FHA Prepayments

Myths and Facts

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Myth: ***Changing GNMA's policy will increase costs of FHA loans***
Fact: The VA loan product is also securitized by GNMA and does NOT have this requirement. Borrowers only pay interest until the day they close on the loan, not after. Even GNMA has admitted that the lack of a prepayment requirement has had no significant impact on VA loan rates.

Myth: ***Lenders will stop offering FHA loans if this requirement is changed***
Fact: All excess interest payments are passed from lenders to the GNMA investors, so this should not impact lender's profit at all. Lenders collect the interest for the rest of the month (until the 1st), which is sent to GNMA. GNMA sends that money to the "security holder" as a kind of prepayment security. Changing this requirement should have no impact on lenders.

Secondly, FHA already compensates lenders for the risk of FHA loans. As borrowers generally pay higher basis points for FHA loans, lenders receive more compensation for FHA loans than they do conventional loans.

Lastly, the free market system will account for any changes in the GNMA policy. Note that lenders continue to offer the VA loan product, which does NOT have this requirement. If some lenders decide not to participate, other lenders will see the opportunity and step in to meet the demand. The FHA mortgage product has uses in the marketplace that conventional mortgage products cannot fill, and thus will still be in demand.

Myth: ***Changing this policy will make FHA loans less desirable to investors***
Fact: FHA loans are more attractive than conventional loans because they carry the guarantee of the federal government, and since interest is generally higher on a FHA loan, they have a higher return. The very process of pooling loans balances the inconsistencies that may occur with individual loans in the pool.

Myth: ***Borrowers are only hurting themselves by not closing on the final day of the month***
Fact: The way an FHA loan contract is written borrowers only have the right to prepay on the 1st of the month. Lenders will allow you to prepay at another time, but collect the interest for the rest of the month (until the 1st). Although this is written in the FHA contract with the consumer, consumers are not made aware of this specific requirement. In fact, as this is not considered a "prepayment penalty", no specific disclosure of this requirement is made when the loan is entered into. Instead, consumers only learn about this requirement when they request a payoff amount from the lender, and then only if they know their specific closing date.

Given the high rate of refinancing and new mortgages in this current market, it is often difficult (if not impossible) to select the date of your closing. Even when consumers are aware of the requirement, they are on the timetable of the buyer, the settlement company, title company, and mortgage lender. Often closings get delayed. If a closing is delayed just beyond the end of the month, possibly just one or two days, the borrowers is required to pay an entire extra month of interest on a loan they no longer have. It is also very difficult to schedule a closing on a specific date because of consumer availability, closing or title company availability, moving dates, working with end of rental dates, etc. to have all closings at the end of the month.

Most importantly the FHA consumer should have the right (like conventional and VA borrowers) to choose what day of the month they want to close that fits with their needs, not be penalized or forced to only close in the last couple of days of the month.

Myth: ***Most FHA loans close on the last day of the month***
Fact: FHA's data demonstrates that this is simply not the case. In fact, in 2003, only 16% of loans were prepaid on the last five days of the month. This compares with the fact that over the last three years, 25% of FHA loans were prepaid on the FIRST five days of the month. Since 2000 more than 40% of FHA borrowers closed on the first 10 days of the month.

Myth: ***The cost of this requirement on consumers is insignificant***

Fact: In 2003, 55% of FHA borrowers paid an average of $528 in excess interest fees. Since January of 2000, FHA borrowers have paid over $1.375 BILLION in excess interest fees.