Introduction

THERE ARE FEW investments in our lives that will be as significant as the purchase of a home, and few events in our lives that will be as stressful as the mortgage application process. Death, divorce, and moving are often considered the three highest stressors in a person's life. Planning a move due to a death or a divorce is stress raised exponentially. Moving is much more than the physical act of packing up your life and transporting it from Main Street to Broadway; it is also a time of mourning the neighbors you're leaving behind with whom you've shared experiences. As you are struggling with these emotions, you are also charged with focusing and navigating through the land mines on the mortgage highway. You're probably looking forward to your mortgage experience much as one would a colonoscopy: You may need the results, but you certainly aren't looking forward to the process.

There is no easier client to serve than one who is ready. Mortgage Matters is written to share with you, the borrower, the things that matter and that are within your control, from beginning to end. While there is no way to completely remove the stress, what we'll be doing is preparing for loan application, to shorten the length of the decision-making phase of your loan request, and in turn, shorten the length of time you will feel stressed.

First Things First

Before the mortgage crisis, I used to tell everyone what I did for a living, as this always paved the way for future referrals. After the meltdown, I gradually stopped. So many people needed to share their story of job loss or underemployment, and while it was evident that they were angry at their lender for not providing better assistance and communication, it was very clear to me that they couldn't keep the losses attributed to the recession from defining how they viewed themselves as providers for their families. They didn't understand why the government was willing to bail out the banks but not them. They wanted answers.

This doesn't have anything to do with the nature of this book, but I wanted to start with this because I think it needs to be said. For all of those who were affected by the financial crisis and lost their home, you are not defined by that event. The Great Recession brought mass unemployment and underemployment that made it difficult for many to make their mortgage payments or repair and maintain their homes, and many suffered the negative psychological emotions of foreclosure that include anxiety, stress, fear, hopelessness, depression, and embarrassment. But you must remember that you didn't cause the Great Recession and your self-worth isn't tied to homeownership. Home is defined by what takes place within our four walls. Let it go. Take this opportunity to move forward.

Will I Have to Earn a Ph.D. in Mortgage Banking?

No matter who you are or how much you earn, all homebuyers share the same fears, concerns, and anxieties. You're nervous, and rightly so. Generally speaking, people aren't all expected to know the same things, we don't all learn in the same way, and we're not all equally interested in the same forms of knowledge. Yet most of us, at some point in time, are expected to know about the mortgage process and how to get through it—and we're expected to do that without any training whatsoever or by relying on partial information given by misinformed people. You may only want to learn about the things that apply to you and this is understandable, but you'll find that most everything in this book applies to you in some way, so there are no shortcuts. The key to success in the mortgage process is preparation. This is going to require a significant investment of your time, but the financial rewards are well worth the time spent.

There are a few sections of the book where I discuss topics that aren't really about how to best prepare for the loan application process, but are necessary for your overall understanding of the workings of the mortgage industry and the issues you may face. You will learn about how the primary and secondary mortgage markets work together to deliver mortgage products, the different designations for institutions that are authorized to originate mortgage loans, the relationship between originating organizations, creditors, aggregators, investors, and the government-sponsored enterprises (GSEs), the necessity for better communication between borrowers and servicers and homeowners associations, and an overview of some key things to keep in mind during the servicing of your home loan. I share my insights on the impact of federal and state laws on the mortgage industry and the effect of lenders' policies that are designed to protect their stakeholders and how those polices determine the types of loan products you are offered by a particular lender.

You may be going into this believing that all lenders offer the same loan products and follow the same set of strict guidelines—and that's the second biggest mistake that you'll make. The first and largest mistake most people make is not putting their finances in order before beginning the mortgage application process. In the face of these facts, you have lots of doubts and are unsure how to formulate your questions. Does a particular lender offer the loan products that best suit your particular needs? Can your loan officer be trusted to accurately represent your financial profile? Will you be offered the best pricing? Will the flow of your loan application be properly directed so that you can receive a timely loan approval and meet your closing requirements by contract date? Will your kids be able to hang their posters on the walls of the bedroom they selected? I get it.

Storytelling

Your loan officer is the storyteller, the person you've retained to write your biography. The representation of your life story will only be as true as the information you give the biographer. Whether or not your loan request is approved is 95 percent attributable to how your story is told. Guidelines are guidelines, facts are facts, and in today's mortgage banking environment, what you don't reveal at application, and is later identified, greatly affects the comfort level of the underwriter who is tasked to make a decision on your creditworthiness.

Know that you are selecting a loan officer, not a lender. Just as not all lenders offer the same products, not all lending platforms offer you the most beneficial service nor do all loan officers have the same skill set. You'll learn how to identify the better loan officers. Although this isn't a term I really like to use because it implies that one person is better than another, the term helps you identify those attributes that a stronger loan officer will have and whose value will undoubtedly increase your likelihood of a successful process.

Guidance and Policy

As unusual as this may sound to you, loan officers aren't allowed to tell you exactly what you need to do to get your loan approved. Organizations put policies in place that prohibit us from telling you how submitting one document over another would be easier for loan approval, as doing so may imply coaching, and prohibit us from having any discussion of loan eligibility requirements, as doing so may imply that we are discouraging you from making loan application that violates Fair Lending laws, or suggesting one product over another, as it may imply steering. So this book is a seasoned loan officer's voice for conversations that time, regulations, and policy may prevent most loan officers from having with you. Here you'll learn how we assess your creditworthiness, and how you can prepare accordingly and ask the right questions

The topics follow the general guidelines of conventional and government underwriting standards at the time of publication. Throughout, the word agency is often used to describe the authority issuing these guidelines under which we evaluate your creditworthiness when deciding a loan. In practice, the term *agency* generally refers to the accepted minimum credit standards for loans delivered to mortgage giants Fannie Mae, Freddie Mac, or Ginnie Mae that are government-sponsored enterprises (GSEs). Just as the Generally Accepted Accounting Principles (GAAP) or standard accounting practices refer to the standard framework of guidelines for financial accounting used in any given jurisdiction, agency guidelines include the standards, conventions, and rules that mortgage lenders generally follow when reviewing loan underwriting criteria in anticipation of delivering your loan to a government-sponsored enterprise for guaranty.

Not all lenders follow agency guidelines and instead institute their own set of policies. Lenders use the term policy to mean one of two things: the specific business practices of anyone involved in the mortgage lending process or a lender's particular rules surrounding their appetite for risk. Keep in mind that policy is specific to each lender and guidelines set by the GSEs are fluid. When a lender has stricter rules on top of agency guidelines, we call these overlays.

I will not spend time educating you on the pros and cons of a fixed-rate mortgage versus an adjustable rate mortgage—there are plenty of free materials available at hud.gov to address the benefits of each. I am fluent in the languages of English, Spanish, and Mortgage and can pick up on conversational Portuguese and Italian. Google Translate is my friend. I've sat across from a Brazilian borrower, typed my questions in English, had them translated to Portuguese, flipped my laptop over to the applicant who read the question in Portuguese, responded in Portuguese, and then Google Translate gave me their responses in English (although not with grammatical perfection). Unfortunately, Google Translate does not support Mortgage Speak, and that's the impetus for this book. I can't help but speak in Mortgage, but I am told I'm very good at interpreting our language so that you will understand. As you read along, foreign terms are introduced and defined. The "Learn the Lingo" section presents a glossary of mortgage industry terms.

I'll leave you with these tips on being a savvy mortgage consumer:

- Decide in advance the maximum monthly housing payment you can afford.
- Know your credit score.
- Follow the recommendations provided identifying creditworthiness.
- Gather current market information about prevailing interest rates.
- Speak with at least two different lenders to get advice on several loan programs and compare their features.
- Get preapplication cost estimates and know the variables used in their calculations.
- Make sure that your loan officer has all appropriate licenses.
- Read and understand any legal document you are asked to sign.
- Don't commit to anything on impulse or under pressure.
- Ask whom to contact if you have a question or problem and your loan officer isn't available.

Sustainable homeownership remains the single best idea for building family wealth and growing the middle class. Housing has been suffering death by a thousand cuts … It's time to change the dialogue of distrust to a dialogue of confidence.

—David H. Stevens, 2014 President and CEO of the
Mortgage Bankers Association

01 Steps Toward Homeownership

Homeownership is a goal for many of us. But how will you know when you're financially ready to meet this responsibility? What's it going to take to get you ready to make the commitment? And what can you do today to ensure the best mortgage products and pricing are available to you when you are ready?

If you are the perfect borrower—a mystical, magical being—employed in the same profession for two or more years, have received a salary with no bonus or overtime compensation, consistently show only deposits into your checking/savings account from employment compensation, have accumulated savings of 25 percent or more of your purchase price, have no prior marriages, have no minor children residing outside of your household, have no off-the-credit-report debt obligations, have not cosigned a loan for anyone, and have no derogatory information on your credit report, then you are the unicorn of loan applicants. You exist only in fairytales. Everyone needs direction to support a successful outcome.

BY THE TIME you finish this book, you'll have more answers than questions, a clear understanding of available loan programs and products within those options, an awareness of how individual loan pricing is determined, command over documentation requests, proficiency in the steps that are necessary to get you to the closing table, and an appreciation of what you can expect during the servicing of your home loan. The student who gets an A isn't always the smartest—he or she may just be the one who did all of the homework, turned it in on time, and stayed up late to study for the exam. The very wise Ben Franklin shared, "By failing to prepare, you are preparing to fail." By reading this, you are taking the first step in preparing for mortgage success. Congratulations!

I believe there are two signs of readiness that will help you identify if you are prepared for homeownership. The first is knowing exactly why it's beneficial for you to own a home; and the second is having a fair sense of whether or not you have financial responsibility.

Benefits of Owning Your Home

Home calls to mind family, community, friends, relationships, and a shared history. Where we live affects our self-esteem, the control we have over our environment, and our perceptions over financial security. Being a homeowner is seen by most as a sign of accomplishment and success. Buying a home takes a lot of thought, hard work, and sacrifice.

Whether you are a single person or have a family, you need to decide whether or not owning a home is right for you. There are many things to consider, including where you want to live, how much you can reasonably afford, and what you are willing to do to make sure your new home maintains its value. How will you know when and if you're ready to become a homeowner? Sure, financial security is one measure of readiness, but why buy when you can rent? Many choose to rent to maintain ease of mobility.

Here are just a few of the financial benefits of owning your home: (1) mortgage payments are a sort of forced savings with a portion of your monthly payment going to reduce the principal balance, (2) the U.S. tax code allows homeowners to reduce mortgage interest from tax obligations, (3) real estate property taxes paid are also fully deductible from tax obligations, (4) if you live in the home for more than two years and then decide to sell it, up to $250,000 of the profit gained from the sale is excluded from capital gains taxes for single persons and up to $500,000 for married persons, and (5) price appreciation helps build home equity, which is the difference between the market price of the house and the remaining mortgage payments.

There are also social benefits of owning a home. Generally speaking, there is greater residential stability for homeowners than for renters. A Harvard study, "Reexamining the Social Benefits of Homeownership after the Housing Crisis" (http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/hbtl-04.pdf) found that despite the sufferings of foreclosure, owning a home remains an important desire for many Americans. Aside from historical equity appreciation, an even greater benefit of homeownership may be the achievements realized by children whose parents maintain a foothold in the community. This benefit was identified in several ways:

- Children of homeowners do not change schools as often. Children who change schools often have been found to do considerably worse in school.
- Residential stability may increase parent participation in local civic organizations, thereby building social networks that are supportive of positive child behaviors.
- Homeownership may require parents to learn home repair, financial, and interpersonal skills that they then pass along to their children.
- Improved self-esteem and reduced financial stress among home-owning parents may positively impact children's behaviors.
- The children of home-owning parents had math achievement test scores that were nine percent higher and reading achievement scores that were seven percent higher than the children of renters.
- Children of homeowners are generally less likely to drop out of school than those of renters.

Responsible Personal Finance

Home buying can be an intimidating process, particularly for first-time homebuyers. A household's ability to obtain ownership is in part a function of the resources available to them and the personal circumstances that make homeownership a desirable outcome. Many people are simply unfamiliar with the significance of credit management, the need to build an emergency fund, and the importance of having a steady and reliable income source. Personal financial education isn't specifically taught in our high schools (the first time I learned how to write a check was in a college mathematics class), and some people lack familial role models who educate on budgeting and the consequences of financial mismanagement. There is much to be learned.

Know Your Budget

Most of us know that we need to budget our money, put some aside for the future, and stay out of debt, but many of us still struggle to follow these three principles consistently. At any income level, the surest road to responsible finance is spending less than we earn. If planning a monthly budget has never been on your priority list, you probably have no idea where your money goes. Knowing where each dollar goes is essential to building opportunities for savings. The key to achieving any goal is to set a date.

For many of us, the word budget conjures up the same feelings of self-induced torture and deprivation that we get when we hear the word diet. Those who live a healthy lifestyle never have to diet. Healthy eaters tend to make meal plans ahead of time and keep a daily journal of what they put in their mouths. If you apply these basic concepts to tracking your income and expenditures for about a month, you'll be able to pinpoint extra funds. We call these extra funds discretionary income. Discretionary income can be used on fun things like a night of bowling or happy hour with your friends at the local pub, or it can be set aside for a future vacation or a down payment on a home. (Visit www.MortgageMattersBook.com to download a Monthly Budget Spreadsheet to help you get started and is easily modifiable to meet your specific profile.)

Begin by identifying and listing fixed costs such as housing, auto loan/lease payments, student loans, utilities (telephone, cell phone, Internet, electricity, and water), cable, parking, commuter expenses, auto insurance, health insurance, life insurance, day care, and tuition. Then add variable expenditures such as minimum payments on credit cards, groceries, meals outside the home, and entertainment. Remember to include allocation for clothing and the nonessentials such as iTunes, gaming memberships, health club memberships, and grooming. Once you have created a clear picture of where your money goes throughout the course of a month, you can begin to spot trends and problem areas and identify where you can cut back and by exactly how much. Just by having the mindset to track expenses, you'll automatically start to think twice about frivolous expenditures, and it'll become easier to hold off on an unnecessary purchase when you have set a timeline for achieving your dream of homeownership.

Gaining Access to Credit and Maintaining Proper Management of Debts

Credit cards can be used as an easy way to track expenses and provide for ease of payments. In the U.S., credit scoring models utilize payment histories on loans and lines of credit to determine a borrower's creditworthiness by assigning a score. Ideally, mortgage applicants will have four active trade lines with a minimum twenty-four-month history of payments. While lenders prefer that the trade lines are ones that report to the credit repositories such as credit cards, auto loans or mortgages, we will accept histories on nontraditional credit accounts, including housing and utilities such as gas, telephone, electricity, water, and cable. Additionally, we may accept payment histories on auto insurance, renters insurance, and daycare and school tuition, to name a few. Here are some things we look for in evaluating credit risk:

a. Older, established accounts generally represent lower credit risk.
b. Revolving accounts with a low balance-to-limit ratio (a term describing how much of your available monies you've used) generally represent a lower credit risk, while those accounts with a high balance-to-limit ratio represent a higher credit risk.
c. Recent late payments represent a higher credit risk than late payments that occurred more than twenty-four-months ago.
d. Mortgage delinquencies within the preceding twelve-month period indicate high risk.
e. Significant derogatory events such as foreclosures, deeds in lieu of foreclosure, and public records information, such as bankruptcies, judgments, and liens, represent a higher credit risk.

Going forward, do not make late payments on any of your debt obligations. You may have made mistakes in the past, but you have to keep your eye on your future goals. Keep track of payment due dates and ensure timely payments. Your credit score determines the price you pay for a mortgage or rent, an auto loan, and homeowners insurance. So let's take a close look at how we manage our access to credit.

Building credit doesn't mean you have to build debt. An effective way to manage this is by following this simple rule: If it isn't a necessity, and if you can't afford to pay for it with the money you currently have, don't buy it. When you buy a nonnecessity expecting money you will receive at some point in the future, you risk accruing debt and increasing the cost of that nonnecessity by incurring interest costs.

For example, if we earn $100 and spend $110 we're now in the red by $10. With credit access, that $10 of borrowed money comes with the additional cost of interest payments. This means we're actually on the hook for more than ten dollars. If this happens on a regular basis, month after month, and with large dollar amounts, it's easy to see how someone can get into thousands of dollars of debt. This is the reason most people feel as if they don't have any money to save.

Only use credit to buy items that have lasting value. For example, it's perfectly normal to buy a car with credit. Or a dishwasher, stove, or other big-ticket items you need to live. On the flip side, avoid credit spending for things like dining out and vacations, because while they may bring you immediate pleasure, they have no long-term value. Use cash for those types of expenses, and make room for them in your family budget.

Establishing an Emergency Fund

Financial emergencies can come in many different forms. Job loss, significant medical expenses, home or auto repairs, or something we've never before imagined can force us to rely on access to credit that could compound the problem. The best we can do to prepare for emergencies that require quick access to cash is by establishing and maintaining an emergency fund.

I understand that many people go through their entire lives just barely making ends meet and this can be very stressful. However, we need to learn how to establish responsible financial habits. Ideally, we should be keeping between three and six months worth of our living expenses set aside in an emergency fund. Living expenses include not only the amount for housing, but also include your entire monthly expenses. A sudden job loss will require some time to find suitable re-employment and a medical emergency may keep us bedridden for a while, and we need to be prepared for these emergencies as our bills won't stop coming in simply because we don't have income. By planning for the bigger emergencies, we get to easily deal with the smaller emergencies such as replacing the hot water heater.

If you currently don't have an emergency fund or find it difficult to save money, the key is to start small. Accumulating one month's worth of expenses will take some time, saving three to six months may seem like a daunting task, but it is achievable. By setting immediate goals to be small and manageable, we have a better chance in reaching them.

Where to Keep Your Savings

While it is most certainly your right to keep your money hidden away underneath your mattress or in a coffee can, the best way to document your savings is through your bank. If this will be your first banking experience, enjoy walking into your local bank and open up a new savings account. The next step is to get into the habit of making regular deposits into this account. Whether it is weekly, biweekly, or monthly, create a schedule and stick to it. Once you make saving automatic, you won't even have to think about it. Many employers offer direct deposit and allow you to deposit money into separate accounts.

Accruing Down Payment and Closing Costs

By building on these steps, you'll eventually reach the place where your financial house is in order, and you'll begin to find a feeling of comfort within a specific range allocated for monthly housing expenses. This is the point where you can identify how much house you are willing to buy. What you are willing to spend can be very different from what a lender says you can afford.

When a new client comes to me to see how much house he can afford to buy, I always begin the analysis with this question instead: What amount are you comfortable spending each month on your total housing expenses? I've gotten into this habit because, nine times out of ten, how much house a person can afford is greater than the amount he or she is willing to expend on housing monthly. Total housing expense includes the monthly amount paid for principal and interest on the mortgage loan, property taxes, insurance, and homeowner association dues, if any. We refer to this as your PITIA or your front-end ratio when we are analyzing your loan file and calculating debt-to-income (DTI) ratios. DTI represents a very important measure of risk and is a determining factor in program eligibility.

A simple rule of thumb says that you should be able to afford a mortgage that is two and a half times your yearly gross income (pretax dollars). For example, if you have yearly household income of $40,000, you should be able to obtain a loan approval in the amount of $100,000. When we say household income what we really mean is the income of those persons who will be qualifying for the mortgage loan. Keep in mind, every individual on the loan transaction will have their income, credit, and liabilities scrutinized during the mortgage approval process.

That said, much more goes into determining how much home you can afford beyond the loan amount you qualify for. You need to take into account a lot of other things that consume your discretionary income. Do you have young children at home requiring daycare? Do you have a college age child that you wish to support while they're in school? Do you help support your parents? Do you like to take lavish vacations? Do you enjoy taking your family out to dinner once a week? Do you have an expensive hobby? Do you invest in a private school education for your minor children? Your choice of how much home you can afford should take into consideration your expectations for quality of life. Monthly expenses tied to daycare, primary, and secondary school tuition are not included in debt-to-income ratios because these are choices and not obligations.

Let's not commingle the emergency fund with the down payment and closing cost fund. Keep the emergency fund active, separate, and ongoing, and instead, open a separate savings account to build the money you'll need to get you moved in to your new home. A positive aspect of keeping that emergency fund separate is that at the time of loan application, you will disclose it to your lender on the application, and it will serve the dual purpose of qualifying as your reserve money that may be needed for mortgage qualification. Reserves are not used in the loan transaction, but they serve as a cushion, and excess reserves can act as a compensating factor to your lender when another aspect of your loan file may be weak.

The Six Basic Steps to Mortgage Approval

Whether you are a first-time homebuyer or a long-time real estate investor, everyone needs to understand and prepare for each step of the loan approval process in order to avoid missteps, miscalculations, misunderstandings, and unintentional misrepresentations that cause delays. There are a total of six steps. The first two steps are completed without the involvement of your lender and will require a significant investment of your time, attention to detail, and effort in making corrections where necessary. The remaining four will have you working closely with your lender.

We are going to prepare your loan file so that we don't give an underwriter a reason to think. If you've given them cause to think, you're in trouble, because their thinking leads to questions, which leads to more documentation requests, which leads to more questions, which leads to various submissions, which leads to closing delays, which leads to frustration and disappointment. By addressing all potential issues upfront, you and the loan officer can work together to minimize delays.

Here's an overview of the steps that pave the path for a successful loan approval process:

1. Obtain a Copy of Your Tri-Merge Credit Report
2. Gather Supporting Documentation
3. Meet with a Loan Officer for Prequalification
4. Make Application for Preapproval
5. Obtain a Conditional Loan Commitment
6. Satisfy Lender's Requirements to Obtain a Final Loan Commitment

Step 1: Obtain a Copy of Your Tri-Merge Credit Report

Knowing your credit profile is key in determining loan eligibility. Step one is to get a copy of your credit report and dissect it confirming accuracy and looking for errors. You can obtain a free copy of your credit history annually at AnnualCreditReport.com or call 1-877-322-8228. While this version is a good place to start, it doesn't provide your credit score that loan officers will need as a guide to prepare your preapplication cost estimates and have discussions around loan programs during the prequalification phase. For a monthly fee, service providers such as MyFICO.com provide tri-merged credit reports that provide raw data from all of the major credit repositories: Equifax, TransUnion and Experian. These services have options to help you monitor credit activity, prevent identity theft, and model the impact of changes to your credit profile. Follow the guided review instructions in chapter 6 and immediately begin working on correcting any errors.

Step 2: Gather Supporting Documentation

In Step 2 you will gather all supplies as listed on the supply list in the "Resources" section, organize them as instructed, and review them for possible issues.

Step 3: Meet with a Loan Officer for Prequalification

Sometimes people use the words prequalification and preapproval interchangeably, but as they apply to mortgage financing, they have quite different meanings. In the prequalification phase, we take a look at your mortgage financing options. You'll likely have a discussion with a loan officer in which you'll share how much you have available for down payment and closing costs, your monthly income and recurring monthly debts, and a calculated guess of your credit score. Using your estimations, the loan officer will perform quick calculations that suggest how much home you can afford and discuss options for loan programs you may be eligible.

At this point, your credit report has not been run by the lender, no formal loan application has been made and you should have no expectation of seeing any written loan disclosures. You should, however, request to be provided with loan comparisons identifying features and benefits and preapplication cost estimates. You'll also learn what documentation is needed to support your loan application and have a general expectation of the timeline for when you should make formal application and the fees required to do so.

While prequalification is an important step in the process, you need to remember that a prequalification letter means absolutely nothing. The reason why a prequalification alone doesn't work is that the amount you tell the loan officer as your monthly income is rarely the exact amount of income that the lender can use as your qualifying income. Qualifying income isn't identified in the prequalification step because the process of prequalification doesn't require the review of any supporting documentation. It naturally follows then if all you have is a prequalification letter, you don't have a solid commitment to lend from a creditor.

Note: A creditor is the entity that funds your loan. It could be a bank, a nonbank mortgage company, or a private investor. Within each of these classifications, there are hundreds of entities providing different loan product options, adhering to different underwriting guidelines, lending on only certain types of housing, and pricing their loans based on assessed risk and desired profit margins. All are necessary in the free market to provide the housing industry with funding options. You can make an application directly with a representative of any of these creditors, or you can engage with a loan officer at a mortgage broker firm who searches for a creditor that matches your specific needs. For purposes of clarity throughout this book, and unless otherwise noted, the word lender is consistently used to describe a creditor.

Step 4: Make Application for Preapproval

The difference between a prequalification and a preapproval is that in a preapproval, a formal loan application is made (with no subject property listed), a credit report is pulled and your estimations of income and assets are run through an automated underwriting system. There are six elements that define when loan application is made; receipt of your name, social security number, income, purchase price, loan amount, and property address. A lender is required to issue loan disclosures within three business days of receiving these six details that trigger a loan application.

With preapproval, you and your loan officer complete a full mortgage application with all the elements, except to be determined (TBD) is used as the subject property address along with an assumption on the type of property (single family, condo, planned unit development, multifamily). At this point, some money may be collected for the credit report and underwriting fees, and this depends on the lenders policy. Your loan officer will then obtain your consent to run your credit report, review with you the liabilities listed on the report to assert accuracy, exclude duplicate listings, match mortgage liabilities to their corresponding property and review derogatory items such as slow pays, collections or judgments. Pricing is rerun based on your usable credit score. Subsequently, the data on your loan application is run through an automated underwriting system. A lender will typically use Desktop Underwriter or Loan Prospector, the proprietary underwriting systems for Fannie Mae and Freddie Mac, respectively. These automated underwriting systems provide lenders a comprehensive credit risk assessment that determines whether a loan meets eligibility requirements. Sometimes a lender will use their own proprietary underwriting system to accommodate their specific portfolio lending programs or additional overlays (restrictions) to agency guidelines. Based on the initial findings, the loan officer will receive a recommendation and a list of conditions that need to be satisfied.

While a preapproval is significantly better than a prequalification because credit history is reviewed and a recommendation of approval is received, the recommendation is based on an assumption that the data you gave to your loan officer about your employment, assets, income, and debts is correct, so preapproval still doesn't confirm your loan eligibility. Only after an underwriter reviews your supporting documentation can you be fairly certain that you've secured financing.

Tip: While with successful preparation and no extenuating circumstances, you could realistically expect to close your transaction within thirty days of making loan application, rarely are there no hiccups. The time to make formal application and request a conditional loan commitment is within three months of buying a home. This is critical. Loan documents have expiration dates. If you apply too early and loan documents expire before the loan funding date, new documents will be requested. Significant changes on the loan application can impact loan eligibility and prior approvals.

Step 5: Obtain a Conditional Loan Commitment

Sellers are far more receptive to purchase offers supported by a lender's conditional loan commitment as this signals that you're a serious buyer who is ready to make your move. Once you've reviewed the loan disclosures and agree with the lender's terms, you must issue your consent to continue with the loan application. Once consent is recorded, application fees collected, supporting documentation is gathered, and the data on your loan application is updated to reflect actual data as evidenced by your supporting documents, only then is your entire loan file submitted to an underwriter. The underwriter is the decision maker in this process and takes a deep dive into your loan file to ensure the data on the application is supported by documentation and is submitted in compliance with lending guidelines. If it does, a conditional loan commitment is issued.

You may be wondering how long it will take to get your loan conditionally approved: it mostly depends on you. Your loan officer can work to get your conditional loan commitment issued within three days to three weeks from loan application—depending on the lender's capacity for review of new files and assuming you've provided all the supporting documents on day one. If you can't be bothered with gathering all necessary supporting loan documentation so that an underwriter can make an informed decision quickly and you don't have the funds to pay for the property in cash, then you're not really serious about the buying process.

Based on my experience, the greatest point of contention between you and your lender will be the lender's calculation of qualifying income as it relates to declarations made on your income tax return for unreimbursed business expenses and rental income. We get that nobody wants to pay more taxes than they absolutely have to pay and will use the benefit of a tax break whenever applicable. What you need to know is that your lender can only use the income as reported to the IRS for loan qualification. For those who are self-employed, receive bonuses, or whose commission income exceeds 25 percent of their total income, an analysis of a two-year average of reported income is required. In chapter 10, I go into the detailed industry standards for calculating qualifying income.

Step 6: Satisfy Lender's Requirements to Obtain a Final Loan Commitment

Once you have found a property and negotiated a sales contract, your lender then orders a property appraisal or valuation report and sends a title request to your selected settlement agent. The settlement agent is a real estate attorney or title agent who conveys the orderly transfer of legal title from the seller to the buyer through the closing process. When the appraisal comes in, you are given a copy and you will begin working with your insurance agent to secure adequate property insurance coverage and provide evidence of that coverage through a certificate of insurance sent to your lender. When the lender receives all documentation you submitted to comply with the preliminary loan conditions and the appraisal is in, the file goes back to the underwriter. Once the documentation submitted satisfies the underwriting conditions, a final loan commitment is issued. The final loan commitment will list any prior to loan funding conditions that can only be satisfied at closing, so you'll never receive a final loan commitment that is completely free of conditions.

As a result of all these possible complexities, it's extremely important for you to remember the steps in the process. While its good to know where you stand, don't make the mistake of pausing at prequalification and jumping into contract negotiations. Know your credit, gather your supporting documentation, research lending programs, and shop pricing.

Bumps in the Road

Even with a lender's conditional loan commitment in hand, things can go wrong once there is a property. If a lender denies your request for preapproval, keep in mind this doesn't exclude you from buying a home. Maybe the amounts estimated for property taxes and insurance are higher than the actual amounts, maybe you wanted a fifteen-year term but only qualify for a thirty-year term. Those are things that can easily be fixed. Fair Lending laws, discussed further in the appendix, apply to preapprovals as well. If you're deemed ineligible for the terms you've requested, in all likelihood, the lender is not going to come back to you to tell you what you can be approved for unless you specifically ask them to rework the numbers. Have a meaningful conversation with your loan officer to determine where you can make adjustments to improve the likelihood of approval.

Here is a short list of some of those things that can go wrong:

a. The amounts estimated on the loan application for property taxes, insurance, and homeowner association dues are less than the actual fees for the property selected and now your debt-to-income ratio is higher than the loan program allows. Does the lender offer another loan program that allows a higher debt-to-income ratio? Do you have additional assets to pay off installment debt or provide a higher down payment? Will doing so bring your debt-to-income ratio inline?

b. The condo association has a high investor concentration, thereby classifying the project as nonwarrantable. Does the lender offer a financing option for nonwarrantable condos? If not, can they refer you to a lender who does?

c. Loans for nonwarrantable condos carry higher risk and are therefore priced higher than loans for warrantable condos. If you have to change the loan program to meet the condo requirements, that loan program may have a higher interest rate thus possibly making your debt-to-income ratio excessive. Explore the adjustable rate mortgage option beginning with an initial fixed interest rate of seven years amortized over a thirty-year term. This option allows you to qualify at the much lower initial offered interest rate (typically at least .5 percent lower than the thirty-year fixed rate option) instead of the higher fully indexed rate.
d. The final appraised value is less than the contract sales price. Are there comparable sales that support a greater value that were not considered in the appraisal? Is the seller willing to drop the sales price to match the appraised value? Can you access additional funds to make up the difference between sales price and appraised value at closing? Does your selected loan program allow for a higher loan-to-value? Is there sufficient time to change your program selection for one that offers a higher loan-to-value and still meet your contract closing date? Will the seller agree to a contract extension?
e. The selected property differs from the property type listed on the initial loan request (e.g., changing from a single family to a 2-4 unit, planned unit development, condominium, or co-operative) thereby requiring a higher down payment or a change from reviewing the most recent year's tax returns to reviewing the average of two years' tax returns which may produce lower qualifying income. Do you have access to additional assets for down payment or for reducing installment debt to bring your debt-to-income ratio inline?
f. Your credit report expired and a re-pull indicates a derogatory item that lowers your usable credit score or identifies an increase in monthly recurring debts. A lower credit score may raise your initially offered interest rate. Having more debt will increase your debt-to-income ratio.

Tip: Do you already have a particular property in mind? Get the property tax bill and have the loan officer use that amount for their property tax estimate. Some lenders use the current tax bill in their qualification of your loan request while other lenders use the estimated future tax cost based on your sales price and the millage rate as determined by the property tax appraisers office in the county. Because of this, loan eligibility from one lender to another lender may vary.

Tip: To prevent last minute blowups, be sure your settlement agent quickly provides the title commitment, which is an insurance policy on title and will list among other things, the amount due on yearly property taxes. If the property taxes shown on the commitment differs from that listed on your loan application, ask your loan officer for an update to your file reflecting the amount of property taxes as listed on the title insurance commitment. Updating this at the last minute may impact your loan eligibility based on your debt-to-income ratio.

Tip: Instead of letting the lender estimate homeowners association dues, if you have a particular community that you are interested in, provide your loan officer the correspondent monthly homeowners association fee for the unit model that interests you and use this information to have her run the numbers.

Tip: If your income alone is insufficient to qualify and are considering adding a cosigner, be sure to ask if the loan program you applied for has the option of a nonoccupant co-borrower. If not, ask your loan officer to review which loan program allows for it.

Tip: If it appears you are short cash-to-close, double check that you have disclosed all of your asset accounts (not just checking and savings) and think about other possibilities. Do your parents have you listed as a co-owner on one of their accounts? Do you have retirement accounts? Is there a cash value on your life insurance policy? Is a family member planning on giving you funds for the transaction?

Tip: Shop insurance providers. Reduce your insurance costs by obtaining a four-point property inspection to take advantage of the many property insurance discounts available based on the age and structure of your property.

The point here is this: The time to explore possibilities is before you sign a purchase agreement so that you can relieve the stress and anxiety of the mortgage process. If you and your loan officer have done your jobs well in documenting your loan file, you should generally expect this conditional commitment to be issued subject only to appraisal, title insurance, and evidence of property insurance. Only now, are you really good to go shopping for a home.

When You're Simply Not Ready

Sometimes no is a good answer, because it is an answer. Think of it this way: Would you rather hear a no today or be fiddled around with for months on end with conditions and review and then more conditions and more review and then subsequent submission of new documentation to replace expired documentation and more conditions and so on? No means your road to approval with that lender is over; pick up the pieces and move on. Don't give up on the approval process, but do learn what was in your control and could have been done better, and then fix it and try again. Be persistent.

The Language of Mortgage

My goal in preparing you for mortgage application is to have your initial, conditional loan commitment issued with very few conditions. Conditions are additional supporting documents requested and reviewed by your lender either prior to scheduling loan closing or at loan closing. You can achieve this goal by submitting the proper documentation to satisfy most loan requirements at the time of loan application. The number one reason this doesn't happen is because a borrower doesn't receive a complete list of required documentation upfront or doesn't understand exactly what is being asked. By following these pages and preparing your loan file for delivery, you can prevent delays due to lack of detailed instruction. As for understanding exactly what is being asked—well, that's a completely different story. Mortgage Speak is filled with a lot of acronyms. We tend to get caught up in our own language and forget that our listeners aren't familiar with our jargon. Whenever possible, clarify with the lender what exactly they're asking of you to avoid breakdowns in communication that lead to closing delays. The language of mortgage begins with an understanding of how credit markets work. For this, we'll take a brief look at the mortgage market.