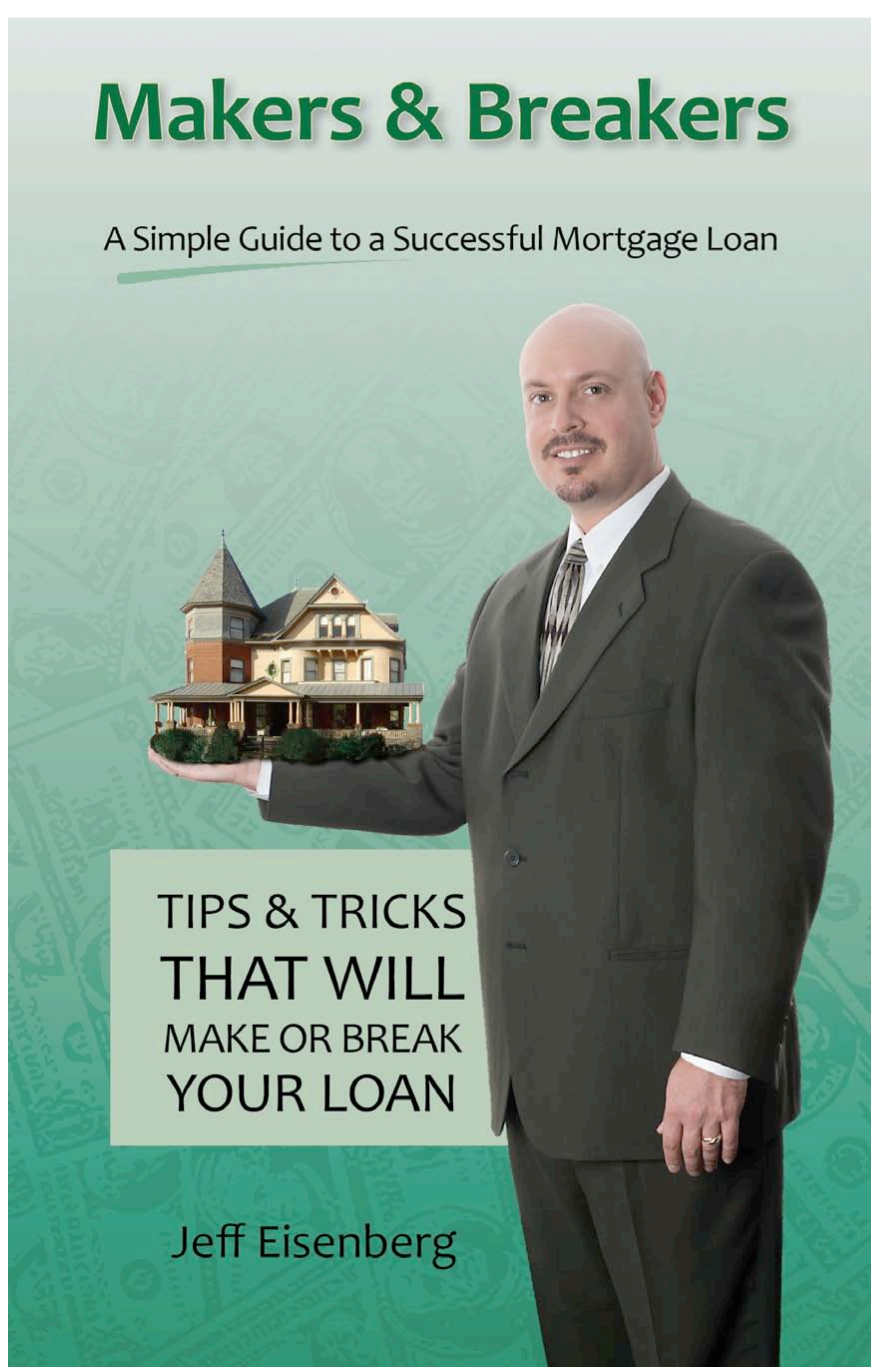
Makers & Breakers
A Simple Guide to a Successful Mortgage Loan
TIPS & TRICKS
THAT WILL
MAKE OR BREAK
YOUR LOAN
Jeff Eisenberg

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Jeff Eisenberg is a licensed broker with the CA Dept. of Real Estate, Lic. #01236132

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Dedication Page

I dedicate this book to my late father, Robert Michael Eisenberg (1940-1995). As far back as I can remember, my dad had faith in me and believed in me. From Indian Guides and Boy Scouts, to tennis and baseball, to sports memorabilia and deep sea fishing, my memories of the times we spent together fill me with joy. He was a kind and generous man who taught me patience and discipline. The love and support that he gave me will always be remembered and deeply felt. This is for you, Dad!

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Jeff Eisenberg

Preface

Several years ago, I realized that there were many people who were interested in purchasing a home but had no idea where to begin. I spent countless hours and many evenings away from home helping these individuals understand the home buying process and its intricacies. There are not classes taught in high school or college that teach people the facts or procedures of arguably the biggest financial purchase in one's lifetime. Thus, I decided that with the wealth of experience and knowledge I had accumulated over the previous 12 years, I would finally put this information in plain and simple English for anyone to access. I have seen almost every situation imaginable and thought that it would be wonderful to put a book such as this together so that everyone could have a reference guide to the do's and don'ts of home financing.

There are many aspects to the entire process, but if I could cover a majority of the typical issues that arise when buying or refinancing, I might be able to make a difference in an industry that I love. There is a powerful and satisfying feeling that comes over me every time I put another delighted client into their home. My dad always said, "It's not as important which career you choose as it is to choose one that you love". I must say being a mortgage broker has brought me fulfillment and pride in knowing I truly help people accomplish one of their biggest dreams. So with that said, I hope you enjoy the contents and may the tips included in this book help you fulfill your dream. Please feel free to email me and let me know how this book guided you in getting the best loan imaginable.

Chapter 1: Credit Tips & Tricks

Be Credit Ready

Think of a time when you had to give a presentation, perform in a production or play in a sporting event. Were you prepared? Did you practice? I bring this up because, too often, we don't prepare ourselves for buying a home. Your credit is a key component to the loan, interest rate and terms of the financing that you ultimately end up with. Being prepared and ready to move quickly is instrumental when buying a home. Don't wait until you are ready to buy to run your credit. Run it six months before. This is, most likely, the biggest purchase you will ever make in the time you have on this planet. So be ready. You will not have a low credit score due to erroneous, derogatory items if you take the time to fix those months before you apply for your loan. Even a slightly higher credit score could save you thousands of dollars in interest over the years. So get yourself in the credit ready position. If you need help or guidance getting there, talk to your mortgage professional.

Five Open Trade Lines

This tip is not mandatory, but it is a suggestion that may increase your credit score. However, there are circumstances in which it may actually hurt your score. Understanding the difference can make or break your loan. Lenders like to see a borrower who has a credit history of at least five open trade lines or credit accounts. These could be major credit cards, an auto loan, a student loan, gas cards or department store cards. Typically they like to see that at least three of the accounts have a history of 24 to 36 months. This shows them that the person they are considering lending money to has a history of paying bills on time.

I often advise my clients who have a minimal credit history to open a couple more accounts to help build their credit scores. This does not mean, however, to abuse these cards. I generally suggest a department store charge card that they charge as little as $20 on, pay off in full at the end of the month and then put away for a while. The goal is for these accounts to build a 24 month history.

The idea to build more credit is great in many circumstances, but can be dangerous in others. For instance, if you have a credit score of 720 with only two open trade lines, both with 36 plus months of history, the lender may be satisfied enough to qualify you. Opening more accounts just prior to getting your loan, which will result in inquiries on your credit and could lower your score, would not be a good move. But if you don't have enough credit to qualify, a good suggestion would be to start building credit now so that you'll be able to qualify at a later date. Knowing this in advance, especially two years in advance, could really make a difference. However, please make sure that you consult with your mortgage professional before applying for too many cards to ensure that you are improving your credit score and not hurting it.

Closing Credit Accounts

There is a huge misperception that exists regarding the closing of existing credit accounts in an effort to improve credit scores. It would seem logical that if you have many open trade lines with moderate to high credit limits, closing some of them would improve your score. The theory is that since you have no use for this card or credit line, why keep the account? It seems to make sense to close it. One would assume that your score would improve since you now have eliminated an account that you could have, in an instant, borrowed against entirely. Well, the reality is different and is two-fold. First, if this account has been established for many years, let's use 15 years as an example, and you rarely use it, you would have 15 years of good credit with limited usage. This works in your favor because you've got an established account with a long history of good credit. Second, if you have a high credit limit and don't use this credit, you've shown that you have willpower and can refrain from using credit even though it's staring you right in the face.

Thus, the right thing to do is to keep long standing accounts open even though you don't use them any longer. My suggestion is to charge a small amount every few years and when the bill comes in, pay it off entirely. This will keep the account active so the creditor doesn't decide to close it for you for non-activity. In a few instances, I've instructed borrowers who have closed accounts right before getting their loan to re-activate them immediately, after ensuring that the creditor will re-establish the history. If the creditor won't re-establish credit history, then I recommend leaving the account closed because beneficial credit history has already been lost. Accounts that are in the open section of your credit report will have the most positive effect on your score, especially if they have a very small balance to limit ratio. Once the account moves into the closed section of a credit report, the history is lost. History makes up a big portion of your overall credit score.

Balances on Credit Cards

One of the fastest and easiest ways to improve your credit score quickly is to pay down your balances on your credit cards (revolving credit) to 30% of the available credit limit. For example, if you have a Discover Card with a credit limit of $10,000, you would want to have no more than a $3,000 balance ($3,000 is 30% of the $10,000 limit). It's amazing how drastically your credit score can change once you go just a few percentage points above the 30% mark. This could have a 30-60 point effect on your credit score and is especially true if you owe more than 50% of the credit limit. What I suggest is that at about two months prior to applying for a home loan, whether purchasing or refinancing, pay all of your credit cards down to that 30% level of their respective limits and keep them there until your loan is completely finished. If at any point during the processing of your loan you rise above this level and the lender decides to run your credit again, it could lower your credit score and could affect your qualification for the program you are applying for. This is really one of the biggest score changing steps that you have complete control over.

One of the biggest mistakes a borrower can make involves the 0% balance transfer offer. It is definitely an attractive option to paying interest and if you aren't applying for a home loan anytime soon, it would be wise. In the case of home loan qualification, however, it can be detrimental. Let's assume that you have 10 credit cards with a total balance of $23,000, and would like to transfer all of their balances to a new credit card with a $25,000 limit. As I said earlier, you would be better off keeping the $23,000 spread out over the 10 cards, thus keeping the balances at no more than 30% of their respective limits. I'm repeating this idea because it truly is one of the simplest ways to improve your credit score. I've seen many clients who have an excellent credit history and have never missed a payment in their lives, but still have a low credit score. 9

times out of 10, it's the ratio of balance to limit that is the culprit. Do yourself a favor and mark this page because it's one of the most important tips to improving your credit score quickly.

Lates in the Last 12 months

Late payments (30 days or more) will always have a negative effect on your credit score. However, lates within the last 12 months will have the largest impact. Lates that are over 12 months old have only a moderate affect and lates that are over 24 months have a very minimal affect. As you might gather, this is something to consider far in advance of applying for a home loan. Lates on different types of credit will also make a difference. For example, having a late on a credit card has a major affect on your credit score. Having a late on an installment type loan, such as a car loan or student loan, will have a moderate affect. But having a late on a mortgage will have a drastic effect and could even cause you to not qualify for the loan you are pursuing. It makes sense. Why would a lender want to grant you a new mortgage if they see that you are currently late on your existing mortgage? Put yourself in their shoes. If it were your own money that you were lending, you would want to protect it at all costs and make sound decisions with all the facts presented. Loaning money to someone who has recently been late to their existing lender clearly raises concerns. My tip is to try your absolute best to avoid any late payments at least 12 months prior to applying for your loan.

A late, in itself, may not destroy your chances of getting a loan but it certainly could cause you to pay higher fees and be charged a higher interest rate. Lenders can charge more when the credit is lower. And you'd be amazed at how much 1/8th (.125) of a percent added to an interest rate over 30 years will cost you in the long run. A late payment under 30 days will not hurt you since it is not reported on your credit, but you may be

assessed a late fee, depending on how late it is and the rules of that lender. While paying late fees will not hinder your chances of getting a mortgage, think of how much money would be wasted if you consistently paid all of your bills late. $15 here and $35 there adds up quickly. Most importantly, though, take measures to make sure you are not 30 days late on any payments because those will show up on your credit report and lower your score.

Collection Accounts

This is one of the TOP 10 best tips to achieving a higher credit score. First, let me explain what a collection account is. A collection account is a derogatory trade line on your credit report that at one time was a credit card, auto loan, medical bill or other type of account. If the account becomes delinquent more than 90 to 150 days, the original creditor can place it into collection. This means that it is no longer an account that you have access to. Sometimes the creditor will sell this account to a collection agency whose job is to harass you day and night until you finally pay it off. The individuals who work for these agencies can be very rude, insensitive and downright nasty. I love to tell mean people that I come across that they should become a clerk at a collection agency because they would make a fortune just by being themselves. On occasion, there are some polite and caring people working for these agencies, but that's so rare you can't count on it.

Here is the detail of a tip that is an extremely valuable asset in your book of things not to do. If you have a collection account that is over 24 months old, it hardly has any affect on your credit score. If it's between 12 and 24 months, it has a moderate affect, and if it's less than 12 months old, it has a significant affect. The tip is … DO NOT pay any collection account off when you are trying to get a home loan. I know that this flies in the face of reason. If you pay it off, this collection account will be

ACTIVATED and, even though it will show as a paid collection on your credit instead of an open collection, it will lower your score dramatically. The scoring model used by Equifax, Trans Union and Experian would now see this collection as an active account and lower your score accordingly. If a lender requires a collection to be paid, pay it through escrow at the close so it will not negatively affect your score prior to getting your loan.

Too often I have clients who come to me believing they have great credit and then are shocked to realize that their score has gone down because a collection account they paid off is now considered active. Paying off a collection is okay if you do it two years prior to applying for a home loan because, as I said, if it is at least two years old, it hardly has any affect on your score.

The tip is to leave collection accounts alone until after you have successfully obtained your financing. Once that is complete, you can pay them off and in two years from that time, they will hardly have any affect on you whatsoever. Make sure that when you do pay off a collection you get the creditor to fax or mail you a letter that says something to this affect, "If we receive your payment of $_____, we will consider your collection paid in full and report to the three credit bureaus that your collection is paid." If you don't get this letter, it could be difficult to get them to update the credit bureaus. You'll have to prove at a later time that you paid them off by sending a copy of your cancelled check and a letter to each credit bureau to get them to update your credit report. What a pain! Collection agencies main objective is to get you to pay them. They typically purchase these debts for less than what is owed and they make their money when they collect the full amount plus interest.

Pre-Approval Inquiries on Credit

We've all gotten pre-approval letters in the mail stating that we are pre-approved, for example, for a $10,000 credit card, requiring only a signature to seal the deal. The real reason behind how the credit companies know to send these to you is that they have run a soft credit inquiry on you. This soft inquiry tells them that you have good enough credit to potentially qualify for their card. It will not tell them your income, job status or whether you can afford this new extension of credit. Running this soft credit inquiry will not, in itself, affect your credit score. What will affect your score is if you decide to take them up on the offer by filling out their form and sending it in. What you are then essentially doing is giving them the right to pull a hard inquiry on your credit. This will affect your score roughly five to six points. You are not necessarily assured of getting approved for the card, but now that they have run your credit, they can determine if you fit their criteria. So my suggestion is to be very careful on filling out these pre-approval offers. Make sure you absolutely need or want the card. After you close your loan is really the best time to apply if you want the card because it doesn't matter at that point if your credit score goes down five or six points.

Maintain Normal Use of Your Credit Cards

When applying for a home loan, continue to use your credit cards as you normally would. Do not change your spending habits abruptly, which would raise red flags. Of course, if you are on the verge of being able to qualify, you might want to consider not using them at all. That is, if your debt-to-income ratio is already too high. You don't want to bring any extra attention to your credit report than there already is. Stay constant and don't change your spending habits unless your mortgage professional instructs you to do so.

If you use your card for travel or work expenses and the month that you are applying for your home loan happens to be the month that you go on a very expensive trip for the office, be aware it could negatively affect your score. In Balances on Credit Cards, I discuss how a balance in excess of 30% of the limit on that card can affect your score 30 to 60 points. Keep a good eye on your finances prior to applying so that you can anticipate these types of situations.

Credit Freezing and Fraud Alerts

Credit freezing occurs when you call the credit bureaus and instruct them to freeze your credit, thus allowing no one access to your information in order to gain new credit. This is a great tool if someone has recently had his or her information stolen. It will provide protection from an identity thief. However, with a credit freeze in place, that person will not be able to get a home loan. He or she would first have to call all three credit bureaus and ask them to remove the freeze. This could take some time depending on what information the bureaus require be provided and may cost a fee, as well.

A fraud alert is a notation on your credit report that states that in order for any new credit to be obtained, the lender has to first call you to confirm that you are allowing this account to be opened. In order for this to work properly, make sure that the phone numbers you supply the bureaus with is accurate. If you enroll in fraud alert protection, you will be asked for a phone number that you can be reached at to verify any new activity. If you move or change your number, you will not be able to get a home loan, or any new credit, until you can be reached for confirmation at the number on your credit report. If the number is wrong, you have to call the credit bureaus, have them change it and then re-run your credit so that the phone number is correct on the credit report and the lender can reach you at that number. Lenders are very strict about this. If you are in escrow and the lender tries to call the number on the credit report and it isn't the right number, it will cause problems.

My suggestion is to always keep the bureaus up-to-date on any changes with your phone numbers when you have a fraud alert on your credit. Take care of any needed changes months before you apply for a loan. It will make a huge difference in having a much smoother loan process.

Consumer Credit Counseling Services

Try to avoid these like the plague. These are services that (in some cases, for absolutely free) lead you to believe they are helping you eliminate or clear off debt. What they do is negotiate with creditors on your behalf and may lower, for example, a $5,000 balance on a credit card to $2,500, which results in a much lower monthly payment than you currently have. It sounds wonderful but what they have actually done is ruin your credit. The credit card companies don't agree to do this without any consequence to you. They will show that your account has been settled for less than owed or, in most cases, report it as a collection account on your credit report. Obviously, this is not good for your credit. What also shows up on your credit report are the nasty little words "managed by consumer credit counseling service" which is just as bad as a bankruptcy to most lenders. Some lenders will not loan to you until two years have passed since you've dealt with a consumer credit counseling service (CCCS). CCCS will usually call all of your creditors, negotiate lower balances, bundle the payments into one lump sum and pay them on your behalf. You then write them a monthly check. As I said, avoid this like the plague. In some instances, I've heard that unscrupulous companies will actually accept your payment but not forward it on to the creditors or they will forward it late, thus adding another late payment onto your credit report. Ouch!

You are better off negotiating with the creditors yourself and seeing if they will help you directly. That way you avoid all of the pitfalls of dealing with a CCCS. If you are really that upside down and struggling to survive, consult your attorney because bankruptcy might be a better choice. While I never recommend bankruptcy, I'm not an attorney so check with a professional and make your own informed decision.

Joining a Credit Watch Program

Joining a credit watch program is a very good idea. There are many credit watch programs that allow you to monitor your credit every month to see if there have been any erroneous or fraudulent charges posted. Many of these programs are available through your bank or credit card companies. There is a charge for this service but it can be very helpful in keeping a watchful eye on your credit, particularly with so many identity thieves around. Some of these credit watch programs actually give you credit scores. Keep in mind, though, that these scores are not the same scores that a mortgage broker or bank/lender will retrieve from the credit bureaus when your credit is run for mortgage purposes.

Mortgage credit reports are flagged by the credit companies as such and include certain additional criteria that determine your score. Likewise, when an auto dealer runs your credit (they usually run it with only one bureau), it is flagged as an auto credit report. A credit watch program can be a useful tool in ensuring that subsequent running of your credit report by several mortgage companies, in the process of shopping for the best loan, does not change your score. See Shopping for Your Loan for a more detailed explanation. Ultimately, though, the benefit of utilizing a credit watch program is to be alerted to any potential issue(s) or fraudulent activity against your credit so that you can attempt to correct it as soon as possible after it occurs. This can make a significant difference in getting the best loan. Just a slight increase in interest rates on a 30 year mortgage can cost you tens of thousands of dollars, or more, over the life of a loan.

Credit Repair Agencies

There is a multitude of credit repair agencies, most of which have popped up in the last two years. As good credit becomes more of a prerequisite for better loan rates, these credit repair companies will continue to flourish. They focus on the many credit laws and acts that are in place to protect consumers. Their intricate knowledge of credit helps them to correct erroneous marks fast and efficiently. What a credit repair company does first is to send out letters to dispute specific issues on a credit report. They continue to bombard the creditor with letters every month that are geared to require the creditor to respond within a specified time frame. If they don't respond within that time frame, the charge, whether accurate or erroneous, has to be removed. Creditors are overwhelmed with the large number of inquiries from individuals alone calling about their accounts, not even considering credit repair agencies contacting them, as well. The majority of these credit repair companies have structured the letters they send with the aid of attorneys, so as to appear more official and professional. They can be very effective. But be forewarned. If the debt is a collection account and they are able to remove it, it could come back at a later time. I have seen bankruptcies and foreclosures successfully removed before their scheduled time, which is generally 7 years. (Chapter 11 and 7 bankruptcies are typically 10 years and Chapter 13 is typically 7 years).

The cost for this service can be as little as $100 or as high as $5,000. Do your research and be very careful that the company you choose is a legitimate organization. Ask for references and then call those to confirm that the company was effective. These services usually take anywhere from one to nine months to complete, depending on what the agency is trying to have removed for you. Consider that you may be able to fix your own credit just as easily. Meeting with a good mortgage professional who understands credit and how it works could save you thousands of

dollars. Take some time to review the tips I've given in the credit section of this book to see the many ways you can increase your credit score on your own.

Chapter 2: Managing Your Assets

Depositing Your Down Payment and Reserves

Let me begin by defining reserves. Reserves are monies that will remain in your bank accounts, investment accounts and/or retirement accounts after the home purchase or refinance is complete. A lender will usually require reserves of two, four or even six month's worth of your housing expense, which is the principal, interest, taxes, insurance and, when applicable, homeowners association dues. Your housing expense is either your current housing expense if you already own a home and are refinancing or the proposed housing expense if you are purchasing a home. As an example of reserves, let's say your new mortgage payment will be $2,000 (principal and interest combined) with monthly property taxes of $350 and fire insurance of $50. Added together, this is a total monthly housing expense of $2,400. If the lender requires two months of reserves, your reserve account must have at least $4,800 in it ($2,400 monthly housing expense x 2 months). This $4,800 would be required above and beyond the funds needed to pay your down payment and closing costs. This money can be in any account that is owned by you, even a retirement account. But if a retirement account is being used as reserves, be aware that the lender will use only 70% of the balance towards the reserve requirement. (See Retirement Funds)

The down payment, if not already in your account, should be deposited at least three months before you actually apply for a home loan. If the down payment is already in your account, make sure that it's been in there for at least three months so you could supply the lender with two months of bank statements to verify that it was yours. Lenders will count monies that have been seasoned in your own account for two months or more as your own funds. The question of what percentage of this money must be your own funds versus money that may be gifted to you often depends on the amount of your down payment. If you are putting down 20% or more, the lenders are usually fine with 100% of it

being a gift from a family member. If you are putting down less than 20%, they usually require you to have at least 5% of your own funds seasoned for two months in your own account. If you don't have 5% of your own funds, then you need to put the gift funds into your account at least three months prior. That way the money will have been seasoning and the lender will see the funds as your own. If you don't do this, you might not be able to purchase when you'd like. If you are depositing gift funds of 20% or more, it's not as important to deposit these funds into your bank account three months early. You could wait until a few weeks before you are scheduled to close to deposit the gift funds. Just make sure that when you make the deposit you take a photocopy of the check, get the receipt from the teller showing that it went into your account and be prepared to supply a current bank statement and gift letter from the donor (person giving you the gift) to prove that they had the capacity to give you the money in the first place. Lenders will require a paper trail of all gift funds. (See Gift Fund Section).

Short on Assets or Reserves?

If you find yourself short on the assets or reserves you need to qualify, an option would be to ask a relative to add you onto his or her account which has the needed balance or history that you are lacking. For example, you need $10,000 in assets to qualify but you only have $4,000. If mom and dad have an account with at least the amount you need and would be willing, they could add your name to it as a co-signer and then your mortgage professional can order a verification of deposit from the bank, showing that the account is in your name, too. This will satisfy the reserve requirement. Be aware, though, that the lender may need a letter from the relative stating that you have total access to all of the funds in that account.

Let this most generous relative know that once the loan is funded, they won't be able to simply remove you from the account. It is much easier to add someone to an account than it is to remove him or her. If they want to take you off of it, the only way to do so is to close it and re-open another one. This could erase the banking history that this account has provided for them. Be sure they confirm with the banker that if they close the account and re-open another one, the bank will transfer over their history to the new account. Furthermore, before they can close a checking account, they will have to make sure all checks have cleared and if they have any electronic or automatic payments coming in or out of the account, they will have to be canceled and reestablished in the new account. All of this is a bit of a pain and inconvenience for your family member, but is a great way to help you obtain your financing.

Gift Funds

The most important aspects of gift funds are the donor's ability to give the funds and documenting the transfer. Let's examine this a bit further. If mom or dad is giving you a gift of $10,000 towards your down payment, you will need to provide the lender with a gift letter (typically provided by your mortgage professional, a sample can be obtained at www.loanmanjeff.com). This letter will state that the funds are donated and you are NOT required to repay them, where the funds came from (e.g. checking, savings or retirement account), what the relationship of the donor is to you (e.g. father, mother, uncle) and the address of the property this gift is being given towards. Documentation is very important. The donor(s) will have to make photocopies of their bank statements from the account that they are providing the funds from and a hard copy of the check or wire transfer from the bank will need to be provided as will proof that the funds were delivered into your checking or savings account. Lenders are very strict about these details. Being aware of how this works beforehand will be beneficial to you. My recommendation is to talk to your mortgage professional regarding this in advance of applying for a home loan. (For additional information, see Depositing Your Down Payment and Reserves.)

Mattress Money

Some borrowers have money sitting around in cold, hard cash. They either get paid "under the table" and don't want to deposit the cash in order to avoid paying taxes to the IRS or are scared to put their money into a financial institution. The latter was definitely a concern during The Great Depression, but now that the Federal Government insures accounts up to $250,000, it is much less of a concern. When applying for a home loan, the problem with this so called "mattress money" is that the lender will not count it toward the reserve requirement or down payment. This is the same with gold and silver. Even though these are valid commodities, lenders will not use them. So what is one with such assets to do? If it is cash that you have, you will have to put it into a checking or savings account at least three months prior to buying a home in order to have at least two months worth of bank statements to show the lender. As far as commodities, they are difficult to convert and typically aren't counted as liquid assets in a real estate loan transaction.

If you are unable to open a checking or savings account because you are on CHEX SYSTEMS (a system the banks use to deny you an account due to excessive non-sufficient funds, fraud or check kiting), you might be out of luck. You may have to use a co-signer on your loan in order to show enough assets to qualify. In the past, there were many programs designed for those who could not show assets the traditional way. There were stated income loans, stated asset loans, no documentation loans, no ratio loans and more. For now, however, such programs are unobtainable. As the market relaxes and guidelines are loosened, those programs will probably be made available again. They may have tighter restrictions than in the past, but they will most likely make their way back in to the system, which would be especially helpful to the self-employed borrower (see Self-employment Section).

Retirement Funds

Retirement funds are any type of fund that has a penalty for early withdrawal and is used for retirement. Examples of this are an IRA, Sep IRA, 401K, 403B, Deferred Compensation and other long term funds used for retirement purposes. Lenders will allow these funds to be used toward the two, four or six month reserve requirement; however, they will only typically use 70% of the value of these funds. If you are short on reserves, knowing what amount is in your retirement account ahead of time can be very beneficial. Don't forget to tell your mortgage professional about all of your assets, including any retirement funds.

Sometimes borrowers will use their retirement funds as part of their down payment. In most instances, retirement plans allow you to withdraw a certain portion of your retirement funds for the purpose of purchasing a home. They usually will waive the penalty to do so. One quick tip that can save you time and money is to look into it two to three months prior to applying so that you are aware of any potential problems that might arise from withdrawing from these funds. You may also find that withdrawing from these funds will not work or will be too costly, so you could use that extra time to figure out an alternative.

Another way to utilize retirement funds to purchase a home is that, in some instances, you can borrow against them. Some retirement plans allow you to borrow up to 50% of the balance. However, if you choose to go this route, be aware that you most likely will have to pay this loan back over a specified time and the lender will require documentation showing what that payment will be. They will want to see a copy of the retirement statement showing that you can borrow against the account and the terms of repaying it. The lender will charge you with this payment by adding it to your debt-to-income calculation to determine whether

or not you can afford this extra monthly payment as it relates to your qualification.

I am a big believer that using your retirement funds as a method of down payment should be your last resort. Remember, these are funds set aside for retirement purposes and withdrawing from them could hinder the compounded growth tremendously. Be careful with this. I strongly suggest you consult with a professional financial advisor before using these funds.

Don’t Reduce Balances on Your Assets

Do NOT take money out of your checking or savings account right before you are going to close escrow. If it is just for normal living expenses, you should be okay. Otherwise, don’t arbitrarily take funds out of an account that was used to help you qualify. I’ve seen borrowers that had borrowed their down payment from a friend or relative and, after they were pre-approved, decided to give the money back to their friend or relative in the middle of their escrow period. This is a bad decision because if the lender wants to see a more current bank statement from your account, it could cause a major problem. You should always ask your mortgage professional how much money you should keep in your account until the end. The lenders can request a verification of deposit from your bank at the last minute if they choose. A verification of deposit is a form that the bank has to fill out that tells the current balance in the account as well as the last two months average balance. To be on the safe side, keep as much money in your account as you can until you are informed by escrow that your loan has recorded with the county.

Chapter 3: Making Sense – Think Before You Do!

Owner Occupancy

Owner occupancy is becoming a big issue these days. Lenders are leery of borrowers claiming that they are going to live in the home they are purchasing when they are actually going to be renting it out. So the best thing to do is to make sure that it all makes sense in the lender's eyes. For example, if you are currently living in a 2,400 square foot home with four bedrooms and three bathrooms and you are purchasing a 1,200 square foot home with two bedrooms and two bathrooms right down the street that you claim you are going to live in, you'd better have a very good reason for doing so. Lenders don't like it when borrowers downgrade. Why would a family move from a nice big house into a much smaller one? Generally, they don't. Most likely, they are buying a rental property and claiming it's going to be an owner occupied primary residence so that they can get a better loan with a lower rate. Well, lenders are on to this.

There are, however, valid reasons for buying down. One would be if you are a senior citizen, are ready to retire and don't want the headache of maintaining a big house because your kids are all grown and have moved out. You could argue that you want to keep the bigger house as a rental property because you owe very little on the mortgage and you would be making a large profit every month that will benefit you during your retirement years. If you have a young family, however, this reasoning will get you nowhere. In that case, do the right thing and call it an investment property. It's amazing how many people try to finagle the system. In the past, they were able to get away with it. Keep in mind that your lender could call the note and make you pay it off early if they learn that you lied to them from the onset. Talk to your mortgage professional and determine what your options are before you submit your loan to a lender. It is best to be prepared upfront so you'll get a favorable decision from the lender.

Second Homes

Buying a second home is a dream for many folks. How nice would it be to own a house in the city and a second home in the country or by the beach? The true definition of a second home is a home that one can travel to that will provide a getaway from the daily grind. Well, that is my definition. When I think of a second home, I think of relaxing with my feet up drinking a fruity drink by the water with soft music in the background. Lenders tend to have their own definition. Their definition relates to whether or not it makes sense to consider the other home a second home. Is it truly a second home? The proximity of it to your current home is an important factor.

If you live in Inglewood, CA and you are buying a second home in Torrance, CA, which is only 18 minutes away, the lender will not consider this a second home. But if you live in Los Angeles, CA and you are buying a second home in San Francisco, CA, then you'd have no problem. The lender likes to see certain characteristics such as is it close to water, is it in a resort type area, or do people typically buy second homes in that area? For example, some places in California that provide great second home purchases are Santa Barbara, San Diego, Palm Springs, Big Bear, Morro Bay, Sonoma, and Ventura. Notice that all of these places have either water, snow or are resort towns.

I have had borrowers that live about five miles from where they want to buy another home and want to call it a second home. Why would they want to do that? The answer is simple. They want to benefit from the better rates. Second homes typically have the same interest rates as do primary residences. If they call it a non-owner occupied or rental property, then the rate is much higher and the cost is usually more. We all understand the investor's logic, but the banks and lenders don't agree. So my tip here would be to ask the question, "Is this truly a second home that

my family and I will travel to that provides a getaway from the daily grind?" If not, it's going to be considered a rental property in the lender's eyes.

There are times when you may live more than an hour or so from work and it would makes sense to purchase a small house or condo very close to your job that you can live at during the week. On the weekends, you'll go home and enjoy your primary residence. The key is to think like a lender and figure out if it really makes sense. It is up to the lender's discretion as to whether or not they'll consider it a second home. What I suggest is that you write a very convincing letter and submit it with your loan package to make your case. Cross your fingers and hope they see it the way you do. This is one of those times that a creative writing class can be a valuable asset.

Tell the Truth

This tip is important because secrets or holding back important information can really hurt you. Your loan professional is there to help you get financing for your new home or your refinance. He or she doesn't want your loan declined or to waste anyone's time. The more honest and truthful you are from the beginning, the better. Tell your mortgage professional everything. Let that person decide what should or should not be used in qualifying you. Nothing is worse than getting almost all of the way through the loan process and then finding out, for example, that you didn't reveal how you acquired your down payment. Perhaps you originally said that they were your own funds, but it's now revealed that it really was a gift that wasn't properly documented. Thus, the lender won't allow them and your loan gets declined. Believe it or not, stuff like this happens. Be truthful and give accurate information. If something is going to detrimentally affect your qualifying and there is no way to get around it, wouldn't you rather know now than when your loan is declined and you potentially lose the money you put down as your escrow deposit?

Report your Rental Properties on Schedule E

If you own any rental properties, it is very important to file Schedule E with your personal tax returns. This is the schedule on which you report the income or loss generated from such properties (see sample at www.loanmanjeff.com). Generally, rental properties provide the potential for a considerable tax write-off to your adjusted gross income. In addition, Schedule E provides proof to the lender of your history of owning the investment property. Lenders prefer to see a two year history of you owning the property in order to consider and use the income from it to offset the mortgage payment on it. The standard way a lender calculates the net on a rental is to take the net income or loss at the bottom of Schedule E and add back in depreciation. This is because depreciation, which the IRS allows to be deducted, is not an actual expense to you. Another way that they may calculate income or loss is by (using the far right column on Schedule E) taking the Revenues generated and subtracting out all expenses. Once the annual income or loss is determined, it gets divided by 12 to arrive at a monthly income or loss.

Sometimes lenders do not ask to see tax returns, in which case they would use the Schedule of Real Estate Owned section on the loan application. Be aware that they will only use 75% of collected rent to offset the payment. For example, assuming you collect $1,000/mo. for rent, the lender will only use 75% of $1,000, or $750, to offset the actual payment. If your payment, including principal, interest, taxes and insurance, equals $1,250, then you'd subtract the $750 from it to determine whether you had a net negative rental income or a net positive rental income. In this instance, $1,250 minus $750 equals $500/mo. This means that you would be short $500/mo. to cover the expense on the rental. So the lender would add $500 to your debts which would affect your debt-to-income ratio and your qualifications. If the figure is a

positive number, then it would be added to your monthly income and enhance your debt-to-income ratio and qualifications.

Make sure that if you do have a rental property, you keep a current rental contract on file. If rent is increased, have the tenant sign a new agreement or addendum just in case you need it when applying for a loan. Rental contracts can be obtained very easily from most stationary stores or online. Most rental contracts are month-to-month, six months or one year. I recommend getting the one year lease agreement. Lenders tend to like them better and feel more comfortable knowing that the rental will be leased for at least a one year timeframe.

Using Friends or Family

This is a tough one for me because I was brought up to treat everyone with respect and professionalism, whether or not they are related to me. It's a bit disheartening that this is a tip I have to discuss but, unfortunately, it is. You've heard the saying, "Don't do business with a family member or friend because it's a great way to ruin a relationship". My personal experience begs to differ because I have personally done many loans for my family and friends and have never had an issue. I never talk about anyone else's credit, income, assets or situation and I treat every step of the process with every client with the same degree of professionalism and integrity. My favorite line is, "If you want to know what so-and-so's income is, ask them yourself".

Apparently, however, this is a somewhat unique characteristic because I have heard many negative stories related to a brother, cousin, friend or other relationship handling a person's past loan. It is usually summed up with, "Wow, I still can't believe they did that to me". Ouch! If you are considering a personal relation to handle your loan, home purchase or sale or appraisal, determine for yourself whether or not the person has the professionalism and integrity to treat you like a client rather than a friend or relative throughout the process and afterward. He or she should return phone calls promptly, answer your questions and concerns and, definitely, never lead you to feel as if you are bothering or interrupting them. It can be a difficult thing to do but you should state your expectations in the beginning. Let the person know that you want a high degree of professionalism or you will have to go elsewhere. Express your appreciation of any help and guidance but stress that this is a business transaction and you need to be treated as if you were a top client. I would expect anyone to understand this concept but if you feel this person doesn't, high-tail it out of there with an apology because this is one of the biggest financial transactions in your life. You should never

be made to feel second rate or worry about your personal information being leaked. This is my advice and, of course, you should always do what you feel is best for your situation. I certainly don't want to start any family feuds but this seems worthy of discussion.

Shopping your Loan

I'm asked many times whether it is wise to shop for the best loan or interest rate when purchasing a home or doing a refinance. The answer is, most likely, yes. I don't suggest you go crazy and apply everywhere, but being informed and making sure you are getting a good deal is your right. Be careful, however, not to have each loan agent run your credit. What I suggest is that you go to whom you were recommended to first and have him or her run your credit. Get a copy of your credit report and bring it with you to the other lenders. Tell them specifically that you do not want them to run your credit. Instead, give copies of your recent credit report and ask them to quote you based on that. If you have multiple mortgage inquiries on your credit within a specified time period, on average 30 days prior to scoring, the lenders are only supposed to count them as one inquiry. Thus, the credit score is not supposed to be affected by each inquiry if several are run for the same purpose. This allows you to rate shop. However, I wouldn't take this risk because each extra inquiry on your credit report can cost you five to six points off of your score. What is supposed to happen is not always the reality. It is safest to run one credit report and have everyone use that to quote you. If they refuse, then that is not the lender for you. Once you decide on the loan professional that is best for you to work with, he or she may have to run it again because all credit reports have to be in the name of the agent's company that ends up doing the loan.

One last comment on this topic that I believe has merit is that it is almost always better to use a lender that has been personally referred by someone who has utilized that lender's services in the past. Many people look on the internet and end up calling companies that are based across the country. Not only are they out of state, but they are most likely dealing with an order taker. Is this a licensed mortgage professional or a college kid who is trying to pay his or her way through school? A licensed mortgage

professional typically has the knowledge to advise you on whether or not you should pay points, whether a loan program is right for your individual needs and, in general, has better knowledge of mortgage and real estate practices. We all have a gut instinct and, when purchasing a home or refinancing, my tip is to listen to it. If you don't feel comfortable with the person you are working with, then you should go elsewhere. This is a huge investment for you. Don't move forward without an inner feeling of comfort and trust.

Loan Fraud

Don't commit loan fraud. It can come in many forms. An example is supplying your mortgage professional with tax returns that were prepared to help qualify you for your loan but are different from the returns you actually filed with the IRS. Another example is printing out falsified pay stubs from a laser printer. This is grounds for imprisonment. Believe it or not, there are mortgage professionals, working for the big banks or as mortgage brokers, who commit this type of loan fraud regularly. You might have seen some of them featured on the 6:00 news. If you have to go to these lengths to qualify for your loan, you shouldn't be buying. Don't let anyone tell you that this is okay, because it is not. If you think your mortgage professional is doing something unscrupulous, get out quickly. Don't just walk away. Run!

Chapter 4: Employment Blunders

Employment History

Your employment history is a key component to qualifying for a home loan. Lenders are looking for a two year history of employment. But even more importantly, the two years should be within the same industry. It's not as important that it be with the same employer as that it be within the same industry. Here is an example. You work as an accounting clerk for Company A, but you've only worked there for two months. Your previous job was as an accounting clerk at Company B, where you were employed for two and a half years. This would satisfy the lender's requirement for employment. But if you've been working as an accounting clerk for six months and previous to that you were a clothing store salesperson for two years, the employment requirement would not be met and they may not use any income from your current job to qualify you. Remember, the lender is looking for employment within the same industry.

The lender's requirement for a two year history would also be met working for the same employer for more than two years even if you switched positions within the company. However, if you are going from a non-commissioned or non-bonus position to a commissioned or bonus position, then you would have to have a two year history of receiving commission or bonus income to use such funds to help you qualify for your loan. My recommendation would be to stay put in one industry at least two years prior to applying for a home loan so that you'll have a smooth transaction.

Job Changes

My best advice would be to stay put. Change jobs after you get your home loan. Lenders like to see consistency. Changing jobs will not automatically disqualify you, but it can create some problems. Changing jobs within the same industry (just switching employers) isn't so detrimental. But it is best to do this at least two months prior to applying for a home loan. The reason for this is that the lender will require the most recent pay stub from the new job. If you switch jobs halfway through escrow and the employer waits a week or two before giving you your first paycheck, you could cause a delay in funding your loan. Some lenders want a full month's worth of pay stubs from a new job before they will proceed. Such delays could cause you to lose your rate lock on the interest rate you were expecting or you could go past the close of escrow date and the other party could give you a notice to perform. That would mean that you'd have approximately 24 hours to rectify the situation or they can cancel the escrow. Chances are that this wouldn't happen, especially if you are far enough along that escrow is almost complete, but it is a risk. You would hope that they wouldn't cancel the deal and start all over with another buyer, but it could, and has, happened.

If you are changing jobs from an industry that you currently work in to a new industry that you don't have a history with, beware (see Employment History). The lender will most likely not use any of the income from the new job. They are looking for consistency. My recommendation would be to suffer at the old job until your loan has funded and closed and you have the new keys in your hands. Then you can do whatever you want.

Constant job changes are also not a good sign of a consistent borrower. The loan application has room for two or three jobs within the last two years, but if you go over that, your jobs will show up on a Continuation Page. This is typically not a good

thing. If a person had eight jobs in two years and you were loaning money to them, wouldn't you be a little nervous about whether they'd switch to another job and eventually run out of jobs in their industry? Yikes! It would scare me. If you keep this in mind prior to getting a home loan, it might persuade you to stay focused in one job for a longer period to build an employment history that will make a lender feel comfortable.

Self-Employment

Self-employment and entrepreneurship are the backbone of our society. Many people would love the opportunity to be in a business of their own. There are the prospects of becoming independently wealthy, being your own boss and making your own hours. Yes, this sounds fantastic! But did you know that many self-employed people fail? The cause boils down to the lack of planning. You've heard the old saying, "You don't plan to fail. You fail to plan". Well, this book isn't about achieving success as an entrepreneur, although I would love to write a book about that! I mention it because the key here is to plan in advance. Lenders want to see a two year history of self-employment. Two years worth of tax returns that show either a Schedule C (Business Profit & Loss) for a sole proprietor, a K-1 (which shows the net income generated from the corporation that gets passed through to the owner(s) of the business) if an S-Corp (Sub-Chapter S) or an 1120 if the business is set up as a C-Corporation.

If you are planning on buying a home or refinancing a home and switch from a W-2 wage earner to a self-employed person, make sure you do this two years prior. There have been many instances in my pre-qualifying of borrowers that this has come up. When I inquire about their job history and they say they are self-employed, I ask them for how long. When they say for only six months, it causes a problem. In those cases, the borrowers will most likely have to wait another year and six months before they can buy or refinance. There are, in some cases, lenders that only require a one year history, but that is not something you can count on. If you are thinking of quitting your job and going out on your own, do it after you've closed escrow on your new home or new loan. Keep in mind that self-employment is a risky proposition and if it was easy, everyone would do it. Don't get me wrong: I'm self-employed and have loved most every minute, but it's certainly not for everyone. Security in the 1st five years can be tough, but if

you make it, the sky is the limit! Consulting with your loan professional beforehand can make all the difference in the world.

Self-Employed Borrowers and CPA's

If you are self-employed, it would be in your best interest to utilize the services of a trained professional, such as a CPA (Certified Public Accountant) or an EA (Enrolled Agent), to prepare your taxes. Besides the fact that they are experts in taxes and live and breathe tax codes for breakfast, it will come in handy when applying for a loan. You wouldn't have a chiropractor do a root canal on you, would you? Or have a dentist do your taxes? No.   So, if you are not a CPA or an EA, why would you do your own taxes? There are many instances in which the lender may require a letter from a CPA or EA to prove self-employment. In the past, many CPAs and EAs would get calls from mortgage professionals asking if they'd write a letter for their client who is self-employed but doesn't utilize the services of a CPA or EA. In the past they would often do this as a courtesy and usually charge a few bucks to do so. Today is a different story. Unless that CPA or EA is currently working for the client and actually doing their taxes, no amount of money will persuade them to write that letter. So plan ahead. Get the name of a good CPA or EA from friends, relatives or acquaintances and have the professionals make sure you are getting all the tax breaks and benefits that a true tax professional can provide.

Keep in mind, however, that when you are self-employed, the goal as your tax professional is to minimize income on paper in order to minimize your tax exposure to the IRS. This works great for your pocketbook but is detrimental for home loans. When you are self-employed, the lender will usually calculate a two year average of self-employment income from your Schedule C (Business Profit and Loss). This figure usually is very low due to

all the write-offs that you may be taking. So be aware that if you really want to buy that house, you may not be able to take all of those wonderful deductions that you'd normally take as you may need to reflect a higher income so that you'll qualify. Knowing this information two years in advance of getting a home loan can really make a difference.

Sales Professionals and Their W-2s

If you are in sales and earn a base salary and commission or bonus, this tip may be extremely beneficial to you. On the home loan application, there is a section to be filled out regarding your base income, commissions and bonuses. If any figures are entered in this section for either commission or bonus, please be aware that the lender will typically ask to see copies of your Federal tax returns to confirm that you haven't taken any 2106 expenses. These are job-related expenses such as mileage, meals and entertainment. If you do have such expenses on your return, the lender will deduct those amounts from your annual income.

Sometimes it is better to qualify for your loan showing only your base salary. If you are able to do so, then the lender will not typically look further by asking for your tax returns. They will only require a copy of your last two years' W-2s. This is not always the case, however. Sometimes just the fact that you are in sales will raise a red flag to the lender. Go over this subject in detail with your mortgage professional in advance to determine whether providing this information will help or hinder your qualifications.

Professions that Require Degrees

There are many professions that require degrees such as doctors, lawyers, dentists, school teachers and professors, chiropractors, scientists, engineers and many more. There are many occupations that require trade school or certification or special schooling to become eligible to conduct business. This would include police officers, firefighters, EMTs (emergency medical technicians) and others. Typically the lender requires a two year history in the same field of employment but for these special categories, a history is usually not required. For example, if you just graduated from medical school and have your degree, your first job could very well be as a doctor in a medical practice. Your salary could be $120,000 right out the door. You would be able to use that income to qualify as long as you provided a copy of your medical degree. If you get a job as an attorney at a big firm fresh out of law school, you could use that income as well. This is all possible without the two year history because the degree acts as your history. Police officers and firefighters who have gone through their respective academies would be able to use their base salaries as income even though they may have been on the job only two months. The downside to this is that you cannot use bonuses, commissions or overtime in calculating income because you don't yet have a two year history of receiving those types of funds. For those occupations, bonus, commissions and overtime can make up a substantial portion of a paycheck. You'll have to wait two years before you could use that income to qualify.

The key is to make sure you keep your degree or certification handy when applying because the lender is most definitely going to need a copy of it. Teachers will have to provide their teaching credentials. Some occupations might even require you to provide your college transcripts. Be proactive and have them ready if you are asked for them. It may save you a lot of time and you won't have the stress of having to scramble for them.

Chapter 5: You are Approved, Now Stay That Way!

Changing Information during the Loan Process

If you just got married and are in the midst of changing names, please be aware that this could cause problems with your loan. If you want to put your new married name on the loan, make sure that you legally change your name at least two months prior to getting a home loan. It's not uncommon that I've had a borrower get married halfway through the loan process and want her new married name on the loan and title. To do that, the lender will require the marriage certificate (usually certified) and, perhaps, the new updated driver's license with picture ID. It can take time to get these things. Dealing with state government agencies, the Department of Motor Vehicles in particular, is rarely easy. The best bet is to wait until after the loan is closed and then do a quick claim deed to change the title into the new married name. A quick claim deed is a one page form that allows you to change names on title. Any escrow or title company should be able to provide one, but the best person to get one from is a mortgage professional. He or she may not have one on site, but should know how to get one and can probably assist in getting it recorded with the county. It will usually only take a week to change the title to the property.

Another item that should not be changed during the loan process is bank accounts. If you are in a situation in which you are unhappy with your current bank, wait until your loan is closed before switching banks. It can become a nightmare to document the transfer of an account from one bank to another right in the middle of your loan. Lenders will require proof that the account was closed and will want documentation to show that you wrote a check from the old account and deposited it into the new account. Our job as mortgage professionals is to help guide you and educate you on what to do and what not to do. Waiting to close the account would be the wisest choice.

New Credit Purchases

One big mistake many borrowers make during the loan process is buying or charging items on credit cards after they get pre-approved for their home loan. They tend to think that, since their loan is already approved, they have nothing to worry about so they go ahead and make a sizeable purchase. This is definitely not a good idea. Pre-approval does not mean that the loan is guaranteed! The lender can still run credit anytime prior to closing and, in most circumstances, they do.

I usually send a letter to my clients stating, "Do not charge $500 or more on your credit card without talking to me first!" The purpose of this is to alert borrowers that charging something over $500 could affect their qualifications. Maybe they were very tight on qualifying in the first place and their debt-to-income ratio was a bit high. Now, with this added debt, they may go from pre-approved to declined and lose their home financing. Additionally, it's possible that the added debt to a card can put it over the 30% maximum that should be charged on that credit card and it would directly affect their credit score by causing it to decrease (see Balances on Credit Card Section). In some instances, such a purchase will not make a difference because the borrowers are very well qualified and the added debt won't affect their situation. However, my advice is to be safe rather than sorry. Always call your mortgage professional prior to making any new purchases that could significantly affect your score or debt-to-income ratio.

New Credit Cards or Installment Loans

It is best to refrain from applying for new credit cards or installment loans 90 days prior to applying for a home loan. If you apply within 90 days, it will put an inquiry on your credit and inquiries that are 90 days or sooner will have a greater impact on your credit score than ones that are older than 90 days. In addition, this will alert the lender that, if you haven't already, are considering adding a new credit card or installment loan to your credit and they will question it. For example, if the lender sees a Toyota Motor Credit inquiry on your credit report, they may require a written explanation of what you were trying to purchase. If you explain that you were thinking of buying a new car, the lender will most definitely re-run your credit right before closing to see if you actually did purchase a car. If you did, it would obviously affect your score and your debt-to-income ratio. Sometimes it takes a month or two before a purchase shows up on a credit report, but your best option is not to make such purchases or apply for any new credit during this time, period! If you want to buy the car, wait until after the purchase of your new home. Resisting the temptation to buy can be tough to deal with, but in the long run the house is almost always the more important of the two purchases.

Co-Signing for a Loan

What does co-signing for a loan mean? When you co-sign for a loan, you are using your income and/or credit to help someone else apply and qualify for a loan. In doing so, you are typically held 100% responsible for the debt that person is applying for. You may not be the one making the payments but, if the person you were helping by co-signing falls on hard times financially or misses payments, it could end up destroying your credit. Co-signing for someone, whether related or not, is typically not a good idea. There are times when co-signing is required, such as for a son or daughter getting his or her first car. The important thing to remember, and I can't stress this enough, is that if you do co-sign for somebody, you should retain control of the process. What I mean is that it is best if you make the payments yourself. Have the debtor give you the money and then you pay the creditor. That way if they fall behind for some reason, you can pick up the slack and keep your credit clean. My belief is that if you can't afford to make the payments should something go wrong, DON'T co-sign. It really is that plain and simple.

Another problem that can arise with co-signing for others is the potential to affect your own qualifications if applying for a loan for yourself in the future. The payment obligation will show up on your credit report and affect your debt-to-income ratio. There is, however, a possible remedy to this situation. In most instances if you can provide the lender with 12 cancelled checks from the person who you co-signed for showing that they were actually making the payments, then the debt will not hinder you from qualifying. The lender will typically remove the debt from the equation. But if the person you co-signed for pays this debt in cash, it will be more difficult for you to demonstrate. In that case, there is no way to prove who is making the payments and it most definitely will be charged against your credit as a debt. This could potentially hinder your qualification. Always have the debtor pay

you by check or, if they don't have a checking account, money order and keep at least a 12 month record of those payments in hard copy. When in doubt, talk to your mortgage professional on the consequences of co-signing so that you don't make a mistake that could come back to haunt you later.

Chapter 6: Important Things You Should Know

Meeting with a Professional Is Important

This is an important tip that, in reality, most people don't realize. It is highly advised that you meet with a mortgage professional at least three to six months before you apply for a new home loan or refinance your existing one. Sometimes this is, understandably, impossible but, in general, it is very good advice. The reason for such a meeting would be to determine if there are any possible issues that could affect you getting the best loan possible. You'll learn what loan amount you can qualify for, find out if there are any credit issues that you should correct or work on (see Be Credit Ready) and your mortgage professional can learn about your plans and give related, pertinent advice. Many issues can be addressed such as how to best handle the receipt of gift money or mattress money, the switching of jobs, the paying off of a collection account and many others that could detrimentally affect you. Meeting ahead truly can make or break your deal and will help prepare you for the best possible financing options. For example, you wouldn't want to apply with a 680 credit score and, ultimately, end up paying more for your loan if you could have a 720 credit score by making a simple correction to your credit prior to beginning the process.

Questions to Ask Your Mortgage Professional

There are two questions that I think are important to ask your mortgage professional to learn how well he or she knows the business. This will give you a good idea as to the level of knowledge. The first is, "What do mortgage interest rates follow?" The answer is the yield on the Fannie Mae 30-year bonds, also known as Mortgage Backed Securities. Your mortgage professional is wrong if he or she answers that it is the 10-year Treasury bond. That and interest rates can have similar trends over time, but they definitely have different daily variances which can make all the difference in the world when it comes to foreseeing where rates are headed. The second question is, "What happens when the Fed lowers interest rates?" When the Fed lowers the Fed Funds, Discount Rate and Prime Rate, it is trying to get people spending. This, in turn, increases inflation, which is then followed by an increase in interest rates on mortgages. When the Fed raises rates, they are attempting to hedge (lower) inflation, which is then followed by a decrease in interest rates on mortgages. The Fed Funds, Discount Rate and Prime Rate are short term rates. Mortgages are long term rates. Their relationship runs opposite. Using another explanation, Prime Rate in particular is tied to consumer debt, such as credit cards and home equity lines of credit so when it goes down, more people spend, inflation rises and so do interest rates on mortgages. The same holds true in reverse.

The detailed information behind these answers can be puzzling but if you are dealing with a true mortgage professional, the answers you receive should be clear and concise. There are times during extreme volatility, such as was seen in 2008, in which these rate indicators can change in the opposite direction of their norm. This is extremely rare, but can happen.

This is the most important purchase of your lifetime and I suspect that there are enough real professionals available to help

you through it in a way that is understandable to you. Experience, knowledge and integrity still comprise the backbone of our industry. To get the best possible service and result, it is important to work with a professional who is licensed by his or her respective state's Department of Real Estate. Many direct lenders do not require that their loan officers be licensed because they operate under rules set by the Department of Corporations, which basically states that these loan officers are employees working under the protection of a corporation. Licensed loan professionals, on the other hand, are held to higher standards, must pass the state test and take continued education courses every four years to stay informed. In the near future, all loan professionals, whether mortgage brokers or bank loan officers, will have to register on a national registry system to better protect the consumer.

Understand Your Loan Program

Make sure you understand the loan program that your mortgage professional is putting you in. A 30-year fixed is the simplest of loans, but not everyone knows what that is. The word amortization is not one that everyone is familiar with. You would expect that a loan professional, whether working for a bank, direct lender or as a mortgage broker would put you in a program that is best suited to your particular situation. That doesn't always happen. As a mortgage broker, that pains me.

There are certain loan programs that benefit lenders and mortgage brokers more than others and, unfortunately, some of these people are unscrupulous in that they will put clients in those loans even though they are not in the best interests of those clients. You should always ask questions and make sure that you understand the loan program entirely. If you don't, ask them to explain it as many times as is necessary until you get it. If you don't understand it, don't sign it. I always say, "There are no dumb questions, just dumb answers". An ethical and honest loan professional will be able to explain the program to you in comprehensible terms. If he or she is unable to explain it to you in such a way, take that as a hint that you probably shouldn't be using that person. Make sure you completely understand the terms, conditions and restrictions of the loan. Don't move forward if you don't!

Communication between Your Real Estate Agent and Loan Broker

This tip is extremely vital to a successful real estate transaction. If your real estate agent and mortgage broker aren't in tandem with each other, it could cost you your deal. Make sure that you always have your agent talk with your mortgage professional. The reason behind this is simple. Your mortgage professional will know how much you can afford, how much you can put down, what your closing costs should be and what your approximate interest rate will be. If your agent makes an offer and isn't fully aware of your financial situation, the offer could go awry. I've seen offers made showing a bigger down payment than the borrower actually possesses. I've also seen situations in which the borrower is cash strapped and the only way the deal can work is if the seller pays, for example, $6,000 towards closing costs but the agent did not know to ask for that in the offer. Another example is if the agent puts in the financing section of the purchase contract a maximum interest rate of 7.5% but the client had only been willing to go up to a rate of 6.75%, the client would be locked into the deal at any rate up to the stated 7.5%. Communication is critical and with it, these situations should never arise.

There are several legitimate ways to back out of a deal. Here are a few:

1. The appraised value comes in lower than the purchase price.
2. The home inspection uncovers major issues or needed repairs and the seller is not willing to address them.
3. Interest rates go up too high and the borrower can no longer afford the loan.
4. The loan gets declined.
5. The terms of the contract are breached, such as the contingencies (loan approval, appraisal and inspection)

were to be removed by a certain date (usually within 17 days from the contract date), but the buyer doesn't remove them, even after a notice to perform has been presented.

There are a few other ways to back out of a deal as well. As you can see, however, communication between agent and loan broker is an important step in ensuring that things are done right and you are protected. Make sure they are in communication with each other before an offer is made.

Pre-Approval vs. Pre-Qualification

Pre-qualification means a mortgage professional has reviewed your income, assets and credit with you and has determined, by some calculations, what amount of a home loan you will qualify for. Pre-approval takes this one step further by not only verifying your income, assets and credit with you, but also taking a loan application and submitting your file to a lender for approval. Lender approval can take anywhere from 24 to 96 hours and is a much more efficient way to prepare yourself when purchasing a home. Most home offers these days require that each borrower be pre-approved prior to making the offer. Some listing agents are actually requiring a copy of the approval from the bank prior to presenting the offer to their sellers.

I have always believed that getting pre-approved is the best way to go. There are some mortgage professionals that do a poor job of qualifying and this leads to a false sense of security. I've heard of many instances where borrowers were told that they qualified for a loan and then, based on that, made an offer on a home which was accepted. When the borrower's file then went to the lender for approval, it was declined. I've also had many mortgage shoppers come in with pre-qualification letters from banks or other mortgage brokers stating they were approved, for example, for $550,000 but when I ran their numbers, they only qualified for $350,000. This is very misleading. Qualifying borrowers is an art form and the more experienced loan professionals know the importance of the pre-approval. Now that you are aware of the difference, make sure that you are pre-approved and not just pre-qualified.

Paying Down Your Installment Loans

Here is a great tip that may help you qualify for more or help if your debt-to-income ratio is too high. An installment loan is a loan in which you are paying equal payments over a period of time, at the end of which you will have paid the loan off in full. A good example of this is a car loan. Lenders will exclude a payment from the calculation of your debt-to-income ratio if you have less than 10 months left to pay it off.

For example, if you owe $3,200 on your car loan and your payment is $600 per month, dividing $3,200 by $600 shows that you have 5.33 months left to pay on that loan, at which point it will be paid off in full. In this instance, the lender will exclude the $600 monthly debt, which in turn will qualify you for a greater loan amount. Keep in mind that this is only for loans in which you will own the vehicle or asset. If you are leasing the vehicle, the lender will not exclude the payment because, once the lease is over, they assume that you will replace it with another vehicle lease. Be sure to check with your mortgage professional, however, before you make any decisions to pay down your installment debt because there are lenders who will not exclude debt with less than 10 months left to pay. That is rare, but it does happen. Knowledge is the key to getting your best loan.

Debt-to-Income Ratio

This tip is very important and understanding it can make the loan process go much smoother. To begin, a debt-to-income ratio is all of your monthly debts (minimum payments on credit cards, car loans, student loans, department store cards or any other payment that would show up on your credit report) added to what your new housing payment will be and then that figure divided by your gross income. Your housing expense includes principal, interest, monthly property tax payment, monthly fire insurance payment and homeowner's association dues, if applicable. Your gross income is before taxes and any other deductions. Here is a simple example: Your gross income is $10,000/mo. and your debts add up to $440/mo. (car payment of $350, Discover card payment of $30, JC Penny card payment of $20 and student loan payment of $40). Your new payment on the house will be $2,300 (remember, this includes principal, interest, taxes and insurance). To calculate your debt-to-income ratio, you add $440 plus $2,300 which equals $2,740. You then divide that by your gross income of $10,000. You arrive at a 27.4% debt-to-income ratio. This would be excellent. This ratio means that 27.4% of your income goes toward your debt. Try to keep this ratio no more than 45%. Doing so will put you in a comfortable position with the lender and you should, in most circumstances, qualify for your loan. Ratios over 45% are more likely to put a financial strain on you and are not preferred by the lenders. Is it possible to get a loan with a ratio higher than 45%? Absolutely, but as I said, it is not preferred and is riskier to all parties involved.

Bankruptcy

Typically, lenders will not lend money to borrowers until at least four years have passed since a bankruptcy was discharged. There are situations, however, in which one can get a home loan with less than one year since a bankruptcy. For example, if it was a medical bankruptcy, an FHA (Federal Housing Administration) loan would still be possible provided proper proof was supplied. A written explanation along with supporting documentation would be sufficient. To explain some terms, a medical bankruptcy arises from a tragic event happening in one's life which causes everything else to get put on hold, including all debts and obligations, due to the seriousness of the illness or life threatening injury. FHA is a loan that is insured by the Federal Government, usually for 1st time buyers or buyers with little down payment (but is not limited to just those borrowers, anyone can apply for an FHA loan). A HUD home is an FHA loan that went into foreclosure.

Claiming bankruptcy is not one's finest hour, but you can do your best to get yourself in a good position to re-establish credit and obtain financing. Lenders want to see that you have applied for new credit and have managed it successfully before they will lend to you again. You should try to establish at least three to five new lines of credit. Don't use them to charge to the hilt. Pay them off right away. The most important tip after bankruptcy is DON'T MAKE ANY LATE PAYMENTS! If you have any late payments on credit cards or installment loans after a bankruptcy, you are basically showing the lender that things haven't changed much and chances are good you will probably be bankrupt again in the future. The goal is to show the lender that the bankruptcy was a one-time event and that it will never happen again.

Don't Pack Too Much Too Soon

When you are purchasing a new home, it is exciting to start packing up your belongings and preparing for the move. As exciting as it is, it can be a stressful undertaking, too. My tip is to be particular about what you pack. It's fine to pack items such as dishes, photo albums, heirlooms, things on the storage racks in your garage, non-important documents, etc. But you will be doing yourself a favor if you do not pack important documents such as bank statements, tax returns, checkbooks, a living trust document, divorce or bankruptcy papers, retirement papers and pay stubs. These are items that you may need to produce during the process of getting your loan approved and closed. Set aside a separate, open box with all of your important papers. Leave this box in a place that is easily accessible. I've seen the failure to do so cause major stress for borrowers when they can't remember where they've put those items.

Action Plan

Now that you've learned the tips and tricks to obtaining a successful mortgage loan, what's next? Keep this book handy and when the timing is right, pull it out and review the topics that relate to you. The table of contents lists each and every tip so that it is easily accessible. My goal in compiling all of this useful information in an easy to read and understand format was so that you can pave the way for yourself to getting approval on the best loan possible.

After you've read through this book, I'd like to hear from you! You can email me at loanmanjeff@gmail.com. If you feel that this book would be a great gift for a first time homebuyer, friend or relative, you can purchase it online at www.loanmanjeff.com.

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Credits

The content of this book was derived from my many years in the industry and my experiences working with clients. Some material was gratefully influenced by the teachings of Linda Ferrari from Credit Resource Corp., LoanToolBox.com, The Mortgage Market Guide and myFico.com.

About the Author

Jeff grew up in Chatsworth, CA and after high school, attended and graduated from California State University, Northridge. He obtained a Bachelor of Science Degree in Business Administration in 1991. During and after college, he worked at Bank of America as a Preferred Banking Officer and then, in 1993, joined Automatic Data Processing, Inc. as a District Manager until 1998. While working for ADP, he applied for his real estate license and began working part-time as a loan officer for a mortgage company in Simi Valley. This is where he found his niche in business and a love for an industry that he still enjoys today. He opened his own mortgage company with a partner in 2002 and then branched off on his own in 2004 to open Southern Oaks Mortgage, Inc. located in Valencia, CA.

Jeff has been married to the love of his life for over 16 years and is the proud father of three beautiful girls. He's very active in the YMCA's Indian Princess Program through which he spends weekends camping with and enjoying his girls. He's an avid tennis player and golfer and loves to travel and experience unique and new places with his family. Jeff's passion is people and networking with others. He's been involved with Business Networking International for almost 10 years and is extremely active in his community. The mortgage industry has provided him with the perfect way to help others with the most important purchase they most likely will make in their lifetime. He has true passion for his job and his life. He currently resides in Stevenson Ranch, CA.

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Frank D. Di Tomaso, Jr. - Vice Chairman, Bank of Santa Clarita

"This is a great educational tool for those that are considering buying a home. A must read! Well done Jeff! This book definitely documents your expertise in this area. Any client would be blessed to have you as their mortgage broker."

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