SECRETS OF A MORTGAGE LOAN

Some experts believe that consumers could have prevented the subprime mortgage fiasco ... if only they were better educated about how mortgage financing works.

But who wants to school themselves on ratios and amortizations and securitizations when there's another type of homework to tackle—like picking out paint chips and light fixtures? Of course, before you can hit the Home Depot to canvas the paint aisle, you have to get the right financing.

So we talked to a veteran in the industry, Joe Parsons, a senior loan officer at PFS Funding in Dublin, Calif., to get his advice on the key things that home buyers need to know—from where to go for your loan to how you can up your chances of being approved for a mortgage

What does a mortgage Loan Officer do?

Joe Parsons: A loan officer at a bank or a credit union is typically just the smiling face of the institution—the officer's job is to accept an application that the borrower has filled out, and then hand it off to the underwriting department.

An independent loan originator, on the other hand, typically renders more service to the borrower, including things like advising the client about the best loans available for their purposes, gathering documentation throughout the process, ordering the appraisal and communicating directly with the underwriter to ensure that the loan gets approved

So what happens if you don't use a Loan Officer?

A large bank or credit union relies on the underwriting department to handle all of the above tasks—and these departments aren't working as representatives for the borrower. The takeaway for the consumer: Mortgage rates available at an independent loan originator, whether it's a broker or a small banker, won't be higher than those offered through a big bank. In fact, in many cases, the rates are somewhat lower, partly because independent mortgage brokers typically have more loan sources available to them compared to the big banks, which usually just have a handful of loan products to offer prospective homeowners.

Why are mortgage rates constantly changing?

Virtually all mortgages are sold on the secondary market—this is the function of Fannie Mae and Freddie Mac. So once a lender has funded your loan (given you the money), they'll sell it to the investor for cash at a small profit. That loan will then be bundled with thousands of others into a bond called a Mortgage Backed Security (MBS), which is bought and sold by investors just like other bonds and stocks. The price of these securities fluctuates daily based on market activity, so when the price of the MBS goes up, the lender will get more for the loan if they sell that day. And that means they can give you the money at a better price.The market for MBS typically fluctuates about .25% from one day to the next. If the MBS price went up .25% (25 cents per $100 of bond value), the lenders would improve the pricing on their loans by that amount, which would show up in the form of a larger credit to the borrower for the interest rate chosen. So an improvementof .25% in the bond market would mean that a $300,000 loan would be $750 less expensive, if the borrower chose to lock in the rate at that time

What's more important: rates, fees or points?

It depends. If someone plans to have a loan for a very short time (two years or so), trading a slightly higher rate for a larger rebate may make sense. As a general rule, raising the rate .25% will increase the rebate from the lender by 1% of the loan amount. Conversely, someone who expects to have a loan for a very long time may benefit from a lower rate attained by paying "points" (one point is 1% of the loan amount). Mathematically, paying 1% of the loan amount to reduce the rate by .25% will break even in about four years, but it seldom makes sense unless the borrower plans to use the lower rate to pay off the loan faster.

As far as fees are concerned, you have to make a distinction between lender fees (underwriting, document prep, processing, etc.) and third-party fees (title, escrow, appraisal, recording, notary). Some lenders and brokers have very high lender fees, while others may have higher rates instead. For this reason, the consumer should get a written estimate of all the fees involved in the proposed transaction, and then compare the options. Case in point: One lender may have $1,000 in underwriting and processing fees, while another has none—but if the "cheaper" lender has rates that are .125% higher, it may be a false economy to go "cheaper."

What top factors determine if someone gets a loan?

The most important thing is the debt-to-income ratio (DTI), which is calculated by taking the total house payment (principal and interest, taxes, insurance and mortgage insurance, if applicable), adding all "long-term" debt payments (any that will continue for more than 10 months), and then expressing that sum as a percentage of the gross monthly income. For a conventional loan, 50% is the maximum value, but some loan programs may allow a higher DTI.

The lender also looks at the loan-to-value ratio (LTV) or the loan amount expressed as a percentage of the home's value. If it's a purchase, the lender will use the lower of the appraised value or the contract price. And if the LTV is higher than 80%, the borrower will have to pay mortgage insurance.

Next, the lender looks at income. Is it stable? Has the borrower been in the same line of work for at least two years? If self-employed, can the person document income from tax returns? Lenders will use the net income from the tax returns, not the gross, plus they typically average the last two years' net income.

Finally, borrowers have to document that they have adequate liquid assets for the transaction. If there are any large deposits appearing on their bank statements, they will have to show the source. Many buyers get gifts from relatives or family friends, and they must be documented in a very particular way

Is there anything you can do to improve your chances of getting approved for a loan?

Buyers' finances should be reasonably well organized before applying for a loan. If they have credit issues, it's far better to get them resolved beforehand. Credit card balances over 30% of a credit limit, for example, will reduce the credit scores—sometimes drastically. If there are tax liens, unsatisfied judgments or other public record items, deal with these ahead of time. A good loan officer can provide advice on how best to accomplish this.

What are the most common reason why people get turned down for loans?

We don't see very many declines, because we prepare our clients before we submit their loans to underwriting. But the most common problem we see is that the DTI is too high—they're trying to buy more home than they can qualify for.For example, a would-be buyer may be self-employed and just beginning to earn a good income. That applicant may be making $100,000 a year now, but if he earned $35,000 in 2011 and $75,000 in 2012, the lender will average his income over the two tax years—and that may not be enough to qualify for the loan he'd like to have

If you've been denied a loan, what can you do to increase your chances with another lender?

If prospective borrowers have been turned down because of their credit profile, they can fix those items—but that may not happen overnight. If they have open judgments, past-due balances, late payments, etc., they may not be ready to take on the responsibility of a mortgage right now. It's absolutely in their best interest to get their finances cleaned up before they buy.

How can I tell if it'd really worth it to refinance?

If you can recover the real costs of the loan within what you consider to be a reasonable amount of time, it's worth doing. If the "non-recurring closing costs" (title, escrow, underwriting fee, document prep, etc.) amount to $3,500, a borrower might recover those costs in, say, three years. At that point, they are "playing on the house's money," so to speak. They have gotten back the $3,500 to do the loan, and from that time forward, the savings are net to them

A very simple calculation would be to find out what the real cost of the loan is, and then divide that cost by the monthly reduction in payment. If the cost is $3,600, and the payment drops by $200 a month, it would take 18 months to break even (3600÷200). One thing to be aware of is that part of the reason the payment goes down in a refinance is that the term is being extended. So if you got a30-yearloanfive years ago, you now have a 25-year loan. Extending the term back to 30 years will account for part of the drop in payment.

Any tips for finding the right mortgage lender?

Since all lenders have essentially the same rates, a consumer should select a mortgage professional based on their perception of the loan officer's experience and diligence. Does the person answer questions in clear, understandable language? Do they talk about the available choices? Do they respond to email and answer or return phone calls? There is a certain amount of "gut feeling" involved too: Does the loan officer seem interested, engaged and friendly?

There's also the issue of the competence of the lender. Some lenders advertise heavily, with jaw-dropping low rates, but they have no one on staff who can deal with challenges to loan approval. In today's world, there are no more "cookie cutter" loans—every transaction has challenges. If the lender's "loan consultants" are call center employees, the chances of getting a loan approved and funded are much slimmer than with a lender whose representative is licensed and registered.