

Report 4

Eight Mistakes Borrowers make when applying for a mortgage

Free Mortgage Information



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THINKING ABOUT GETTING A MORTGAGE LOAN?

The task of getting a **mortgage loan** can be difficult. It is helpful to see an overview of the process. A *mortgage broker or banker* can be a useful guide through this process, even before the search for a house begins. The mortgage broker/banker takes you through the four basic phases from the preliminary decisions through the final loan funding. Let's take a closer look at these steps:

Step #1 - Preliminary decisions First, working with you, we will determine what type of loan will benefit you most. Based on factors such as your employment history, income and debts, and credit history, we can decide the general amount that a lender would loan you and how large of a payment you could make. We will also consider the best terms available and the legal ramifications of ownership.

Step #2 - Pre-Qualification Next, we will gather and review the necessary information (such as residence and employment history, assets, etc.) and run a credit score in order to give you a Pre-Qualification Letter. This letter tells the seller that you are a viable buyer. Now you are ready to look for the home that best fits all your needs.

Step #3 - Loan Application Now that you have found the house you want, made an offer, and the seller has accepted your offer, the next step is the loan application. You have already gathered much of the necessary information. You may fill out the form on this website, and we will arrange for an appraisal when appropriate.

Step #4 - Loan Funding Once your loan is approved, the realty agents of both the buyer and seller will agree on an escrow/title company to serve as an agent in handling the loan closing process. We'll coordinate with the escrow agent to help make sure that your lender has all the paperwork they need in order to facilitate this final step. The final stage of the closing process will require your signature on the formal loan papers. The escrow agent will arrange this and then the loan and the house is yours!

In this confusing and pressure-filled atmosphere, it's easy to make some mistakes. Here are some common ones that lenders and mortgage brokers see, and what you can do to prevent them.

MISTAKE #1 NOT BEING FAMILIAR WITH YOUR CREDIT RATING AND FICO SCORE

When you apply for a mortgage, the prediction of your credit performance is measured by a numerical score. Although there are slight differences among the systems used by major credit reporting agencies, the fico model is the most popular. The fico scoring system was developed by Fair Isaac and Company, with the goal of filtering out non-relevant factors, such as race or gender. This single rating score sums up your credit history, projecting the likelihood of meeting future payments and indicating your level of credit risk.

Higher scores indicate a better *credit risk*. These scores not only may qualify you for a mortgage, but possibly better mortgage rates also. As with the other major scoring models (BEACON and EMPIRICA), FICO takes into account the statistics available in your credit report. Each item of data is assigned a weighted value, resulting in a single score that ranges from 300 (low likelihood of repayment) to 850 (high probability of repayment). A typical rating for a home buyer might fall within the range of 600 to 800. These credit scores particularly evaluate:

Payment History – *Have your payments been timely?*

Credit Card Balances – *What balances do you still owe?*

Credit History – *What credit have you maintained and for how long?*

Credit Types – *What type of credit have you obtained?*

Credit Inquiries - *How often have you had your credit checked?*

As most of these factors cover a timeline of credit history, there is not much you can do to *change your score* at the time of applying for a mortgage. However, you can begin to monitor your credit rating, know what your score is and ensure that the history is *correctly recorded*. For information and tools to help you, Fair Isaac has created a web site (www.myFICO.com) that lets you access your FICO score from all of the three major reporting agencies (Equifax, Experian and TransUnion), along with your credit report. The FICO site and each of these reporting agencies' sites (<http://www.equifax.com>, <http://www.experian.com>, and <http://www.transunion.com>) offer services to help you determine the best way to impact your FICO score.

When you have access to pertinent information, you will be in a better position to obtain the optimum mortgage available to you.

How can I raise my credit score?

Raising your credit score is a task that must be accomplished over time. The credit score is an assessment of credit history factors. Therefore, it is generally impossible to change your score during the short period of time you are applying for a loan.

As such, it is important to be aware of the positive and negative variables that affect your rating so that you can improve your credit score before you need to use it as a tool to obtain a loan. You can improve your credit score a little each year (by as much as 50 points) by careful management of your credit obligations.

Positive Habits

- Develop habits that promote good credit history (make payments on time, pay down cards leaving available balances, etc)
- Monitor all three credit reporting bureaus (*to ensure accurate reports*)
- Obtain credit reports annually and request corrections in writing
- Look around for lenders that will loan to high-risk consumers:
- Alternative lending sources can help re-establish credit and recover from damaged credit history. They often charge higher interest rates to reduce their risk.
- Create a savings account. Money down is a positive motivator to a lender as it reduces the credit risk
- Pay timely even if the bill is not a loan (such as your utility bills)
- Explain one-time digressions; lenders may take it into consideration

Negative Habits

- Don't request a series of credit checks in a short period of time – lenders presume unstable credit conditions (However, lenders understand that vigilant credit managers will monitor their own credit reports to keep them accurate and positive)
- Don't take on more credit than you can consistently manage
- Don't "max out" your credit cards
- Don't spend beyond your ability to pay - lenders are not going to want to fund extravagance beyond your economic abilities

- Don't quit building credit because of a setback such as a bankruptcy – go to work re-establishing credit (even a small consumer loan allows you to rebuild a good payment history)

Many lenders are more concerned with what you have done since a derogatory incident than what happened before, say, a bankruptcy
Don't leave **errors** undisputed; request corrections in writing

MISTAKE #2 FAILURE TO RESEARCH THE BEST POSSIBLE LOAN PROGRAMS

Whether you are looking for a first mortgage, adding a second mortgage or trying to refinance an existing mortgage, it is helpful to understand more about how the general loan classifications.

Mortgage loans are categorized as either fixed rate mortgages (FRM), adjustable rate mortgages (ARM) or some combination (hybrid) of the two. This classification is based on the type of interest rate structure governing the loan. The most common mortgage terms are 30 or 15 year loans (also, 25, 20 and 10). Generally, a short term loan will have less interest and higher payments - a long term loan, more interest and lower payments. A 15 year mortgage may have less than half the interest costs of a 30 year mortgage.

Characteristics of a fixed rate mortgage:

- The interest rate is fixed for the life of the loan (whether interest rates go up or down)
- Payments generally stay the same each month

Characteristics of an adjustable rate mortgage:

- The interest rate is adjusted periodically by adding a margin to an index specified by the mortgage (a 1-year ARM adjusts annually)
- Payments generally fluctuate along with the interest adjustment
- ARM's have limits on the amount of interest adjustment that can be made in given periods and across the life of the loan

Characteristics of a hybrid loan:

- The interest rate follows some set plan for adjustment, using a combination of fixed and adjusting interest rates
- Options are designed to meet a wider variety of needs
- Qualifying standards are often more liberal than traditional loans

Mortgage loans are also categorized as government loans or conventional loans. Government loans are FHA, VA and RHS loans; all other loans are conventional.

Government Loans

FHA loan

The Federal Housing Administration (FHA) does not make the loans; it provides mortgage insurance which protects the lender. Although FHA loans have statutory limits, the qualifications are generally more liberal than those for conventional loans. They have lower down payment requirements (only 3 percent down), lower monthly insurance premiums, and often, lower closing costs which can also be financed. FHA loans are intended to aid eligible families with low-to-moderate incomes who do not qualify for conventional loans.

VA loan

Like the FHA loans, VA loans are only guaranteed by the U.S. Department of Veteran Affairs; lenders make the loans to eligible veterans for the purchase, construction, or energy-saving improvement (approved by the lender and VA) of a home. VA loans also have easier eligibility requirements than conventional loans, often lower closing costs, and more liberal terms (usually no down payment is required) including negotiable interest rates. If you are eligible, the VA will issue a certificate of eligibility that you take to the lender when making application for your loan. Lenders generally place a maximum limit on VA loans.

RHS loan

RHS loans, guaranteed by Rural Housing Services under U.S. Department of Agriculture, much like the other government loans, also contain easier terms (such as no down payment and low closing costs.) RHS loans are available to rural residents with low-to-moderate incomes that are without adequate housing and unable to obtain credit elsewhere. RHS loans are for construction or repair of new or existing homes.

Conventional Loans

Conventional loans are classified as conforming or non-conforming.

Conforming loans

Loans that adhere to the guidelines set forth by *Fannie Mae* (from FNMA: Federal National Mortgage Association) and *Freddie Mac* (from FHLMC: Federal Home Loan Mortgage Corp), two corporations that purchase, package and sell loans that meet their conditions as securities to investors. These are referred to as "A" paper loans. Conforming loans must meet certain guidelines regarding down payment, loan limits, borrower qualifying criteria and appropriate properties.

Non-conforming loans

Loans that fall into "B, C or D" paper profiles are the non-conforming loans. They are often

offered to high *credit-risk* borrowers with a detrimental credit history by portfolio lenders. Portfolio lenders don't intend to sell their loans so they can be more liberal about their borrowers' eligibility requirements. However, these loans, often called jumbo loans, generally have a higher interest rate than conforming loans.

With the variety of loan possibilities, it is important to consider your needs in conjunction with the options available before making your loan choices. Your decision is often influenced by the amount of payment you can afford and how long you plan on staying in your house. Unless your intention is to stay long term, you may want to consider an option other than a fixed rate mortgage, such as an ARM or Hybrid loan. Some of these options allow for lower interest rates in the earlier stages, with options to convert or phase into a fixed rate over time.

Some of the more common loans you may want to consider are:

Second mortgage (or home equity loan)

A second mortgage is a loan secured by the equity in your property that already has a first mortgage. Generally, considering both loans together– the first and the second, a lender will not loan more than 75 to 80 percent of the home's appraised value. Compared to the first mortgage, the second mortgage will often have higher interest rates and a shorter life term.

The ability to borrow on the equity of your home for various reasons (home improvements, credit consolidation, other current financial needs, college funds, etc) is a big advantage to a home owner. However, because a second mortgage lender is at a greater risk, taking second place to the first mortgage lender, the terms are less flexible. As with the first mortgage, you will be required to obtain an *appraisal*, verify information such as income, and show credit in good standing.

Home equity line of credit

A home equity line of credit (HELOC) is similar to a home equity loan, except that the funding can happen over a period of time. An appraisal will be required to determine the amount of the equity-based line of credit. This credit line is an approved sum against which the borrower may draw (or pay down and even draw back up) as desired, up to that pre-determined amount, for a specific duration of time (5, 10, even 20 years). Most often the interest rate will fluctuate month by month during the funding period. Generally you will make monthly interest-only payments until the loan is completely funded. Once that pre-set funding period is over, the credit line will convert to a second mortgage loan, and payments for both the principle and interest will begin. Many of the loan costs and fees applicable to the first mortgage are required for the HELOC as well.

“Carry Back” loan

When a borrower does not have sufficient down payment to qualify for the first mortgage (generally at least 20% down is required), a seller may offer to “carry back a second mortgage” for the difference. Although the interest rate on the seller's loan is generally

higher than the first mortgage, the carry back loan provides a way for the buyer to finance the portion not included in the first mortgage.

Two-Step mortgage

A Two-Step mortgage begins with a fixed rate (usually lower than a fixed rate mortgage would be). There is one adjustment after a certain time (usually 5 or 7 years) to a new fixed rate - set at the current market rate at the time of the change. This adjustment has a cap to ensure that it will never be more than 6 percentage points higher than your original rate.

Convertible ARMs

Much like a two-step mortgage, some ARMs provide an option to later convert to a fixed rate (based on the current market rate, at the time of conversion, but generally a little higher). The option may be easily exercised at certain specified times (generally during the first five years) for a nominal fee.

Fixed-period ARMs

Contrary to convertible ARMs, fixed-period ARMs begin with a fixed rate that extends for a specified "fixed" period. At the end of that period, the interest rate (with certain caps) adjusts annually. The interest rates are lower than a standard 30-year mortgage as the lenders risk is lower since they are not locked in so long.

Balloon loans

A balloon loan is a short-term fixed-rate loan with low, fixed payments for the short term period, but requiring a single large payoff, due at the end of the term (5, 7 or 10 years.) This can be advantageous if you plan on moving or selling within a few years. Even if you stay beyond the end of the short term of your balloon loan, you may be able to reconsider financing options at that time.

Piggyback loans

Generally a first mortgage will only finance 80 percent of the value of your property, requiring the borrower to pay a down payment for the difference. If your down payment is short, a piggyback loan serves like a second mortgage to make up the difference. The two loans are approved at the same time.

Zero Down Mortgage

Qualification for a zero down mortgage is based on your ability to make your monthly payments. However, the loan will be larger than a typical mortgage and the interest rates higher. Not all lenders will make zero down mortgages; you may have to shop around. However, FHA loans have extremely small down payment requirements, coming close to a zero down mortgage.

Bridge loans

Bridge loans cover the time period between when a buyer closes on a new mortgage and finalizes the sale of his previous home, at which time the bridge loan is paid off. This time period of owning both houses creates several problems for the buyer. Offers made with a contingency clause (contingent on the sale of the current house) are often turned down. Also, the buyer would be obligated on two mortgages, causing financial overburden repercussions.

Bridge loans are usually 1 year loans, structured to pay off the first house, provide for six months interest on the bridge loan and closing costs, and contribute toward the down payment on the new house. The bridge loan is paid off when the first house sells. If the house does not sell within the first six months, the buyer will make interest-only payments on the bridge loan.

Buydown Options

A buydown loan is a fixed rate mortgage that allows the borrower to pay points to lower the interest rate. The option may include a reduction for the life of the loan or only for a specified few years at the beginning of the loan. Some options will even finance the discount points. A buydown option lowers the payment amount and opens the possibility of qualifying for a higher priced home.

Reverse Mortgages

A reverse mortgage is designed to help elderly home owners benefit from their equity without having to sell their house or make payments. The loan is funded through a lump sum payment, monthly payments or a line-of-credit. The money received from the loan is not taxable nor is it considered in determining Social Security or Medicare benefits. The loan does not have to be paid until the homeowner sells the property, moves or passes away. The elderly home owner is secure in the home even if the loan term ends or the loan grows beyond the value of the property.

MISTAKE #3: NOT GETTING PRE-APPROVED FOR A MORTGAGE LOAN

A pre-qualification letter, supplied by the *mortgage broker* not the lender, does not guarantee that you will get the loan, but it does raise the probability. First, it helps ensure that you are looking for the loan and the house that will be the best fit with your financial abilities. It is an estimate of what you could qualify for. Second, it gives you a vote of confidence with both the seller and the lender. It tells them that you are a viable home buyer and that you are working with a professional. Third, it pre-determines guidelines for an appropriate offer when you begin negotiations. It tells you how much you could offer. Before you are able to obtain a mortgage loan, you will complete a loan application, which will include a formal *verification process*. Some buyers go so far as to complete the *loan application* process first and get pre-approval. But even a pre-approval is subject to certain conditions being met, such as obtaining a home *appraisal* or meeting

certain date obligations. Also, such changes as a decline in your financial position or rising interest rates could affect the final loan approval.

The pre-qualification process is a more informal assessment, simply determining whether the buyer appears to qualify for a certain amount based on given information. However, there are some things that you can do to improve the impact of your pre-qualification letter. For example, a bad credit report can disqualify you for a loan. If you instruct your mortgage broker to run a credit check and state in the pre-qualification

MISTAKE #4: NOT REQUESTING A GOOD FAITH ESTIMATE OF CLOSING COSTS

What costs should I expect at the loan closing?

At the *loan closing*, you will be required to pay your down payment and other various closing costs and fees. Most of the closing fees are paid by the buyer, but some of the fees are prorated, by date, to the seller and the buyer. In order to be prepared to pay the closing costs, you may request a Good Faith Estimate from the lender. However, the estimate often differs from the actual closing costs, so it is important to understand what to expect.

Before you make long term decisions about the terms of your mortgage, such as locking in an interest rate, you should review the Good Faith Estimate to determine if there are hidden costs that may change your decision.

Typically, total closing costs will be from 3-6% of your mortgage amount. Although the Good Faith Estimate is subject to change, under (RESPA) the Real Estate Settlement Procedures Act, you have a right to request a HUD-1 Settlement Statement (one day before the actual settlement or closing). The HUD-1 details the actual fees that will be required. It is important to review this statement to ensure that you agree with and understand all the costs and fees listed.

At times, fees such as the application fee, credit report fee, or the appraisal fee may be required with the loan application before the closing. Certain fees vary from lender to lender, but generally, taxes, appraisals, credit reports and title insurance should be comparable for all borrowers. Sometimes, your fees may be included in the mortgage amount, depending on the *terms* negotiated. But generally, the buyer comes prepared to pay the related fees at the time of the loan closing. Common closing costs and fees that you may expect are:

Loan Origination Fee: a percentage of the mortgage (generally 1%), charged to set up and evaluate the *loan application*

Application Fee: required by the lender to process your loan application; often required

with the application, generally non-refundable

Credit Report Fee: requested by the lender in order to *evaluate* your loan application (generally obtained from one of three major credit reporting agencies: Equifax, Experian, TransUnion)

Appraisal Fee: used to obtain an independent *appraisal* of the home to be mortgaged; the appraisal is a factor in determining the amount the lender will loan

Survey Fee: may be required - verifies the legal position of the home on the property and ensures that there has been no encroachment on the property

Title Search Fee: charged for a detailed search of the historical records related to a property to ensure that the seller is legal owner, that there are no liens, restrictive covenants, outstanding judgments or other claims against the property (A certificate of title issued as a result of a title search does not necessarily protect against hidden defects which did not show up in the search – often the lender will require title *insurance* for protection against such claims)

Title Insurance: often required by the lender for protection against hidden title defects; a lender's policy only protects the lender – a buyer may also opt to purchase an owner's title insurance policy

Discount Points: optional payment to lower the *interest rate* (each point is 1% of the mortgage amount - \$120,000 mortgage discount point would cost \$1,200 and typically lower the interest rate by 0.125 percent)

Recording or Transfer Fees: a small fee charged to cover the paperwork to record the home purchase and transfer ownership
Interim Interest: interest from the closing date to the end of the month generally charged to the buyer

Property Taxes: buyer's prorated portion of state and local government property taxes already paid by the seller (such as annually paid taxes)

Escrow Account Payments: (often required by the lender) charges to cover costs or payments which will be due after the closing; *escrow accounts* are often set up to continue for the life of the loan, where a specified portion of the mortgage payment goes into escrow to cover certain on-going property related expenses and payments such as taxes and insurance.

MISTAKE #5: NOT BEING PREPARED FOR THE LOAN CLOSING.

What is the procedure at the loan closing?

The loan closing is a process of finalizing the sale and the loan. The seller, buyer and lender

(generally with the aid of an *escrow agent*) execute the final documents. You will receive a commitment letter from the lender once the loan application has been approved.

- Once you have the loan commitment letter, you can set a settlement date for the closing

It is important that the settlement take place before your “rate lock period” expires. A rate lock is a commitment by the lender to hold a promised interest rate and points for you for a specified period of time. Although longer rate lock periods generally cost more, there are other ways to influence your *interest rate*.

It is also important to have any final *inspections* done before this set settlement date, especially if any repairs or maintenance are part of the purchase agreement.

- You should be prepared at the closing to pay the *down payment* and any *closing costs* applicable to the buyer.

Under the Real Estate Settlement Procedures Act (RESPA), the lender is required to give the buyer a Good Faith Estimate of closing costs within three business days of receiving the loan application. This estimate lists the costs that the buyer is likely to pay at the settlement.

For the actual closing costs, you have the right to request to see The HUD-1 Settlement Statement (the prescribed form from the U.S. Department of Housing and Urban Development) one day before the actual settlement. The escrow agent fills out the Hud-1 statement. Prior to the closing, you should review all items on the settlement statement and all documents that you will need to sign in order to clarify any misunderstandings.

- All participating parties will sign the necessary documents at the closing. Make sure you understand what you are signing. Some of the documents are:

The HUD-1 Settlement Statement

This statement must be signed by both the buyer and the seller.

1. **The Deed** The deed is the legal document that transfers title to real property. The deed should contain an accurate description of the property, be signed and witnessed according to the laws of the state where the property is located, and should be delivered to the purchaser (after the agent officially records the deed).
2. **The Mortgage** The *mortgage* is a lien on the property that gives the lender the right to foreclose on the property if you default on the loan.
3. **A Deed of Trust** A *deed of trust* is a document used in some states instead of a mortgage, that transfers legal title of the property to the trustee until the loan is paid

off, giving the trustee the power to sell the property to satisfy the debt in the case of default on the loan.

4. **The Note** The note is the legal debt document and a promise to pay according to the terms of the loan.
5. **The Truth-in-Lending statement** The truth-in-lending statement is a mandated if there have been any changes in loan terms since the loan application. It must disclose the terms of the loan, the interest rate, the loan amount, the annual percentage rate and the total payments required.
6. **The Initial Escrow Statement** The initial escrow statement lists the estimated costs to be paid from the escrow for the ensuing year, the escrow payment amount and any required cushion.
7. **The Mortgage Servicing Disclosure Statement** The mortgage servicing disclosure statement tells the borrower whether the lender will be servicing the loan or transferring it to another lender. It is important to know when your first payment is due and where it should be made.

After the escrow and agent properly records all the documents, you may take possession of your property according to the settlement agreement.

MISTAKE #6 - NOT DISCLOSING EVERYTHING TO YOUR LENDER

Everyone has encountered financial problems at some point in their life. Mortgage brokers understand this and are trained to accommodate the best possible loan program and rate for your individual situation.

When you meet with the mortgage professional be open and honest with your current situation. This will make it easier for the lender to gauge your situation and provide you the best possible loan. If you withhold certain information needed for the loan process and the lender finds out later, it could cause difficulties in obtaining your loan and extend the time frame of funding.

MISTAKE #7 – FAILING TO AVOID MISTAKES BEFORE APPLYING FOR YOUR LOAN

The most critical time to avoid mistake is immediately before you begin the loan process, this is when it counts the most! Failing to avoid the below mistakes can cost you thousands!

6 months before you apply make sure you:

- Avoid making large credit purchases such as automobiles, Home Furnishing, Electronics etc.
- Don't transfer large amounts of money to and from you various accounts.
- Don't apply for credit cards or other loans
- Do not incur any late payments on any accounts such as credit card, automobile etc.
- Don't change employment

MISTAKE #8– BELIEVING YOU NEED PERFECT CREDIT AND 20% DOWN TO GET APPROVED

If you are a First Time homebuyer or unfamiliar with the many loan programs it might surprise you to find out that even if you have bad credit, no credit or no down payment, you may still qualify for a loan. Many people continue to rent and withhold the benefits of home ownership simply because they make the mistake of believing they need perfect credit and 20% down to get approved.