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# MortgageStraightTalk.com

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As I mentioned in the last newsletter, my associates and I spent an inordinate amount of time putting together a website. To me, it's a thing of beauty, but then again, doesn't every parent think their son or daughter is the handsomest or prettiest. Despite its mid-June launch my precious progeny has proven to be something of an "Ugly Duckling" with relatively few visitors to the website to view "My Swan", as it were.

The website was originally conceived to provide information to borrowers with straight talk, stripped of the mystery and mumbo-jumbo that surrounds much of the loan process. I am still committed to this idea. So as the saying goes, "If Mohammed won't come to the mountain, the mountain will come to Mohammed." Hence, many of the future newsletters will be articles directly from the website.

The topic of the previous newsletter was the distinction between PRE-QUALIFIED, PRE-APPROVED, and LOAN APPROVAL.

Continuing in this vein is a discussion of QUALIFYING that's germane to many first time home buyers and others who have been stunned by the recent run-up in real estate prices during the past year (38% in San Diego County for the past 12 months according to the California Association of Realtors, June 25, 2004).

## *QUALIFYING*

It's been said that the three most important things in real estate are Location, Location, Location. Whether your a first-time home buyer or refinancing for the Nth time, for a borrower the three most important things in obtaining a loan are Qualifying, Approval and Funding. In reality, it's QUALIFYING, QUALIFYING AND QUALIFYING. Because if you don't qualify, you'll never get to the other two. Fortunately, I've rarely found this to be a problem for my clients and it's not because I work only with "A Paper" clients. At one point sub-prime and Alt A (A-) borrowers comprised 90% of my business.

Nowadays, (As I've already observed) there are loans out there for just about anyone with a valid social security number and a pulse.

At the risk of outraging the mortgage community, I believe in large part, THE MAJOR DIFFERENCE BETWEEN QUALIFYING FOR A LOAN AND NOT QUALIFYING HAS TO DO WITH YOUR LOAN OFFICER. Ineptitude and laziness on the part of loan officers account for a significant percentage of the declined applications with two notable exceptions. Mortgage bankers are precluded from consideration because they are constrained by a narrow product line. Sub-500 FICO borrowers are excluded due to their de facto credit history (Their scores identify them as being among the riskiest 1% of borrowers in the credit data base).

Now is as good as time as any to discuss qualifying ratios. What conventional lenders look for are ratios of 28% on the front end (F.E.) and 36% on the back end (B.E.). What this means is your HOUSING EXPENSE SHOULD NOT EXCEED 28% OF YOUR GROSS MONTHLY INCOME AND WHEN ADDED TO YOUR LONG -TERM DEBT (which is anything with more than 10 months of payments left) SHOULD NOT EXCEED 36%. Some lenders will allow HIGHER ratios like 33% and 38%. Others will go as high as 36% ON THE FRONT END RATIO (F.E.R.) AND 45% ON THE BACK END AND SUB-PRIME LENDERS HIGHER STILL WITH BACK END RATIOS (B.E.R.) TOPPING OUT AT BETWEEN 50 TO 55%.

Regardless of what the ratios are with a particular lender a broker can always lobby for you with that lender's underwriter by presenting what are known as compensating factors. It may work, it may not. Nevertheless, here is a partial list of them:

***COMPENSATING FACTORS***

1. No debt or little debt.

2. Excellent long term credit, including previous mortgage and/or rent payments and high credit scores.

3. Proven ability to pay debt in excess of allowable ratios.

4. Large amount of liquid assets left after closing.

5. Proven ability to save.

6. Good potential for increase in income.

7. Long term stability.

8. Possessing an advanced degree or are working toward one.

9. Large down payment, low LTV loan.

10. Ability of nonworking co-borrower to obtain a job in which he or she has a background.

11. Potential for a large amount of overtime or a bonus.

12. Shorter loan term.

13. Little or no increase in housing expense.

14. Other income not used in qualifying.

Computer underwriting through proprietary software programs like FANNIE MAE'S DESKTOP UNDERWRITING (DU) or FREDDIE MAC'S LOAN PROSPECTOR (LP) skips the human element of an underwriter and can significantly improve on even the most liberal qualifying ratios. I have seen 90% LTV loans with 45% FE's / 70% BE ratios and 95% LTV's with 38 F.E.R/65 B.E.R., THESE ARE NOT THE NORM, however.

A major sub-prime lender, a lender I spoke with said that only 19.6% of the applications they receive result in loan closings. I suggested that the low percentage might have more to do with the fact that they were a sub-prime lender. He replied, "Not really, the industry average is about 1 in 5 or 20%".

Because I strongly pre-qualify people by taking a detailed loan application (Form 1003) my closing ratio is over 95%. In fact I had only 3 people drop out last year--one was a rate chaser who abandoned me for an 1/8th of a point difference the day of the appraisal (I don't know if his loan ever closed), another because of a family death and the last was where a third party to the transaction asked to withdraw the application.

If you're a first-time home buyer that's a bit short of the needed down payment or the cash reserves that most lenders like to see borrowers have,

(in the event that one loses their job or has an accident that temporarily keeps them from working), here are some strategies you may wish to consider:

1. EMPLOYER. If you're relocating at your employer's request, your company may pay some or all of your down payment and home purchase costs as an employee benefit.

2. LIFE INSURANCE. You may be able to tap the cash value of your policy if it's a whole life or universal life policy.

3. TAX REFUND. It may be enough for your down payment or the cash reserves that a lender requires.

4. RETIREMENT PLANS. The government allows first-time home buyers to access up to 10,000 from their IRAs and 401Ks prior to age 59 1/2 (without a penalty for early withdrawal). So, a couple could obtain as much as $20,000 here alone.

5. GIFTS. Some parents or generous in-laws help their off-spring with their starter home by gifting them some amount toward that all too crucial down payment. The current tax law permits tax-free gifts of up to $10,000 per calendar year.

6. EQUITY SHARING. This situation allows two or more people to buy a house that one or more of them occupies as a primary residence. For example a non-occupant investor might make the down payment and closing costs in return for a specified interest in the property, while the actual occupant(s) would have a greater or lesser interest in the property in exchange for making the monthly mortgage payments, taxes, insurance and maintenance.

7. CARRY-BACK FINANCING. This situation involves having the seller carry a 10 or 20% second mortgage or some variation on this. If for example, one had only 10% for a down payment, have the seller carry a 10% second mortgage and obtain a 80% first mortgage via a conventional lender.

Next issue's topic -

**The Two Biggest Mistake Borrowers Make.**