

## **Mortgage Guide: FHA And HUD Home Loans Explained**

FHA loans are sometimes referred to as HUD loans as well. These types of mortgages are federally insured programs designed to provide affordable housing options to first-time homebuyers and low-to-moderate-income borrowers who may not be able to qualify for a conventional mortgage. This article answers the question, "What is an FHA or HUD loan?" and describes various types of FHA or HUD loan programs available to potential homebuyers, including fixed rate, adjustable rate, graduated payment, and reverse mortgages. It also outlines the pros and cons of an FHA home loan compared to a conventional mortgage when considering a home purchase or refinance.

The Federal Housing Administration (FHA) was created in 1934. It became part of the U.S. Department of Housing and Urban Development (HUD) in 1965. An FHA loan is a mortgage that is insured by the FHA and HUD. FHA loans are insured by the U.S. government, but are still financed through traditional lenders. Because the mortgage loans are federally insured, lenders allow for lower down payments, fewer closing costs, less stringent credit score requirements, and more flexible financing terms.

### **Qualifying for an FHA or HUD Loan:**

When it comes to income qualification criteria for an FHA or HUD loan, no specific income minimum or credit score is required, but borrowers should be able to provide a 3.5% down payment and show a steady employment and income history for the past two years. Additionally, any past bankruptcy should be at least two years old and any foreclosure should be at least three years old -- with evidence of good credit since either or both incidents. Any tax debts, liens, or other judgments should already be repaid, or repayment plans should be established prior to applying for an FHA or HUD loan.

### **Types of FHA Loan Programs:**

There are several different types of FHA loan programs that borrowers can choose from:

The Section 203(b) FHA loan is the most popular. It allows homebuyers to finance up to 97% of their purchase, as well as necessary and qualified home improvement, using the same mortgage loan. There are certain debt-to-income ratio requirements, but no minimum salary must be met. This type of mortgage loan is the cornerstone of the FHA mortgage insurance program, and offers borrowers a fixed rate home loan.

A Section 251 FHA loan is an adjustable rate mortgage (ARM). This typically means that your mortgage payments can start out lower, but will adjust over time. The

interest rate established at the loan origination period may also increase or decrease over the life of the loan based on interest rate fluctuations in the market as a whole.

A Section 245(a) FHA loan, or Graduated Mortgage Payment loan, offers small mortgage payments that gradually increase over time. This is helpful for borrowers who currently have a limited income, but expect their salaries to consistently increase over time.

A Section 255 FHA loan, also known as an FHA Home Equity Conversion Mortgage or HUD Reverse Mortgage for Seniors, allow homeowners aged 62 and older to borrow against the equity in their homes without having to make any monthly payments. The FHA reverse mortgage loan amount is determined by the current interest rate, the appraisal value of the home at the time of the loan origination, and the age of the borrower. FHA or HUD reverse mortgages do not have to be repaid as long as the property functions as the primary residence of the borrower. But, if the home is sold, the lender is owed whatever cash you received from the reverse mortgage plus interest. Any remaining equity from the sale of the home belongs to you or your heirs. A reverse mortgage can never exceed the equity available in the property.

Keep in mind that these are only a handful of the many FHA loan options available. If you're considering an FHA or HUD loan, definitely discuss all your options with a mortgage lender of your choosing before moving forward.

### **Pros and Cons of FHA Loans:**

The biggest benefit of FHA loans is that their more flexible finance terms, less strict credit standards, and lower down payment requirements and closing costs allow borrowers unable to qualify for traditional mortgage loans to achieve their dreams of home ownership.

FHA loans do have some potential drawbacks though. First, be aware of your local area's loan cap limits. FHA mortgage loan limits, or maximum loan amounts, vary from state to state and are based on median regional home prices. If a loan exceeds the FHA loan cap limit, then it is considered a "jumbo loan" and no longer meets FHA loan qualification criteria.

A second consideration for FHA and HUD loans is that the paperwork and approval process sometimes takes longer than a standard or conventional mortgage does. Finally, a one percent origination fee is usually charged and added to the total amount of an FHA or HUD loan.