The Real Estate Guide to Lending

Note: This guide was written for realtors to help guide their buyers, but it also can be a guide for home buyers to understand the loan process.

Rocco Sansone (NMLS 1723468)

Encompass Mortgage Services, Inc. (NMLS 1614463)

RoccoSansoneMortgage@gmail.com

https://tampamtg.com

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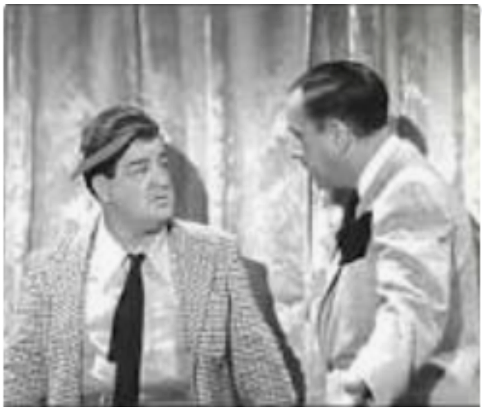
I. INTRODUCTION

The purpose of this guide is to make you more knowledgeable about the lending process and enable you to educate your buyers about lending and buying solutions and thereby gain more credibility with them. Though we don't expect sweeping changes to the requirements for Conventional, FHA, VA, etc., at the same time, we usually see some requirement changes from year to year.

II. PRE-QUALIFICATION PROCESS

Who's on First?



Today it's become standard that contract offers must be accompanied by a buyer pre-qualification (pre-qual), however it may be confusing as "Who's on First" to know whether you need a pre-qual or pre-approval first and to know the difference between them.

The pre-qual process: What service does our pre-qual provide for you and your buyer?

1. We pull credit - More times than not, buyers have no idea what their "real" credit/score is. The free credit services from their bank or credit cards are considered retail credit and are usually inflated scores compared to those from the commercial credit bureaus, which are required Fannie/Freddie, FHA, and VA loans.

2. We evaluate income and employment – Regarding income, many times the buyer may assume a higher amount for which the lender will credit them. For instance, the borrower may state income from the latest year's self-employment, bonus, and overtime earnings, not realizing the underwriter averages these income sources over a few years.

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The lower income credited to them could be enough to disqualify them for a loan. Regarding employment, for conventional, they need at least two years of employment history in the same type of work, but for FHA, they could qualify with less than two years. However sometimes exceptions can be made for instance for students who have no employment history but a recent college degrees or trade certificate. So, it's helpful to ask basic employment questions like how long they have been in the same line of work if they recently graduated. Many times, a borrower may have variable income from self-employment, bonuses, and overtime which typically must be averaged. Part of our pre-qual process is to analyze their variable income to determine how much of it can be used. I'm sure you understand that If income and employment is glossed over, borrowers can miss out on potential opportunities, or receive an invalid pre-qual that could result in wasted time and resources for you and the sellers.

3. We compile assets. As you know, the cash required to close can be a daunting number, and in a competitive market, seller concessions may not be an option, so it's critical to know up-front whether the buyer can gain access to the assets necessary to close. We prepare you to ask some high-level questions. However, for asset screening as mentioned however our prequal will delve deeper to estimate the cash needed to close. This is done by evaluating three areas of costs: 1) Closing costs 2) Prepaid items 3) Down payment. If proper questions are <u>not</u> asked, sometimes the borrower's available assets may be understated or overstated. For instance, if assets are not seasoned or have recently appeared in their accounts, the lender will invalidate them. On the positive side, if your client has access to gift funds from acceptable sources, such as certain family members, they may have more assets than they realize. The asset evaluation service we provide in the prequal allows us to dive deep into personal assets in the borrower's personal, investment, and retirement bank accounts.

Our mission is to serve you in understanding the mortgage process so you can provide professional advice and some level of screening as the first point of contact with the buyer regarding financial questions they may have, but of course, when you're ready to get serious with a buyer, then we will come alongside to provide a high level of confidence in their ability to buy with a pre-qual because as you are aware, without an accurate picture of credit, employment, and assets, you could be wasting your time.

One of the advantages of partnering with us is we want to give you the tools and mortgage knowledge to succeed. Often, realtors in the selling role will call us for advice on buyers working with their own lenders. For instance, we can help you with some of the basic pre-qual questions so you can ask the lender if pulled all three credit bureaus and if the income if fixed or variable. For those of you who have been in business for a while you understand, both on the real estate and the mortgage side, there are always new scenarios for which you have never encountered. Regarding mortgages, call us even if we are not involved in your deal, such as if you are the selling realtor, or your buyer has come with another lender, and we can help guide you in challenging scenarios.

III. PRE-QUALIFICATION VS. PRE-APPROVAL

This is a common question we receive to explain the difference between a pre-qual and pre-approval. Many realtors know effectively that a pre-approval provides a higher probability of a final approval, but are not aware why. So, again, if we can educate you more on the mortgage process, then you can offer more service to your client, and we all know that customer service is crucial for success. A pre-qual should be as reliable as a pre-approval and the advantage is that your loan officer can provide a pre-qual within one day. In most cases, an experienced loan officer's pre-qualification will be all you ever need. However, we understand sometimes you'll need us to provide a pre-approval because the contract may require it. Here is how a pre-approval is different:

- Only lenders can "pre-approve" a loan. This includes submitting a full application to the lender with some essential documentation to run through their automated underwriting system (AUS) to seek an automated pre-approval. The most significant advantage of the pre-approval is that it's based on AUS and provides a high probability that the loan would be approved provided the information stated in the application is verified by an underwriter. The pre-approval process is longer and could take from 1-3 business days.

- Some pre-approvals could require 3-5 business days if the AUS refers to a manual approval by an underwriter.

- Sometimes realtors request a pre-approval to submit a competitive offer, and sometimes the loan officer will recommend a pre-approval when the pre-qual process identifies the borrower's qualifications are suspect or borderline. Our responsibility is your success, so we know you don’t want us to take chances on borrowers who we are not confident will qualify. When there are too many variables in which we can’t be sure what Fannie Mae or Freddie Mac would approve, then we recommend AUS to be sure. Sometimes we can push this through in one day but a pre-approval could take 1-3 days.

IV. **ENCOMPASS VS. ONLINE MORTGAGE BROKERS**

- **Always available**: We work when you work, so we are available seven days a week. Most online lenders are not accessible on Saturdays, Sundays, or evenings.

- **Source for mortgage information**: We want you to educate about mortgages if it can give you an advantage as a realtor, so call us with questions. Call us whether we are working on a deal together or not. There are endless scenarios we could advise in, but here are a few examples of areas in which we have offered advice: Avoid non-warrantable condos, prepare for an appraisal, migrate borderline DTI by paying off loans or borderline cash to close with seller concessions, structuring gift of equity contracts, offering various loan programs from no-income verification to reverse mortgages.

- **Provide personal service**: Online services will not give you personal service but will shuffle you from person to person, and they will only have notes that can only be as good as those taking them. Unlike an online broker, we will follow up with you on issues that need explanation or qualification.

- **Provide credit assistance**: Another advantage of working with us is that If a person is not qualified now, we will help them know what they need to do to become qualified in the future. We have worked with our credit agencies, for instance, who provide a service for a small fee that predicts with high reliability what bills to pay off to gain a certain point increase in credit score.

- **Access to multiple products**: Most online services only offer the products of one lender; we offer the products of various nationwide wholesale lenders. From week to week, one lender may provide better discounts than another. So, one of the advantages of being able to represent multiple nationwide wholesale lenders is that we have access to some of the best rates in the country and don't need to pull credit multiple times for the shopping experience.

- **Troubleshooting a buyer's scenario**: Sometimes, we provide more cash for the borrower to close by slightly raising their interest rate. Sometimes we recommend removing a borrower if both partners are not needed to qualify for first-time homebuyers or programs that require lower median income. With certain loan programs, we can qualify someone moving into the area without a job. So, many times we can help someone prepare through creative solutions and loan programs.

V. QUESTIONS TO ASK YOUR BUYER

Suggestion - ask in a “conversational” manner vs. a “probing” manner.

Examples:

1. **Employment.** Nice to meet you. What do you do for a living? Great, how long have you been in that line of work?

2. **Down payment.** Typical down payments range from 0-20%. What percent do you feel comfortable with?

Buyers are not always forthcoming, so a little conversation could help identify issues. Also, by realtors asking some high-level mortgage questions it can draw out important information that the buyer may not offer to the loan officer and vice versa.

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VI. STEPS IN THE LOAN PROCESS

1. Buyer pre-qual.

2. Find a home.

3. Execute a contract.

4. Apply for financing.

5. Sign loan documentation and receive an lender Loan Estimate.

6. Provide supporting documentation. (Some of this is done through entire loan cycle.)

7. Lender underwriting.

8. Appraisal ordered (this can be simultaneous to #7).

9. Assuming a conditional approval, satisfy lender conditions.

10. Clear to close at least three days before the closing date.

11. Closing.

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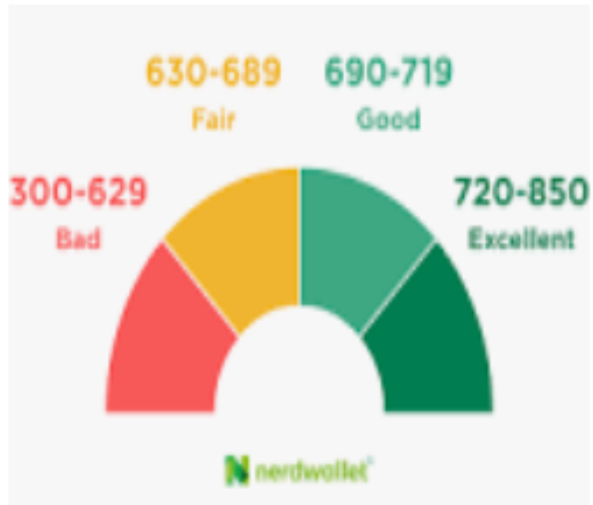
VII. GENERAL GUIDE TO CREDIT

Credit Bureaus Scores:

All three credit bureaus scores should be pulled – this provides a full picture of a person's credit profile. Without all 3 bureaus, we do not have an accurate picture of your buyer's credit. Not all bureaus report the same data. Sometimes a borrower may not have accumulated sufficient credit and may not have all three agencies reporting. Sometimes the AUS will approve these borrowers, but many times, a manual underwriter approval will be necessary.



Many factors determine the interest rate, but credit score is a major input to the calculation. The only credit score used by the lender is always the middle credit score.

If there is more than one borrower, then the lower of the middle scores will be used. Ex: If borrower one has 700, 701, 702 scores, and borrower two has 680, 681, 682, the 681 score would be used.

Credit reports period:

- Credit reports are valid for 120 days.

- Credit is only pulled one time during the lending process (unless closing exceeds 120 days since credit was originally pulled).

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Hard versus Soft Pulls:

Credit pulls are considered a hard pull but minimally impact scores for a mortgage pull. However, when borrowers excessively shop online for the best rates, these multiple hard pulls can begin to lower their scores because it signals to lenders a borrower may be at a higher risk.

To avoid multiple pulls, we offer soft-pulls but for high-level evaluation of credit that does not affect one's credit score, but all pre-approvals and approvals require a credit report resulting from a hard-pull.

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Borrowers receive a copy of their credit, and a tri-merge credit report currently costs about $50 for a single borrower and $80 for joint borrowers.

VIII. FIRST TIME HOME BUYER (FTHB)

What's a First-Time Home Buyer (FTHB)?

A FTHB includes more than borrowers who have never bought a home but includes borrowers who haven't bought a home in the last 3 years.

Perks of the FTHB:

There are significant advantages for the FTHB, like needing less cash and lower interest rates.

- Only 3% down conventional loan.
- Lower interest rate Fannie/Freddie loans (Conventional).
- Lower PMI rates with some programs.
- To qualify, all borrowers' income cannot exceed 80% of the area's median income. Currently, that is $65,680 for Pinellas, Hillsboro, and Pasco counties, and $72,730 for Manatee and Sarasota counties.
- By being able to present the FTHB option to your buyers, you can provide them with more value add.

IX. CASH REQUIREMENTS TO BUY A HOME

How much does a buyer need to buy a home?

Too many factors affect the cash required to close, and they vary from borrower to borrower. First, however, we can discuss the major factors that will affect a borrower's cash needed. (Note that after interviewing a borrower, our pre-approval reliably estimates cash to close).

Cash required from the Borrower:

- Down Payment: These vary by program. Minimal down payment requirements are 3% FTHB, 5% Conventional (Fannie/Freddie), 3.5% FHA, and 0% for Rural and VA. 20% is required to avoid PMI.

- Closing Costs: Closing costs include title fees, taxes, services provided to the borrower, like surveys and appraisals, and lender costs. Because only some of these costs are fixed percentages, and many have to be estimated, its not possible to provide using a percentage so that is why the initial cost presented to the borrower from both the loan officer and the lender are estimates. After the borrower receives an approval to their application the lender sends out a loan estimate which the borrower must sign within three days.

- Prepaid items. Typically, these are per-diem interest for the current month, homeowner's insurance (About fifteen months), and a few months of taxes.

- Special Assessments (like Local Upfront Community Fees, HOA upfront fees, etc.).

- Installment loans or credit cards that may need to be paid to meet the debt-to-income requirements.
- Outstanding judgments or debts may be required to be paid at closing.
- Reserve requirements – typically 3-6 months. (Usually for borrowers with more challenging credit issues).

Cash credited to the Borrower:

- Gifts (Requires a gift letter)
- Seller Concessions (3% max for conventional and 6% for FHA)
- Lender Credits
- Down Payment Assistance Programs

Ex. of Minimal Cash Requirements:

With a VA or USDA loan that requires $0 down and a strong seller concession and/or a down payment assistance program (Do you want to discuss down payment assistance since we don't work with any?) a borrower may not need any cash to close.

Example of Higher Cash Requirements: Conversely, a borrower with a weak credit history, applying for a no-income verification loan, purchasing a non-warrantable condo could be looking at 25% down at a minimum plus closing costs, prepaid items, and higher lender fees.

When providing a pre-qualification, we compare the cash required against the buyer's verifiable assets to ensure your buyer has sufficient cash.

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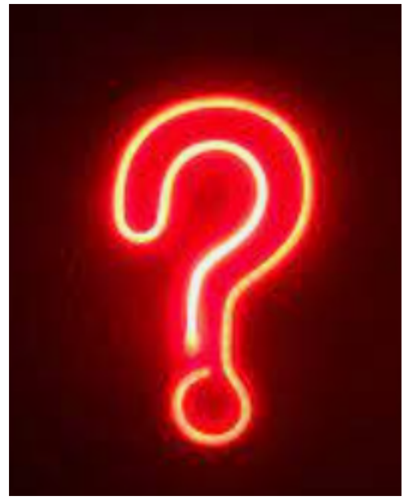
X. DOWN PAYMENT OPTIONS

- VA – 0%
- USDA – 0%
- Conventional – 3-5%
- FHA – 3.5%
- Reverse purchase – 50-65%



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XI. GIFT FUNDS

Often a down payment can come in the way of a “gift” from a family member. Knowing this, you can ask that question if your buyer does not have all the funds they need.

All funds for a down payment must be in a financial institution such as a checking, savings, or investment, or retirement accounts.

The same rule above applies to a donor’s gift funds.

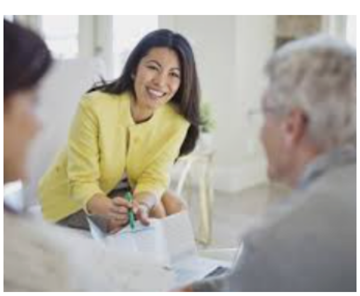
Sometimes the borrower can sell assets for down payment funds.

XII. SELLER CONCESSIONS

Seller concessions are a real estate term that refers to a seller of a property agreeing to pay for some of the buyer's closing costs, repairs or other expenses associated with the purchase of the property. In relation a mortgage here are the current limits for how much a borrower can receive towards seller concessions based on the type of loan program:

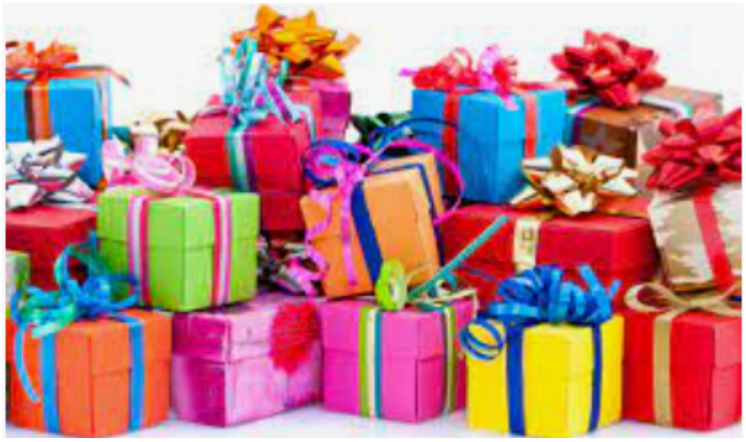
Conventional – 3% allowed.

- FHA – 6% allowed.
- VA – 4% allowed.
- USDA – 6% allowed.
- Reverse purchase – 0% allowed.



As realtors, you know that for seller concessions to work requires a market where sellers must offer this as an option to be competitive. Also, the home must appraise to cover the sales price increases, but you should also be aware that the lenders limit the concessions depending on the type of loan product, as identified above.

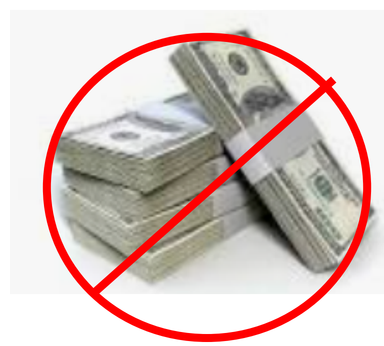
XIII. GIFTS



Gifts (unlike) can be a bridge to provide down payment and closing costs and buyer's own resources.

Generally, gifts are typically from family members. However, FHA adds employers and friends with a defined interest and VA has an even broader definition. They all have one thing in common – gifts <u>can't</u> come from interested parties (i.e., sellers or their real estate or loan professionals).

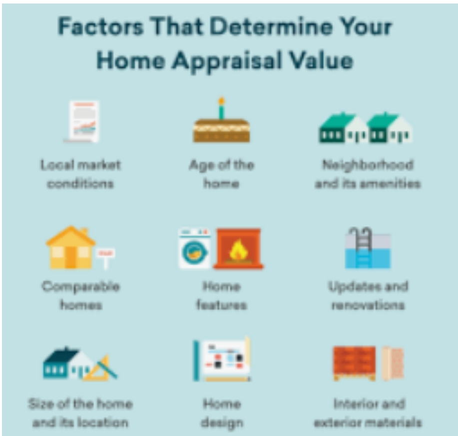
For primary homes there are few limitations. For second homes or investment properties, the restrictions become significant greater.



Gift funds may not be a cash gift and no repayment can be expected. Funds must be able to be sourced (show that they have been in a bank account for a period (usually 2 months).

There are additional restrictions for various programs and lenders, including minimum borrower contribution to the loan under some circumstances (i.e., low credit score).

XIV. APPRAISAL FACTS



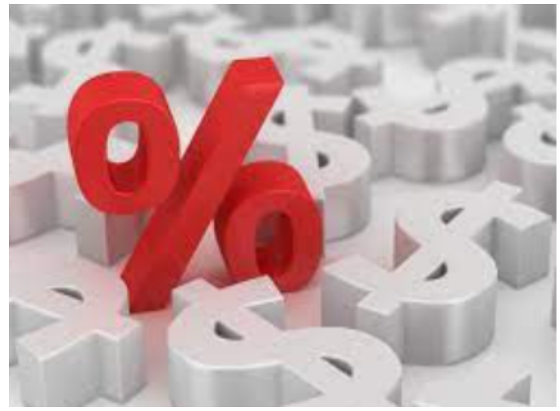
FHA and VA appraisals do NOT appraise lower due to the program. FHA and VA do NOT create more issues than conventional appraisals. Public records are used for the appraiser's data. Be sure if your listing data is correct!

This misconception about government appraisals is very widespread. However, the reality is VA and FHA are more concerned about the safety issues in the home. If you don't have exposed wiring, peeling paint (danger is consumption by a child, plumbing, unsecured railings etc. You should not have issues with these types of appraisals.

XV. INTEREST RATES

What are the Interest Rates Today? Why are they different?

These are typical questions borrowers ask not realizing many factors affect rates such as the market indexes but also on the borrower's financial standing (Credit, cash, capability), loan purpose, property type, mortgage program, and other numerous factors that impact a borrower's rate: Here is some more detail on these factors affecting rates:



- **Loan Programs**: (Fixed, adjustable, 30-year, 15-year, VA, Conventional, FHA)

- Credit scores – The lower your credit score range, the higher the chances of a higher interest rate (Except for Reverse mortgages). According to Equifax, here are categories of credit ranges:

  - 800 to 850: Excellent - Low Risk.
  - 740 to 799: Very good - Positive credit history.
  - 670 to 739: Good - Acceptable and lower-risk.
  - 580 to 669: Fair - Higher risk
  - 300 to 579: Poor - Difficulty getting approved

- **Down payment (loan to value)**: Most people know 20% down eliminates PMI, but they don't realize, the more they put down <20% the lower their PMI will be.

- **Type of property (SFR vs. Condo vs Mfg.):** The lender can raise the interest rate significantly for condos and manufactured home versus conventional credit.

- **Ownership of property (primary, second or investment home):** Investment loans usually carry the highest rate compared to primary and secondary ownership.

- **Income versus debt levels (Debt-to-income – see below**):

- **Lenders vary in rate**: Unlike bank loan officers who can only offer one program, we shop with many different lenders for the best program and rate.

- **Interest rate lock period (30 vs 45 vs 60 days:** The longer period the higher the rate.)

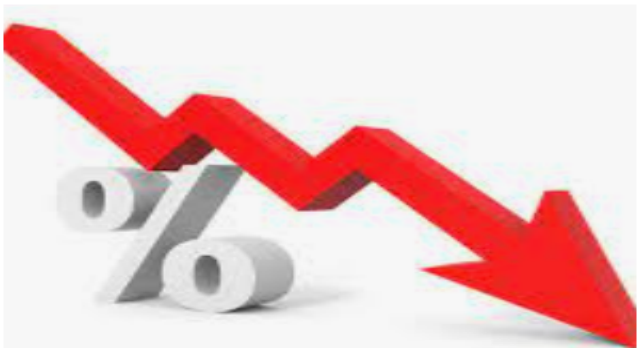
- **Escrow of taxes & insurance:** (Some lenders offer a lower rate to escrow).

- **Amount of loan:** For instance, Jumbo loans, or loans not conforming to Fannie Mae's loan limits ($647,200 for 2023 in the Tampa Bay Area and surrounding counties), typically carry higher interest rates. Lenders may charge a higher interest rate when loans are too low.

- Non-QM (Non-Qualifying) Such as interest-only and balloon loans and loans or non-conventional loans for borrowers who do not meet normal qualifying requirements, such as some self-employed borrowers, or borrowers with higher DTI ratios, lower credit, etc. These loans typically require higher down-payments and interest rates.

- Loan purpose (purchase vs. refi, vs. cash out refi). Typically, a cash-out refi comes with a slightly higher interest rate.

- Market conditions change (Mortgages are based on market indices that sometimes change multiple times in one day)



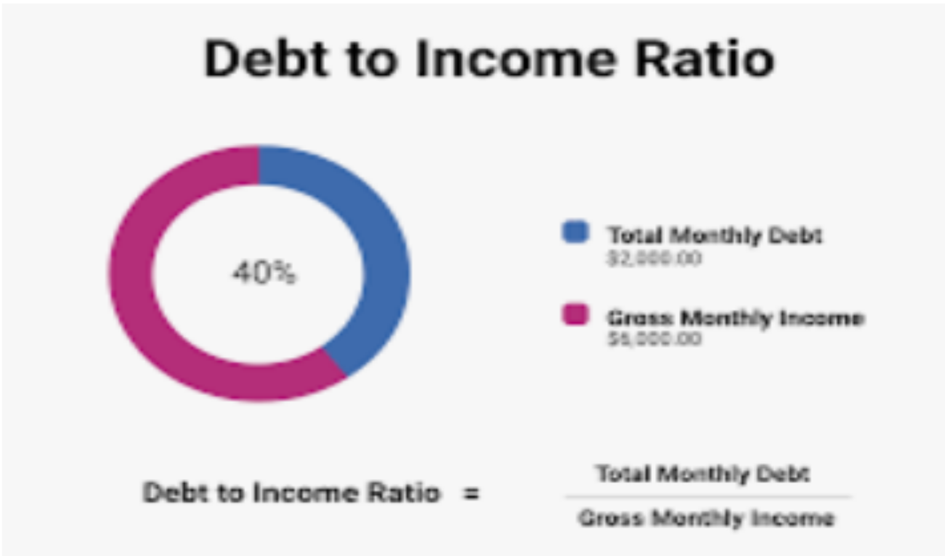
XVI. PRIVATE MORTGAGE INSURANCE (PMI)

Most people know if you don't have *20% down you will have PMI (applies to conventional loans).* However, that is not always true. VA loans have no monthly PMI. There is no reason to be scared off by the thought of PMI. PMI is dictated by:

- Down payment
- Type of home
- Credit score
- Loan type
- Other factors.

PMI is a factor of the down payment, so the higher the down payment under 20%, the lower the PMI and the faster making regular monthly principal and interest payments eliminate it. As a result, PMI is not what it used to be, especially for a good borrower.

XVII. DEBT-TO-INCOME RATIOS (DTI)



What's makes up DTI? It contains two parts:

1. **Debt:**

House Debt: The total house payment (Principle, interest, taxes, and insurance (PITI), HOA, PMI & all other applicable house costs like flood if applicable, etc.).

Personal Debt: Everything on a credit report. This part also includes any private loans, or alimony/child support not shown on a credit report.

What is not considered as debt in the DTI calculation? Utilities, installment debt, like auto loans, under 10 months remaining, cell phones, and normal living expenses ex: food and entertainment.

2. **Income**:

- Employment income in the form of W2, 1099, self-employment income
- Social security and disability income guaranteed for the next three years.

- Retirement monthly income that is guaranteed for the next three years.
- Annuities guaranteed for the next three years.

  Alimony or any income the borrower can substantiated with the proper documentation to continue for at least three years.

Debt ratios can make or break a loan approval and the acceptable number cannot be predicted as it varies by loan program and the strength of the buyer's credit standing but in general the lower the ratio the better yet higher debt ratio can be accepted if other offsetting factors exist such as good credit, a large down payment, the home type, ownership etc.

The bottom line is that size **<u>does not</u>** fit all. There are so many factors that exist on all loans and thus a qualified loan officer needs to look at all aspects of your borrower to ensure mutual success for all parties.

Regarding student loan debt, conventional loans, Fannie Mae adds 1% of outstanding student loan balances to a borrower's debt load, and Freddie Mac adds .5%. So, for example, if the borrower has $100,000 in student loan debt, their monthly debt load increases by $1000 for Fannie loans and $500 for Freddie. In the past, Fannie/Freddie did not include student loan debt as part of the borrower's debt, but now it is and could make large student loan balances challenging for some buyers to qualify.

XVIII. COMMON PROBLEMS & SOLUTIONS

Problem	Possible Solution
Short on Down payment	• Gift funds • VA/USDA/FHA • D.P.A.
Short on cash to close	• Lender credits • Realtor credits • Seller concessions
Appraisal too low	• Formal dispute of appraisal • Negotiations with seller • Lender credits • Realtor credits (to make up shortfall)
Poor credit	• Pre-qual w/a plan to increase scores • Pay off debts • Rapid rescores
Self-employment – can't support actual income via tax returns	• No-doc loans • Bank statement loans
Poor job history but have cash on hand	• No doc loan or bank statement loan

Problem	Possible Solution
High debt	• Pay off or pay down debts to qualify • Co-signer • Student Loan Deferment • Alternative programs

XIX. SENIOR BUYING OPTIONS

Did you know a senior (as young as age 55) can buy a home with approximately 50% down payment and have NO mortgage payments (P&I) for as long as they live there?

Did you know how this can help you close more transactions every year?

Did you know this may double the buying power of any senior buyer?

If not, we have dedicated an entire training session to this. Please reach to one of the loan officers to learn how this can help your buyers!

XX. OTHER UNIQUE LENDING PROGRAMS

- Bank statement programs vs. standard paystub income documentation.

- No documentation loans – lenders don't verify a job, just your down payment, credit, and ability to repay (reserves) for 12 months.

- Jumbo VA – Now Veterans can get loans in the millions vs. being stuck at the county loan limits.

- Asset Dissipation – Lenders look at assets available to use towards payment.

XXI. LOAN TYPES

FHA, VA, USDA, Conventional and Alternative Loan types all have their advantages and disadvantages. Therefore, these various programs give your buyer options and options are buying power.

Some of these differences are:

- Ownership. While all will do primary residences, not all will do second homes or investment homes.

- Treatment of debt (i.e., debt to income ratio, treatment of student loans, etc.)

- Application of mortgage insurance.

- Rates. Government-backed loans tend to have a lower interest rate, but there are other restrictions that go with those lower rates.

- Rules toward acceptable income.

- Rules on seller concessions.

- Locations of home.

Not only are there a lot of differences between programs, the regulations associated with each are changing constantly.

We are ready to help your buyer select the program that maximizes their buying power.

XXII. LENDER VARIATIONS

Each lender has various qualifications … just like your buyer. Some have limitations or restrictions that exceed those required by Fannie/ Freddie, FHA, VA, etc. Examples:

- Rates.
- Maximum debt to income ratio.
- Maximum loan amounts.
- Minimum FICO credit scores.

Our knowledge of multiple lenders gives your buyer the best possible options, which are generally better than a loan officer who represents one financial institution cannot provide.

XXIII. CONCLUSION

We hope this mortgage guide can be used as a reference to make you more knowledgeable about the lending process and enable you to educate your buyers about lending and buying solutions, thereby gaining more credibility with them. Since the mortgage laws change yearly, we'll keep this up to date and send out new ones each year. As in real estate, it's impossible to cover every detail scenario, so feel free to contact us if you have any questions regarding mortgages, whether it's for a loan we are servicing or not. However, we would gladly help provide a pre-qual service for you and your buyers. We understand the stress of the real estate business, so we are available seven days a week to assist with any of your mortgage needs.