

# New FHA Alternative Boosts Low Down-Payment Options

By: Ted Rood | Fri, Jan 3 2014, 3:54 PM

As Fannie Mae and Freddie Mac eliminated their **100% and 97% purchase loans** following the housing meltdown, FHA financing once again became a preferred low down payment option. FHA loans offer a minimum 3.5% down payment, which **can be gifted** from a close family member. Thus, buyers whose sales contracts specify seller paid closing costs and who use the gift down payment, can often purchase a home with minimal out of pocket expenses.

FHA allows borrowers with credit scores as low as 580 to put just 3.5% down (those with lower scores face increased down payment requirements), and routinely approves higher debt loads than Fannie Mae or Freddie Mac. The combination of marginal credit scores and low (or no) buyer financial investment contributed to FHA's default rates as the housing market crashed. As a result, FHA has raised MIP significantly and has long since eliminated seller-paid down payment assistance programs.

Fannie Mae **also allows** down payment funds to be gifts from close family members for single family principal residences, with down payments as low as 5% for qualified borrowers. Until recently, however, private mortgage insurance (required for loans exceeding 80% of sales price) vendors required buyers to contribute at least 2% of their own funds in a transaction in addition to any gift funds. PMI provider United Guaranty recently altered [their guidelines](#) and now allow down payments to be exclusively gifts, a move likely soon adopted by competitors. The announcement gives eligible buyers a distinct advantage over FHA's considerable MIP costs.

FHA's upfront **MIP fees** are now 1.75% of the loan size added to the loan balance (\$1750 on a \$100,000 loan, 3.5% down), with an additional monthly charge of \$108.33, which applies for the life of the loan. Conventional PMI costs vary slightly, but have NO upfront fee. United Guaranty's pricing engine returned a price quote of \$64.17/mn for a 720 score, 5% down borrower, a substantial savings of \$4,399 over just the loan's first 5 years compared with FHA's fees.

The more conservative underwriting guidelines for Fannie Mae **gift-funded down payments** aim to ensure only qualified applicants receive these loans. Credit scores of 720 or higher (versus minimum scores of 620 for loans without gifts) are required. Debt ratios are limited to a 41% of applicants' gross income, an even stricter restriction than non-gifted loans. The home must be a primary residence for all those on the loan, and no second mortgages, balloon notes, or temporary interest rate buy downs are allowed. The credit score, debt ratio, and other limitations set Fannie's 5% down program apart from FHA's less stringent standards and should result in far fewer defaults.

It is important to note, however, that many lenders have restrictions on gift funds, despite Fannie Mae's acceptance. Shopping for this program may be challenging. Here's a few steps to start the process: if you have a preferred lender, call and ask whether they offer this program; if you need a lender, contact a loan officer in your area. You might have to shop around to find a lender offering the program with no overlays.

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