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FHA Loans May Become More Competitive

If you are a home buyer with less than perfect credit, you may be wondering where and how you can find funding in today's credit crunched mortgage market. Rising foreclosures in the subprime or poor credit lending sector have caused lenders to shy away from making loans to such borrowers, especially loans with little documentation or down payment money. Help may be on the way for you in the form of a Federal Housing Administration (FHA) loan if some pending legislation gets passed in Congress soon.

FHA loans have been around for several decades. They were designed by the government to assist lower and moderate-income Americans in becoming homeowners. First-time buyers have also traditionally been drawn to FHA loans as they require less stringent credit standards and lower down payments than conventional market loans.

During the recently-ended housing boom, credit standards all over the market were looser as cash investments were pumped into the industry. Borrowers who would not have traditionally qualified for a home loan without government loan aid found a wide array of lenders and loan programs available for their needs. Subprime loans offered borrowers competitive rates without all the same requirements and restrictions of FHA loans.

As the subprime mortgage market blossomed, the FHA saw its market share of home loans drop dramatically. According to a June report from the Government Accountability Office, FHA mortgages made up 19 percent of all home loans across the nation. By 2005 that market share shrunk to a mere 6 percent, a sign that the FHA niche had been taken over by the private mortgage market.

Now that the bottom has dropped out of the housing boom and poor credit borrowers are hard pressed to find home loan funding, FHA mortgage lending could step up once again to fill the market need. Indeed, as troubles in the subprime market have elevated to crisis status, many more borrowers have looked to the government-sponsored mortgages for funding. New FHA loan applications increased by 76.8 percent during the last six months, with April reporting a record 67,525 applications, the most in one month in three years.

Surprisingly, even though applications have jumped radically in the past few months, the number of closed or completed FHA loans have not increased by the same measure. Closed FHA loans only grew by 18.8 percent from April to June, a much smaller rate than would be expected with the disappearance of outside credit. In fact, FHA loans currently hold only a 3 percent market share of the mortgage market.

An agency internal research paper reported, "The fact that FHA has not returned to a more historic level of applications and originations suggests that FHA is constrained by its underwriting and loan limits."

Many lenders and government officials have argued that the gap between applications and actual FHA loans is a product of behind-the-times lending standards in need of revamping in order to be of use for today's consumers.

Presently, FHA loans require a 3 percent down payment which remains a substantial barrier for many lower and middle income buyers in the country's more expensive housing markets.

Look for the conclusion of this article in this section tomorrow.