Capital One: The Costs and Benefits of FHA Loans

Everyone wants a lower-cost way to get a home, and an FHA loan might be the answer. But they do have requirements that can't be overlooked.

As you're looking to buy a home, you'll probably hear a lot of terms—conventional mortgages, FHA loans, fixed-rate loans and adjustable-rate mortgages. They might not always make sense at first, and it can be hard to understand which loan might be the best for you.

The loan you decide on will depend on several things, but it'll come down to talking it all through with your lender and real estate agent. And you may just end up being one of the many Americans who pick an FHA loan.

FHA loans, which are backed by the Federal Housing Administration, have been around for decades, but they get talked about regularly these days. That's because they can be a lower-cost way to get a new home.

If you have limited savings or your credit score isn't as high as you'd like it to be, an FHA loan might work for you. But you have to understand the possible drawbacks along with the positives.

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Understanding an FHA Loan

Probably the most popular benefit of an FHA loan is that it gives you the ability to put a lower down payment on a home. With an FHA, you could offer as little as 3.5% down if you're eligible, making the first part of buying a house more manageable. In other words, a $200,000 house would only require a down payment of $7,000.

Also, FHAs can be easier to qualify for. As long as the home will be used as a primary residence, lenders may let you have a higher debt-to-income ratio and lower credit score than you might find with a conventional loan.

The FHA says it will insure your home loan if you have a credit score as low as 500, but it'll depend on your lender for what their specific requirements will be. To be eligible for 3.5% down, FHA requires your credit score to be at least 580. With a score under that, you'd need to put down at least 10% in order to meet FHA requirements.

However, because the FHA doesn't manage loans directly, you'll have to go to a bank or other lender to apply for your mortgage, and they'll look at your financial situation. That means you may in fact need a credit score that's higher than what's set in the

FHA's rules. When a lender has additional or stricter requirements than the FHA or another housing agency has, it's called an "overlay."

FHA loans also have certain costs to think about. Initially, you'll have an upfront mortgage insurance premium, which could be several thousand dollars. Generally, it will be added automatically to your total loan amount and paid down over time.

Then, the loan requires a monthly mortgage insurance premium that could continue for the entire term, no matter how much equity you have in the home. FHA mortgage insurance can add hundreds of dollars to each month's payments, and with an FHA, you might have to pay it for up to 30 years. And although a low down payment is a great benefit, it also means you'll start out with less equity in the home—and it might take longer to build up your ownership.

So whether an FHA loan is the way to go really comes down to your situation and goals. Talk to an expert about your options, and they'll help you get the right mortgage for your home.

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