CHAPTER 8 WHAT'S IN A LOAN OFFICER'S BAG OF TRICKS?

In the world of mortgage lending, there are many different types of loans and loan terms. How can you decide which loan best fits your financial circumstances? Knowing what goes into your loan application and what happens when you submit it will help you become a more knowledgeable participant in the lending process.

You've determined what you need and want in a home and you have a "ballpark" figure on how much you can afford to spend. Now it's time to ask a loan officer exactly what you're worth as far as a home loan goes. Let's peek inside the loan officer's magic bag of tricks.

"Money talks but credit has an echo."

-Bob Thaves

What types of home mortgages are available?

The home-mortgage process can be complex and filled with pitfalls for uninformed consumers. The lender and the type of loan you choose will affect your upfront costs as well as your monthly payments. Before you choose a home, take time to explore the different types of financing so you can choose one that will best fits your needs. You can begin by looking at the differences between a fixed-rate and an adjustable-rate mortgage.

A ***fixed-rate mortgage*** will have the same principal and interest payment amounts throughout the life of the loan. Most fixed-rate mortgages can be repaid in 30 years or less. An ***adjustable-rate mortgage***, or ***ARM***, will have interest rates and payments that change from time-to-time over the life of the loan. Depending on the type of ARM, your interest rate may increase gradually every couple of years until it reaches a preset ceiling. Or, your rate may stay level for a short time and then have a large final payment known as a "balloon payment" at the end. When you apply for an ARM, you'll be told how, when and why the rates may change.

An ***assumable loan*** is an existing mortgage loan that a buyer takes over or assumes from a seller. Assumable loans may be fixed-rate or adjustable and are more common when high interest rates make homes difficult to sell. You may also find an assumable loan when a seller is having difficulty making mortgage payments and needs to be relieved of the mortgage debt. If you are thinking of assuming a loan, first do your homework. Read the mortgage contract to be sure you understand and can accept its existing terms. Contact the lender or loan servicer to find out the current loan balance and make certain that loan payments are current. Also find out if the lender will allow an assumption. The lender may be able to call the loan, which means he can demand immediate payment of the entire balance if you try to assume it without permission.

There are advantages and disadvantages to fixed-rate mortgages and ARMs. Take a look at the chart on the following page to compare the two.

Table 8-1: Fixed- and Adjustable-Rate Mortgages - Pros and Cons

Rate	Advantages	Disadvantages
Fixed	• Your monthly principal and interest payment will never change, but your cost for taxes and insurance may increase.	• **Fixed-rate loans do not take into account any anticipated increases in your earning power.**
ARM	• Your monthly principal and interest amount will be lower when the loan is new; however, your cost of taxes and insurance may increase. • Interest rates sometime decrease. If the index that your ARM is based on goes down, so will the amount of your monthly mortgage payments.	• **Be prepared to factor increases into your budget after two, three, or five years if interest rates increase.** • **Take care to avoid loans that offer extremely low "introductory" rates. When you could be stuck with a much higher full rate-and monthly payments you can't afford.**

Another area to explore is the availability of ***government-sponsored loans*** vs. ***conventional*** or privately insured loans.

Many forms of ***government-sponsored loans*** are offered by federal or state government agencies. These loans help specific groups of people to become homebuyers by providing insurance to protect lenders against default. For example, FHA offers loans to meet the needs of low-and moderate-income buyers: VA loans help active duty and former members of the nation's armed forces and RHS loans are geared towards serving rural populations. In general, these federal loan programs require low or no down payments from buyers. The programs offer advice and counseling services to guide buyers through the entire process of purchasing a home. They also provide counseling and intervention services to assist program participants who have difficulty repaying their mortgage loans.

Conventional loans are available from traditional lenders such as banks, savings and loan institutions, or credit unions. These loans are available to any borrowers who meet the lending institution's qualifications. Unlike the government, conventional lenders don't limit the size of individual loans. However, they protect themselves from default by requiring borrowers to make larger down payments.

What type of loan is best for me?

Before you answer this question, you need to look at your personal financial situation, your long-term goals and the needs of your household. Where do you plan to be living in the next few years? How secure is your job? Where will the money come from for your down payment and closing costs? There are trade-offs when choosing between a government-backed loan and a conventional loan. The low- or no-down payment government-sponsored loans may be less expensive initially. This allows buyers who have steady incomes with little or no personal savings and other assets to become homeowners. Many of these buyers have been shut out of the conventional market because they couldn't make large down payments or couldn't obtain private mortgage insurance. However, over time, the cost of these loans may be higher because of insurance premiums and interest paid on higher loan amounts.

On the other hand, a conventional loan that requires a 20% down payment and all closing costs paid upfront may cost less over time. Less interest will be paid on the lower loan amount and mortgage insurance may not be required. Plus, the government-backed programs don't permit wealthier buyers to obtain "jumbo" mortgage loans. The following tables 8-2 and 8-3 offer some basic guidance to help you make this choice.

Table 8-2: Fixed Rate or Adjustable - Which Is Better?

A Fixed-Rate mortgage might be better if…	An Adjustable-Rate mortgage might be better if…
• You plan to live in your home for many years. • You believe your income will remain level for many years.	• You plan to stay in your home for only a few years. • You have a good reason to believe your income will rise steadily over the years. • You intend to refinance at a lower fixed rate once you reach the ARM's interest cap.

Table 8-3: Government-Backed or Conventional - Which Is Better?

A Government-Backed loan might be better if…	A Conventional loan might be better if…
• You qualify for a government- backed loan (e.g., veteran status, low-income, etc). • You have a steady income, but not much money for a down payment. • Affordable conventional loans aren't available in your area.	• You can afford to make a large down payment. • The home you want to buy costs several hundred thousand dollars. • You don't want to pay for private mortgage insurance. • You don't want to finance fees or closing costs.

Once committed to purchasing a home, your decision for a fixed-rate mortgage or an ARM, and your choice of a government-backed loan or a conventional loan, should be based on your personal needs and financial situation.

What goes into a loan application?

Remember, you must meet certain financial standards to qualify for a mortgage. Most lenders will want to see that your monthly mortgage payment including taxes, insurance, and all other fees, does not exceed 28% of your gross or before-tax monthly income. Generally, lenders will want you to have your monthly mortgage payment and other debt payments under 36% of your gross monthly income. You may find a lender who will let you exceed this guideline if you have an excellent credit history or can make a large down payment.

Your ability to qualify for a loan will depend on the ***"Four C's"*** of credit:

- ***Capacity*** to repay the debt.
- ***Credit history*** of how much and how often you borrow, whether you pay bills on time, and whether you're living within your means.
- ***Capital***, or the amount of cash you have for a down payment, settlement costs, and cash reserves.
- ***Collateral*** to protect the lender's investment.

The language of mortgages may seem foreign at first, but you can learn to speak and understand the basic terms that your loan officer will use. Before you meet with a loan officer, refer to the glossary for definitions of these terms:

- Adjustable rate mortgage (ARM)
- Amortization
- Appraisal
- Cap
- Cash reserve
- Closing
- Closing statement (settlement)
- Equity
- FHA insured loans
- Floor
- Graduated-payment mortgage
- Good faith estimate
- Interest
- Market value
- Mortgage
- PITI
- Points
- Principal
- Private mortgage insurance
- Settlement
- Title
- VA loan

You'll be able to complete a ***loan application*** quickly when you arrive with the following documents:

- W-2 forms for the past two years**,** or tax returns for the past two years if you're self-employed.
- Earnings statements or pay stubs for the past two months.
- Bank statements for the past three months for savings, checking, mutual funds, and other accounts.

Self-employed homebuyers will need to provide additional documentation including signed copies of their business tax returns, W-2 forms and 1099 forms for the past two years. The lender may ask for statements to verify retirement accounts, or funds received from an annuity or alimony. Without this type of documentation, the self-employed buyer may need to make a larger down payment.

You'll be asked to sign an authorization form that allows the loan officer to get your credit report. If you've identified the home you want to buy, you'll sign another form to authorize a property appraisal. If you've been divorced, you may need to show your divorce decree to prove that you're now legally single. If you're not a United States citizen, you may need to provide proof of residency such as a green card, or visa.

The ***Equal Credit Opportunity Act*** ensures that you will not be subjected to discrimination based on your race, color, religion, national origin, sex, marital status, age, or reliance on public assistance for any part of your income. As part of the act's compliance measures, your lender must ask for and report information on your race, sex, marital status, and age when you submit your loan application.

What does the loan officer do with my application?

Your loan officer will use the documents you provide to verify your employment history and income and the market value of the home you want to buy.

The loan officer will examine your assets such as cash or stocks to make sure you have money for a down payment and closing costs. While your application is under review, you shouldn't deposit or withdraw any large sums of money without telling the loan officer and providing proof of where the money comes from or where it goes. You should also avoid any large credit purchases that would adversely affect your debt-to-income ratios.

You may be asked to provide additional documents. Respond as quickly as possible to avoid delays or denial. Your loan officer will also use your application as a basis for developing a list of costs and fees that you'll pay over and above the sale price of the home.

When you apply for a mortgage loan, *RESPA,* ***the Real Estate Settlement Procedures*** *Act*, requires your lender to provide the following documents when you apply for a mortgage loan:

- ***Information booklet*** that describes various real estate settlement services.
- ***Good Faith Estimate*** of closing costs the buyer can expect to pay.
- ***Mortgage Servicing Disclosure Statement*** that tells if the lender will service the loan or transfer it to another loan servicer.

The Good Faith Estimate will give you a detailed list and explanations for closing costs - amounts you'll pay over and above the sale price of your new home. The number and dollar amount of these costs may vary according to the size and type of loan you have. Your lender will tell you which costs are exact and which are estimates. They may include the following:

- **Loan fees** - Origination, appraisal, administrative, credit report, survey attorney fees and fees for discount points.
- **Title fees** - Insurance, document preparation, escrow, and recording fees.
- **Escrow accounts** - Prepaid mortgage insurance premiums, taxes, and interest.

You can pay these costs at closing from your personal savings, gifts, contributions from the seller or government grants. Some of these costs will be deductible from your income when you prepare your tax return.

RESPA allows your lender up to three business days after you submit your application to mail these documents to you. However, if your loan is denied within three days, the lender is not obligated to provide this information.

RESPA entitles you to obtain certain facts about your closing costs beforehand. It also protects you against unfair referral fees such as kickbacks, which plagued home buying transactions in the past. The U.S. Department of Housing and Urban Development (HUD) enforces RESPA provisions for loans on one-to-four-family residential properties. This includes purchase loans, refinancing loans, assumptions, home improvement loans and home equity lines of credit.

You may also receive an Affiliated Business Arrangement Disclosure notice from the individual handling the closing. Federal law requires you to get this notice whenever the closing agent refers you to any service provider such as a lender, or attorney with whom the closing agent has any kind of business relationship. The notice must describe the business relationship and provide an estimate of the second service provider's charges.

Your loan officer will also explain the value of ***points***. Basically, the more money you pay at settlement, the less money you pay in monthly repayments. A point is a percentage of your loan amount that when paid at closing can be used to lower your interest rate and reduce your monthly payments. Should you pay discount points?

As with so many other home buying matters, the answer depends on your plans and your financial situation. In general, paying discount points is a good idea under the following circumstances:

- You have the money available at closing.
- You can quickly make up in monthly savings the extra amount you pay out.

For example, on a $100,000 loan with a 10% APR, and no discount points, you would pay about $880 each month in principal and interest. However, if you can pay one discount point an extra $1,000 at closing which lowers your APR by one-half of a percent, you would pay about $840 each month in principal and interest. In about two years, the monthly savings would allow you to recover the extra amount you paid out at closing.

Before you say yes or no to paying discount points, figure out if you can afford the extra money required to pay points. Then, ask how much each point would reduce your monthly payments. Finally, find out how long it would take you to recover the cost of paying points. Keep in mind that your lender is not required to offer discount points. Also, if your lender offers points, the offer may be structured in a way that takes you a long time to recover the extra money you pay out at closing. If the numbers are in your favor, consider paying the points.

Your loan officer will also explain how ***prepaid expenses*** are paid. Costs that are collected at closing include the following:

- Pro-rated interest.
- Homeowner's insurance.
- Pro-rated property taxes.
- Mortgage insurance.

If your LTV is over 80%, you'll also pay a portion of these expenses as part of your monthly mortgage payment. These partial payments will be collected in an escrow account that your lender will use to make periodic payments for these expenses. If you borrow less than 80% of the home's value, you'll most likely be able to pay your property taxes and homeowner's insurance on your own.

Why did I get turned down and what do I do next?

Having your loan application rejected might be disappointing, but it's not the end of the world. Before you think of giving up on your goal of homeownership, talk to your loan officer to find out why your request was turned down. Most applications are denied for the following reasons:

- ***Bad credit score*** - You can challenge any errors and possibly explain other negative information on your credit report.
- ***Too much debt*** - You may have to pay off some of your debts, or look for a less expensive home before your loan can be approved.
- ***Insufficient income*** - If your current rent is almost the same as your proposed mortgage payment, ask your loan officer to reconsider. Also, different lenders use different formulas to calculate how much they think you can afford. Another lender may be more accepting.
- ***Insufficient down payment*** - You may be eligible for a government backed low- or no-down payment loan. Or, you may be able to use cash gifts from relatives to pay all or part of your closing costs.
- ***Low appraisal price*** - If your written purchase offer includes a contingency covering a low appraisal, you may be able to negotiate a lower selling price the lender will finance.

If your loan application is denied, your loan officer must explain the denial in writing. The problems may be real, or you simply may need to provide additional information. Depending on the reason for rejection, you may be able to provide information or explanations that convince your loan officer to reconsider the loan denial. If that fails, your choice is to search for another lender who will accept your application. Or, you can use the loan officer's explanation as guidance to take the necessary steps that will improve your financial situation so you CAN get the loan approved.

Can I really get a home loan online?

Although most steps in the home buying experience are still "face-to-face," there are many steps in the process that you can do from your home or office. Getting a home loan certainly is one of them. Before you fill out an online application, however, you'd be wise to **first review various online resources.**

Start by looking at online information resources that can help you work through the maze of financing a new home. Many public and non-profit organizations are waiting to hear from you.

- The ***U.S. Department of Housing and Urban Affairs*** provides information about finding, financing, and keeping a home. Go to www.hud.gov.
- ***InCharge Debt Solutions*** counsels potential homebuyers, educates and prepares them for the purchasing process. Visit www.incharge.org and choose "Housing Counseling" from the list of services, or call toll-free 877-267-0595.

Once you familiarize yourself with the process and terminology, you'll be better prepared to look at the private lenders' websites. Online lenders will tell you if they participate in government-backed lending programs. You can usually get interest rate quotes and loan pre-qualifications very quickly.

However, you'll still have to provide the same detailed financial information to a virtual lender that a brick-and-mortar lender would require. And you'll have to use the same caution in rating online loan offerings that you would use when applying face to face. There are a few important financial safety points to remember before you apply online for a loan:

- ***Limit the number of applications you make***. It's easy to fill out applications and submit them with the click of a mouse. But be aware that too many applications in a short period of time may hurt your credit score. Unfortunately, you'll seldom get a rate quote until you submit an application, but instead of seeing the rates go down, you may see them go up after you've submitted loan requests to several lenders.
- ***Watch out for "bait and switch" offers***. As it sometimes happens face-to-face, you may be offered a great low interest rate online, only to see the low rate disappear just before you go to closing. While you may qualify for better terms elsewhere, the cyber-lender is betting that you don't have time to search, apply and get approved before your closing date. Make sure your online rate is locked in, the same as you would when dealing with a lender face-to-face.
- ***Make sure you know where your financial data goes.*** Online fraud gets more creative everyday and it's not difficult for con artists to create attractive, professional-looking websites. Don't be fooled by offers of unbelievably low rates from unknown lenders. Identity theft really happens and online lending often makes it easy. If you submit a loan application but don't receive a response, what can you do? Before you transmit your social security number, bank and credit account numbers and other personal information online, be sure the "lender" is real.

What is predatory lending?

Predatory lending is unfair, fraudulent and/or deceptive lending. The easiest targets are borrowers who are not informed and those who do not comparison shop for loan rates and terms. While women, the elderly and minorities are affected in greater numbers, anyone can become the victim of a predatory loan.

The U.S. Department of Housing and Urban Development has identified specific "hot spots" in several cities where predatory lending has become almost epidemic. Check www.hud.gov to see if you live near one.

How can you protect yourself from predatory lending? First, be aware that it exists. Take time to read the real estate section of your local newspaper or search online to see what interest rates local lenders are charging. When you are considering a loan, ask if the loan terms being offered are the best terms for which you qualify. Above all, learn to recognize predatory lending practices.

- Avoid lenders who call and offer to send a "loan officer" to your home.
- Examine fees and charges. A loan origination fee higher than 1% of the loan is a red flag.
- Access the Better Business Bureau report on the lender to see if complaints have been filed.
- Don't accept costly pre-paid credit insurance and disability insurance that you'll have to finance.
- Avoid prepayment penalties. If you can refinance at better terms, those prepayment penalties can cost you up to 5% of the original loan amount.
- Demand to know exactly what your monthly payments will be. If you can't afford the payments, don't accept the loan.

Victims of predatory lending can find themselves locked into high-fee mortgage loans with steep variable interest rates, costly pre-paid credit insurance, huge balloon payments, and severe prepayment penalties. When a borrower fails to make timely payments, the predatory lender will "flip" the loan. This means the lender will refinance the loan with additional high fees or foreclose and seize the borrower's home. In the end, the borrower gets a damaged credit score, loses equity in the home or loses the home.

Table 8-4: Warning Signs of Predatory Lending

The Promise	The Reality	The Result
"Bad Credit? Use the equity in your home to get the cash you need."	• **Even with an imperfect credit history, you can usually find better loan terms elsewhere if you look.**	• **Your credit score suffers even more when you fall behind on payments.** • **You lose your home to foreclosure.**
Low payments, low fees and low interest rates.	• **The interest rates and loan processing fees are 3-4 times higher than honest lenders charge.**	• **These higher rates and fees lead to higher monthly payments than you expect.**
Low-cost insurance to protect you in case you can't pay.	• **The total cost for years of credit and disability insurance is added to the loan principal.**	• **You pay finance charges and interest on insurance policies, as well as on the loan.**

If you're still not sure that you need the loan or that it's a good deal - or that you can even afford it - call **InCharge Debt Solutions** at 877-251-1882 and talk to a mortgage counselor before you possibly sign your way into foreclosure and credit dismay.

Summary

Consider government-sponsored programs for first-time homebuyers, lower income purchasers, and military veterans, as well conventional mortgage programs.

- Examine and compare interest rates.
- Take time to understand how loan costs, insurance, and other fees will affect your repayment amount.
- Don't be afraid to ask questions about anything you don't understand.
- Be prepared to negotiate - with real estate agents, lenders, and sellers.
- Be aware of predatory lending practices and take care to avoid them.