MortgageLoanPlace Your Resource for Everything on Mortgage Loans

Complete Guide to FHA Loans

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Introduction to the updated FHA Guide

MortgageLoanPlace.com's "Complete Guide to FHA Loans" has helped countless prospective homebuyers through the process of understanding FHA loans.

Since we first published the Complete Guide to FHA Loans, the residential mortgage market has undergone substantial changes. In the aftermath of the housing bust, which hit many borrowers and prospective borrowers with falling home equity, tighter qualifying standards and more expensive financing, FHA loans have become more important than ever in helping thousands of Americans buy and keep their homes. According to the Federal Housing Administration, in 2011, FHA loans made up roughly 15 percent of all approved U.S. mortgages.

This revised version includes key changes that reflect the many regulatory responses made by the Federal Housing Administration and FHA lenders in recent years, such as the increases announced in February 2012 to upfront and annual mortgage insurance premiums for most FHA loans. We've taken out sections on option ARMs and interest-only loans, which have all but disappeared from the scene, and we've added or updated sections on new FHA mortgage qualification requirements and programs such as the FHA Short Refinance for underwater homeowners.

We hope that these revisions to the Complete Guide to FHA Loans arms you, the reader, with a solid foundation of current information that will allow you to shop for your home and mortgage with confidence.

Special thanks to mortgage expert Gina Pogol, whose invaluable insights on the ever-changing mortgage landscape and the home financing process played a key part in this major update.

The MortgageLoanPlace.com Editors
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I. What Is an FHA Mortgage?

Most people need some sort of loan in order to buy a home. According to the U.S. Census Bureau, the median price of a home in the United States was $212,300 in October 2011. Very few people have the cash to make that kind of purchase without taking on a mortgage.

FHA loans are mortgages insured by the U.S. government. The program reduces the risk to lenders, which makes them more willing to fund mortgages, keeping home financing more accessible and less expensive than it otherwise would be.

With an FHA home loan, the government doesn't actually lend you the money. Private lenders (for example, banks, credit unions or mortgage finance companies) do. The money used to pay for the home comes from the lender, not the U.S. government. The government's role here is to insure that loan, promising to repay the lender if the borrower defaults. With this government insurance, lenders are more willing to lend because they know that if a borrower can't pay the loan, the government insurance will cover the lender's losses.

The "FHA" in "FHA loan" stands for the Federal Housing Administration, a government agency that is part of the Department of Housing and Urban Development (HUD). The FHA was created in 1934 during the Great Depression, one of America's worst economic downturns. During the Great Depression, millions of Americans were unable to make payments on their debts, the banking system failed, and millions of homes and farms were foreclosed (a process in which a lender takes back a home and resells it to cover its losses).

Since its origins amidst the Great Depression, the FHA continues to play a significant role in making home ownership available to many Americans. In fact, the role of FHA financing in aiding home purchases has grown in recent years. FHA mortgages comprised well over one in every 10 U.S. home purchases in fiscal year 2011, and nearly two out of every 10 home purchases the year prior.

Advantages of FHA home loans

Before FHA mortgage financing existed, lenders often required down payments of 50 percent of the home's sale price, and home loans were made for terms of just five years – after which a "balloon" payment for the balance was due. It's no wonder that fewer than 50 percent of people back then could afford to own their homes. To help stabilize the economy during the Great Depression and provide some security to its citizens, the United States government set up the FHA, which was designed to provide struggling families with loans so that they could purchase homes.

Though the Great Depression ended in the late 1930s, the FHA's mission has remained the same since: to increase access to home financing for those who otherwise would have difficulty obtaining it.

If you earn a lot of money, have saved a huge down payment, and boast a perfect credit rating, you can find affordable home loans in many places. If you don't, FHA mortgages offer several advantages:

- Low minimum credit score requirements
- Low down payment requirements

- No risk-based pricing adjustments (additional fees for property or borrower factors)
- Coordination with down payment assistance programs
- Flexible underwriting standards
- Non-occupying co-borrowers allowed
- Loan assumability, or the ability to transfer the loan to another borrower upon sale of the property
- No prepayment penalty
- Limited rate adjustments on adjustable-rate loans

More about risk-based pricing adjustments

One of these advantages of FHA vs. conventional loans – the lack of risk-based pricing adjustments imposed by conventional (non-government) lenders – is one that is particular relevant today. How do these adjustments work? Fannie Mae and Freddie Mac charge extra fees on conventional loans depending on factors that raise the risk of loan default: your credit score, your down payment, the property type (condo, single family, multifamily, manufactured home) and loan features (interest-only, adjustable-rate, cash-out, etc.).

It's hard for many borrowers not to trigger one or more of these risk factors. These fees can add thousands to your conventional mortgage costs, even if you have a decent credit score and significant equity. For example, as of April 2012, someone with a 659 credit score buying a condo with 10 percent down and an adjustable-rate mortgage would pay 3.50 percent in extra fees. On a $250,000 mortgage, that's an extra $8,750 added to the regular loan fees! FHA borrowers do not have to worry about these surcharges.

Disadvantages of FHA mortgages

Of course, the advantages of FHA loans are balanced by some tradeoffs. Here are the main drawbacks:

- Upfront and annual mortgage insurance premiums. The cornerstone of the FHA loan is mortgage insurance, which is what reduces risk for lenders and allows the program to work. FHA mortgages come with upfront mortgage insurance premiums of 1.75 percent (which you can wrap into your mortgage so you don't need to pay it out-of-pocket) plus annual insurance premiums. The annual mortgage insurance premiums vary by loan term, the amount of your down payment, and the loan amount. For instance, a borrower of a 30-year FHA mortgage of less than $625,500 and less than 5 percent down on the property would need to make an annual mortgage insurance payment of 1.25 percent of the loan balance. The annual premiums are divided by 12 and added to your monthly principal and interest payment.

FHA's annual mortgage insurance premiums can apply even if your home equity has risen, but there are circumstances under which you can stop paying annual mortgage insurance:

- If you've chosen a loan term of more than 15 years, you have to pay annual mortgage premiums for a minimum of five years. After that, once the principal balance drops to 78 percent loan-to-value (LTV), you can stop paying annual mortgage insurance. This happens automatically if the 78 percent LTV is reached through paydown of the loan on the original amortization schedule, or by the borrower initiating a request to cancel annual premiums if the 78 percent LTV was reached early through additional principal payments.
- Loans with a 15-year amortization period or less are exempt from annual mortgage insurance premiums once the principal balance drops to 78 percent LTV (least 22 percent equity), without any five-year minimum. If you already have a 78 percent LTV at the time you receive a 15-year FHA loan, you are exempt from paying annual mortgage insurance premiums from the start.

You won't be able to apply for cancellation of annual mortgage insurance if your home equity rises through property appreciation rather than scheduled or accelerated paydown of principal. In other words, the FHA will not consider new appraised values as a way of reaching the mortgage

insurance cancellation requirements.
Premium amounts and rules are adjusted from time to time by the FHA in order to maintain adequate backing in its mortgage insurance fund.

- Loan limits. FHA mortgages are not designed to make it easy for people to buy mansions. Rich folks can get FHA loans too, but they can only purchase moderately priced homes with them. FHA loan limits vary by county and are based on the median price of homes in that location.
- Financing for primary residences only. FHA mortgages cannot be used to purchase rental properties or vacation homes.

Any time you shop for a mortgage, it's a good idea to compare an FHA mortgage with a conventional mortgage and see which turns out to best meet your goals.

FHA loan limits

FHA loan limits are set each year and change as median housing prices increase or decrease. The lowest maximum loan limits across the country for 2012 were set as follows:

- One-unit property limit: $271,050
- Two-unit property limit: $347,000
- Three-unit property limit: $419,425
- Four-unit property limit: $521,250

Loan limits in high-cost areas

Pricier parts of the country have higher median home prices, so the FHA loan limits are higher in those areas. The highest maximum loan limits that apply in the most expensive parts of the country, again as of 2012, are:

- One-unit property limit: $729,750
- Two-unit property limit: $934,200
- Three-unit property limit: $1,129,250
- our-unit property limit: $1,403,400

For all but the most expensive counties in the U.S., FHA loan limits equal 115 percent of the median

home price. Special rates apply to Alaska, Hawaii, Guam, and the U.S. Virgin Islands. The current FHA loan limits are available on the FHA's online lookup tool.

II. Who Should Use FHA Home Loans?

Many prospective homebuyers mistakenly believe that FHA mortgages are for just people with low incomes or bad credit. There are a variety of financial situations in which an FHA mortgage may be the best option available.

FHA mortgages are suitable for:

- Buying a home with a smaller down payment or less-than-perfect credit. FHA mortgages are suitable for people who don't have a large sum of money for a conventional loan down payment or stellar credit.
- Refinancing after previously poor credit history. FHA mortgages are great for refinancing out of subprime mortgages when you have paid your bills on time for a year or so, or if it has been a couple of years since you discharged a bankruptcy.
- Financing or refinancing homes for special purposes. FHA home loans can in some cases be the best mortgages for people who want to take cash out when they refinance, buy condos, or co-sign mortgages for their children.

In short, FHA mortgages should be used by anyone who can get a better deal on an FHA home loan than they could with conventional mortgage financing – and there's no way to find out if an FHA mortgage is a better deal unless you run the numbers. A lender that offers FHA loans can help you compare loan programs.

The changing face of FHA borrowers

The popularity of FHA mortgages waxes and wanes depending on what other programs are available in the private mortgage marketplace. For example, when lending standards were quite loose, homebuyers could get mortgages with no down payments at all, so the low FHA down payment offered no real advantage. FHA also compels applicants to prove their incomes, so when loans that did not require income verification were available, demand for FHA loan financing fell.

In 2006, during the housing boom, FHA loans accounted for less than 4 percent of the mortgage market. In contrast, in mid-2010, almost half of all mortgage approvals in the U.S. were for FHA home loans. You can also see the jump in popularity of FHA loans during this same period, as credit tightened in the wake of the financial crisis, by looking at the average credit scores of borrowers. In 2006, the average FICO score for FHA borrowers was 621; by 2010, it exceeded 700 – meaning many borrowers with good credit scores were flocking to FHA loans over conventional loans.

Types of FHA home loans

FHA insures several mortgage products to meet the different needs of its borrowers.

- 30-year fixed-rate home loan. This mortgage is amortized (paid off) over a 30-year period. The mortgage rate and payment do not change during that time.
- 15-year fixed-rate home loan. This mortgage is paid off over 15 years, so your monthly payment is higher than it is for a 30-year loan. However, mortgage rates on 15-year home loans are usually about 0.5 percent lower than they are for 30-year loans. Moreover, FHA mortgage insurance is lower for 15-year fixed-rate loans than for 30-year fixed-rate loans, so you can save thousands in both mortgage interest and mortgage insurance payments.
- Adjustable-rate mortgages (ARMs) and hybrid ARMs. These mortgages have rates that are initially lower than those of fixed-rate mortgages. After that initial period, the mortgage rate can increase or decrease as the economy changes. The loans are explained in greater detail in the next section.
- Nonoccupying borrower or coborrower ("kiddie condo") loans. These loans allow relatives or close friends to be co-borrowers on mortgages while only requiring 3.5 percent down. Typically, parents who buy condominiums for their college-bound children use these, so they have been given the nickname "kiddie condo."
- 203(k) rehabilitation and repair mortgages. You can use these FHA loans to finance and rehabilitate a property in a single permanent loan. For instance, you can purchase and pay for approved renovations on a fixer-upper with a single mortgage, or refinance and get cash to repair a home in the same loan. With a 203(k) rehabilitation loan, you don't need to get separate financing for the construction or repair.
- "Good Neighbor Next Door" program. This program for first-responders and teachers allows them to pay half price for selected homes and get into them with as little as $100 down. This program is explained in greater detail later in this guide, in the section on Home Purchase Programs.
- Energy-Efficient Mortgage (EEM). This program allows borrowers to finance 100 percent of the value of eligible energy-efficient home improvements. It can be added to any other FHA mortgage.
- Home Equity Conversion Mortgage (HECM). This is the FHA reverse mortgage, which allows seniors 62 and older to convert their home equity into cash, in the form of a line of credit, a lump sum, or regular monthly payments. Seniors can also use the HECM to purchase a home.

FHA Adjustable-rate mortgages (ARMs)

Adjustable-rate mortgages (ARMs) offer some advantages over fixed-rate loans but also have

some drawbacks. As with conventional ARMs, FHA ARMs have four components:

- An index (this is a generally referenced economic indicator, such as LIBOR)
- A margin (this is a percentage set by the lender to be added to the index)
- An interest rate cap structure
- An initial interest rate period

How your rate adjusts

Here's how an ARM loan works: The initial interest rate, also called a start rate, is in effect until the initial interest rate period ends. Then, the mortgage rate begins adjusting on an annual schedule. The new interest rate is calculated by adding the margin (which stays the same) to the index (which fluctuates according to macroeconomic conditions). Lenders disclose the margin at time of loan application. Margins are not set by FHA and vary from lender to lender, which is why it's is a good idea to shop around for your mortgage.

As the index figure moves up or down, your interest rate adjusts accordingly. Acceptable index options on FHA-insured ARM loans are the Constant Maturity Treasury (CMT) index (weekly average yield of U.S. Treasury securities, adjusted to a constant maturity of one year) or the 1-year London Interbank Offered Rate (LIBOR). You can find these indexes online and see how high and low they have gone in the past. FHA offers a standard 1-year ARM and four hybrid ARM products. Hybrid ARMs offer a start rate that is fixed for the first 3, 5, 7 or 10 years, after which the interest rate adjusts annually.

Rate caps

What if there is an extreme swing in your ARM's index? Increases or decreases to your interest rate are limited by the interest rate cap structure of your loan. The interest rate caps protect borrowers from huge interest rate swings. There are two types of caps: annual and lifetime. The annual cap limits the amount the interest rate can change, up or down, in any given year. The lifetime cap limits the maximum and minimum interest rate you can pay throughout the life of the mortgage. FHA ARM caps offer more protection than those of many conventional lenders:

- FHA 1-year ARMs and 3-year hybrid ARMs have annual caps of 1 percentage point, and life-of-the-loan caps of 5 percentage points. For example, if your initial interest rate were 3.5 percent, the highest possible interest rate would be 8.5 percent, and the soonest you could adjust to that 8.5 percent is over a period of five years.
- FHA 5-, 7- and 10-year hybrid ARMs have annual caps of 2 percentage points, and life-of-the-loan caps of 6 percentage points. For example, a 10-year hybrid ARM with a 4.5 percent start rate would max out at 10.5 percent and take at least three years to reach that limit.

III. FHA Mortgage Requirements

Before beginning the process of applying for an FHA mortgage, it is important to know what requirements you'll have to meet. The financial, credit and employment guidelines may seem intimidating at first, but the FHA's conditions are usually much easier to fulfill than those of private mortgage insurers and lending institutions.

Basic requirements

To get an FHA mortgage, you need a valid Social Security number and you need to be living in the United States legally. You must also be of legal

age to obligate yourself on a mortgage. (The minimum age varies from state to state but ranges from 18 to 21; there is no maximum age.)

Employment and income

FHA underwriters want to know that your past income is likely to continue, to allow you to repay the loan. You'll have to provide at least a two-year employment history (or evidence that you were a student or in the military) and explain any gaps in employment. This history will be examined to determine if your income can be considered reliable.

In general, anything less than a year of wage-earning or two years of self-employment is considered insufficient for income qualification. However, there is no hard-and-fast minimum for time with your company or in your current position. According to FHA guidelines:

"To analyze and document the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment. A borrower who changes jobs frequently within the same line of work, but continues to advance in income or benefits, should be considered favorably. In this analysis, income stability takes precedence over job stability."

Sources of income

What constitutes income? Many sources qualify: full-time wages from your employer, self-employment income, part-time pay, overtime pay, bonuses, seasonal pay, pension distributions, child support paid to you, alimony paid to you, investment income, rental income and even money paid by roommates to you (though you have to claim it on your tax returns for it to be counted). Government-based sources of income can also be included, such as Social Security payments, unemployment compensation, military pay and VA benefits.

How much income is enough?

How much income do you need? It depends. Any of these factors can affect the level of income you need to show in order to qualify for an FHA loan:

- Your credit score (the better your credit history, the less income you need)
- The down payment (the higher your down payment, the less income you need)
- Your savings (the more you have in savings, the less income you need)
- Your future earning potential (for instance, if you just graduated from medical school, you may not have high income in your recent employment history but have strong prospects for earnings in the future)

It also helps to show a history of a conservative attitude toward credit use and to have a proposed house payment that won't be significantly higher than the rent you've already been paying consistently.

Credit history and score

One of the main advantages of FHA loans over conventional loans is that you don't need extremely high credit scores to be approved for a mortgage. To meet FHA credit requirements with 10 percent down, you need a credit score of at least 500. To qualify for a loan with a 3.5 percent down payment, you'll need a score of at least 580. (For more on these minimum credit requirements, see the following section on recent changes to FHA mortgage qualifying.)

You won't get approved if your credit history shows that you make a habit of paying your bills late. FHA says that lenders must determine "whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower." You need to have paid your bills on time for at least a year in most cases.

However, FHA does consider mitigating circumstances such as job loss, illness or death of a wage earner. If you are in this situation, be prepared to explain what happened – why you could not pay your bills, how you solved the problem and why you'll be able to pay your mortgage in the future.

Bankruptcy and foreclosure

You can get an FHA home loan if one year has passed since the discharge of a Chapter 7 bankruptcy or two years after a mortgage foreclosure. If there were not mitigating circumstances, you have to wait an extra year and have to reestablish credit. You can get an FHA mortgage after 12 months of timely payments to a Chapter 13 bankruptcy plan, if the Bankruptcy Trustee approves.

Little or no credit history

Applicants with no credit or very little (this is called a "thin file") can prove their creditworthiness with on-time rent payments, payments to utilities and even regular deposits to a savings account.

If you don't use much credit, it's even more important for you to pay these accounts on time, so that what little history shows on your report reflects responsible use of credit.

Recent changes to FHA mortgage qualifying and insurance

FHA mortgage programs are always evolving to meet borrowers' needs and to comply with new laws. It's important for homebuyers to understand the changes that may apply to them. Here are the most recent modifications to FHA programs.

The Housing and Economic Recovery Act of 2008 increased the minimum FHA down payment from 3 percent to 3.5 percent, and almost immediately there were calls from housing and lending experts to raise it again to at least 5 percent. Others, including HUD officials and many community organizations, countered that such action would do little to decrease mortgage defaults but would put home ownership beyond the reach of many deserving Americans.

Instead of raising the down payment requirement for all FHA borrowers, HUD implemented changes that imposed more fees and higher down payments on the riskiest borrowers. The resulting compromises went into effect in 2010 and 2011 and included the following updates:

- Borrowers must have minimum representative credit scores of 500 or higher to qualify for any FHA loan.
- Minimum 10 percent down payments were imposed for borrowers with representative credit scores below 580.

In early 2012, the FHA announced several changes to the upfront and annual mortgage insurance premiums required for different types of FHA loans:

- Upfront mortgage insurance premiums for purchases and refinances from non-FHA loans were increased from 1.00 percent to 1.75 percent.
- In contrast, upfront mortgage insurance premiums for existing FHA borrowers refinancing into another FHA loan fell to 0.01 percent.
- Annual mortgage insurance premiums were raised across the board by 0.10 percentage points, or more in some cases. On a 30-year loan exceeding a 95 percent loan-to-value ratio (i.e., where the borrower is contributing less than 5 percent down), the annual mortgage insurance premium became 1.25 percent. The equivalent loan with a balance over $625,500 saw its annual mortgage insurance premium rise even more, to 1.50 percent.

IV. Getting Prequalified for an FHA Mortgage

Most FHA-approved lenders can prequalify you for an FHA mortgage fairly quickly, or you can use an online prequalification calculator to see how much you might be able to borrow. Prequalification involves looking at several things.

Debt-to-income ratio

Debt-to-income (DTI) ratios indicate how much of your income goes toward your debt obligations. One of the most commonly used DTI ratio is calculated as all your regular expenses divided by your income:

DTI = monthly debt payments / gross monthly income

So, if you make $4,000 a month and you have to pay $1,000 a month for your rent, car payment and credit cards, then 25 percent of your income is going towards these payments. Your debt-to-income ratio is 25 percent: $1,000 monthly payment / 4,000 gross monthly income = 0.25, or 25 percent.

When you prequalify for a home loan, lenders generally take your gross monthly income and multiply it by some DTI between 36 percent and 45 percent to establish the maximum debt payment you can comfortable make each month. The ratio that lenders allow you depends on their policy as well as the strength of your file.

Let's say again that you earn $4,000 a month; 45 percent of that is $1,800. Next, a lender would subtract your other payments – debt payments that you have to make outside of your housing expense. If you have a $200 monthly car payment and a $100 monthly credit card payment, that leaves you $1,500 for a house payment ($1,800 - $200 - $100 = $1,500).

To approve mortgages at higher DTIs, lenders require one or more of these factors:

- Large cash reserves
- Good credit history
- Ability to make a large down payment
- Mortgage terms that are less than the allowed maximums
- A decrease in monthly housing expenses from current expenses

Down payment

One of the main things people worry about when buying a home is the down payment, which is a percentage of the home's total sale value to be paid in cash upon obtaining the mortgage. For many low- and moderate-income families, a large sum of cash is hard to come by.

Fortunately, FHA mortgages have one of the smallest down payment requirements among all home loans. The minimum down payment for an FHA loan is just 3.5 percent for borrowers with credit scores of at least 580 and 10 percent for borrowers putting down at least 10 percent. Borrowers can use their own savings for their down payments and can also use loans or gifts from family members, community organizations or employers. In fact, the FHA allows 100 percent of the down payment to be a gift from friends, family or other sources, as long as the sources will not benefit financially from the transaction. (Your seller, real estate agent and mortgage loan officer cannot help you with the down payment.)

Lender overlays

One thing that is confusing to many FHA borrowers is the fact that there are FHA guidelines and standards, but lenders can impose stricter requirements. These additional requirements are called "overlays."

For example, though FHA requires a minimum credit score of 580 for a mortgage on a 3.5 percent down payment, many FHA mortgage lenders require minimum credit scores of 600, 620 or 640 for this kind of loan. Only about 20 percent of FHA lenders are willing to approve a loan for a borrower with a 580 credit score. Other overlays include requiring lower debt-to-income ratios than FHA's guidelines stipulate.

What does this mean for you? It means if your qualifications are sketchy, you'll want to ask lenders about

their overlays when shopping for a mortgage. You don't want to get turned down by a lender with overlays when you could have gotten approved by one without.

V. Obtaining FHA Mortgage Financing

The process of obtaining FHA loans includes prequalifying, shopping for a lender and submitting a loan application package. Here are the basic steps you'll need to follow.

Step One: Preparation

Check your credit
As soon as you can before applying for an FHA mortgage, check your credit history and credit score. To get a free credit report, www.AnnualCreditReport.com; it's where anyone can access a free report from each of the three major credit reporting bureaus in a given year. The free credit report won't come with a credit score, so if you want current information about your score, consider paying to get those as well.

Review your credit report carefully. If you find any inaccuracies that could cause you problems with your application, contact each credit reporting bureau (Equifax, TransUnion and Experian) according to their instructions to get them fixed. Resolving inaccuracies can take the greatest amount of time out of all these steps, which is why it's important to check your credit report early in the process.

Assemble financial and personal documentation
Because FHA lenders cannot grant loan approval without seeing your income, asset, and credit documentation, making sure you have all the necessary documents available before you apply will make the process go much more smoothly. Here is a list of the documents you should locate before beginning the FHA loan process:

- If not self-employed:
  - Last two tax returns, with W-2s and supporting schedules
  - Two most recent pay stubs
- If self-employed:

  - Last three years of tax returns
  - Year-to-date profit-and-loss statements
- Most recent two months of statements for all banking and investment accounts (all pages)
- Personal documents such as ID or driver's license, green card, work permit, child support paperwork and divorce decrees
- Award letters for Social Security or pensions

In addition, if you have credit issues, assemble the following documents:

- Most recent bill statements
- Your last landlord's contact information (to attest to your rental payment history)
- Any bankruptcy papers and any other papers related to your credit history

Step Two: Shopping for lenders

You can get mortgage quotes from lenders online, by calling around or by visiting lenders in person. Online resources include MortgageLoanPlace.com's own FHA section, fha.mortgageloanplace.com, where you can input basic information about the loan you are seeking and be contacted by lenders. However you find mortgage lenders, be sure to contact several and check on the following:

- Can the lender do business in your state? Not all lenders can do business in every state, so be sure to find out if the lender can help you finance your home in your state.
- Is your lender FHA-approved? You should only get quotes from lenders approved to do FHA mortgages.
- Will the lender give you a written quote on a Good Faith Estimate? Ask for written quotes on Good Faith Estimates (GFEs), not just worksheets. Worksheets do not obligate lenders the same way that GFEs do.
- Does the lender apply overlays that affect you? As discussed in the above section on prequalification, many FHA lenders have minimum requirements that are more stringent than the minimum requirements set out by the FHA. If you know your credit score is 600, you won't waste time with lenders that require 640.

When comparing mortgage rate quotes, you won't be able to negotiate lender fees line-by-line, the way borrowers could before recent mortgage reforms. However, you should still shop between different lenders to nail down the best FHA rates and lowest fees. You don't need great negotiating skills; gathering several quotes for similar loans and ask about the differences.

Though price matters, don't work with a lender you don't like. A good lender should be responsive to you, return calls promptly, explain things thoroughly and get enough information from you to make solid decisions. Your mortgage is a big deal – if you aren't getting the attention you deserve, find someone else.

Step Three: Getting credit approval

Once you've found a trustworthy lender with acceptable interest rates and good mortgage terms, you need to get preapproved. Preapproval means that your information and documents have been evaluated by an underwriter, and as long as you choose an acceptable property you should be able to close on your purchase.

Your lender will ask you for credit information and other details of your finances and to complete a loan application. If you have your documents ready to go, as advised in Step One, this part can go very quickly; it can anywhere from an hour to a month. How long your preapproval takes is largely based on how complex your financial situation is and how well-prepared you are with documentation and information.

Preapproved buyers are far more attractive buyers to sellers, because there's far less chance that lack of financing will cause a deal to go bad later on. In fact, many home sellers won't accept offers from those who are not preapproved. Not only that, but many real estate agents will not let you sign a contract to buy a house until you've been preapproved. This is why it's important to get preapproved before house-hunting. In addition, if you've been preapproved prior to house-hunting, your real estate agent will know your price limit and will be able to narrow down your search to only the properties you can afford.

Step Four: Buying your home

At this point, you should be preapproved by a trustworthy lender with reasonable FHA loan rates. You'll shop for homes until you select a property in your price range and get an approved offer. You and the seller will agree on which fees will be paid by whom. You'll deposit earnest money with a title company or escrow agent.

Your lender will order a home appraisal. You will not be required to complete your home purchase if the property doesn't appraise for at least the sales price. The property appraisal will be reviewed by an underwriter to make sure that the home meets FHA's standards.

If all goes well, you'll be issued full mortgage approval and can close on your home purchase.

Step Five: Closing on your home purchase

If you have not yet locked in your mortgage rate, you'll need to do that at this point. Your mortgage documents will be drawn up. You'll need to bring your down payment and other out-of-pocket costs to the closing, and they must be in approved forms of payment – for example, wire transfers or cashier's checks.

Your mortgage lender will wire the loan proceeds to the closing, usually to a title company. You'll sign your final documents. Check them carefully and make sure that the mortgage rate, loan amount and other provisions are as agreed. This is your last time to get anything you don't understand cleared up, so take advantage of this opportunity. If you want your loan officer to attend your closing, make sure he or she knows this ahead of time. Many routinely attend closings, so don't feel that asking is an imposition.

Finally, you will get copies of everything you have signed, you'll shake a few hands, and you'll collect the keys to your new home.

VI. Home Purchase Programs

Buying a HUD Home

The U.S. government has a number of programs that furnish big discounts on homes. These discounts usually involve "HUD Homes" – properties that are owned by the Department of Housing and Urban Development.

When someone gets an FHA loan and can no longer make their monthly payments, the FHA lender forecloses on the house and the FHA takes possession of the property to sell it to the public. These properties become HUD Homes, and you can find good deals on them by checking HUD's website.

FHA and HUD want to sell these HUD Homes as quickly as possible in order to make back as much money as possible. This can be to the buyer's advantage.

If you want to buy a HUD Home, you must either have cash or qualify for a home loan. You can use an FHA loan to purchase and finance a HUD Home. If you intend to occupy the home that you purchase, you may have a leg up: HUD puts HUD Homes up for sale to owner-occupants first. Following that, other people, such as real estate investors, can purchase a HUD Home. Sometimes HUD will use an auction format to sell HUD Homes.

HUD Homes are sold as-is, so anybody buying a HUD Home should get the home inspected.

Finding HUD Homes

Visit www.hud.gov/homes to browse or search property listings. HUD Homes for sale are easily accessible through a number of online listing sites. Keep in mind that these listing sites are not operated by the government – they are run by management companies under contract with HUD. Any real estate broker can make an offer for a HUD Home.

"Good Neighbor Next Door" program

The purpose of the Good Neighbor Next Door program is to improve the state of America's communities, and HUD believes that offering a huge discount on home prices will attract upstanding citizens to areas where they are needed.

Through this program, any full-time teacher, law enforcement officer, emergency medical technician or firefighter can purchase a HUD Home located in a "revitalization area" at a 50 percent discount. For instance, if HUD lists a home at $100,000, then a participant in the Good Neighbor Next Door program can purchase that house for only $50,000.

What's a revitalization area? Generally, this is an area characterized by one of the following:

- Very low-income compared to the surrounding metropolitan area or state
- Many vacant or foreclosed properties
- Low home ownership rate
- Above-average crime rate

If you buy as part of the program, you have to live in the home for at least three years, after which you can keep any profit from the sale of your home.

Finding eligible properties

To locate properties that can be purchased as part of the Good Neighbor Next Door program, visit HUD's website for details and browse listings by state.

VII. Refinancing with FHA Loans

Mortgage borrowers often don't keep the same loan for the entire time they own a home. They often choose to refinance their mortgages. A mortgage refinance essentially involves replacing your current mortgage with a new one, usually to get better terms or a lower mortgage rate.

You can refinance an FHA mortgage into another FHA mortgage, or refinance a conventional (non-FHA) loan into an FHA mortgage. There are two main types of FHA refinances: "traditional" and "streamline." Each type has a different purpose and process that borrowers must go through.

Traditional FHA refinance

A traditional refinance can be used to pay off any existing mortgage, whether it is conventional, FHA or VA. There are many reasons for getting a traditional FHA refinance, including paying off a conventional mortgage, dealing with a divorce or property settlement or exchanging home equity for cash.

A "cash-out" refinance can be used when the borrower wishes to replace an existing mortgage balance with a larger one and take the difference in cash. That cash can then be used to pay off other debts or finance any other expenses.

FHA streamline refinance

An FHA "streamline" refinance can be used to refinance an FHA mortgage to another FHA mortgage. Borrowers may refinance to reduce the principal and interest payments, add or delete individuals from the title, change to a loan with a different term (shorter or longer) or change from a fixed rate to an adjustable rate or vice versa.

Streamlined mortgage refinances require no credit qualifying as long as you don't have an open bankruptcy and the mortgage to be refinanced is current. These transactions also don't require a property appraisal as long as you don't increase the loan amount. However, if you wish to do a streamlined refinance wrapping the refinancing costs into the new loan, you'll need an appraisal and enough equity to accomplish this.

In March 2012, the FHA announced premium reductions for the streamline refinance program, with upfront mortgage insurance premiums falling to 0.01 percent and annual mortgage insurance premiums falling to 0.55 percent for certain FHA borrowers. This step was taken to encourage FHA borrowers to refinance to lower rates, on the assumption that reducing payments on borrowers who were current on their loans would help preempt future foreclosures.

FHA Short Refinance for underwater homeowners

The FHA Short Refinance program is the latest of the federal government's attempt to offer help to mortgage borrowers who owe more on their home loans than their properties are worth (this is also referred to as being "underwater").

As part of this refinance, your current lender must agree to write down your principal balance to 97.75 percent of the property's current value. This write-down must be a minimum of 10 percent of your loan balance, and it's strictly voluntary on the part of the lender.

Here are general guidelines for the FHA Short Refinance:

- You must owe more on your mortgage (s) than your property is worth, i.e., be underwater.
- Your current mortgage cannot be an FHA mortgage.
- You must occupy the property as your primary residence.
- The mortgage you wish to refinance must not be in arrears, meaning you must have kept up with your payments.
- You must have a representative credit score of at least 500, and you must otherwise qualify for the new loan under standard FHA underwriting requirements.
- The maximum loan-to-value ratio for the mortgage refinance is 97.75 percent. For homes with more than one mortgage, the maximum combined loan-to-value ratio is 115 percent of the current property value.

- You can refinance a modified mortgage through the program as long as the modification is permanent and you are not in a trial period.
- You cannot have been convicted within the last 10 years of felony larceny, theft, fraud, forgery, money laundering, or tax evasion in connection with a mortgage or real estate-related transaction.

The FHA Short Refinance was initially considered a dismal failure after it debuted in August 2010, because so few lenders were willing to write down borrower mortgages. However, some larger lenders got on board in early 2011 and the program has finally gained some traction. Contact an FHA lender if you think you qualify for a Short Refinance.

Have a question about FHA loans?

Thank you for downloading and reading this Complete Guide to FHA Loans. If you have questions, visit MortgageLoanPlace.com for more information. On our site, you can also submit a question to our FHA Experts.