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FHA Loans Not a Bad Idea for Bad Credit Borrowers

If you are prospective home buyer with less than perfect credit, you have probably realized (perhaps the hard way) that the current market provides fewer loan opportunities for those with your credit rating. Recent waves of foreclosures among subprime or poor credit mortgage borrowers have resulted in many subprime lenders leaving the industry, closing up shop, selling out to others, or simply cutting back on their available loans. The good news is that the current foreclosure crisis is helping to weed out the shadier mortgage lenders and unconventional loan programs. There are still options for bad credit borrowers; one of the safest and most available is the FHA loan.

FHA loans, or Federal Housing Administration loans, enjoyed widespread popularity among low and middle income home buyers from the time of the Administration’s inception during the Depression until about twenty years ago. As new, more convenient loan programs popped up for bad credit borrowers, FHA loan use dropped off. According to data from the National Association of Home Builders, FHA loans accounted for 18 percent of all loans on the market in 1990, but that percentage dropped dramatically to 4 percent by 2006. Now that credit has dried up for those riskier, exotic loans, FHA mortgages may again provide the best funding for those with small incomes, bad credit, or both.

The reason these loans work so well for those with bad credit is that, while they are not made directly by the government, they are insured by the government. This means that lenders take on less risk by loaning money to a bad credit borrower than they would otherwise. They can be assured that if the borrower defaults on the loan, the lender will be compensated for any losses by the government. This makes it possible for lenders to offer loans to such borrowers and with reasonable interest rates, no less.

Other great benefits provided by FHA loans include low down payments which start at 3 percent of the loan value, agency-provided credit counseling services, and loan program options like fixed rate or adjustable rate mortgage choices. FHA ARM loans are especially helpful for those needing a low initial interest rate in order to break into the housing market. These ARMs have yearly resetting caps of no more than 1 percent higher than the original rate. They also have a maximum rate cap of 5 percent, meaning there should be less “payment shock” associated with these loans than with other subprime ARM loans.

There are a few drawbacks to the FHA loans however. First of all, they require a lot of paperwork and generally more effort to acquire than other loans. There are also borrowing limits, currently set at $417,000, which may be a problem for those trying to buy in the nation’s pricier areas. Also the interest rates are not as low as those offered for prime rate loans. (Although if you have poor credit, you would be unable to qualify for a prime rate anyway, making that point moot.)

Still even with the limitations and restrictions of FHA loans, they may be the very best option for bad credit borrowers in the current mortgage market.