Section 13 – Part 4

SLIDE 1 – Qualifying for a Loan (Cover Page)

SLIDE 2

The Loan Application Process

The steps to home ownership go through the loan application procedures which are fairly common throughout the industry.

1. Prequalification
2. Find the property
3. Make an offer
4. Complete the loan application
5. Closing

SLIDE 3

Prequalification

The first step in getting a new buyer into a home is to get them prequalified (or pre-approved) for a mortgage loan.

Pre-qualified – The lender makes an estimate of how much a buyer might qualify for based on preliminary calculations.

Pre-approved – Lenders will provide a pre-approval letter after verifying credit, employment and other information.

SLIDE 4

Find the property

As a broker or agent you must under-stand the buyers wants and needs.

The agent should be prepared to walk the buyer all the way through the search process.

SLIDE 5

Make an offer

Once the buyer has settled on a property they should immediately extend an offer to purchase which can have many aspects:

- Price offer
- Contingencies
- Comparables
- The seller's needs

SLIDE 6

Complete the loan application

There's more to applying for a mortgage loan than filling in a form.

- Required documentation
- Proof of income
- Last two tax returns
- Employment history
- List of assets and debts
- Source of down payment
- Property appraisal

SLIDE 7

Closing

The closing is the last step in the home buying process.

You must ensure the buyer is ready for closing and has:

- Homeowners insurance
- Certified check for all closing costs including balance of down-payment.

SLIDE 8

The things that happen at closing:

- Terms of the agreement between the buyer and mortgage lender are confirmed.
- The loan goes into effect and the buyer receives his mortgage
- The terms of the sales contract are confirmed
- Ownership of the home is transferred

SLIDE 9

Income qualification

Lenders want to be assured that the borrower has adequate means to make all necessary periodic payments on the loan in addition to other housing expenses and debts such as credit card payments and car payments. Most lenders use two ratios to estimate an applicant's ability to fulfill a loan obligation: an *income ratio,* or *housing ratio*, and a *debt ratio*, or *housing plus debt ratio*. They also consider the stability of an applicant's income.

SLIDE 10

Income qualification

Income ratio – The income ratio, or housing expense ratio, establishes borrowing capacity by limiting the percent of gross income a borrower may spend on housing costs. Housing costs include principal, interest, taxes, and homeowner's insurance, and may include monthly assessments, mortgage insurance, and utilities. The income ratio formula is:

$$\frac{\textit{Monthly housing expense}}{\textit{Monthly GROSS income}} = \textit{Income ratio}$$

SLIDE 11

Income qualification

To identify the maximum monthly housing expense an income ratio allows, modify the formula as follows:

Monthly gross income x Income ratio = Monthly housing expense

Most conventional lenders require this ratio be *no greater than 25-28%*. In other words, a borrower's total housing expenses cannot exceed 28% of gross income.

For an FHA-backed loan, the ratio is 29%. VA-guaranteed loans do not use this qualifying ratio.

For example, if a couple has combined monthly gross income of $4,000, and a lender's maximum income ratio is 28%, the couple's monthly housing expense cannot exceed $1,120:

$4,000 x 28% = $1,120

SLIDE 12

Income qualification

Debt ratio – The debt ratio considers all of the monthly obligations of the income ratio *plus any additional monthly payments the applicant must make for other debts*. The lender will look specifically at minimum monthly payments due on revolving credit debts and other consumer loans. The debt ratio formula is:

$$\frac{\text{Monthly housing expense} + \text{Monthly debt obligations}}{\text{Monthly GROSS income}} = \text{Debt ratio}$$

SLIDE 13

Income qualification

To identify the housing expenses plus debt a debt ratio allows, modify the formula as follows:

Monthly gross income x Debt ratio =
Monthly housing expense + Monthly Debt obligations

Most conventional lenders require that this debt ratio be *no greater than 36%*. For an FHA-backed or VA-guaranteed loan, the debt ratio may not exceed 41%. The FHA and VA include in the debt figure any obligation costing more than $100 per month and any debt with a remaining term exceeding six months.

Using the 36% debt ratio, the couple whose monthly income is $4,000 will be allowed to have monthly housing and debt obligations of $1,440:

$4,000 gross income x 36% = $1,440 expenses and debt

VA-guaranteed loans also require a borrower to meet certain qualifications based on net income after paying federal, state, and social security taxes, housing maintenance and utilities expenses. Such residual income requirements vary by family size, loan amount, and geographical region.

SLIDE 14

Income qualification

Income stability – A lender looks beyond income and debt ratios to assess an applicant's income stability. Important factors are:

How long the applicant has been employed at the present job	How frequently and for what reasons the applicant has changed jobs in the past
How likely secondary income such as bonuses and overtime is to continue on a regular basis	How educational level, training and skills, age, and type of occupation may affect the continuation of the present income level in the future.

SLIDE 15

Cash qualification

Since a lender lends only part of the purchase price of a property according to the lender's loan-to-value ratio, a lender will verify that a borrower has the cash resources to make the required down payment.

If some of a borrower's cash for the down payment comes as a gift from a relative or friend, a lender may require a gift letter from the donor stating the amount of the gift and lack of any requirement to repay the gift.

On the other hand, if someone is lending an applicant a portion of the down payment with a provision for repayment, a lender will consider this another debt obligation and adjust the debt ratio accordingly.

This can lower the amount a lender is willing to lend.

SLIDE 16

Net worth

An applicant's net worth shows a lender the depth of the applicant's cash reserves, the value and liquidity of assets, and the extent to which assets exceed liabilities. These facts are important to a lender as an indication of the applicant's ability to sustain debt payment in the event of loss of employment.

SLIDE 17

Credit evaluation

A lender must obtain a written credit report on any applicant who submits a completed loan application. The credit report will contain the applicant's history regarding:

Outstanding debts	Payment behavior (timeliness, collection problems)
Legal information of public record (lawsuits, judgments,	Bankruptcies, divorces, foreclosures, garnishments, repossessions, defaults)

Problems with payment behavior and legal actions are likely to cause a lender to deny the application, unless applicant can provide an acceptable explanation of the circumstances that caused the problem.

SLIDE 18

Credit evaluation

If a lender denies a loan on the basis of a credit report, the lender must disclose in writing that the applicant is entitled to a statement of reason from any creditor responsible for the negative report.

Since 1995, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association have been encouraging lenders to use *credit scoring* to evaluate loan applicants. Credit scoring is a computer-based method of assigning a numerical value to an applicant's credit. The credit score is a statistical prediction of a borrower's likelihood of defaulting on a loan.

Section 13 – Part 5

SLIDE 1

Qualifying the Property

Qualifying the property is essentially a matter of having the collateral appraised and inspected. The appraisal is focused on establishing a **Fair Market Value** for loan purposes, while the inspections are to verify the collateral’s condition and corroborate disclosures made by the current owners/sellers.

The results of independent inspection reports should be compared to the seller disclosure statement to identify, clarify and reconcile discrepancies.

SLIDE 2

The appraisal is primarily concerned with establishing a fair market value for the collateral the lender will be accepting as security for the loan.

The appraiser must adhere closely to the Uniform Standards of Professional Appraisal Practice (USPAP,) which were an outgrowth of the FIRREA legislation of the 1980’s.

It is important for everyone involved in the transaction to understand that an appraiser is rendering his or her opinion of value.

SLIDE 3

This means that direct communication between the property owner, real estate agent, lender's loan officer and the appraiser selected for a particular assignment is very limited, and in some cases, prohibited.

One of the biggest criticisms of Appraisal Management Companies is that they draw on a pool of less experienced appraisers whose main business activity is significantly removed from the market they have been chosen for an assignment.

SLIDE 4

The Appraisal Process –
The emphasis here will be on market value, and not other values which could be determined for a property such as going concern, use, assessed, insured or investment.

Value may be considered a relationship between a thing desired and a potential purchaser.

The value which individuals are willing to ascribe to goods and services changes over time, as their personal preferences and needs change.

SLIDE 5

Value, particularly market value, is viewed always from the perspective of the consumer.

Real estate salespersons very often find themselves acting as intermediaries between the appraiser and the banker when a transaction's success hangs in the balance.

SLIDE 6

If markets were perfectly competitive, market price and market value would be equal and there would be no need for appraisers.

Market price is a historical fact or artifact based on actual transactions between buyers and sellers.

Market value is an opinion based on actual transactions, but rendered by an individual under a set of well-defined conditions.

SLIDE 7

The "as of" date on the appraisal is absolutely essential since it establishes the contextual framework governing the appraiser's information gathering, analysis and final value reconciliation.

Value is a function of the productivity of a commodity such as real estate. Productivity, however, is determined by use or utility of the goods to the consumer.

SLIDE 8

The types of values which can be measured or estimated share two common observations:

a) Each is a reflection of the purpose for which the measurement is undertaken.
b) In one way or another, each reflects market (consumer) interactions, perceptions, attitudes and preferences.

SLIDE 9

Market value is the most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale.

This definition assumes that there is a consummation of a sale as of a specified date and the conveyance of title from seller to buyer under the following conditions:

a) Buyer and seller are typically motivated.

b) Both parties are well informed or well advised and each is acting in what is considered his/her own best interest.

c) A reasonable time is allowed for exposure of the property in the open market.

d) Payment is made in cash, or its equivalent.

e) Financing, if any, is on terms generally available in the market at the specified or effective date; and typical for the property type and its location.

f) The price represents a normal consideration for the property sold and is unaffected by special financing amounts and/or terms, services, fees, costs; or credits incurred in the transaction.

SLIDE 10

Qualifying the Title

Qualifying the title is largely a matter of assessing and securing assurances regarding the veracity and accuracy of the title rights associated with the real property being accepted as collateral by the lender/mortgagee.

The recordation of written documents regarding real estate transactions provides the most complete resource possible for examining, verifying and authenticating the quality of title being transferred, or taken as collateral.

SLIDE 11

The development and maintenance of recording systems, along with the introduction of information technology, allows for the efficient and relative rapid research of the historical record of property ownership. These historical reports are called abstracts of title, and recite a complete summary of all recorded documents affecting title to property.

SLIDE 12

The abstract is then delivered to an attorney who examines the title evidence, and renders an opinion with regard to its quality and possible remedies for defects which have been identified.

Even with the best efforts of the abstracters and the expertise of the attorneys, there are no guarantees that the completed abstract is completely accurate.

SLIDE 13

Private companies have been organized to sell insurance to indemnify property owners and lenders against losses arising from title deficiencies, such as those listed above, as well as from errors in title examination.

Title insurance policies can be written to protect both owners and lenders.