

# Mortgage Guide

A Buyer's Loan Guide from Application to Closing



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# Mortgage Process

Home buying is an exciting and rewarding experience, but it can also be the most challenging if you don't understand the mortgage process. Preparing for this journey and knowing what to expect will help you make the best decisions about your home purchase. This guide was created to help you navigate through the process and to provide the steps necessary to ensure a smooth closing.

- Submit an application for a mortgage loan
- Your lender will issue a pre-approval letter
- Start the house hunting and get under contract
- Order an appraisal on the home
- Your loan file will be processed and submitted to underwriting
- Your underwriter will underwrite the file and issue a conditional approval
- Satisfy all loan conditions
- Your loan will be reviewed a final time and will be clear-to-close
- Attend the closing and sign all documents





# Mortgage Process Explained

## 01 - Application

The first step in the mortgage process is to submit an application to your lender. The application form called the *Uniform Residential Loan Application* or Form 1003 includes information about you, your finances, and the details of your potential mortgage.

## 02 - Pre-Approval

Once the application is complete, your lender will review it with you and will send it through the organization to obtain approvals. If your loan is pre-approved, you will receive a pre-approval letter, which is the lender's conditional commitment to lend you a specified amount of money for the purchase of your home. (The pre-approval is good for a certain time, typically 60-90 days). With this letter, you will know the maximum amount your lender is willing to lend you. While this is helpful information, you need to decide for yourself if you can live comfortably with the amount of your suggested mortgage and the associated monthly mortgage payment.

## 03 - House Hunt

Armed with your pre-approval letter, you can now begin the house hunting process. Exciting times! Your real estate agent will present you with a list of properties that match your criteria and housing budget set by you and your lender. Once you identify your dream house, you will put in an offer. Your agent will know how to structure the offer. It may include contingencies or conditions that must be satisfied before the deal is completed. If accepted, you are officially under contract.

## 04 - Appraisal

At this point you will submit a copy of the contract to your lender for the appraisal process to begin. The appraiser will inspect the home and will provide a report stating the independent estimate of the home value. Note that the appraiser is 'independent' of the process. Most lenders don't order appraisals directly from any appraiser in particular. They typically use a third party company.



## 05 - Processing

This step in the process is considered behind-the-scenes as it is mostly a waiting period for you. Your loan processor will prepare your file to enter underwriting. During this time, all necessary reports are ordered, such as your title search and tax transcripts, and all information on your application is verified such as bank deposits and payment histories.

## 06 - Underwriting

Once your processor has put together your complete loan package, it is sent to your underwriter. During this step, your underwriter will review your information in great detail. Note that your underwriter may come back with questions. Be sure to respond in a timely manner to ensure a smooth underwriting process.

## 07 - Conditions

After a full review, your underwriter will issue a formal approval. In most cases, there will be conditions attached which must be satisfied before you can close. Once you provide your documents addressing your loan conditions, it will then go back to the underwriter for a review. Note that sometimes a loan file may be reconditioned, meaning once your underwriter reviews the requested items, additional questions may arise prompting additional conditions.

## 08 - Clear-to-Close

Once all conditions are met, your underwriter will review your file a final time and will issue a clear-to-close. Your loan can now be scheduled for closing.

## 09 - Closing

What is a closing? A closing is a meeting that involves all the parties signing the final documents and legally transferring the property to you. When you are finished signing the closing documents, you will be given the keys to your new home. Congratulations!



# Homebuyer Facts

- In 2021, 31% of buyers were first-time homebuyers
- in 2020, there were 2.38 million first-time homebuyers
- The average first-time homebuyer is 34 years old
- The median down payment for first-time homebuyers is 7%



# Qualifying



Obtaining a mortgage loan is no small step. However, qualifying isn't as difficult as you may think. The basic thresholds or minimum eligibility requirements are no secret and are actually not hard to meet. With a bit of knowledge and preparation, you'll be well-equipped for the qualifying process.

## Are you a good credit risk?

When qualifying for a mortgage loan, lenders start by reviewing your completed loan application and your financial documents. Both sets of information together will paint a picture of your financial position and will provide the information necessary to pre-approve your loan. Lenders will then assess your ability to repay and will determine exactly how much you can afford. They want to know that your loan is a good risk and that your likelihood of default is low. Additionally, they will also ensure that your loan meets its lending policies and program guidelines.

To accomplish this, lenders will evaluate your loan based on four basic criteria. Let's dive into what they are as well as what financial documents lenders will require from you.

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## Credit

One of the first things your lender will look at is your credit - credit score and credit history. A high credit score typically means that you pay your bills on time, don't undertake too much debt and you watch your spending. A low credit score typically means that you fall behind on payments or you have a habit of taking on more debt than you can afford.

Credit also affects interest rates. Typically, the higher your credit score, the lower your interest rate will be. Conversely, the lower your credit score, the higher your interest rate. (The best rates are offered to borrowers with a 740 credit score or better).



## Income

The next thing a lender will look at is your income. There is no minimum amount but your lender does need to know that you have enough income to support your mortgage payment as well as your existing debt obligations.

The income lenders will accept can take various forms. It doesn't have to be a salary. Lenders will consider income as long as it is stable, predictable, and expected to continue. If you are applying with a co-applicant, income (as well as debts) from both may be factored.

Income is considered steady from a lender's perspective if you've received it consistently from the same line of work or the same source over the last two years and if you expect to continue receiving it for the next three years.

Note that a two-year work history will be required. If you have a gap in income during this period, it may be ok but be prepared to explain away the gaps.

Lenders will also require documentation to prove income and calculate your debt-to-income ratios.

### Common income sources:

- Base pay
- Self-employment income
- Retirement
- Rental income

### Income from other sources:

- Trust
- Alimony
- Child Support
- Disability
- Foster Care
- Social Security

*\*Talk to your lender if you need to qualify using other income as this is not a complete list. Your lender will provide guidance on your income scenario.*

### ***Debt-to-Income (DTI)***

Your DTI ratio is the amount of debt you have relative to income, including your projected mortgage payment. To qualify for a mortgage, depending on the loan program, your DTI should be capped at 43%, although there are some exceptions.

If your DTI is too high, you'll either have to buy a cheaper home or pay off debts before you try to borrow for a house.





## Assets

The next thing a lender will look at is your assets. The reason is two-fold: Do you have enough liquid assets to cover your down payment and closing costs and is it properly sourced? (Unfortunately, mattress money will not be accepted since there is no paper trail). Lenders will need to document where your source of funds are coming from as only verifiable assets are accepted. Be prepared to submit two months of bank / asset statements.

If your down payment will be coming from a donor such as a parent, your lender will also need a gift letter from your donor clearly stating that it is a gift and not a loan that you will have to pay back.

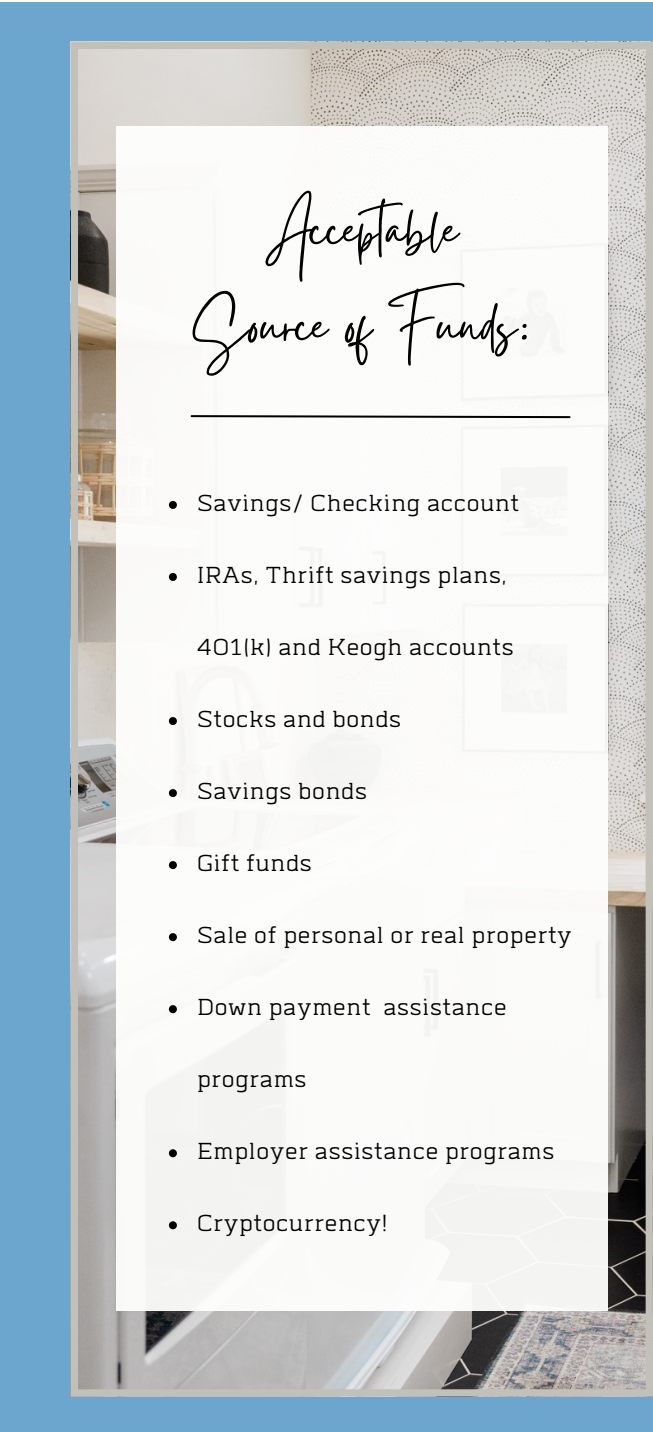
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## Collateral

Lastly, lenders want to ensure that the home they're financing is in good condition and is worth the purchase price. They will require an appraisal on the home and will determine how much you're allowed to borrow based on the appraised value. Lenders typically do not lend above the home's value (unless it's a specialty loan such as a renovation loan where the value increases upon completion).

If the value comes in at or higher than the offer price, you're in good shape. If it comes in lower than the offer price, you will have to make up the difference or renegotiate the offer price.

When lenders review your bank statements, they will also look for any large deposits as that may signify recently opened debt or suspicious activity. Try to avoid any large deposits in the months prior to your home purchase. This will eliminate the added loan conditions, any re-conditions, and explanation letters addressing deposits.



### Acceptable Source of Funds:

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- Savings/ Checking account
- IRAs, Thrift savings plans, 401(k) and Keogh accounts
- Stocks and bonds
- Savings bonds
- Gift funds
- Sale of personal or real property
- Down payment assistance programs
- Employer assistance programs
- Cryptocurrency!

## Mortgage Tip

# Loan Documentation

Every mortgage loan may be different, but the documentation lenders will need in order to pre-approve a loan are standard. The common items are listed here. Be ready to submit these along with your application:

Acceptable form of ID

Social Security card

Two year residential address history

Two year work history

Income verification - Employer info

Two recent years of W-2s

Two recent pay stubs

Two months of bank statements

Copies of recent federal tax returns

If VA - Certificate of Eligibility

List of assets -  
particularly real estate owned

If self-employed - business license, personal and business federal tax returns, business bank statements, and business Profit & Loss Statement





# Mortgage Payment Composition

Your mortgage payment is a significant portion of your monthly expenses; therefore, it is important to understand it's composition.

## PRINCIPAL

The principal is the part of your payment that goes towards paying the outstanding balance of the loan. This is the amount borrowed.

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## INTEREST

Interest, on the other hand, is the part of your payment that goes towards the costs of borrowing the principal. It is the money you pay your lender in exchange for giving you the loan. For the first several years, your mortgage payment will be primarily paying interest.

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## TAXES

This is the portion of your payment that is applied to the property taxes assessed on the property. No matter where you live, you'll have to pay property taxes on your home. These taxes go to your local government to fund things like schools, roads, and fire departments.

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## INSURANCE

### Homeowner's Insurance

This is the portion of your payment that is applied to your homeowner's insurance premium. Insurance isn't legally required to own a home, but lenders do require it to protect their interest.

### Mortgage Insurance

If your down payment is less than 20%, you will be paying private mortgage insurance (PMI) to protect the lender against default.

For government loans like FHA, you will be paying mortgage insurance premium, similar to PMI.



# Loan Programs

When it comes to mortgage loans, one size does not fit all. There are a number of loan programs available in the market but not all will be the right one for you. Each program is tailored to a specific need, borrower, or scenario.

This section describes the common loan programs and highlights the main characteristics of each loan.



## Conventional

Conventional loans are the most common in the mortgage industry. They are not government-backed but they do follow lending rules set by Fannie Mae and Freddie Mac.

Conventional loans are for buyers who want a basic, standard loan. It is designed for primary residences, second homes, and investment properties.

Conventional loan characteristics:

- Minimum credit score of 620
- Down payment as low as 3%
- Flexible Mortgage Insurance Payments
- No upfront loan program related fees
- Loan amounts up to conforming limits
- Rental / Second Property Eligible

## FHA

FHA loans are insured by the Federal Housing Administration and are designed for homebuyers with less-than-perfect credit. The loan requirements are slightly more lenient compared to other loan programs, therefore, it serves a larger population of prospective buyers, especially first time buyers.

FHA loan characteristics:

- Minimum credit score of 580
- Down payment as low as 3.5%
- 1.75% Upfront FHA funding fee
- 0.45-1.05% mortgage insurance premium
- Primary residence only
- Loan amounts up to county limits





## USDA

USDA loans are designed for those who prefer pastures over pavement. It is a loan insured by the U.S. Dept of Agriculture and used to finance eligible rural properties.

Metropolitan areas are generally excluded, but some opportunity to utilize this program can exist in suburbs. Rural locations are always eligible. Discuss this option with your Loan Officer if your desired location may be eligible.

### USDA loan characteristics:

- 0% down payment
- No minimum credit score
- No maximum loan limit
- 1% funding fee and 0.35% annual fee
- Rural properties only
- Primary residence only

## VA

VA loans are backed by the Veterans Administration and offered to veterans, active duty service members, guardsmen, reservists, and surviving spouses.

A valid Certificate of Eligibility will be required to take advantage of this loan program. A VA Funding Fee is assessed to the loan amount for veterans who do not have a 10% or more service related disability.

### VA loan characteristics:

- 0% down payment
- No minimum credit score
- No PMI
- Funding Fee assessed
- Primary residence only
- Loan limits up to conforming limit

## Jumbo

Jumbo loans are designed for luxury homes, higher-priced properties or homes located in an area where housing is more expensive.

This type of loan exceeds the conforming loan limits and therefore cannot be purchased, guaranteed or securitized by Fannie Mae or Freddie Mac. Since in most cases the lender/ investor must carry the risk, the requirements differ from lender to lender. The ones listed here are common with most lenders.

Jumbo loan characteristics:

- 10-30% down payment
- 680+ minimum credit score
- No PMI with 20% down payment
- Typical loan amount up to \$2MM



Loan Characteristics	Conv	FHA	VA	USDA	Jumbo
Credit score requirement	620+	580+	None	None	680+
Down payment	3%	3.5%	0%	0%	10-30%
Maximum DTI	50%	56%	60%	41%	38-43%
Upfront fees	None	1.75%	1.4+%	1%	None
PMI	Yes	No	No	No	Yes
Annual fees/ MIP	No	Yes	Yes	Yes	No
Primary residence only?	No	Yes	Yes	Yes	No

Notes:

1. *FHA* - minimum 3.5% down with 580 credit score; 10% down with 579 credit score and lower.
2. *VA* and *USDA* - agencies don't have a minimum credit score requirement but most lenders do.
3. *Jumbo loans* - requirements set by lenders/investors.



# Closing Costs

Closing costs are costs incurred to settle a real estate transaction. Some costs are paid to the lender while other costs are paid to third party settlement service providers such as a title company or an appraisal company. You can expect these costs to be between 3-4 percent of the loan amount.

## Origination Fee

An upfront fee paid to lender to process and underwrite the loan.

## Discount Points

Prepaid interest; fee to reduce the interest rate over the life of the loan.

## Mortgage Insurance (PMI)

Required if down payment is less than 20%. Protects lender against default.

## Appraisal Fee

Paid to the appraiser to assess the market value of a home.

## Title Search

An examination of public records to determine current ownership and encumbrances.

## Title Insurance

Protects the lender and you against title claims.

## Termite/Pest Inspection Fee

Required to certify the home is free of termite/pest damage.

## Survey Fee

Paid to the survey company to verify property boundaries.

## Flood Certification Fee

Cost to determine if the home is in a designated flood zone. If it is, you will be required to purchase flood insurance.

## Closing or Settlement Fee

Paid to the title company, attorney or escrow company that conducts the closing.

## Recording Fee

Paid to the state to record the transfer of property from one owner to another.

## Transfer Tax

Paid to the state, based on the loan amount.

## Prepaid Interest

Covers mortgage interest due between the closing date and the first mortgage payment.

## Prorated Property Tax

Covers property taxes from the closing date to the tax due date.

## Homeowners' Insurance

Covers the first full year's cost upfront.

## Homeowners' Association Transfer Fee


Paid on properties governed by associations to transfer ownership documents.

## Initial Escrow

Required to establish an escrow account and to collect the first two months of next year's homeowners' insurance, flood insurance and property taxes.



# Mortgage Tips



The saying 'Preparation is the key to success' has never rung truer than when you're buying a home. The more you know and prepare today, the better your chances of securing a mortgage loan in the future.

Let's look at what you can do to ensure a successful homeownership.

## Save money.

Most buyers already know to start saving for a down payment and closing costs well in advance of buying a home, but what is often forgotten is the true cost of homeownership which includes repairs and maintenance. The last thing you'd ever want is to deplete your bank account buying your dream home and not having the funds to make the necessary repairs. Save early and save plenty.

## Check your credit report and know where you stand.

As you learned in this packet, your credit score is key to qualifying for a mortgage loan. It also determines the rate that you will be offered so best practice is to pull your credit and check your score. If it could use some improvement, now is the time to work on it. Make all your debt payments on time and keep revolving account balances low. Credit card balances of less than 30% is good but less than 10% is best.

You can check your credit on [www.annualcreditreport.com](http://www.annualcreditreport.com).

## Clean up credit blemishes.

Believe it or not, errors on your credit report are common. They include identity errors such as wrong name or address and reporting of accounts belonging to another person with a similar name, incomplete reporting status like closed accounts reported as open or accounts incorrectly reported as delinquent, data management errors such as accounts listed multiple times, and balance errors such as incorrect reporting of balances or credit limits. As you can guess, these errors can adversely impact your much desired credit score. Best practice - review your credit report for errors and get them corrected.

## Get a pre-approval letter.

When you are ready to search for your perfect house, set an appointment with your lender to start the pre-approval process. This will tell you how much you are pre-approved for and how much home you can afford. You don't want to start house hunting without it as you can very well be out of your price range whether it be too high or too low. Don't lose out on your dream home searching in the wrong price range!

## Sit tight and don't make changes.

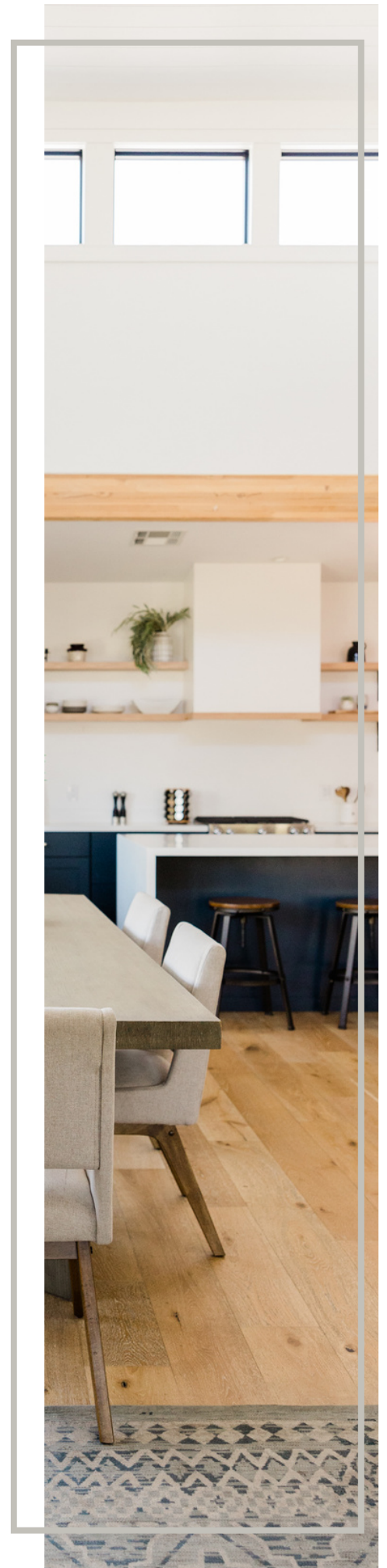
Don't make any financial changes that would impact your loan. Switching jobs, getting a new car, making big purchases on credit, co-signing for a loan - these are some common yet avoidable mistakes that may stop you from closing your loan and buying your dream house. Hold off on big changes. (Yes, lenders will do a credit refresh and employment verification right before closing to ensure that nothing has changed since your pre-approval or your conditional approval). So, sit tight, close on your loan, and enjoy your new home!

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*Don't wait to buy real estate.*

*Buy real estate and wait.*

*- Robert G. Allen*







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