i-want-to-own-a-home/>) as we will explore, a highly leveraged but savvy investment, like an FHA-backed purchase, also has the potential to create substantial wealth through appreciation.