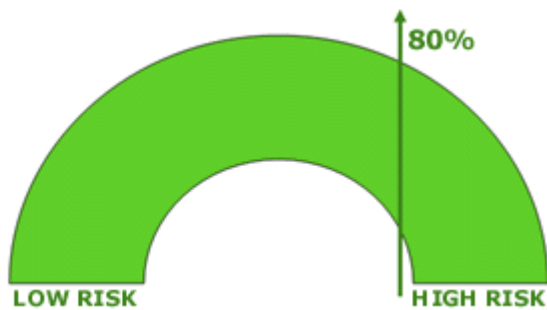


PEAK FINANCIAL ACTIVITY 4e: Intro to Underwriting and What It Means to You

Underwriting is a term used to describe the loan approval process. A decision to grant a loan is based upon the likelihood that the borrower will repay the loan according to the agreed upon terms.

A decision to reject a loan request is based on what your income, credit, job stability, assets, or the security (the real estate; the house) indicate regarding risk. Any weakness in these areas have historically shown lenders that a borrower might not make their payments as agreed or, worse, default on their obligation and not make any payments at all.

Look at the illustration below:



This picture illustrates one of the traditional views of risk in the lending industry. The green arc represents all people who might want a loan. The line that marks 80% divides the picture into low risk and high risk. Traditionally, those people putting 20% down or more on a home purchase historically have low default ratios. Those people putting less than 20% down on a home purchase historically have higher default ratios.

Basic Types of Mortgages

Here are examples and descriptions of different mortgages.

A Conventional Mortgage A conventional loan amount is generally limited to the most common housing prices. It is reviewed and adjusted based upon changing economic information. Currently, a conventional loan balance is limited to \$369,650. A loan balance more than this is considered non-conforming.

As trends in personal savings decreased in the U.S., fewer and fewer people had 20% in assets to use toward a down payment. The industry introduced Private Mortgage Insurance (PMI). A private company, in exchange for premiums paid by the borrower, will offer a guarantee to the lender. Since the introduction of PMI, other alternatives have been introduced by the lending industry in order to make low or no down payment options available.

FHA Loan An FHA loan (Federal Housing Authority) has a lending limit set for each county in each state. Other than the loan limit, anyone may qualify for an FHA mortgage. An FHA mortgage is not just used for first time homeowners. There are no income limits. The location of the property is limited to residential areas. An FHA loan has Mortgage Insurance (MIP) that is paid monthly and financed into the loan. An FHA loan allows for a minimum 3% investment (down payment). The required 3% down payment can be a gift from any number of qualified sources; a family member, a finance company, a qualified down payment assistance program, or even a charity.

FHA loans are not credit score driven. A borrower's credit report is reviewed to make sure he or she handles credit obligations responsibly. Letters of explanation are requested and reasons are considered for delinquencies or derogatory credit. An underwriter can forgive past bad debts if the borrower can support that the reasons for the derogatory debt was due to circumstances beyond his or her control. Lack of a credit history is not enough of a reason to reject a FHA loan. Other forms of obligations can be used to demonstrate a borrower's willingness to pay their obligations as agreed.

VA Loan The VA extends loans to qualified veterans at 100% Loan-To-Value. This loan requires no down payment. The Veteran pays a Funding Fee to the government. In exchange, the government guarantees the loan to the lender. If the Veteran defaults on the mortgage, the lender can seek satisfaction from the government. VA loans are not credit score driven. The credit report is reviewed to make sure the borrower has handled his or her obligations responsibly. Letters of explanation are requested and reasons are considered for delinquencies or derogatory credit. An underwriter can forgive past bad debts if the Veteran can support that the reasons for the derogatory debt was due to circumstances beyond his or her control. Lack of a credit history is not enough of a reason to reject a VA loan. Other forms of obligations can be used to demonstrate a borrower's willingness to pay their obligations as agreed.

Bond Programs Bond programs are offered through various government departments. These programs may be restricted to moderate or low income individuals, limited to certain areas, limited by loan amount, may have asset limitations, and may be restricted to first time home owners.

Rural Housing The Rural Housing Department offers loans for homes located in rural areas. A funding fee is charged to the borrower but it can be financed. This loan allows closing costs to be financed up to the appraised value even if the sales price is lower than the appraised value.

Non-conforming B/C Loans Another industry has grown in the last decade to take advantage of credit-impaired individuals. These loans are also called non-conforming but are commonly referred to as B/C loans. Such loan products will often have lower credit score thresholds, carry prepayment penalties, and have higher interest rates. All terms to such a loan should be reviewed with extra care.

Accepted sources of funds for covering your mortgage closing costs

Savings	A savings pattern is impressive to underwriters in light of how few people manage to save.
Income, Bonus, Sale of Personal Property, Tax Refunds, Relocation Funds	These are all acceptable sources of funds to close. They must be documented from the source to the deposit. If recent deposits can be demonstrated to have originated from your pay check, you can use these funds to close.
401(k) Loan	This is an acceptable source. Consider carefully borrowing pre-tax dollars that are paid back with after tax dollars. When dollars are withheld from your gross income for a 401(k), they are taken before taxes are calculated. If you borrow against your 401(k), your loan repayment will be taken from the net proceeds of your check, after taxes have been calculated and withheld.
Gift	This is an acceptable source. Gifts must be documented from the donor to the recipient. Borrower and donor must sign a gift letter that states there is no requirement to repay the gift. The recipient can elect to repay the gift but cannot be required.
Down Payment Assistance Program (click link to www.getdownpayment.com net sheet calculator)	The seller makes this happen. The borrower negotiates terms rather than price. By offering full price, the seller can make a donation equal to up to 6% to help the borrower gain mortgage approval. Discuss this with your mortgage lending professional team member if you are considering this option.
Gambling Winnings, Lottery Winnings	As long as you can document that funds came from gambling or lottery winnings you can use these funds to close.

