

Advantages and Disadvantages of FHA Loans

If you're looking to buy a home, you may have been attracted to the loosened approval standards that can come with a government-backed Federal Housing Authority (FHA) loan. But before jumping into an FHA mortgage, it's important to understand the possible benefit and drawbacks.

Potential advantages

- **Less challenging credit requirements:** If you have little or no credit history, it can be comforting to know that FHA approval requirements tend to be less stringent than those for conventional loans. At this time, it only takes a 500 credit score to qualify for a loan, according to the FHA. Maximum financing is available for anyone with a score over 580.
- **Smaller down payment:** Whereas conventional mortgages often require down payments of 5-10% of the purchase price of the home, FHA loans can be nabbed for only 3.5% down.
- **Friendlier debt ratios:** Keeping in the theme of more forgiving approval requirements, FHA loans can make qualifying easier if you already have a large amount of existing debt. For conventional loans, you are normally limited to having monthly housing and other debt payments equaling no more than 36% of your income. With FHA loans, this number gets boosted to 41%.
- **Potentially better interest rate:** If you're in the not-so-great credit category, you may run into a lot of big numbers while interest rate shopping. Since FHA rates are the same regardless of credit and are generally competitive, you could end up saving a lot on interest payments with an FHA loan if your credit is lacking.

Potential disadvantages

- **Lack of reward for good credit:** The flip side of the same-for-all interest rate is that you may be missing out on a lower interest rate if you have great credit. Over the life of the loan this could cost you thousands of dollars.
- **More mortgage insurance paid:** Because you are making a lower down payment, you will have to pay more private mortgage insurance (PMI) to make up the difference. With FHA loans, you also have to pay an upfront mortgage insurance fee. This can be financed, but it will cause your mortgage insurance payments to be more expensive than with a conventional mortgage.
- **Inspection standards:** To qualify as an FHA-eligible property, a home must go through a property standards inspection. This may limit your choices of available homes and can also make it difficult or impossible to get an FHA loan for a fixer-upper.
- **Fewer loan choices:** You aren't going to find the variety of loan options with the FHA that you typically would with conventional loans. This is especially true if you are looking for an adjustable-rate or interest-only mortgage.
- **Lower loan ceiling:** The maximum amount you can borrow for an FHA loan is different from county-to-county. In certain areas with low supply and high demand, you may find that an FHA loan won't allow you to buy the house you want because the price tag falls outside the allowable amount.
- **Limited condo supply:** If a condominium fits your housing needs, be aware that the list of available FHA-approved units could be pretty short. The FHA is known to be very tough on giving the green light to condos, so be prepared to really hunt if you go with the FHA/condo combo.

The consensus among housing experts is that – all things being equal – FHA loans will usually cost you more over the life of the loan. However, if your only current option for becoming a homeowner is through the FHA's eased standards, you can certainly consider a government-backed loan as a way to quite literally get your foot in the door.