



# Qualifying for a Mortgage

by  
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*A Washington State Approved Real Estate School under R.C.W. 18.85.*



# Read this information first!



## Clockhours by Mail

1. You will be provided with a booklet of with the class material here in a pdf format. It is a THREE CLOCKHOUR CLASS.
2. The course has been divided up into sections. In Washington State a "clock hour" is 50 minutes. There are questions about each section. They can be answered while reading the material, at the end of the session, or at the end. Print out the quiz and the evaluation.
3. **Answer** the questions on the quiz sheet.
4. If you have any questions regarding the material or the questions, don't hesitate to email Natalie Danielson at the email below.
5. **E-Mail** Scan your Quiz and Evaluation and email to Professional Direction.
6. The certificate will be mailed or emailed asap after receipt of quiz and evaluation. If you are desperate... just email us!!!!

Disclaimer.. the course materials and questions are not to be used for legal advice. Information can change over time. Real estate transactions are handled different ways in different regions in the State of Washington. If you have any comments or concerns about the material contact Professional Direction.

Thanks!

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# Qualifying for a Mortgage

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This 3 hour course is designed to present an overview of the procedures that a mortgage lender uses when qualifying a borrower for a loan on a residential home. It is not meant to train agents to qualify borrowers, but to train them on the financial requirements to obtaining mortgage financing.

1. Analyzing Income, Debt, and Assets
2. Loan Application and processing
2. Annual Percentage Rate and Costs
3. Qualifying for a Conventional Loan
4. Conventional Loan Programs
5. Qualifying for FHA/VA Loan Programs

## Course Objectives

*Upon completion of this course students will be able to do the following:*

- Illustrate the importance of the qualification process to agents, buyers & sellers and lenders.
- List the pitfalls to avoid when qualifying the purchaser.
- Understand the annual percentage rate, loan to value ratio, and loan fees.
- Describe an overview of the qualification process that will help them educate buyers.
- Discuss the differences and advantages of Conventional, FHA, and VA loans.
- Identify different loan products available.
- Know vocabulary words.
- Perform rudimentary analysis and calculations of income, debt and asset for loan qualification.

# Qualifying for a Mortgage

## Curriculum

Session Hours	Major Topics	
1 ½ hour	Introduction Prequalifying Analyzing Income, Debt and Assets	<ul style="list-style-type: none"> <li>• Identify the different types of acceptable income, debts and assets in the qualification process.</li> <li>• Identify the different closing costs associated with a loan</li> </ul>
2 ½ hour	Loan Application and Processing	<ul style="list-style-type: none"> <li>• Understand what kind of verifications are necessary</li> <li>• Know that the credit report and score affects borrowing ability</li> <li>• The title report can list information affecting buyers ability to buy</li> </ul>
3 ½ hour	Annual Percentage Rate Loan to Value Discount Points	<ul style="list-style-type: none"> <li>• Know the difference between the Annual Percentage Rate and the loan rate</li> <li>• Identify discount points</li> <li>• Know what a loan origination fee is.</li> </ul>
4 ½ hour	Qualifying for a Conventional Loan	<ul style="list-style-type: none"> <li>• Identify the factors a lender uses in qualifying a borrower for a conventional loan.</li> <li>• Calculate and solve a qualification problem</li> </ul>
5 ½ hour	Conventional Loan Programs	<ul style="list-style-type: none"> <li>• Identify different types of conventional loan programs.</li> <li>• Demonstrate the reason for using one loan program over another.</li> </ul>
6 ½ hour	Qualifying for FHA and VA Loans CFPB Regulations	<ul style="list-style-type: none"> <li>• Identify the differences between government loans and conventional loans</li> <li>• Compare and contrast the different FHA and VA loans available and describe unique qualifying requirements when compared to conventional loans.</li> <li>• Know the basics of the CFPB changes in August 2015</li> </ul>

# Introduction

There are few buyers in our world today that open their wallets or checkbooks and purchase a home with all cash. Most buyers are lucky to have scraped together enough cash for a down payment and they need to qualify for a mortgage loan.

Though many real estate agents can drive by a house and give a "guestimate" of the value, it is not wise to qualify buyers in the same way. How much they can afford depends on many factors.

You can drive buyers around in your car all day. You can work all week for hours on end looking for that perfect home for them. You can be an excellent negotiator when presenting an offer for them. Months later, you can still not earn a penny. You are paid directly as a result of the number of transactions you put together that successfully close.

By understanding what is required financially to purchase a property, you, as an agent can help identify opportunities for your customers. As an agent, you are involved throughout the lending process and it is necessary to understand the process and follow the transaction.

Pre-qualifying the buyers is one of the most important steps in the home buying process. This course is designed to be an introduction to the qualifying process. It is not meant to train you to be a loan officer. It is a brief overview of the way a lender qualifies buyers. Do not let this be a substitute for sending your buyers to a lender for a professional analysis of their financial status.

# Getting Pre-Qualified for a Mortgage

## Learning Objectives

*In this section the students will do the following:*

- Identify the 4 basic aspects for qualifying for a mortgage loan

Just about every prospective home buyer has fears associated with applying for a mortgage loan. Most of their fears are unfounded. Prospective buyers should definitely get prequalified prior to looking or evaluating properties. An unqualified home buyer previewing properties, is like looking for a prom dress without knowing how much money is in your wallet. The challenges to getting a mortgage approved usually fall in the following categories.

### **Credit Issues**

The credit report is important for the lender to use to determine the credit worthiness of the borrower. It is a risk assessment of the borrower. The credit score evaluates all aspects of the borrowers credit. It could be low because the borrower has unresolved credit issues. It could be debts that are not paid, old debts that the borrower did not realize, and errors on the credit report. It also can show the payment history including late payment. A borrower may be carrying too much debt in relationship to his/her income. A credit score is one of the most important aspects to qualify for a mortgage. A credit score, the FICO score, is determined based on the three major scoring companies.

### **Income documentation**

A buyer needs to have clear documentation of his/her income. This can be simple if the borrower(s) have regular careers for several years. But, many borrowers are self employed, independent contractors or have another source of income. The documentation of that income is important including tax returns.

### **Down payment**

Many people do not have savings accounts to build up money for a down payment. If that money is borrowed, then they are required to have that documented. Any borrowed funds must come from a close relative accompanied by a gift letter. The lender has this information for the buyer.

### **Problems with the property**

With the active market the Northwest has enjoyed for several years has meant that properties are climbing in value. There are times that the appraiser does not agree with the sales price as collateral for the loan. The home inspector may find problems with the property that could affect the value of the property including work orders that would be required to be completed. This could include a new roof, for example.

# Analyzing Income, Debt and Assets

## Learning Objectives

*In this section the students will do the following:*

- Identify the different types of acceptable income, debts and assets in the qualification process.
- Identify the different closing costs associated with a loan



## Analyzing Income

Where will the money for the payment come from?

The loan officer does not just list the information on an application, but has to sift through it to determine what is applicable and what is not. Decisions need to be made on how to treat various sources of income, assets and debts. The way they are included on the application can affect the amount of mortgage loan a borrower will be allowed. Each case is different and there is much gray area.

A lender is looking at three aspects of the income; quantity, quality, and durability.

- The borrower must be able to verify the necessary income to qualify for the loan amount. Not all income is treated equally.
- The quality of the income is dependent on the source(s).
- The income must be expected to continue for a period of time to be durable.

In general, the lender is looking for a history of a minimum of 2 years of stable continued employment in the same field. Advanced education or training or promotions are included as the employment history.

## Gross Monthly Income

A borrower's **Gross Monthly Income** is the before tax income. It is not the income shown on the paycheck.

The buyer may have just one paycheck a month for the past several years. But, many buyers have income from more than one place. Here is an outline of the sources of income most often seen on loan applications.

Monthly regular income	Spouses income
Cottage business income	Bonus checks
Overtime	Unemployment
Child support payments <i>(can be an eligible source of income if consistent and documented)</i>	Social security checks
Spousal maintenance	Retirement income
Pending bonus	Pending inheritance
Children's income	Commission sales income
Stock or investment income	Rental income
Tip	Gifts
Public Assistance	

The kind of questions lenders want to answer include:

Does the date of employment cover a 2 year history? What are the reasons for gaps, if any?

*Borrowers are requested to provide a 2 year employment history.*

What is the borrower's current position? Does it match the loan application?

What is the probability of continued employment?

What is the average of the overtime, bonus, or commission the borrower is claiming?

If the base pay is hourly, did the employer state the hours per week on the verification?

Compare last year's income to the current year's income to check for lapses.

All income is verified by the lender with an employment verification form sent directly to the supervisor. The borrower must also provide W-2 forms for 2 years plus pay stubs for 30 days. In addition to, or in the case of self employed individuals, the last two years of tax returns are required.

The borrowers income most often must be expressed as a "monthly income." Often it must be converted from weekly or hourly wages to a monthly figure.

# Analyzing Debt and Credit

Can you afford more debt?

The lender must evaluate the debt and credit history of the borrower for the past 7 years. Revolving credit, installment debt, mortgages and other debts is evaluated on it's history of payment, the total amount owed, and the payment relates to the borrowers income.

The following are examples of the types of debt found on many borrowers loan applications.

Car loans	Business debt	Visa, Master Charge, Discover
American Express	Department Store Cards	Gas Cards
Child Support	Daycare	Student loans
Children's school tuition	Medical bills	Judgments
Liens	Foreclosures	Bankruptcy
Other mortgages	Child care	

The kind of information the lender is evaluating includes:

Current and High balances	Late payments
Debt Consolidation	Refinancing
Collections	Repossessions
Foreclosures	Judgments
Bankruptcies	

Lenders have to verify all debt and analyze the history of payments as well as the balance. The kind of questions the lenders ask include:

- Is the debt to be paid off in the next six months installments? Nine months?
- Have the payments been made on a regular basis?
- What is the minimum payment on the credit cards if there is no balance?
- What is the credit limit on the charge cards? What is the current balance?
- What are the reasons for late payments? Can they be explained?
- Are there disputes with the creditors?

The lender orders an in-depth credit report that includes the credit history as well as a check of the county records. Some major debt, mortgages and judgments will show on the preliminary title report. The borrower can explain credit problems to show that they were a temporary situation giving the underwriter the option to approve the mortgage.

## Assets and Net Worth

What does your overall financial picture look like?

The borrower must show the ability to manage finances. The lender will ask for a balance sheet showing the assets as well as the liabilities for the borrower. The borrower must have enough verifiable liquid assets to cover the down payment, closing costs, and required reserves.

### The Down Payment

The amount of the down payment will differ with the borrowers available assets as well as the different loan programs.

The minimum amount of a down payment on a conventional loan under the FNMA guidelines is 3% down. There are few lenders offering programs with this amount down. Most often, lenders offer conventional loans to borrowers with at least 5% down. But, there are all kinds of loan programs with different requirements.

The Community Home Buyers Program is a FNMA program whereas buyers can qualify for a mortgage with as little as 3% down if they meet the requirements.

FHA loan programs require as little as 3.5% down. Veterans purchasing with a VA loan can purchase a home up to \$417,000 with no down payment.

The amount of money the borrower uses to close the loan must be verified by the lender. Though there have been cases where buyers have stored their savings in the freezer, the lender usually required that the money used for a down payment be verifiable and held in a bank, stock brokerage, or credit union. This is called Cash to Close.

The amount the buyer has to put down will affect **the loan to value LTV** ratio. Most of the programs specify the maximum LTV permitted by each. The program the borrower fits into and the interest rate the lender offers will vary with the LTV. The LTV is the amount of the loan compared to the value of the property. If the buyer puts 10% down on the property, the LTV ratio is 90%. Lenders express the LTV ratio in round figures. The loan usually has a 95%, 90% or 80% LTV ratio.

## **Source of Funds**

The borrower can pay all their costs and down payment out of their savings. Often, buyers do not have a large savings account. *The buyer can get gift funds from a relative for part of the down payment.* Conventional lenders always require that at least 5% of the down payment come from the buyers savings unless borrowers are putting down at least 20%. The source of the down payment must be verified by the lender. Any gift funds must be accompanied by a gift letter and verification of ability to give.

The buyers, as part of the negotiating can ask the seller to pay part of their closing costs. Conventional lenders require that the seller can only pay 3% to 6% of the buyers total closing costs. This must be clearly detailed in the purchase and sale agreement.

The buyer can also get secondary financing paid in regular installments to pay part of the down payment or closing costs. The buyer must have at least 10% of the down payment in their own funds. The maximum LTV ratio is 75%. The buyer must qualify for both loan payments.

In the case of government loans the borrower can use gift funds for the entire downpayment.

# Loan Application and Processing

Once the loan officer has compiled the information for the initial application, the file is turned over to the "Processor." The first step in processing the loan application is the "ordering out" of the file.

The processor orders the verifications, credit report, appraisal, and title policy. Once the information starts to return to the processor it is reviewed.

Often there are items that do not match the application or that need additional verification or need to be investigated.

## Verifications

At the time of application, the borrower signed authorizations to verify the information on the application. Some information the borrower provides, but in order for the information to be deemed reliable, a third party must verify it. The borrower can't, for example, have a down payment unverified because he/she saved money from selling illegal drugs.

The verifications can include:

- Verification of employment (if self employed 2 years tax returns are required) **VOE**
- Verification of rent or mortgage
- Verification of bank account balances verification of deposit **VOD**
- Verification of outstanding loans
- Verification of Earnest Money deposit
- Verification of pension, if applicable
- Authorization to release information

Substitute documents can be used instead of verifications, as in the case of the self employed.



## Credit Report

The processor orders a credit report for each of the borrowers. It must be one that complies with FNMA, FHA and VA standards. It must include 7 years activity and have information from the public records.

Today, lenders look at the FICO score. FICO stands for Fair, Issac and Company. It is a computer generated assigning points to information on a credit report to evaluate the credit of a borrower. Everyone has "blemishes" on their credit. Often they can be explained away with a letter detailing the reason for the problem. Poor credit during a certain time period could be attributed to, for example, health problems. Certain debts may need to be paid off prior to closing. Sometimes there are errors on the credit report. They can include inaccurate figures to debts that do not belong to the borrower. (There are a number of John Smith's in the state!)

*Lenders are restricted on how reporting or showing the credit report to anyone even the spouse!*

This includes the real estate agents involved in the transaction. Often there is a clause on the agreements that says the credit may be made available, but in reality, the lender will not have the permission to release the credit information because of the Federal Fair Credit reporting act and the Gramm-Leach Bliley Privacy Act.

Where there are items on the credit report that are out of line either the lender will give the borrower directions to pay off debts, straighten out problems directly with the creditor, or will ask borrower for a letter explaining the credit problems and what they are attributed to .

## Appraisal

The property the borrower is buying must meet guidelines. It becomes collateral for the loan. The **appraisal** is for the lender to establish whether it is good collateral for the loan. It is a paid opinion of value by a licensed appraiser in Washington State. The lender does not choose the appraiser.

## Title Report

The processor orders the **title insurance** report. The title insurance company provides initially a "preliminary title report." This report will identify information including the legal description, the parties full names, any judgments against either party, liens on the property, any recorded easements, CCR's, and any clouds on the title. For example, a judgment against a buyer would affect his/her ability to qualify for a loan. The judgment may not show up on the credit report.

# Mortgage Loan Rates



## Learning Objectives

*In this section the students will do the following:*

- Know the difference between the Annual Percentage Rate and the loan rate
- Identify discount points
- Know what a loan origination fee is.

## Annual Percentage Rate

If lenders advertising on rate sheets targeted consumers it would have to conform to Regulation Z. In 1969 the federal government passed the Truth in Lending Act requiring lenders to make certain disclosures to consumer loan applicants so they will know exactly what they are paying for credit. **Regulation Z** was designed to regulate the disclosure of the charges. The most important disclosure required is the annual percentage rate (**APR**). The **Annual Percentage Rate** APR includes some of the costs for a loan expressed as an annual percentage of the loan amount. With this knowledge borrowers should be able to compare credit costs and shop around for the best terms.

What costs can be included in the APR?

*The costs include the interest rate, the loan origination fees, discount points, prepaid or interim interest, document preparation fees, processing fees, underwriting fees, tax registration, and the mortgage insurance costs.*

When does the APR have to be disclosed?

*The lender must disclose the APR in a good faith estimate of the finance charges within 3 business days of receiving the written application. If the figures change over the course of the transaction, the lender must provide a new disclosure no later than settlement.*

Why not just compare the APR on the different rate sheets provided by the lenders?

*The rate sheets, since they are not designed to advertise or extend consumer credit they are exempt from Regulation Z. They are for agents to use to be made aware of the different programs available. So, only some rate sheets will have the APR listed some will not. When you do try to compare the APR from one loan program to another, you may not be comparing apples to apples.*

What is the difference between the way the lenders figure the APR?

*The APR includes the costs for each loan. But, the same loan with the same basic costs can have a different APR.. Lenders are not consistent with the way it is calculated. An example is the prepaid or interim interest. This is the interest charged for the loan that is prorated based on the closing date. If the lender assumes a closing date that is the end of the month, there is no prepaid interest. But, another*

*lender may assume a closing date towards the middle of the month. Another example is the mortgage insurance premium, if charged, is sometimes included in the lender's estimate of APR.*

How accurate does the APR have to be?

*The government requires that the APR vary no more than 1/8 of 1% of the exact calculation. That variation should not go either way, negative or positive.*

## **Interest Rate**

There is no single interest rate for mortgage financing. The interest rate is only one measurement of the cost of the money borrowed. The annual percentage rate was designed to help consumers compare loan programs because the interest rate is not the only measurement.

Well, isn't it most important to get the lowest interest rate?

*In very general terms there is only one primary source for all the money in the U.S... the federal government. All of the lenders get it at different times under different circumstances and then package it differently as a product to the consumers.*

*If a lender offers an unbelievably low interest rate, then the borrower will often pay for the lender's costs of that money. Those costs can be blatantly obvious or hidden.*

*The interest rate changes every day. There are no guarantees except "locks" which the lender might require a fee.*

*The borrower actually has very little control of the interest rate. They only have control on the amount of risk they are willing to assume to get a lower rate and the costs they are willing to pay for that rate.*

What is the interest rate today?

*The rate sheets that agents get daily often have no date or they are out of date. With a financial market that is constantly in flux, never assume that rate will be available tomorrow, next week, or next month when the transaction closes.*

How can I make sure that my buyer gets the lowest rate?

*The borrower must make the final decision on the lender for the transaction. The loan program chosen may not have the lowest rate, but may have the lowest costs associated with it so the borrower can afford to close.*

*The mortgage loan chosen will have many variables besides interest rate and costs. The loan program could be fixed (15 or 30 year), have a balloon, be an ARM or a 3/1 buydown. It will depend not only on the rate and costs but the program that the buyer qualifies for.*

## Discount Points

You cannot talk about mortgage financing without including the discount points. They are as critical to the costs of the loan as the interest rate. **Discount points** are a form of prepaid interest. They are a lump sum of interest paid at closing to increase the lenders yield or profit on the loan.

How much does a point cost?

*One point costs 1% of the loan amount. It does not equal one percentage point off the loan amount.*

What loans are they associated with?

*Discount points are charged on conventional as well as government loans.*

Who pays the points?

*The buyer or the seller may pay the discount points depending on the way the purchase and sale agreement is written. In the past, the seller had to pay the points on VA loans, but for now that has changed so that the borrower can pay them.*

What is "par"?

*When a loan is at the "par rate" there are no discount points attached. Seldom do you see a loan at "par" on a rate sheet.*

How many points are charged?

*The number of points generally range from one to six points and can be higher. The number of points are directly related to how the lender's quoted interest rate compares to the market rates.*

Why pay points?

*Since points are prepaid interest, they lower or buy down the interest rate for the life of the loan. The buyer may have an easier time qualifying for the loan because the lower the income required if the interest is low with several points. But, the buyer must have the cash to pay the points at closing. The points, though, can be paid by the seller to open the door to more buyers.*

## Loan Origination Fees

**Loan Origination Fees** are administrative costs associated with mortgage loans. These costs can include costs of processing, overhead, facilities, salaries and commissions.

Why are they charged?

*These costs are the costs that the lender occurs to get that loan for the borrower.*

Who pays the loan fees?

*The loan fees are generally paid by the borrower but the purchase and sale agreement could state the seller is to pay costs including the loan fee. In the past, the sellers were required to pay the discount points on a VA loan, but now the veteran borrower can pay the points.*

How much are loan origination fees?

*They vary with the lender on conventional loans, but usually they range from 1% to 3% of the total loan amount. On government loans the loan fee is 1%.*

## **Finance Costs and Pre-Paid Costs**

There are other costs associated with mortgage loans. Lenders call them by a variety of names.

What are the other costs that the borrower must pay to get a mortgage loan?

*These costs can include the following:*

*Loan fee, discount points, appraisal, credit Report, processing fee, underwriting fee, title insurance, settlement or escrow fee, recording fee, tax registration, flood hazard, funding fee and several other miscellaneous fees depending on the transaction.*

### **Private Mortgage Insurance**

Of course, lenders prefer lower LTV ratios because their risk is lower. Conventional lenders require **Private Mortgage Insurance (PMI)** on loans with LTV ratios that are higher than 80%. PMI covers the lenders losses should the borrower default and the lender is forced to foreclose. With LTV ratios of 80% or lower, PMI is not required by most lenders because there is lower risk. *PMI is NOT charged to people with poor credit... but for loans where there is less equity.*

PMI is called MIP in the case of FHA loans. It is required with every FHA loan regardless of the LTV. There is no private mortgage insurance on VA loans however there is a VA Funding Fee.

### **Discount Points**

**Discount points** are considered *prepaid interest*. A loan at "par" has no discount points. Almost every loan in order to have competitive interest rates have discount points. Each discount point costs 1% of the loan amount.

Buy downs are also prepaid interest. Temporary buy downs are paid at closing and lower the interest rate on the loan for the early years of the loan. After the buy down period ends, the loan interest rate is fixed for the remainder of the term. Discount points are paid on conventional and government loans. The seller can pay some or all of the discount points on conventional and now on government loans.

### **Loan Fees**

**Loan fees** generally vary with the lenders, but usually they are 1 to 2% of the loan amount. They are considered an administration fee for the lender. Loan fees are restricted to 1% on FHA and VA Insured Mortgages.

## **Closing Costs**

In addition to PMI, discount points and loan fees, there are other fees associated with closing the loan. They can include, but are not limited to:

- Appraisal
- Title insurance
- Credit report
- Inspections (pest, roof, septic)
- Septic or well permits
- Document preparation fees
- Flood Certifications
- Escrow fees or Settlement Fees.

A veteran getting a VA loan used to require that the seller pay the escrow fees. *Excise tax is paid by the seller at closing.*

## **Reserve Account**

With most loans, the borrower is required to maintain a **reserve account** for the payment of taxes, insurance and mortgage insurance (if any). Some lenders will make this optional on conventional loans when the LTV is over 80% or lower. Reserve amounts are prorated at the time of closing. With most lenders, it is now acceptable for the Seller to pay a portion of the borrower's reserves that are due at the time of closing.

## **Pre-Paid**

What are pre-paid?

*Pre-paid* are costs that are prorated depending on the time of closing. These include:

*Interim interest: The loan is paid in arrears (backwards). At the time of closing the borrower must have the loan paid through the month that the transaction closes. If it closes at the end of the month, there is no pre-paid interest.*

*Hazard or Fire Insurance: This is a yearly cost and the first year is paid at closing.*

*Taxes: The real estate taxes are pro-rated between the seller and buyer for the year.*

# Qualifying for a Conventional Loan

## Learning Objectives

*In this section the students will complete the following:*

- Identify the factors a lender uses in qualifying a borrower for a conventional loan.
- Compare different conventional loan programs.
- Calculate and solve a qualification problem.
- Demonstrate the reason for using one loan program over another.



## Introduction

Lenders qualify borrowers applying for a conventional loan using ratios to determine if they have sufficient income to pay the loan. The guidelines that most conventional lenders use are those established by Federal National Mortgage Association (FNMA).

There are a number of factors the lender must consider when qualifying the buyers, but the ratios are the initial step in the process. The ratios are used to analyze the relationship between the borrowers income and the loan payment, as well as the relationship between the borrowers current total debts and their income.

## Housing Expense

The lender evaluates the borrowers position to qualify for a loan based initially using the **housing expense ratio**. The lenders takes 28% of the borrowers gross monthly allowable income to determine the highest monthly payment allowed for a loan including the principal, interest, taxes, insurance and homeowners dues, if any (PITI).

## Debt to Income Ratio

In addition, the lender takes into account all the borrowers installment debt plus the PITI. This is the **debt to income ratio (DTI)**. The FNMA guideline is that it should not exceed 36% of the borrowers gross monthly allowable income. If the debt exceeds 36%, the PITI is reduced.

# Conventional Loan Programs

One of the advantages to a conventional loan is that there are many lenders and programs to choose from. Though all the lenders have to remain competitive, there are advantages or benefits offered by one lender and not another.

Most of the lenders, retail and wholesale, follow the FNMA guidelines. They have to qualify the borrower and structure the program so that the loan can be sold on the secondary market. This will free up the lender to have more money to lend. Often the lender retains the servicing of the loan and the borrower is not aware that the loan itself has been sold.

There are lenders in the market place that do "portfolio" some loans. They can choose to not follow the FNMA guidelines, but the borrower will pay for that flexibility.

## 30 Year Fixed Rate Loans

The most common mortgage loan in the country since introduced in the 1930's is the fixed rate loan amortized over a 30 year period. That means that there are equal payments over the term of the loan that include principal and interest. These loans offer the borrower the stability that the payment will not change over the term of the loan. The interest rate can be slightly higher than other programs.

## 15 year Fixed

This is a loan where the payments are fixed over a 15 year period. The borrower in effect pays considerably less interest than a 30 year loan. The borrower pays off the loan and builds equity faster. The payment is higher.

## Balloon Loans

Balloon loans are fixed interest rate loans amortized over a period of 30 years. They are to be paid off at a certain date. Usually they are for a 5 or 7 year period. They are known as "thirty due in 5" or "thirty due in 7" loans. Many balloon loans can be extended beyond the time period with an adjusted interest rate.

The advantage to one of these loans is that the payment is usually lower. Many buyers will only live on the average in a home or refinance it within the 5 to 7 year time period. But, the buyers assume some of the risk of the market fluctuations. A **balloon payment** is a large payment due on a loan or the balance of the principal that is due at a particular time as agreed.

## Jumbo Loans

The secondary market has guidelines that include the maximum loan amount. Loans above this amount are considered "jumbo loans."

## Non Conforming Loans

There are borrowers who do not have the qualifications to meet the FNMA guidelines.

## Adjustable Rate Mortgages

An **adjustable rate mortgage** is a loan with an interest rate that fluctuates at regular intervals during the period of the loan. The rate is adjusted and changes made to the payment based on a market rate index that varies with the different programs. The initial interest rate on adjustable rate mortgages is usually very low. The borrower can predict the worst case payments over the life of the loan if the index continues to climb. The borrower does not qualify at the initial interest rate. Usually they qualify at the note rate or the rate at the first adjustment period.

### Elements of Adjustable Rate Mortgages

#### Rate Adjustment Period

The borrower's interest rate is not adjusted every time the index changes. The rate adjustment period is the interval at which a borrower's interest rate is adjusted. The adjustments may be made every six months, once a year, every three years or every 10 years

#### Payment Adjustment Period

The borrower's actual payment will change at a given interval. That interval does not always coincide with the interest rate adjustment period. There are two ways the rate and payment adjustments are handled.

1. The lender can adjust the rate periodically as called for in the loan agreement and then adjust the mortgage payment to reflect the rate change.

*An example is a one year ARM that the rate and payment adjust each year.*

2. The lender can adjust the rate more frequently than the mortgage payment.

*An example is an ARM with interest rate adjustment every six months but changes in mortgage payments every three years.*

### Index

Lenders tie the ARM interest rate to changes in an "index rate." It is an index that reflects the cost of money. The indexes usually go up and down with the general movement of interest rates.

There are a variety of indexes that ARM rates are based upon. Lenders choose the indexes as a part of the loan program. The type of index does not change during the life of the loan. Some indexes are more volatile than others. But, they all generally follow a pattern.

#### **One year Treasury Bill or CMA (Constant Maturity Average)**

This was the first and the most common index for ARM's. It is the monthly average of the weekly auction on the Treasury bills.

#### **Eleventh District Cost of Funds (COFI)**

This is also known as the FHLB 11 District. It is the average of the interest rates savings and loans pay for deposits and other borrowings with a certain range of maturities in the Federal Home Loan Bank's 11<sup>th</sup> District. The 11<sup>th</sup> District is comprised of member banks in California, Arizona and Nevada.

#### **The London Interbank Offering Rate (LIBOR)**

Also known as the LIBOR, this is one of the newer indexes in use for ARM's. It follows the London interest rate. It is an international index based on the rate commercial banks pay for short-term loans from other commercial banks on the London Market. It follows the money market but does not react with the high's and lows that the one year Treasury Bills do. It is a common international interest rate index.

#### **There are other indexes used for ARMS**

**Margin**

The margin on the ARM is as significant as the index. The margin is the spread between the index rate and the interest rate the borrower is charged. This is the percent that the lender makes on the loan. Whatever the index rate is, the lender adds the margin and passes the new rate on to the borrower. *Index Rate + Margin = ARM Interest Rate*

**Caps**

Caps are designed to protect the borrower and the lender so that the borrower knows the "worst case scenario" if the index rises to a very high rate. When the interest rate and therefore the payment rises the borrower can find themselves in "payment shock." Caps can be on the interest rate for each period, the interest rate for the entire loan term or a cap on the monthly payment.

# Qualifying for FHA/VA Loan Programs

## Learning Objectives

*In this section the student will complete the following:*

- Identify the differences between government loans and conventional loans
- Compare and contrast the different FHA and VA loans available and describe their unique qualifying requirements when compared to conventional loans.



## FHA Loan Programs

### Background

Since 1968, the **FHA (Federal Housing Administration)** is part of the Department of Housing and Urban Development (HUD). Its primary function is insuring mortgage loans. The FHA compensates lenders who make loans through its programs for any losses that result from borrower default.

The FHA does not build homes, make loans or insure the property. It insures the loans made by the lenders. The FHA is like a giant mortgage insurance agency. Its insurance program, Mutual Mortgage Insurance Plan is funded with premiums paid by FHA borrowers. The premiums are paid up front by the borrowers at closing and as an annual mortgage insurance premium prorated monthly.

Under the plan, lenders who have been approved by the FHA to make insured loans, either submit applications from prospective borrowers to:

1. The local FHA office for approval, or,
2. Perform the underwriting functions themselves, if authorized by the FHA to do so (direct endorsement).

The prospective borrowers always apply to an FHA approved lender, not to the FHA itself. As the insurer, the FHA is liable to the lender for the full amount of any losses resulting from default and foreclosure. In exchange for insuring a loan, the FHA regulates many of the terms and conditions and qualification on which the loan is made. The lenders follow the FHA guidelines.

## Requirements

Technical requirements were established under congressional authority that must be met before the FHA will issue the insurance. Three of these requirements are as follows:

1. In addition to paying interest, the borrower is charged a one time mortgage insurance premium for the FHA insurance. This amount may be paid at closing by the borrower or someone else, or it may be added to the loan amount. The current UFMIP amount is 1% of the financed loan amount.
2. The mortgaged real estate must be appraised by an approved FHA appraiser. Under no circumstances, however, shall the loan amount be in excess of the maximum loan amount currently being accepted as defined by the local FHA jurisdiction. If the purchase price exceeds the FHA appraised value, the buyers may pay the difference in cash as part of the down payment. In addition, the FHA has set maximum loan amounts for various regions of the country.
3. The FHA regulations set minimum standards for the type and construction of buildings and the credit worthiness of borrowers.

## Characteristics of FHA Insured Loans

The most common FHA loans are 30 year fixed terms, but shorter terms and adjustable rate mortgages are available.

The FHA used to set a maximum interest rate, but now the rate is freely negotiable between the borrower and the lender. As a result, interest rates for FHA loans are determined by market forces.

The features that distinguish them from standard conventional loans include:

- More flexible qualifying standards. *It can be easier to qualify for an FHA loan than for a conventional loan.*
- Lower down payments. *The down payment required for an FHA loan is often considerably less than it would be for a comparable conventional loan. Currently at 3.5% of purchase price.*
- No secondary financing for the down payment. *The borrower may not use secondary financing from the seller of a lender to make up any part of the required minimum cash investment.*
- Borrower may finance some closing costs. *An FHA borrower can finance certain closing costs along with the sales price. That is not ordinarily permitted with a conventional loan.*

- Mortgage insurance is required on all loans. *Regardless of the size of the down payment, mortgage insurance is required on all FHA loans. It can be paid in one lump sum or finance part over the life of the loan.*
- No prepayment charges. *FHA loans may be paid off at any time without additional charges.*
- The loan must be for an owner-occupied primary residence. *FHA borrower must intend to occupy the property they're buying. The property must be used as the borrowers primary residence, not as a second home.*

## **Qualifying for an FHA Insured Loan**

### **Ratios**

Up to 29% of the borrower income can be used for the housing expense if the borrower has no monthly installment debt or open revolving accounts.

If the borrower has debt, the proposed housing expense plus the monthly bills should not exceed 38%. This ratio can go as high as 41% if there is:

- a large cash investment,
- a high residual income,
- high cash reserves, or
- co borrowers.

The housing expense includes the monthly loan payment including principal, interest, taxes, homeowner's insurance, MIP paid monthly, and homeowners association dues or assessments, if any.

## **FHA Insured Loan Programs**

### **Regular loan program**

The maximum loan amount varies per county. These limits do change periodically, though seldom by reduction. Maximum Loan Amount in King, Pierce and Snohomish Counties is \$567,500.

### **Fixed rate**

The most popular program is the traditional 30 year fixed rate mortgage loan. The loan is amortized over the 30 year period with equal payments. There are 15 year fixed programs also available.

## **Adjustable rate mortgage**

The FHA has an adjustable rate mortgage (ARM) available. There is no negative amortization. The payments adjust yearly. There is a 1% per year maximum adjustment in the interest rate and a 5% lifetime cap on the interest rate adjustment. The index is the U.S. Treasury Bills. The ARM is not convertible to a fixed rate. The borrowers qualify at the initial interest rate, even if that interest rate is an artificially low “Teaser Rate.”

## **Temporary Buydowns**

There are two different 2-1 Buydowns. The straight Buydowns is where the difference between the straight rate and the note rate is paid up front at closing. It gives you a lower initial rate but higher closing costs. The borrower is qualified at the start rate. The lender funded Buydowns is not as common and depends on the lenders. The Buydowns is not paid for up front, but in a slightly higher note rate. The borrower qualifies at the start rate.

## **Graduated Payment Loan**

Under the graduated payment plan, the payments are lower in the early years and increase at specified intervals until the payment reaches an amortizing basis. The monthly payment in the first years is kept lower by not requiring the borrower to pay all the interest due in those years. The unpaid interest, however is added back to the principal. This is known as negative amortization. (not currently used)

## **FHA/VA Loan**

The FHA 203(b) (2) program is available to veterans of military service. It is not related in any way to the regular VA loan program. Use of this program by a veteran does not affect his or her eligibility for a loan under the FHA program. The advantage of this program is that no down payment is required on the first \$25,000 of acquisition cost.

## **Condominium Loan**

The FHA 234 (c) loan is similar to the FHA (b) loan except that it insures loans for individual condominium units. Not only must the condominium unit itself meet FHA specifications, but also the condominium complex must meet FHA requirements for construction, number of units, owner occupancy level, and homeowner association structure. Most FHA approved lenders have a list of the approved condominium complexes approved in the local area.

# VA Loan Guaranty Program

## Background

The Veterans Administration guarantees repayment of certain residential loans made to eligible veterans. The program is a loan guaranty, not the actual funds, to institutional lenders who provide the loans according to the VA guidelines. Just as the FHA insurance program protects lenders against default, so the VA guaranty covers a lender's loss at the time of foreclosure. This is not an insurance program and so there is no mortgage insurance premium to be paid.

The VA loan program was created for eligible veterans.

Lenders who have been approved by the VA to make these loans take and process applications from borrowers and loan approval is handled:

1. By the local VA office, or,
2. By the lender if they have the authority to approve the loans in their underwriting department.

The prospective borrowers apply to lenders and not directly to the VA.

## Requirements

The requirements to get a VA guaranteed loan include:

1. The veteran must have a Certificate of Eligibility. Veterans must meet the minimum requirements to be eligible for the program.
2. It is a guaranty program and the lender is only to be reimbursed for the amount of the guaranty. The size of the guaranty is known as the veteran's entitlement a standard amount which is established by the Department of Veterans Affairs. The entitlement is \$36,000 for home valued at less than \$144,000 and \$50,750 for home appraised at values between \$144,000 to \$203,000. The maximum loan offered by most lenders currently is \$417,000 with the ability to go upwards with a very small down payment.
3. The home must be appraised by a VA appraiser and is called a Certificate of Reasonable Value and it must meet minimum standards of construction and maintenance.
4. VA loans are available for financing a home, new construction, mobile homes or condominiums.

## Characteristics of VA Guaranty Loans

These loan programs target only eligible veterans or surviving spouses. But they are an ideal program for a veteran.

- A veteran can purchase a home with no down payment. *This is the only institutional loan program available to buyers with no down payment up to a maximum loan amount. The veteran has the option to put more down to make up the purchase price if higher than the maximum..*
- VA loans are fixed rate mortgages most often 30 year terms. There are some 15 year loans available as well as a 3-2-1 Buydowns. Veterans are required to qualify at the fully indexed note rate.
- The VA Loan is an insured loan. Therefore, there is no Mortgage Insurance. It is a “Guaranteed Loan”. The Veterans Administration does extract a loan guarantee fee, called a “VA Funding Fee”. The Funding Fee is collected on all VA Guaranteed loans, unless the Veteran has a VA related disability. Veterans with disabilities are exempt from being charged the VA Funding Fee. For Veterans who have never obtained a VA loan before, the funding fee is 2% of the loan amount. If the Veteran is placing a down payment into the transaction, he/she may qualify for a less expensive funding fee, depending on the percentage amount of the down payment. Under certain circumstances, members/former members of the “Active Reserves” may qualify for a VA Guaranteed loan. The Funding Fee for Reservist is 2.75% of the loan amount. All of the funding fee may be financed, (that is, added into the loan) .
- The loan can be assumed by another veteran using their certificate or not. *It can be assumed by another party without VA eligibility that makes a full application to qualify for the loan amount.*
- There are no prepayment charges. *VA loans may be paid off at any time and the veteran gains back his/her eligibility to get another VA loan providing that the veteran has sold the subject property.*
- The property must be owner-occupied primary residence.

## Qualifying for a VA Loan

### Ratios and Cash Flow Method

Lenders use the guidelines established by the Veterans Administration when qualifying a veteran. The Veteran must qualify under the ratio and cash flow methods. The total debt to income ratio is 41% of the borrowers gross income. This figure includes the vet's monthly debts as well as the proposed housing expense.

Using the cash flow method, the lender takes the proposed housing expense, all recurring obligations, and certain taxes and subtracts them from the vet's gross monthly income to determine his or her residual income. This residual income must meet the VA's minimum requirements which vary per region. The VA guidelines are generally more flexible than FHA and Fannie Mae.

# Qualifying for Different Loan Programs

When the lender uses the ratios, they determine the maximum housing expense the borrower can use to pay a loan payment, PITI. (principal, interest, taxes and insurance) The lender looks at the borrower's Gross Monthly Income or the pre-tax income.

The lender then translates that figure into a loan amount based on the loan program and the current interest rates.

First the total gross monthly income for the borrower(s) is calculated. Then, the lender multiplies that figure by 28% or .28. That is the maximum allowable housing expense or house payment.

Then, the long term debt (over 10 months left) is calculated. This includes any installment or revolving credit card debts. The total amount of monthly debt cannot exceed 36% or .36 of the gross monthly income.

## **Example:**

Elizabeth and Michael together make \$\_\_\_\_\_ gross per month. They have a car loan of \$\_\_\_\_\_ and a master charge will with a \$\_\_\_\_\_ minimum per month.

What is their maximum housing expense ratio?

What is their debt ratio?

Based on the ratios, what is the maximum PITI the lender will allow?

At that PITI, what is the maximum loan they can get with a 30 year fixed loan at today's rate?

## **Most Borrowers can Qualify**

There are loan programs for just about every borrower. If a borrower does not conform to these figures because they have a higher debt ratio, or they have some past credit problems, there is a loan program that can meet their needs, most likely.

Do not make the assumption that a prospective buyer can or cannot qualify. Make sure that they meet with a lender that can fully evaluate their specific situation.

# CFPB Regulations

The Dodd Frank acts required that the two agencies that created forms for residential real estate transactions be integrated. In August 2015 there will be major changes to the closing documents and some regulations that will affect the closing of all residential transactions.

One of the most important that affects real estate agents and lenders is the additional time that will be required to process the transaction and paperwork. The buyer will have to review the documents three days prior to closing. Any changes will affect this time period and create a longer extension.

The closing documents will be called the Loan Estimate and the Closing Documents. The Loan Estimate will replace the Good Faith Estimate and Initial Truth in Lending disclosure. It will provide a summary of key loan terms and estimates of costs. The Closing Disclosure will replace the HUD 1 and the the final Truth in Lending Disclosures. It will provide an accounting of the transaction.

A new consumer guide called "Home Loan Toolkit" will replace the current Settlement Costs booklet.

Your Home Loan Toolkit is designed to be used in connection with the new Loan Estimate & Closing Disclosure forms. It will replace the current Settlement Cost booklet when the TILA-RESPA Integrated Disclosures go into effect on August 1, 2015.

<http://www.consumerfinance.gov/regulatory-implementation/tila-respa/>

## Conclusion

Once the buyers have been pre-qualified, then stick to those limits. This is what they can afford. It is not as if they have a credit card with no limit.

If you do not show them houses in that price range, you are gambling with your time, money, and reputation. You deserve to treat them and yourself, as a professional, with respect.

For the past decade, the average sale to list price only varied about 5% at most in the Puget Sound area. There is often very little room for negotiation. That small amount of "flexibility" may have to include personal property as well as discount points or loan fees. It isn't wise to shop homes and assume the seller will drop to what the buyer can afford! Sellers that are already overpricing their homes are usually the least likely to come down on their price. It is very easy for buyers to choose a home that is more expensive than they can afford.

Consider that if the buyers can't qualify for the home you just 'wrote up" they may choose to start the process all over and often with another agent who won't let that happen to them again.

## Qualifying Quiz

Write the definitions or what you learned about the terms.

1	Housing Expense Ratio	
2	Gross Monthly Income	
3	Appraisal	
4	Loan Fees	
5	Loan Approval	
6	Disbursement of funds	
7	Verification of Deposit	
8	Title Insurance	
9	Document preparation	
10	Recording	
11	Adjustable Rate Mortgage	
12	Index	
13	Margin	

14	Balloon payment	
15	Due on Sale Clause	
16	Regulation Z	
17	Private Mortgage Insurance	
18	Escrow	
19	Reserve Account	
20	Pre-Paid	
21	Annual Percentage Rate	
22	Loan Origination Fee	
23	Debt to Income Ratio	
24	Discount Points	
25	FICO	
26	FHA	
27	VA	
28	ATM	
29	LIBOR	
30	APR	
31	ARM	
32	PITI	
33	PMI	

34	RESPA	
35	HUD	
36	FNMA	
37	COFI	
38	LTV	
39	DTI	
40	VOE	

41. True/False Mortgage loan applicants are requested to provide a two year employment history.
42. True/False Private mortgage insurance premiums are only charged to people with poor credit.
43. True/False Points are considered pre-paid interest.
44. True/False Excise tax is considered to be a buyers closing cost.
45. True/False The buyer can get gift funds from a relative for part of the down payment.
46. True/False Child support is an eligible source of income used to qualify for a mortgage loan.
47. True/False Lenders cannot share credit reports with agents or even the spouse.
48. True/False The APR is the loan interest rate NOT including the fees and points.
49. True/False The housing expense ratio for FNMA is \_\_\_\_\_%.
50. True/False The debt to income ratio for FNMA is \_\_\_\_\_%.
51. True/False The CFPB regulations will affect the time required to close a transactions.
52. The new closing documents will be called \_\_\_\_\_ and \_\_\_\_\_

Name \_\_\_\_\_ Company \_\_\_\_\_

Date Completed \_\_\_\_\_

Attach to mandatory evaluation to get clockhours.

## Mandatory Evaluation

Did you read the material in the booklet on this date? YES / NO

Did you complete the quiz and attach answer sheet? YES / NO

Did you pay Tuition? YES / NO

Did you fill out and sign this form? YES / NO

Why did you choose to take this course? Topic? Time? Cost? Ease? Other?

A "clock hour" is 50 minutes. This 3 hour class should take about 2 hrs 30 min. How long did it take you to complete the course? \_\_\_

Will the material you learned improve your performance?	
Were the course materials easy to follow?	
Were the course materials relevant to your profession?	
Were your objectives met by attending the class?	

What are 3 things that you learned from the course?

1. \_\_\_\_\_ 2. \_\_\_\_\_ 3. \_\_\_\_\_

Qualifying for a Mortgage		
Print Name CLEARLY	Signature	Company
Address	City Zip Code	Phone
Email		
License Renewal Date		Date class taken

*Thanks for taking this class! I really appreciate the agents that take clockhours from my school! I am always working on my classes and writing new ones!  
Thanks, Natalie*

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