FHA Changes Its Mortgage Guidelines

FHA mortgages account for nearly 1-in-4 closed mortgages nationwide. Getting approved for one, though, is tougher for borrowers "on the margin" than it once was.

The Federal Housing Administration (FHA) changed its mortgage guidelines, affecting how lenders underwrite and approve FHA-insured loans.

The FHA tightened its income verification for self-employed and part-time workers; and changed the ways it treats certain debts, including student loans and credit card balances.

The agency also upped its documentation requirements for gift funds used to purchase a home.

The changes render FHA loans more difficult for which to qualify, but certaintly not impossible (or even *improbable*). FHA loans remain among the simplest mortgage loans for which to qualify based on their forgiving qualification standards plus the agency's common-sense approach to homeownership.

Rates are low with FHA loans, too.

Since mid-2014, FHA mortgage rates have averaged close to 15 basis points (0.15%) less than rates for a comparable conventional loan via Fannie Mae or Freddie Mac; and, for borrowers with average or below-average credit, FHA mortgages can be a long-term win.

The FHA Is The World's Biggest Mortgage Insurer

The Federal Housing Adminstration is not a mortgage lender. Rather, it is a mortgage insurer -- and always has been.

Established in 1934 to promote homeownership and neighborhood stability, the FHA provides insurance to mortgage lenders making loans to U.S. homeowners.

In order to "get the insurance", though, lenders must certify that loans being made meet the FHA's insurable standards.

These standards -- commonly known as the "FHA mortgage guidelines" -- encompass all areas of a home loan approval and establish minimum standards for a borrower's income, assets, and credit score, as examples; and, for the home's appraised value.

Loans meeting FHA guidelines can be insured by agency and, therefore, approved by a bank. Loans which fail to meet FHA guidelines can't get approved.

Among the most well-known FHA guidelines are the ones governing downpayment on a home.

The FHA requires home buyers to put down just 3.5% on a property.

In order to qualify, properties must be designated as your new primary residence, and must not have more than 4 units. Condos and town homes are okay. And, for subsequent refinances of the same home, the FHA will waive the "home equity" portion of this guideline altogether.

Even if your home has no equity, it can be refinanced via the FHA Streamline Refinance program, which requires neither a home appraisal, nor a re-verification of income, assets, or credit.

If you've been paying on-time and are current on your loan, you can refinance your FHA loan to lower rates immediately.

FHA: Income & Debt To Be Treated Differently

For today's home buyers who plan to use an FHA-insured home loan, mortgage guideline modifications may make it more difficult to get qualified.

The majority of updates concerns how income is calculated on a mortgage application; and how applicant debt should be treated by an underwriter.

Many FHA borrowers are unaffected by changes. Some, though -- including buyers with student loans -- are affected directly.

Student Loans

Formerly : Loans in deferment for at least 12 more monthly did not count towards a borrower's debt-to-income (DTI) ratio

Now : All loans in deferment apply toward a borrower's debt-to-income. The corresponding payment is 2% of the outstanding balance, unless a specific payment can be documented. With $25,000 in student loans, then, the FHA assumes a monthly payment of $500.

Credit Cards

Formerly : "Authorized" users of a credit card had no responsibility to make monthly payments. Payments did not count toward a borrower's debt-to-income (DTI) ratio.

Now : Authorized users of a credit card must include the card's monthly minimum payment in their DTI unless it can be shown with canceled checks that the last 12 payments have been made by the credit card's primary owner.

Installment Loans / Car Loans

Formerly : Installment loans with 10 or fewer payments remaining was not included in a borrower's DTI.

Now : For installment loans with 10 or fewer payments, only the portion of the payment which exceeds 5% of a borrower's monthly income must be included in the DTI calculation. For example, a $500 car payment against $8,000 of monthly income would require $100 to be used in the DTI (5% of $8,000 = $400).

Self-Employed Borrowers

Formerly : In order to use self-employment income on a mortgage application, a borrower was required to show 2 years of work history, which could include time spent in "Training and Education"

Now : In order to use self-employment income on a mortgage application, borrowers must show two years of actual work experience. For self-employment in the same line of work as your previous job, 1 year of work experience may be considered. Tax returns are required.

Overtime Income

Formerly : In order to use overtime income on a mortgage application, borrowers were not required to prove a history of earning such income.

Now : In order to use overtime income on a mortgage application, borrowers must show a two-year history of earning such income. Employer verification may be required.

Part-Time Income

Formerly : In order to use part-time income on a mortgage application, borrowers were not required to prove a history of earning such income.

Now : In order to use part-time income on a mortgage application, borrowers must show a two-year history of uninterrupted part-time income.

Gift Funds

Formerly : Documentation requirements for gift funds were sometimes waived, at the discretion of the underwriter.

Now : Gift funds for downpayment on a home -- in addition to "large deposits" into a bank account -- must be detailed, sourced, and documented for a mortgage underwriter.