

Government Affairs Update

FHA Prepayment Penalty

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The Federal Housing Administration (FHA) single-family mortgage insurance program allows borrowers to prepay their loans, but requires that it be done on the last day of the month. In the event that the mortgage is paid on a day other than the last day of the month, the borrower must pay interest for the complete month in which they prepay their loan. This interest is a requirement of Ginnie Mae (GNMA), the securitizer of FHA, VA and rural housing loans, as payment to investors. Neither VA, RHS, nor conventional loans require a full month's payment of interest when prepaying. For all these loan products interest is prorated to the date of prepayment.

The only way to avoid paying this penalty on FHA loans is to payoff the loan on the last day of the month. Given that home settlements are at record highs, it has become increasingly difficult for homeowners and homebuyers to schedule their closings on a specific date, if they are even aware of this requirement. Additionally, last-minute problems that are out of the control of the borrower can force a settlement date from the last day of the month to the start of the following month. In such a situation, an FHA borrower will incur substantial additional costs just to pay off the loan. For example:

- In 2003, 55% of FHA borrowers paid an average of \$528 in excess interest fees.
- In 2003, over 425,000 FHA borrowers paid an average of \$622 in excess interest fees.
- In 2003, only 16% of loans were prepaid on the last 5 days of the month.
- Every year for the last three years, approximately 25% of FHA loans were prepaid on the first 5 days of the month.
- In 2003, FHA borrowers paid a cumulative \$587,425,543 in excess interest fees.

At a time when homeowners are facing unprecedented housing costs, this penalty places an unreasonable and often unexpected burden on FHA consumers. The goal of the FHA program is to assist low- to moderate-income families. Imposing interest penalties on FHA borrowers contradicts this goal.