GUIDELINES FOR THE AVERAGE MORTGAGE

A mortgage lender reviews a loan applicant's financial history to determine the likelihood of receiving on-time payments. The primary items reviewed are:

*** Income** *** Debt** *** Credit** *** Savings** *** Ratios**

INCOME:

Income is one of the most important variables a lender will examine because it is used to repay the loan. Income is reviewed for the type of work, length of employment, education training required, and opportunity for advancement. An underwriter will look at the source of income and the likelihood of its continuance to arrive at a gross monthly figure.

- **Salary and Hourly Wages:** Calculated on a gross monthly basis, prior to income tax deductions.
- **Part-time and Second Job Income:** Not usually considered unless it is in place for 12 to 24 straight months. Lenders view part-time income as a strong compensating factor.
- **Commission, Bonus and overtime Income:** Can only be used if received for two previous years. Further, an employer must verify that it is likely to continue. A 24-month average figure is used.
- **Retirement and Social Security Income:** Must continue for at least three years into the future to be considered. If it is tax free, it can be grossed up to an equivalent gross monthly figure. Multiply the net amount by 1.20%.
- **Alimony and Child Support Income**: Must be received for the 12 previous months and continue for the next 36 months. Lenders will require a divorce decree and a court printout to verify on-time payments.
- **Notes Receivable, Interest, Dividend and Trust Income:** Proof of receiving funds for 12 previous months is required. Documentation showing income due for 3 more years is also necessary.
- **Rental Income:** ***Cannot*** come from a Primary Residence roommate. The only acceptable source is from an investment property. A lender will use 75% of the monthly rent and subtract ownership expenses. The Schedule E

of a tax return is used to verify the figures. If a home rented recently, a copy of the current month-to-month lease is acceptable.

- **Automobile Allowance and Expense Account Reimbursements:** Verified with 2 years tax returns and reduced by actual expenses listed on the income tax return Schedule C.

- **Education Expense Reimbursements:** Not considered income. Only viewed as slight compensating factor.
- **Self-Employment Income:** Lenders are very careful in reviewing self-employed borrowers. Two years minimum ownership is necessary because two years is considered a representative sample. Lender uses a 2-year average monthly income figure for the ***Adjusted Gross Income*** on the tax retunes. A lender may also add back additional income for depreciation and one-time capital expenses. Self employed borrowers often have difficulty qualifying for a mortgage due to large expense write offs.

DEBT:

An applicant's liabilities are reviewed for cash flow. Lenders need to make sure there is enough income for the proposed mortgage payment, after other revolving installment debts are paid.

- **All loans, leases, and credit cards** are factored into the debt calculation. Things like utilities, insurance, food, clothing, and schooling are not.

- If a loan has less than 10 months remaining, a lender will usually disregard it.

- The minimum monthly payment listed on a credit card bill is the figure used, not the payment made.

- An applicant who co-borrowed for a friend or relative is accountable for the payment. If the applicant can show 6 to 12 months of on- time canceled checks from the co-borrowee, the debt will not count.

- Loans can be paid off to qualify for a mortgage, but credit cards sometimes cannot (varies by lender). The reasoning is that if the credit card is paid off, the credit line still exists and the borrower can run up debt after the loan is closed.

- A borrower with fewer liabilities is thought to demonstrate superior cash management skills.

CREDIT:

Lenders require a residential merged credit report from the 3 main credit bureaus: Trans Union, Equifax and Experian. Underwriters study the credit report to determine the likelihood of receiving an on-time mortgage payment. Many studies have shown that past performance is a reflection of future expectations. Any unpaid judgments, collections or charge offs must be paid prior to closing a mortgage. Here are some rules of thumb most lenders follow:

- **12 plus months positive credit** will usually equal an A paper loan program, depending on the overall credit. FHA loans usually follow this guideline more often than conventional loans.

- **Unpaid** collections, judgments and charge offs must be paid prior to closing an A paper loan. The only exception is if the debt was due to the death of a primary wage earner, or the bill was a medical expense.

- If a borrower has negotiated an acceptable payment plan, and has made on time payments for 6 to 12 months, a lender may not require a debt to be paid off prior to closing.

- Credit items usually are reported for 7 years. **Bankruptcies expire after 10 years**.

- **Foreclosure – 3 years must elapse** to be considered for an A paper loan program.

- **Chapter 7 Bankruptcy** – A borrower is eligible for an A paper loan program **4 years after discharge, provided they have reestablished credit and have maintained perfect credit after the bankruptcy.** In some cases, 3 years out of a bankruptcy with a good reason will be acceptable.

- **Chapter 13 Bankruptcy – 12 months continuous on-time payments**, and a letter from a court trustee, can result in an approved A paper loan.

- ***The good credit of a co-borrower does not offset the bad credit of a borrower.***

- **Credit scores** usually **range** from **400 to 800**. A credit score **above 640 usually results in an A paper loan approval**. 660 or more usually is the minimum required for an A paper No Income Verification loan

- **A credit score below 600 may require an alternative credit mortgage program (Subprime)**

- Misinformation on a credit report can be repaired! The FTC states, "Credit repair companies take your money and vanish." Anything a credit repair company does for a fee, a consumer can do for free.

- If a borrower falls behind on a payment, the creditor should be contacted as quickly as possible. Most creditors will work with a borrower who makes an initial good faith effort to communicate with the.

SAVINGS:

Lenders evaluate savings for three reasons:

1. The more money a borrower has after closing, the greater the probability of on-time payments.

2. Most loan programs require a minimum borrower contribution.

3. Lenders want to know that people have invested their own funds into the house, making it less likely that they will walk away from their life's savings. They analyze savings documents to insure the applicant did not borrow the funds or receive a gift.

Lenders look at the following types of accounts and assets for down payment funds:

- **Checking and Savings:** 90 days seasoning in a bank account is required for these funds.

- **Gifts and Grants:** After a borrower's minimum contribution, a gift or grant is permitted.

- **Sale of Assets:** Personal property can be sold for the required contribution. The property should be appraised and a bill of sale is required. Also, a copy of the received check and a deposit slip are needed.

- **Secured Loans:** A loan secured by property is also an acceptable source of closing funds.

- **IRA, 401K, Keogh & SEP:** Any amount that can be accessed is an acceptable source of funds.

- **Sweat Equity and Cash on Hand:** Generally not acceptable. FHA programs allow it in special circumstances.

- **Sale of Previous Home:** Must close prior to new home for the funds to be used. A lender will ask for a listing contract. Sales contract, or HUD 1 closing statement.

RATIOS

The percentage of one's debt to income is one of the most important factors when underwriting a loan. Lenders have determined that a house payment should equal approximately 30% of Gross Monthly Income. Gross monthly income is income before taxes are taken out. Further, a house payment plus minimum revolving and installment payments should be less that 40% of Gross Monthly Income.