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# **Do You Pass The Mortgage Lender Analysis? Understanding The Home Loan Application And Mortgage Approval**

When a mortgage lender reviews a real estate loan application, the primary concern for both home loan applicant and the mortgage lender is to approve loan requests that show high probability of being repaid in full and on time, and to disapprove requests that are likely to result in default and eventual foreclosure. How is the mortgage lender's decision made?

The mortgage lender begins the loan analysis procedure by looking at the property and the proposed financing. Using the property address and legal description, an appraiser is assigned to prepare an appraisal of the property and a title search is ordered. These steps are taken to determine the fair market value of the property and the condition of title. In the event of default, this is the collateral the lender must fall back upon to recover the loan. If the loan request is in connection with a purchase, rather than the refinancing of an existing property, the mortgage lender will know the purchase price. As a rule, home loans are made on the basis of the appraised value or purchase price, whichever is lower. If the appraised value is lower than the purchase price, the usual procedure is to require the buyer to make a larger cash down payment. The mortgage lender does not want to over-loan simply because the buyer overpaid for the property.

The year the home was built is useful in setting the loan's maturity date. The idea is that the length of the home loan should not outlast the remaining economic life of the structure serving as collateral. Note however, chronological age is only part of this decision because age must be considered in light of the upkeep and repair of the structure and its construction quality.

### **Loan-to-Value Ratios**

The mortgage lender next looks at the amount of down payment the borrower proposes to make, the size of the loan being requested and the amount of other financing the borrower plans to use. This information is then converted into loan-to-value ratios. As a rule, the more money the borrower places into the deal, the safer the loan is for the mortgage lender. On an uninsured home loan, the ideal loan-to-value ratio for a lender on owner-occupied residential property is 70% or less. This means the value of the property would have to fall more than 30% before the debt owed would exceed the property's value, thus encouraging the borrower to stop making mortgage loan payments. Because of the nearly constant inflation in housing prices since the 40s, very few residential properties have fallen 30% or more in value.

Loan-to-value ratios from 70% through 80% are considered acceptable but do expose the mortgage lender to more risk. Lenders sometimes compensate by charging slightly higher interest rates. Loan-to-value ratios above 80% present even more risk of default to the lender, and the lender will either increase the interest rate charged on these home loans or require that an outside insurer, such as FHA or a private mortgage insurer, be supplied by the borrower.

### **Mortgage Closing Settlement Funds**

The lender then wants to know if the borrower has adequate funds for settlement (the closing). Are these funds presently in a checking or savings account, or are they coming from the sale of the borrower's present real estate property? In the latter case, the mortgage lender knows the present loan is contingent on another closing. If the down payment and settlement funds are to be borrowed, then the lender will want to be extra cautious as experience has shown that the less of his own money a borrower puts into a purchase, the higher the probability of default and foreclosure.

### **Purpose Of Mortgage Loan**

The lender is also interested in the proposed use of the property. Mortgage lenders feel most comfortable when a home loan is for the purchase or improvement of a property the loan applicant will actually occupy. This is because owner-occupants usually have pride-of-ownership in maintaining their property and even during bad economic conditions will continue to make the monthly payments. An owner-occupant also realizes that if he/she stops paying, they will have to vacate and pay for shelter elsewhere.

If the home loan applicant intends to purchase a dwelling to rent out as an investment, the lender will be more cautious. This is because during periods of high vacancy, the property may not generate enough income to meet the loan payments. At that point, a strapped-for-cash borrower is likely to default. Note too, that lenders generally avoid loans secured by purely speculative real estate. If the value of the property drops below the amount owed, the borrower may see no further logic in making the loan payments.

Lastly the mortgage lender assesses the borrower's attitude toward the proposed loan. A casual attitude, such as "I'm buying because real estate always goes up," or an applicant who does not appear to understand the obligation he is undertaking would bring low rating here. Much more welcome is the home loan applicant who shows a mature attitude and understanding of the mortgage loan obligation and who exhibits a strong and logical desire for ownership.

### **The Borrower Analysis**

The next step is the mortgage lender to begin an analysis of the borrower, and if there is one, the co-borrower. At one time, age, sex and marital status played an important role in the lender's decision to lend or not to lend. Often the young and the old had trouble getting home loans, as did women and persons who were single, divorced, or widowed. Today, the Federal Equal Credit Opportunity Act prohibits discrimination based on age, sex, race and marital status. Mortgage lenders are no longer permitted to discount income earned by women even if it is from part-time jobs or because the woman is of child-bearing age. Of the home applicant chooses to disclose it, alimony, separate maintenance, and child support must be counted in full. Young adults and single persons cannot be turned down because the lender feels they have not "put down roots." Seniors cannot be turned down as long as life expectancy exceeds the early risk period of the loan and collateral is adequate. In other words, the emphasis in borrower analysis is now focused on job stability, income adequacy, net worth and credit rating.

Mortgage lenders will ask questions directed at how long the applicants have held their present jobs and the stability of those jobs themselves. The lender recognizes that loan repayment will be a regular monthly requirement and wishes to make certain the applicants have a regular monthly inflow of cash in a large enough quantity to meet the mortgage loan payment as well as their other living expenses. Thus, an applicant who possesses marketable job skills and has been regularly employed with a stable employer is considered the ideal risk. Persons whose income can rise and fall erratically, such as commissioned salespersons, present greater risk. Persons whose skills (or lack of skills) or lack of job seniority result in frequent unemployment are more likely to have difficulty repaying a home loan. The mortgage lender also inquires as to the number of dependents the applicant must support out of his or her income. This information provides some insight as to how much will be left for monthly house payments.

### **Home Loan Applicants' Monthly Income**

The lender looks at the amount and sources of the applicants' income. Sheer quantity alone is not enough for home loan approval; the income sources must be stable too. Thus a lender will look carefully at overtime, bonus and commission income in order to estimate the levels at which these may reasonably be expected to continue. Interest, dividend and rental income would be considered in light of the stability of their sources also. Under the "other income" category, income from alimony, child support, social security, retirement pensions, public assistance, etc. is entered and added to the totals for the applicants.

The lender then compares what the applicants have been paying for housing with what they will be paying if the loan is approved. Included in the proposed housing expense total are principal, interest

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