

How to Qualify for a Loan

Believe it or not, most first time home buyer programs do not require you to be a first time home buyer and if they do, a first time buyer is somebody who has not owned a home in 3 years. Also, I would like to point out the fact that two people do not have to be married to apply and qualify for a loan. If you are married, you don't have to include both borrowers on the loan. For example, if the husband makes most of the income and has good credit but the wife has terrible credit, you don't have to include her on the loan. Finally, there are programs which allow a parent or friend to be a co-borrower on the loan and they may not have to live in the property. Please consult your loan officer to determine which programs are best for you based on your qualifications.



There are five main factors to consider when qualifying for a Loan-Credit, Assets, Income, Debts, and Property Type:

1. Credit

The first thing you must do is check your credit. You can receive your credit report and FICO score online in seconds. Your score impacts the mortgage interest rate you are likely to receive. A lower rate can save you thousands of dollars in interest over the life of your loan. You can send your credit report to your loan officer so that he can determine which loan program will best suit your financial needs. **Do not apply** for every loan online or let every loan officer pull your credit because the inquiries will lower your score, and in some cases I have seen credit scores drop 25-50 points from too many inquiries. The cut off point is 620 for most first time home buyer programs except the Also, if you have any collections or



judgments, they will most likely have to be paid off prior to closing unless you have made payment arrangements and been making payments for at least 1 year. The FHA program is one of the last programs left which considers all the circumstances on your loan file before making an underwriting decision to approve your loan. If you have credit issues, you should work on cleaning up your credit 6 months to 1 year prior to loan application.

Consumer credit counseling, bankruptcy, and no credit history deserves special consideration. Some programs will require you to get out of consumer credit counseling program to qualify. These agencies will tell clients it will help their credit but, in reality, it hurts your chances of getting a mortgage loan. In regards to Chapter 7 bankruptcies, you will need to have a bankruptcy discharged a minimum of 2 years with re-established credit such as credit cards and installment loans with no late pays to qualify. If there were extenuating circumstances for the bankruptcy such as medical illness, then you may qualify for an FHA loan after 1 year. Also, you only need 12 months satisfactory pay history and Trustee approval for Chapter 13 bankruptcy. The middle score is the score that lenders use to qualify you for a loan program. For example, if your scores are 592, 650, and 675, your middle score is 650. You would ignore the low score (592) and high score (675) and take the middle (650), **not the average** of the 3 scores. Also, you should try to establish non-traditional forms of credit such as rent, phone, electric, gas, health club, car insurance, cell, etc. for 6 months-1 year so that a lender can build a credit report for underwriting to review.. Due to the Mortgage Crisis and tightening of loan guidelines by all lenders, it is now more important than ever to make sure your credit is in the best possible standing before applying for a home loan. If you get approved for a great loan program today, please don't wait too long to buy a home because the loan program could disappear tomorrow.

2. Assets

Funds used for a mortgage loan is one of the biggest factors when applying for a mortgage. People think they can get money from anywhere and dump it into their bank account at the last second and the lender will not question the source of these funds. Wrong! Lenders want to know how you got the money and where did it come from. Large deposits must be verified or explained in a letter. For example, if you are receiving a bonus from work, you need to copy the check and get an electronic deposit slip. If you are receiving a gift from a relative, you must have a gift letter filled out (provided by lender), make a copy of the cashier's or certified check, and get a deposit slip. You will need certified or cashier's check, otherwise, the bank may verify your relative's bank account history to see if they had sufficient funds to give you a personal check. Trust me; your relative does not want to reveal their bank account history. Most of the first time home buyers I deal with have sufficient credit to qualify for a loan but no money for a down payment or closing costs.

If you want to make your life a lot easier, deposit any funds you may use for a loan such as 401k loan proceeds, cash advance on a credit card, personal



loan, money owed by a friend, or gift from relative at least 3 months prior to applying for a mortgage. Most lenders will only ask for 1-2 months bank statements and the deposit will not show up on these statements and there will no questions asked and no paper trail will be required. Also, do not keep transferring funds in and out of accounts because the paper trail is difficult to follow. Ideally, you want to provide the lender with 1-2 current bank statements which show only payroll or automatic deposits such as disability or social security income, not funds flying in and out of the account.

3. Income

People work on all types of income structures and lenders will use different formulas to figure out what income to use to qualify you for a home loan. Most lenders will use gross monthly income to qualify you, not take home or net pay. **Here are some examples of different types of pay structures and how lenders may calculate income.**

The most straight forward type of income to calculate is salary or hourly pay. Some examples:

If you make \$48,000 year salary, your gross monthly income would be $\$48,000/12$ months or \$4,000 per month. If you make \$12 hour, your gross monthly income would be $\$12$ per hour x 40 hours per week x 52 weeks = $\$24,960/12$ months= $\$2,080$ per month.

This type of income is usually reported on W2 form and if you do receive a 1099 form for employment income please let your loan officer know because the income will have to be computed using different formula.

The tricky part is bonus, overtime, and commission pay. Most lenders will average this type of income over 2 years plus year-to-date to qualify you. For example, if you had \$5,000



overtime for 2001, \$6,000 in 2002, and \$4,000 year-to-date as of September 30th, your average overtime would be $\$6,000 + \$5,000 = \$11,000/33$ months= $\$454$ per month. So, if your current base salary is \$35,000 then your total gross monthly income would be $\$35,000/12$ months= $\$2,916 + \$454 = \$3,370$ per month. If you receive a raise in your hourly or base pay, you can use it immediately to qualify for a loan but if you have received bonus or overtime for less than 2 years, you may not be able to use this income at all. For individuals who work on commission, lenders will average the net income (commissions minus

expenses) from last 2 years tax returns. Caution: If your overtime, bonus, or commission income has decreased dramatically from last year to current year, the lender may use a much lower income figure.

Calculate income for self-employed individuals is an art form. You will need 2 years complete personal and corporate and partnership forms if applicable to calculate income. Also, you may need a year-to-date profit and loss statement. You should use an experienced loan officer to structure these types of loans.

Alimony, child support, permanent disability, retirement, social security income. In most cases, you must show monthly receipt of funds and prove that the income will continue for at least 3 years if they are to be used to qualify for a loan.

Trust and dividend income-Lenders will average last 2 years tax returns.

Part-time income-Must have 2 years on job and lenders will average last 2 years.

Unemployment, side job, short-term disability, types of income usually can't be used to qualify for a loan.

Today, technology has taken over the mortgage industry and approvals generated by submissions to automated underwriting will spell out what type of income documentation will be required to complete the loan application. You may need less documentation than stated above to calculate income, but it always best to be conservative. Also, you do not need to be on your current full-time job for 2 years to qualify for a loan or in the same field for that matter. You can be a recent college graduate just starting your first job and lenders will use the starting salary based on an employment contract only. Lenders have tightened the guidelines, but you should consult a loan officer to see which program will best suit your needs based on your current income situation. Make sure to get pre-approved.

4. Debts

Lenders utilize front-end and back-end or total debt ratios to qualify you for a loan. The front-end ratio is simply the housing payment divided by your gross monthly income. For example, if you were a computer consultant making \$48,000 per year who was buying a home for a \$150,000 and the payment came out to be \$1,200 per month including taxes and insurance, your front-end ratio would be $\$1,200 \text{ mortgage payment} / \$4,000 \text{ gross monthly income}$ or 30%. In most cases, your front-end ratio should be in the 28% to 33% range but if you have excellent credit, no debt, or if the loan program does not consider the front-end ratio you may be able to greatly exceed this ratio. The back-end or total debt ratio is the housing + minimum monthly credit card + installment + child support/alimony (if applicable) payments divided by your gross monthly income. Minimum required credit card payments are



used to qualify, not how much you pay every month, which can be much lower and thus keep your debt ratio down. You must use student loan payments to qualify for most conventional loans even if they are in deferment. Only revolving and installment debts shown on credit report are used to qualify. In most cases, we will not count certain types of payments such as utility, car and health insurance, cell phone, 401k deductions, etc. Some first time home buyers will need to pay off or restructure debt at least 2-3 months prior to mortgage application to qualify for a home loan because the ratios are too high. Also, your credit scores should improve and make sure to monitor your progress. Finally, please don't buy a new car or pick up a computer payment just before applying for a home loan.

5. Property Type

There are many types of residential properties and they can require special underwriting consideration. Here are some examples:

Single family home/PUD's-Single family homes and PUD's or Planned Urban Developments located in residential areas are the easiest types of properties to finance.



Condo/Town homes-If you purchase a new condo or town home, most first time home buyer programs will require that the building phase is complete and 70% of the units have been sold and under contract, not closed, prior to closing your loan. If you are buying existing construction, some lenders will require that 60% of the owners in the complex actually live in the units. I have had situations

where buildings were less than 60% owner occupied, which means 40%+ of the units were being rented out, and the financing options were limited. So please get the phone number of the management company or association for the complex so that the loan officer can determine which first time home buyer programs are available. For the most part, town homes are in the same class as condos for underwriting purposes except you may be required to obtain home insurance for a town home which will increase your monthly mortgage payment. In side the Walls home insurance is required on a condo in addition to a blanket insurance policy provided by the complex.

2-4 unit buildings-Underwriting will use rental income to qualify for a multi-unit property but the guidelines are usually more conservative. In most cases, you can only use 75% of the rental income to qualify and that income is added to your gross monthly income figure and not subtracted from the mortgage payment and the remainder used for qualification purchases. For example if you bought a 3-unit building and the total income for the 2 rental units is \$1,500, underwriting would add $\$1,500 \times 75\%$ or \$1,125 to your gross monthly income. If the mortgage payment was \$2,000, underwriting would not subtract \$1,125 from the \$2,000 to get \$875 payment to qualify you for a loan. Remember, you must live in the property to qualify for most first time home buyer programs. Otherwise, it is considered an investment property which could dramatically change which programs are available and you may have to put more money down and pay a higher interest rate.

There are many factors to consider when qualifying for a loan program and you need to be aware how lenders will look at your particular situation and type of home you are thinking about purchasing before applying for a first time home buyer loan.