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Now, an FHA loan with zero down, zero cash

Washington Post Writers Group

WASHINGTON — What do you say to zero down on your first home purchase? And how about rolling your closing fees into the mortgage, giving you a home loan that costs you virtually nothing out of pocket upfront?

That intriguing offer could become a standard, government-backed option for an estimated 150,000 or more first-time home buyers if Congress approves a new "zero down" program to be proposed in President Bush's forthcoming federal budget. Zero-down-payment mortgages could go as high as $290,000 in high-cost markets on the East and West Coasts.

If sanctioned by Congress, the program will be run by the Federal Housing Administration (FHA), the nation's largest single source of mortgage money for first-time buyers.

FHA loans typically carry minimum down payments of 3 percent. The new program would essentially remove the requirement for home buyers to come to the table with any cash. That, in turn, is expected to open the door to a first home for thousands of families and singles who have sufficient incomes to pay monthly rents as high as mortgage payments, but who find it difficult to save enough to handle a down payment and closing fees. If approved by Congress, the program would become a permanent addition to the FHA menu of mortgage options.

The new zero-down FHA program is also aimed at first-time buyers whose credit profiles are non-traditional or contain a few bumps and bruises. FHA underwriting rules allow loan officers to approve applicants who have trouble qualifying on credit grounds elsewhere in the conventional mortgage marketplace.

Besides low — and now zero — down-payment options, FHA allows applicants to have higher household debt ratios. Monthly housing payments can go to 29 percent of monthly household income, and total monthly debt can go to 41 percent of monthly household income. Both standards are more generous than many lenders in the private, "prime" market allow.

FHA is not a mortgage lender in its own right. Rather, it is a government-owned mortgage insurance enterprise in the Department of Housing and Urban Development. Borrowers are charged an upfront insurance premium that typically is rolled into the principal amount of the loan, plus they pay a small premium each month. Though it was chartered by Congress to help higher-risk, lower-income home buyers than conventional market lenders usually serve at close to prime interest rates, FHA's insurance operations turn a substantial annual profit that flows back into the federal Treasury. Last year the insurance agency funded an all-time record of $157 billion in home loans, and assisted 600,000 new-home purchases. Eighty percent of its buyers were first-timers.

FHA officials say the zero-down feature adds an extra layer of risk of potential default to any loan, but the agency expects to manage that risk with slightly higher insurance premiums than charged on the standard FHA program. Instead of the current 1.5 percent premium upfront on a 3 percent down FHA mortgage, zero-down borrowers will pay 2.25 percent. But the premium will be rolled into the principal balance and financed over the life of the mortgage.

The zero-down option also will require a slightly higher monthly premium payment than the traditional 3 percent-down program, effectively adding a one-quarter of 1 percent "bump" onto the loan rate during the first five years of the mortgage. The zero-down plan is expected to be open to all FHA applicants buying their first homes. It will not be available for refinancings.

In an interview, FHA Commissioner John C. Weicher said the agency is moving to zero down payments "because we think we now have a better ability to distinguish at the higher-risk end [of the marketplace] who is a good risk and who is not." FHA's underwriting methods, unlike the conventional market's, require hands-on, case-by-case holistic evaluations of borrowers' credit and risk profiles. FHA does not base funding decisions on FICO credit scores, unlike virtually the entire conventional mortgage marketplace. Zero-down loans will be capped at the FHA maximum of $160,000 in many smaller and moderate-cost housing markets, but will go to $290,000 in large, high-cost markets. Initial reactions to the plan from lenders active in the traditional FHA programs appears to be highly enthusiastic.

Angelo Mozilo, chairman of Countrywide Financial Corp., said "any down payment, even 3 percent, is a major, unnecessary obstacle for lower-income borrowers, and the wealth gap in America encumbers minorities at a disproportionate rate." Countrywide has for years been one of the highest-volume FHA lenders and a participant in other low- or no-down-payment programs targeted at minority and immigrant home buyers and backed by giant investors such as Fannie Mae.

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