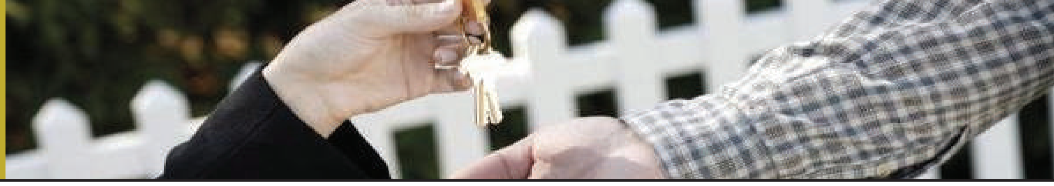

MORTGAGE SECRETS

for Real Estate Investors

How to ***BEAT MORTGAGE LENDERS*** at their own game and ***INCREASE YOUR PROFIT*** on every real estate investment.

by

Susan Lassiter-Lyons

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This book was designed to give correct and helpful information, but there may be typographical errors or mistakes in content. Care should be taken to use this book as a general guide to real estate investment and finance information and not as the ultimate source of this type of information. In addition, the information in this book is only current up to the date of publication.

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Dedication

Dorothy H. Lassiter

1910 – 1997

My Grandmother and Teacher

Thank you for the love, the lessons and the laughter.

Foreword

The mortgage business is a complicated and ever-changing industry. It is important that you understand how the mortgage market works and how the lenders make their profit. In doing so, you will gain an appreciation of loan programs and why certain loans are offered by certain lenders.

Investors use mortgage loans to increase their leverage. The more money an investor can borrow, the more he can leverage his investment. Rarely do investors use all cash to purchase properties, and when they do, it is on a short–term basis. They usually refinance the property to get their cash back or sell the property for cash.

The challenge is that loans for investors are treated as high–risk by lenders, as compared to non-investor (owner-occupied properties) loans. Lenders often look at leveraged investments as risky, and are less willing to loan money to investors. Lenders assume that the less of your own money you have invested, the more likely you will walk away from a bad property. The goal of the investor thus is to put forth as little cash as possible, pay the least amount in loan costs and interest, while keeping personal risk at a minimum.

As an investor, getting a mortgage may seem like a straightforward process on the surface. But as Susan and I well know it is the financing that can make or break the profitability of any real estate investment. It pays to do business with the experts and it pays to educate yourself about the process, with its many pitfalls and challenges, before you ever make offers on properties.

Real estate investing will make you a lot of money if you learn the techniques and apply yourself. The bottom line is that education will help you avoid mistakes and learn new ideas. Read books, go to seminars and learn from other investors. Your best investment is in yourself.

I regularly refer Colorado investors to Susan when they have challenging loan scenarios so I know the information you'll learn from this book will serve you well in the future.

WILLIAM BRONCHICK

William Bronchick, CEO of Legalwiz Publications, is a Nationally-known attorney, author, entrepreneur and speaker. Mr. Bronchick has been practicing law and real estate since 1990, having been involved in over 1000 transactions. He has trained countless people all over the Country to become financially successful. His best-selling book, *"Flipping Properties,"* was named one of the ten best real estate books of the year by the Chicago Tribune. William Bronchick is also the author of the highly acclaimed books, *"Financing Secrets of a Millionaire Real Estate Investor"* and *"Wealth Protection Secrets of a Millionaire Real Estate Investor."*

William Bronchick has served as President of the Colorado Association of Real Estate Investors since 1994.

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Introduction

Congratulations! You're An Investor

Congratulations! You have decided to become a real estate investor—or you already are one! It's an exciting profession and hobby. I first began investing in real estate back in 1994. My friends from work and I went to a seminar about investing in tax liens and, convinced we would soon be millionaires, set about researching the tax lien auctions that were happening in the counties of Colorado.

We formed a limited liability company and called ourselves The Lien Lords. Pretty clever, huh? When we got to the auction we had a pooled sum of $1000 and we ended up winning four tax liens. Tax liens back then paid close to 16% upon redemption so we made a few bucks when three of the liens redeemed within a year. The 4th lien, to this day, has never redeemed. This was a dinky $17 lien on a piece of vacant land in an area of Colorado called Strasburg. I figure if urban sprawl ever really sprawls then we will apply for the treasurer's deed and make a profit when we sell the land.

My next foray into investing was after attending a seminar on lease options. I learned how to structure the sandwich lease option. I managed to get two properties under contract but then could never re-lease option them.

Never one to be daunted, I then attended a seminar on how to invest in apartment buildings. This time, something happened—I got it! I actually understood the concepts and realized that multi-units were the strategy for me. I immediately bought a triplex that needed some work for $199,000. I put $16,000 into fixing it up and today it cash flows and is worth $315,000. Finally, after all those seminars, home study courses, mentorships and books read, I was finally a REAL real estate investor. This continues to be my personal focus today. I look each week for bank owned or distressed 3 and 4 unit buildings and have my realtor make offers.

However, as adept as I felt I was at the investing side of things, the one big gaping hole in my knowledge that I couldn't really seem to find any information on, was the financing piece of the puzzle. I couldn't figure out why there were so many rules that made no sense. For example, when I went to my bank and told them I wanted a loan for my triplex that gave me 100% of the purchase price plus rolled in all of the closing costs and repair costs, they actually laughed at me. LAUGHED at me right there in the office.

Again, never one to cave to a challenge, I went to work for a mortgage company. I figured it was a decent way to make a living plus gain insight into the lending process for investment properties. Turns out my gamble paid off. I started in a department called Secondary Marketing where I learned the mortgage industry from the top down. I learned how Wall Street buys pools of mortgages and I learned all about mortgage backed securities. I also learned how to price loans and how current events and economic indicators drive interest rates.

Then I went to work part-time on the side as a loan originator for a local broker to generate some real money for my knowledge. When my first commission check on one loan turned out to be bigger than my pay check for two entire weeks at the mortgage company, I quit on the spot to originate full time. After an appropriate number of months, I became a broker and set up my own shop arranging residential and commercial financing for real estate investors and that is what I continue to do today.

This book is my attempt to give you the benefit of the education I have received through lessons learned and hard knocks. Every mistake I have made and every crazy scenario I've encountered through my clients and associates is in this book. You now are privy to more than 6 years of insider mortgage knowledge. Use it wisely!

The Problem with Those Investment Gurus

In my previous chapter I mentioned a few real state investment seminars that I have been to. It seems like there is a new one every week and a new guru to go with it. Now I am all for education and benefiting from knowledge that someone else has gained and is willing to share with me for a price, but I feel that some gurus are lacking in real world application. The stuff always sounds better in theory than it plays out in real life. Like the cash back at closing thing that so many people tout. Carleton Sheets says there are 10 ways (or more) to get cash back at closing. I know for a fact that many of them can never be accomplished using a conventional lender to finance your loan. You have to use hard money and pay almost three times as much for it.

Sometimes the tricks that they share with you just do not fly in the real world. This book will never be guilty of that. This is because I have spent a great deal of time rescuing people that are trying to do it according to some guru. Creatively finding ways to accomplish the theory in the real world is essentially my specialty. So, do not fear! This will not be another one of those situations where you could be rich if only the strategies actually worked. These strategies DO work and if you follow my advice, you will discover ways to get around some of the messes that other gurus can get you in.

Industry Secrets

> A mortgage represents a loan or lien on a property that has to be paid over a specified period of time. Think of it as your personal guarantee that you'll repay the money you've borrowed to buy a home. Mortgages come in many different shapes and sizes, each with its own advantages and disadvantages.

Back before 1934, insurance companies were the only entities providing financing for homes. After 1934, the Federal Housing Authority (FHA) was established to try to stimulate homeownership and they established mortgages with down payments as low as 50% and amortized over 5-7 years with balloon payments at the end of the term. Yikes!

Over time, the down payment requirements were lowered and many new types of loan programs were developed and marketed to make home ownership appealing and affordable to the masses.

Today we have literally hundreds of entities offering hundreds of different mortgages or loan programs. Ultimately most mortgages are securitized and sold off in bulk to agencies such as Fannie Mae and Freddie Mac through the Secondary Mortgage Market which is just a market in which existing mortgages and mortgage-backed securities are traded. Most lenders will either sell their loans outright for cash or swap them for mortgage-backed securities such as Participation Certificates which they can hang on to or sell to dealers for cash.

The Secret Agencies

> An agency is just a congressionally chartered corporation which buys mortgages on the secondary market, pools them and sells them as mortgage-backed securities to investors on the open market. Monthly principal and interest payments are guaranteed by the agency but not by the U.S. Government. Examples of agencies in the mortgage industry are Fannie Mae (FNMA), Freddie Mac (FHLMC), FHA and Ginnie Mae (GNMA). All agencies have requirements for the types of loan they will buy or securitize. This is where rules or guidelines come into play. If the loan is "outside of guidelines" it is considered non-conforming. Non-conforming loans are also referred to as whole loans.

If a loan is outside of Fannie Mae's standard guidelines, the agencies won't buy it and the lender either has to service the loan themselves while holding it in their own portfolio or find a whole loan buyer that will buy it from them. Most whole loan buyers are Wall Street companies such as Bear Stearns, Credit Suisse, Lehman, Goldman Sachs, etc.

Lenders pool whole loans together with credit enhancements to create whole loan collateralized mortgage obligations or CMOs. Credit enhancements are designed to make the loans more palatable and to ensure investors receive timely interest payments. This, my friend, is why there are so many rules about mortgages for investment properties. Because mortgages on investment properties are the riskiest mortgages out there, the originators have to have these crazy rules to make them less risky and more attractive to the end buyer.

In a nutshell, this is why EVERY lender will do a 20% down 30 year fixed owner occupied mortgage but only a few will do a higher loan-to-value adjustable rate mortgage for an investor. The 30 year is an easy sell but they have a harder time unloading the riskier investor adjustable rate loan.

Mortgage lenders or originators also have the option of selling the loan and the servicing rights or just the loan or just the servicing. There are lots of different ways to profit from the sale of a mortgage.

This book isn't meant to be a course in secondary marketing and mortgage securitization (thank goodness), I only bring it up to give you an idea of what is going on in the background and who is really making the rules.

Mortgage Rate Secrets—why do they go up and down?

To understand why mortgage rates change, we must first ask the more general question, *"Why do interest rates change?"* It is important to realize that there is not one interest rate, but many interest rates!

- **Prime rate:** The rate offered to a bank's best customers.
- **Treasury bill rates:** Treasury bills are short-term debt instruments used by the U.S. Government to finance their debt. Commonly called T-bills they come in denominations of 3 months, 6 months and 1 year. Each treasury bill has a corresponding interest rate (i.e. 3-month T-bill rate, 1-year T-bill rate).
- **Treasury Notes:** Intermediate-term debt instruments used by the U.S. Government to finance their debt. They come in denominations of 2 years, 5 years and 10 years.
- **Treasury Bonds:** Long-debt instruments used by the U.S. Government to finance its debt. Treasury bonds come in 30-year denominations.
- **Federal Funds Rate:** Rates banks charge each other for overnight loans.
- **Federal Discount Rate:** Rate New York Fed charges to member banks.
- **Libor:** London Interbank Offered Rates. Average London Eurodollar rates.
- **6 month CD rate:** The average rate that you get when you invest in a 6-month CD.
- **11th District Cost of Funds:** Rate determined by averaging a composite of other rates.
- **Fannie Mae-Backed Security rates:** Fannie Mae pools large quantities of mortgages, creates securities with them, and sells them as Fannie Mae-backed securities. The rates on these securities influence mortgage rates very strongly.
- **Ginnie Mae-Backed Security rates:** Ginnie Mae pools large quantities of mortgages, secures them and sells them as Ginnie Mae-backed securities. The rates on these securities influence mortgage rates on FHA and VA loans.

Interest rate movements are based on the simple concept of supply and demand. If the demand for credit (loans) increases, so do interest rates. This is because there are more buyers, so sellers can command a better price, i.e. higher rates. If the demand for credit reduces, then so do interest rates. This is because there are more sellers than buyers, so buyers can command a lower better price, i.e. lower rates. When the economy is expanding there is a higher demand for credit, so rates move higher, whereas when the economy is slowing the demand for credit decreases and so do interest rates.

This leads to a fundamental concept:

- Bad news (a slowing economy) is good news for interest rates (lower rates).
- Good news (a growing economy) is bad news for interest rates (higher rates). A major factor driving interest rates is inflation. Higher inflation is associated with a growing economy. When the economy grows too strongly, the Federal Reserve increases interest rates to slow the economy down and reduce inflation. Inflation results from prices of goods and services increasing. When the economy is strong, there is more demand for goods and services, so the producers of those goods and services can increase prices. A strong economy therefore results in higher real estate prices, higher rents on apartments and higher mortgage rates.

Mortgage rates tend to move in the same direction as interest rates. However, actual mortgage rates are also based on supply and demand for mortgages. The supply/demand equation for mortgage rates may be different from the supply/demand equation for interest rates. This might sometimes result in mortgage rates moving differently from other rates. For example, one lender may be forced to close additional mortgages to meet a commitment they have made. This results in them offering lower rates even though interest rates may have moved up!

There is an inverse relationship between bond prices and bond rates. This can be confusing. When bond prices move up, interest rates move down and vice versa. This is because bonds tend to have a fixed price at maturity—typically $1000. If the price of the bond is currently at $900 and there are 10 years left on the bond and if interest rates start moving higher, the price of the bond starts dropping. The higher interest rates will cause increased accumulation of interest over the next 5 years, such that a lower price (ie. $880) will result in the same maturity price, i.e. $1000.

Effect of economic data on rates

Number of arrows indicates potential effect on interest rates. **1 arrow=least effect, 5 arrows=max. effect.**

Economic Event	Effect on Interest Rates	Significance of event
Consumer Price Index (CPI) Rises	▲▲▲▲▲	Indicates rising inflation
Dollar Rises	▼	Imports cost less; indicates falling inflation
Durable Goods Orders Increase	▲▲▲	Indicates expanding economy
Gross National Product Increases	▲▲▲▲▲	Indicates strong economy
Home Sales Increase	▲▲▲	Indicates strong economy
Housing Starts Rise	▲▲▲	Indicates strong economy
Industrial Production Rises	▲▲▲	Indicates strong economy
Business Inventories Rise	▼▼▼	Indicates weak economy
Leading Indicators (LEI) Increase	▲▲▲	Indicates strong economy
Personal Income Rises	▲	Indicates rising inflation
Personal Spending Rises	▲	Indicates rising inflation
Producer Price Index Rises	▲▲▲▲▲	Indicates rising inflation
Retail Sales Increase	▲▲	Indicates strong economy
Treasury Auction Has High Demand	▼	High demand leads to lower rates
Unemployment Rises	▼▼▼▼▼	Indicates weak economy

OK! On to the good stuff!

Your Secret Ratio

Debt to income ratio is simply your total debt divided by your gross monthly income. But to get the real picture, there are two types:

1. One is your top ratio or your payment to income ratio. This is the total present monthly housing expense divided by your gross monthly income.
2. The second ratio is the most important one in terms of mortgage lending and it is known as the bottom or back ratio. This is calculated by dividing your total monthly debt payments by your gross monthly income.

Back ratios can go as high as 60% for some sub prime programs. For most investment loan programs, 50% is the max and if you are trying to qualify for an agency loan the max is normally 41%.

Let's use our plumber again as the example. Let's say that according to his credit bureau his monthly debt obligations are as follows:

- Countrywide (primary residence mortgage payment) $1500
- MBNA VISA $25
- Macy's $25

His total monthly debt payment is $1,550. If we divide that by his income in $5000 then we have a back ratio or debt ratio of 31%. So far, so good!

Special Secrets for the Self Employed Investor

All investor loans must be fully documented which means if you are self employed they will use your tax returns to get your income. Make sure you're showing enough income on your taxes so that your debt to income ratio will qualify!

Credit Score Secrets

Here we go. This chapter could be a book all on its own. I hope as an investor you realize that this is a cornerstone of your business and you therefore already have a good understanding of it. I will explain your credit score as it relates to mortgage lenders and underwriting guidelines.

When you first begin the loan qualification process, your mortgage broker will pull a tri-merge credit report on you. This means that one single credit report will pull in your scores and reported information from all three of the main credit bureaus.

The Credit Bureaus

Experian/FICO
TransUnion/Empirica
Equifax/Beacon

We pull from all three because not all creditors report to all three bureaus. This is just the lender's way of making sure they don't miss anything. Once they get the report, they will use the middle of the three scores as the credit score on the file.

Let's say that your scores are:

Experian/FICO: 678
TransUnion/Empirica: 701
Equifax/Beacon: 708

We would say that your score is 701 for the purpose of this particular transaction.

If a bureau doesn't have enough reported information in order to score you then sometimes it won't return a score at all. In this case you would just have two scores and the lender will use the lower of the two for the transaction.

The general rule is that you can qualify for a conforming mortgage with a minimum credit score of 620. Anything below that is considered sub prime and anything 720 and above is considered A+. This rule is for full doc primary residence loans only. For a stated income investor loan the minimum score is usually 680. If you are a full doc investor you'll want to have at least a 660. Again, this is a rule of thumb so don't despair if your scores are lower. There are many lenders out there that will accept much lower scores on investment loans.

Investors ask me all the time what they can do to improve their credit scores. There are three types of debt reported on your credit report—mortgage, installment and revolving. Hopefully you know what a mortgage debt is! Installment debt is anything that has a fixed monthly payment such as a car payment and revolving debt is debt that can fluctuate on a monthly basis like a credit card.

Anytime you have a late payment (30 days or more) it will affect your credit in a negative way. However, if you are having a bad month and you have to choose one obligation NOT to pay, the one that will affect your score the least is the revolving debt. If you are an investor, you must take care to NEVER pay a mortgage late. It truly could be the kiss of death. Also, try not to utilize more than 50% of your total available revolving credit and try to limit the number of times your credit is pulled to no more than four times per quarter.

To check your three scores online instantly visit the Bonus Offers page at
http://www.mortgagesecretsbook.com/Bonus

Loan to Value Secrets

Mortgages are categorized and priced fundamentally based on the loan to value of the subject property. The definition of LTV from **investopedia.com** is:

> "A lending risk assessment ratio that financial institutions and others lenders examine before approving a mortgage. Typically, assessments with high LTV ratios are generally seen as higher risk and, therefore, if the mortgage is accepted, the loan will generally cost the borrower more to borrow or he or she will need to purchase mortgage insurance."

Calculated as:

$$\textbf{Loan to Value Ratio} = \frac{\textbf{Mortgage Amount}}{\textbf{Appraised Value of the Property}}$$

Fannie Mae and other agencies require that the borrower have mortgage insurance on a loan that has an LTV of 80.01% or higher.

I get scenarios all the time where investors have a seller that has agreed to carry back a 2^{nd} mortgage of 20% and they want 80% financing for the property. With all conventional lenders this is still going to be a 100% deal because the CLTV adds up to 100%. You can't just say it's an 80% loan even though that's all you're asking of the lender because you are still going to have secondary financing on the property.

Mortgage insurance coverage is usually charged as a percentage of the loan amount and the higher the loan to value, the higher the coverage percentage.

Property Type Secrets

Now, just as the underwriter is qualifying you based on your credit history, reserves, etc they are also qualifying the subject property. Lenders don't want to write loans on properties that they think are weird or "outside the guidelines". The easiest property to finance is obviously the single family residential detached house or SFR.

Lenders are just like the rest of us—they stick with what they know.

Most lenders will follow Fannie Mae's guidelines to determine what properties are eligible for loans and which ones aren't. Here's a list of eligible properties according to Fannie Mae.

Eligible Property

- 1 - 4 unit Single-Family dwelling (detached, semi-detached, attached);
- Unit within a planned unit development (PUD) (detached, semi-detached, attached);
- Unit within a condominium building with no restrictions on the number of stories.

Eligible Structure

- Site Built;
- Modular Precut/Panelized Housing.

Ineligible properties according to Fannie Mae are:

Ineligible:

- Manufactured Housing:
- Condo-hotels (condotels);
  - Non-warrantable condos;
  - Boarded-up Properties;
  - Post-Pier-Beam, Stilts and Cantilevered foundations (may be considered on a case-by-case basis);
  - New properties without a satisfactory Certificate of Completion or Certificate of Occupancy and a final appraisal certifying completion and value;
  - Commercial properties;
  - Co-ops;
  - Property damaged or deteriorating, such that if it is prohibitively expensive or unfeasible to restore the structure to habitable condition;
  - Economic Life of Less than 30 Years;
  - Properties with current or potential environmental hazard risk;
  - Properties with marketing time in excess of nine (9) months;
  - Properties that are not insurable because they are situated in a flood hazard area not eligible for participation in the National Flood Insurance Program;
  - Properties with identified potential for property damage from local geological conditions;
  - Properties located on or near hazardous waste sites;
  - Properties designated by the appraiser as "Not highest and best use;"
  - Houseboats, including those permanently affixed to piers, docks, or moored to land;
  - Properties that are a wholly illegal or non-conforming use for the site;
  - Illegal/Ineligible Improvements/Additions;
  - Properties that are an imminent threat to the health or safety of the occupant;
  - Properties with less than present code foundations (i.e., mud sills, unreinforced brick, concrete blocks) and residential properties that are not permanently affixed by a foundation;
  - Properties without permanently affixed legal heating systems (not space heaters or fireplaces);
  - Properties that lack city or county maintenance or services;
  - Properties without full utilities installed to meet all local health and safety standards including: Continuing supply of potable water, public sewer or certified septic system, public electricity, natural or LP gas;
  - Vacant land or properties that are effectively vacant land (i.e. improvements contribute 10% or less to the total value), value will be given only to the lot with residential improvements;
  - Properties with more than four (4) units;
  - Properties listed for sale within the past six (6) months;
  - Properties with severe location detriments;
  - Poor marketability's (access, condition, etc.);
  - Mobile Homes share all the same characteristics as Manufactured Homes (see definition)

except that they were built prior to June of 1976 when the Federal Manufactured Home Construction and Safety Standards (HUD code) became effective;

- Identified recent or pending zoning changes which would have a negative or destabilizing impact on residential market values;
- Raw Land;
- Resort properties that are not within a reasonable commuting distance of employment centers;
- Rooming and Boarding Houses;
- Timeshares;
- Working farms where the Borrower's income is derived from use of the land (agriculture, horse ranch, etc.);
- Residential properties that are not permanently affixed to land by a foundation;

and

- 2-4 units within a PUD
- Condominium projects with recreation leases
- Manufactured Homes purchased from a Manufactured Home dealer
- Properties that cannot be rebuilt 'as is' if destroyed

And I can add two that I have been asked about recently—geodesic domes and abandoned school busses with no electricity or plumbing. Don't ask.

Now, I don't want you to look at this list and freak out. Just because the agencies deem it ineligible, there are lenders out there that specialize in ineligible properties.

One very important thing to remember is just because a property is eligible doesn't mean you will be able to get 90% financing for it. For example, some lenders will offer 90% financing on single family residences but only 85% on triplexes.
For investors you will usually be able to find 90% financing for residential 1-4 unit properties and condos.

QUICK SECRET NO. 1

If you buy condos, ask to see the HOA questionnaire to make sure that your condo is warrantable and there aren't any problems financial or otherwise with the home owners association.

Condo Secrets

Condos need a chapter all of their own because there are a ton of special rules and guidelines, secrets if you will, regarding condos. A condo will be deemed by the lender as either warrantable or non-warrantable. A warrantable condo will usually sail through for any type of financing but a non-warrantable condo requires a special lender.

Condominiums create additional risk because the homeowners' association has legal rights that could adversely impact the lender's rights. Prior to funding a loan a lender will require that a HOA fill out a questionnaire. Each lender has a standard form and this is how they get info about warrantability, etc. If an HOA seems iffy, it's not a bad idea to have your broker have them fill out the questionnaire before you make an offer. That way you know before you even make an offer if there will be issues regarding the project.

I once had a client that had a bunch of condos in the same development under contract. These condos were all in foreclosure and we suspected that the HOA was pretty shaky. The lender required the questionnaire from the HOA and they said that they could never get a hold of the manager. I called my client and told him what was going on and he said, *"Well, he doesn't have a computer and his phone got shut off but I can go knock on his door and see if he'll give me the records."* Um, yeah. Good luck with that.

Generally, lenders do not want to lend on more than 20% of the total units in a project, will not lend if the HOA is involved in any type of litigation, and if there is commercial space (i.e. first floor restaurant, deli, hair salon, grocery store, etc.,) there should be no more than 20% commercial space within the building.

Additionally, lenders like to see that the project is at least 90% completed, that no more than 10% of the units are owned by a single entity, that it is no more than four stories and that at least 50% of the units are owner occupied.

I just had a deal where the HOA was being sued by a home owner and the lender declined the loan. I requested a copy of the suit from the attorney and discovered that it was all over a "funny smell" in one unit. Because the litigation did not involve a structural issue, the lender reconsidered and approved the loan. Oh, and my borrower (also my nephew) reports that his unit smells just fine.

Rural Property Secrets

Real estate investors are everywhere and not all of them have the advantage of living in metropolitan areas. Unfortunately, rural properties and properties with a lot of acreage can be difficult to finance. The main reason for this problem is that the value of the property can often be difficult to determine.

Appraisals rely heavily on comparable sold prices within a mile or so of the subject property. In a rural area with houses far away from each other, it's hard to get good comps. These homes tend not to sell very quickly and the lender may shy away since their main concern is always about taking the property back through foreclosure.

Usually, lenders will require larger down payments on these types of properties.

Mobile Home Secrets

There are investors that invest in mobile homes as rentals and they do very well. Financing mobile homes, especially as a non-owner occupant, is difficult. Mobile homes, also known as manufactured housing, are not universally liked by lenders. If you are considering investing in mobile homes here are a few guidelines to follow to ensure you can get these things financed:

1. Make sure the mobile home was manufactured later than 1976. All manufactured homes built since June 15, 1976, must conform to the HUD Code, a building code administered and enforced by the U.S. Department of Housing and Urban Development. Manufactured homes are the only form of housing constructed to comply with a national building code. Look for the HUD certification label on the home.

2. Make sure it is a double-wide.

3. Make sure it is on a permanent foundation with all wheels, axels, and hitches removed.

4. Make sure you have a down payment. High LTV financing is not available for investors on this type of property.

Loan Application Secrets

Fannie Mae form 1003 is also known as the Uniform Residential Loan Application. All lenders are required to use this industry specific form. If you have applied for a mortgage before, I'm sure you have completed or at least signed one of these documents. The document is usually five pages long and has nine sections:

1. The type of mortgage and terms of loan
2. Property information and purpose of the loan
3. Borrower Information
4. Employment Information
5. Monthly Income and combined housing expense information
6. Details of the transaction
7. Declarations
8. Acknowledgement and agreement
9. Government monitoring section

QUICK SECRET NO. 2

Make sure to never let the name of your LLC have anything to do with real estate investment.

For investors, you'll want to make sure that the application states you are purchasing an investment property and in the declarations, state that you do not plan to reside in the property. Sometimes my clients will mark up the application and change the amount owed on credit cards or installment loans. Don't do this. This information is usually automatically populated from the credit report so when completing the application it's important that the numbers match the credit report.

Another thing to remember, with regard to your employment on a loan application, NEVER claim that you are a real estate investor. You might as well say you're a drug dealer in terms of what an underwriter will think of you being a real estate investor. All it means to them is that if you are investing in real estate as a job there is really no way for you to earn regular income. It means that you are waiting for houses to sell or conditions to be right so you can purchase additional inventory for your business so you can flip that inventory. They don't ever like to see employment that has anything remotely to do with real estate investing.

If you are a new investor just setting up your entity, and I could give you one good piece of advice it would be please don't name your company something like Foreclosure Investment Specialists, LLC or Real Estate Investment Services Inc., or anything like that. This will be a big tip off to the underwriter as to what you do. In fact if you are self employed (and I do this with my self employed real estate clients that invest full time), I would prefer to say you are involved with property management or that your company does home improvements instead of saying you are a real estate investor just so we don't raise any eyebrows.

Ok, back to the application. If you recently paid something off and it has not been reflected in your credit report yet let your broker know, especially if it's really affecting your debt to income ratio. If you provide proof of the payment the lender can usually get a quick update from the credit bureau to reflect the lower balance.

QUICK SECRET NO. 3

If you are using rental income to qualify for a loan remember that you are only allowed to use 75% of that rental income for income qualification purposes. Lenders don't let you use 100% of the income to allow for expenses.

Also, make sure to check your income and list of real estate owned very carefully. Remember you are signing a legal document so use appropriate care.
For purposes of the application you will need to also submit some documentation to support what you have stated in the loan application. The documentation will vary based on the documentation type loan you have chosen (full doc, stated income, no doc, etc) but for now we will assume that you are applying for a full doc loan.

The standard list of documents your broker will need to include in your loan package are:

Verification of income

- **Earnings statements:** W-2 forms, recent pay stubs and tax returns for the past two years;

- **If you are self-employed:** profit and loss statements and tax returns for current year and previous two years;
- **Additional income:** social security, overtime bonus, commission, interest income, veteran's benefits and so on.
- **If you have rentals and you are using rental income to qualify,** the lender will also want to see a copy of the lease(s). Most lenders will only count 75% of the gross rental income as income. This means that if your lease says you collect $1000 rent each month the lender will only give you income credit for $750 so plan accordingly!

Verification of your assets

- Checking and savings account statements for the previous 2-3 months;
- List of savings bonds, stocks or investments and their approximate market values.

Information about the purchase

- Copy of the ratified purchase contract
- Copy of the earnest money check

Your debts

- Evidence of mortgage and/or rental payments
- Copies of alimony or child support or divorce decree if applicable.

Lenders may also ask you about the origin of your down payment. If the money for the down payment is a gift from a relative, get a gift letter and copy of the gift check. The gift letter states that the money will not have to be repaid.

Keep in mind that different lenders may have slightly different information requirements, so these requirements may vary. Also, after your loan is submitted to the lender and goes through underwriting, your broker may need to get additional documentation from you that the underwriter requests so be ready!

Pre-Approval Secrets

This is a good one. Buyers with a mortgage pre-approval have a huge advantage when they are making offers on properties. A pre-approval shows the seller that you are a fully qualified buyer with financing already in place and can sometimes make the difference between a seller choosing to accept your offer over another offer.

Pre-approval will determine the maximum you can spend on a house before you shop, so you know what price range to target. Many buyers aim too high, bidding on a property that they later learn is beyond their means because of debt to income issues or due to cash flow issues relative to the monthly mortgage payment (in the case of a rental).

The contract you sign when you make an offer on a property allows a finite period in which to find a mortgage—typically 30 days or less. If you fail to secure financing within that period, the seller may cancel your contract and you lose your earnest money.

Pre-approved buyers can usually close more quickly and that is a bonus to a seller. Ultimately, being pre-approved gives you bargaining power.

Some brokers pre-qualify applicants based on a cursory check, never actually pulling credit or verifying assets and income which is necessary to guarantee a loan. Without these steps, it's not a true pre-approval and it carries no weight. In a true pre-approval, the lender will give you a letter bearing your name and the maximum loan amount you are pre-approved for.

The length of the pre-approval process varies, depending on the lender and applicant. Some brokers can complete it in a few hours. Lenders that promise 20-minute pre-approval usually take that amount of time to gather and discuss the applicant's information, but the approval is still pending a review of the applicant's resources, income and debt.

The next step in this process, the actual underwriting or final approval, happens after your offer has been accepted and your loan has been processed, packaged and sent to the lender. Once all the underwriting conditions have been satisfied, the underwriter will issue the final approval and give your broker the clear to close!

Reserve Secrets

When you apply for a mortgage there will usually be what's known as a reserve requirement. This just means that in addition to your down payment and closing costs the underwriter wants to make sure you have some money in the bank to cover the first few monthly payments. The requirement varies from lender and loan product but as an investor you should try to have a minimum of six months payments in reserves. The reserve requirement on refinances and owner occupant purchases can be as little as zero to two months.

Some lenders will also require that these reserves be seasoned and sourced. "Seasoned" means that you can prove that you have had the money for 60 days or so. This is usually determined from your bank statements. When they want to "source" the money that means that if all of a sudden a huge deposit shows up on your bank statement, the underwriter will want to know where it came from. In this situation they may ask you to provide documentation of the source of the money. For example, if you just sold a house they may ask for a copy of the HUD1 settlement statement to source the money.

If you are going to have a problem sourcing and seasoning your cash to close, then let your broker know. Sometimes there are ways around using your statements to source and season the money such as obtaining a Verification of Deposit from your bank.

Some lenders will require 6 months' PITI per property owned so make sure you get the details of what they require early in the process since that can really add up!

Loan Product Secrets

The loan product that you select for financing an investment property is probably the most important decision you will make with regard to your profitability. This decision is also wholly dependant on your exit strategy. Before you ever make an offer on a property, you should have an idea of what your intention is with regard to your particular investment strategy and ultimately your exit strategy. This will naturally lead you to the correct loan product for your investment goal.

> The most important question you need to ask yourself is whether you will be flipping this property or keeping it as a rental. Secondly, how comfortable are you with the future of interest rates if you will be holding it long term. These questions will help you make informed decisions about fixed or adjustable financing, prepayment penalties and points and fees.

A fixed rate mortgage is one that has the same rate for the loan term—usually 30 years. The rate will never change during the course of your loan.

An adjustable rate mortgage is different. There will be a fixed rate period—anywhere from one month to ten years. After that period is up your loan will adjust and your rate will change. ARM payments are based on the index plus the margin. The final rate will be known as the fully-indexed rate.

The most common mortgage loan indexes or indices if we're being grammatically correct are:

- Prime Rate
- 11th District Cost of Funds Index (COFI)
- 1 Year Treasury (CMT)
- 12 Month Treasury Average (12MAT/12MTA)
- Fed Funds Target Rate
- Certificates of Deposit Index (CODI)

- Cost of Savings Index (COSI)
- 1 Month LIBOR
- 3 Month LIBOR
- 6 Month LIBOR
- 1 Year LIBOR

CMT, COFI, and LIBOR indexes are the most frequently used. Approximately 80 percent of all the ARMs today are based on one of these indexes. You can find historical comparisons of these indices and their comparative volatility online.

The Secret of Determining Your Interest Rate

Let's say you have a 5/1 LIBOR ARM. This means that you have an adjustable rate mortgage that is fixed for the first five years of the loan term. After that the rate will adjust to the LIBOR index plus the margin agreed to at the start of your loan. The margin is the number of percentage points (for example, 2.75) the lender adds to the index rate to calculate the fully indexed interest rate at each adjustment.

The margin is set in the mortgage contract, remains fixed for the term of the loan and is not impacted by the financial markets and movement of interest rates. When trying to determine margin, just know that the less money you put down and the less documentation you provide, the higher your margin will be.

Additionally, ARMs will have what is known as rate caps. Rate caps limit how much interest you can be charged. There are two types of interest rate caps associated with ARMs. Periodic caps limit the amount your interest rate can increase from one adjustment period to the next. Not all ARMs have periodic rate caps. Overall caps limit how much the interest rate can increase over the life of the loan. Overall caps have been required by law since 1987.

A payment cap limits how much your monthly payment can increase at each adjustment. ARMs with payment caps often do not have periodic rate caps.

Example Life-Time Cap:

ARM index rate: 4.5%
ARM margin: 2.5%
Life-Time Cap: 4%
Current Interest rate: 7.0% (index rate + margin)

When your fixed rate period is over let's say that the ARM index rate has jumped to 8%
The new interest rate equals 8% + 2.5% = 10.5%
The life-time cap limits the new interest rate to: 4.5% + 4% = 8.5%

Example Adjustment Rate Cap:

ARM index rate: 4.5%
ARM margin: 2.5%
Periodic Adjustment Rate Cap: 1%
Current Interest rate: 7.0% (index rate + margin)

The ARM index rate has jumped to 6%.
The new interest rate equals 6% + 2.5% = 8.5%.
The adjustment rate cap limits the new interest rate for the adjustment period to: 4.5% + 1% = 5.5%.
So your new rate will be limited to: 5.5% + 2.5% = 8.0%.

Rate caps may not be important to you now but they should be a very important factor when deciding to go with an adjustable mortgage over a fixed rate. You do not want to experience payment shock when your initial fixed rate period is up and you adjust to the fully indexed rate. It could wipe out all of your monthly cash flow and more on a rental.

Amortization Secrets

According to investorwords.com, which is a great website by the way, the definition of amortization is the gradual elimination of a liability, such as a mortgage, in regular payments over a specified period of time. Such payments must be sufficient to cover both principal and interest.

Amortization really just has to do with the ratio of principal and interest to be paid with each payment. Your broker can provide you with an amortization schedule that shows the amount of principal and interest made with each monthly payment.

Here is a snapshot of a sample 3 year amortization schedule of a $100,000 loan at 7% interest:

	Principal	Interest	Cum Prin	Cum Int	Prin Bal
1	81.97	583.33	81.97	583.33	99918.03
2	82.44	582.86	164.41	1166.19	99835.59
3	82.93	582.37	247.34	1748.56	99752.66
4	83.41	581.89	330.75	2330.45	99669.25
5	83.90	581.40	414.65	2911.85	99585.35
6	84.39	580.91	499.04	3492.76	99500.96
7	84.88	580.42	583.92	4073.18	99416.08
8	85.37	579.93	669.29	4653.11	99330.71
9	85.87	579.43	755.16	5232.54	99244.84
10	86.37	578.93	841.53	5811.47	99158.47
11	86.88	578.42	928.41	6389.89	99071.59
12	87.38	577.92	1015.79	6967.81	98984.21

Even though this just shows the first 12 payments, you will see that as the payments go on, the amount of principal you pay increases while the amount of interest you pay decreases.

The rule of thumb is that if you have a loan amortized at 30 years, the principal reduction will be less monthly than a loan amortized at 15 years. As a result, the monthly payment on a 15 year loan is significantly higher than the payment on a 30 year loan.

Here are the first 12 payments for that same loan amortized over 15 years:

Pmt	Principal	Interest	Cum Prin	Cum Int	Prin Bal
1	315.50	583.33	315.50	583.33	99684.50
2	317.34	581.49	632.84	1164.82	99367.16
3	319.19	579.64	952.03	1744.46	99047.97
4	321.05	577.78	1273.08	2322.24	98726.92
5	322.92	575.91	1596.00	2898.15	98404.00
6	324.81	574.02	1920.81	3472.17	98079.19
7	326.70	572.13	2247.51	4044.30	97752.49
8	328.61	570.22	2576.12	4614.52	97423.88
9	330.52	568.31	2906.64	5182.83	97093.36
10	332.45	566.38	3239.09	5749.21	96760.91
11	334.39	564.44	3573.48	6313.65	96426.52
12	336.34	562.49	3909.82	6876.14	96090.18

You can see that this is a much more aggressive payment schedule.

A balloon loan is a loan that is amortized at 30 years but due to be paid off with a balloon payment at the end of a term of usually 5, 10 or 15 years. Five year balloons aren't a very popular loan program for investors but a fixed rate 2nd mortgage is usually a balloon product. It's called a 30 due in 15 which means that the payment is amortized over 30 years but you have a balloon payment at 15 years.

Secret Loan Features for Investors

It's very important to understand the difference between a loan product and a loan feature. It may help to think of the concept in terms of a car. You buy a certain model but that model has additional features that you pay extra for—same with loans. Just remember, if you add these features to your loan, it will usually cost you a little more in rate each month.

Here are some loan features that are popular with investors:

Interest Only

This is probably hands down the most requested loan feature for investors. **It is a way to reduce your monthly payment (and increase your monthly cash flow) by paying only an interest payment each month—no principal.**

Not paying principal each month means that you are relying solely on appreciation to increase the equity in your property, so make sure you are only applying this feature on those properties that you feel will appreciate a little faster than normal.

When this feature was first introduced it was usually a free feature. Now lenders charge anywhere from .125 to .500 for the feature, so do the math before you decide if it will work for you. For example, take a look at this scenario:

Loan amount: $200,000
Interest rate: 7%
Interest Only feature: .375%
30 year amortization

Your fully amortized payment (principal and interest) will be $1330.60*

Your interest only payment will be
$1229.16 (200,000 * 7.375%/12).

You will save $100 a month but is it worth it to pay a higher rate and not have the benefit of principal reduction/equity increase to save $100/month? Only you can decide.

* You can find a free calculator online that will calculate this for you at **http://www.realdata.com.**

QUICK SECRET NO. 4

If your deal is 80% LTV or below (meaning you are putting down 20%) you can waive escrows in order to reduce your closing costs. That means you will not have to fund your escrow account for taxes and insurance at the closing. That will really reduce your closing costs.

Waive Escrows

As an investor, sometimes you prefer to pay the taxes and insurance separately from the mortgage. You can do this if you choose to not allow the lender to set up an escrow account to collect and pay the taxes and insurance on your behalf. This is known as "waiving escrows" or "no impounds". Escrows are also referred to as "prepaid closing costs".

If you are putting 20% down on the deal and your loan to value is 80% or less, then the lender doesn't really care and will charge nothing for this feature. If you are using higher LTV

QUICK SECRET NO. 5

Choose a 40 year amortization over an interest only loan to get some principle reduction if you will be holding the property long term.

financing, then the lender does care and this feature will usually cost you .250. The advantage to waiving escrows can really be seen at closing. Since you have to fund your escrow account at closing, you can actually use waiving escrows as a strategy to reduce your out of pocket closing costs.

40 year amortization

40 year amortization is a feature that was introduced to give the advantage of an interest only payment and the benefit of a principal reduction each month. If we use the same loan scenario from above and assume that this feature will also cost us .375 in rate, the monthly payment will be $1297.70. It kind of lands you halfway between the interest only and the 30 year. Again—an option.

Hard Money Loan Secrets

Hard money loans are also known as asset based loans. Investors are usually trained to finance their acquisitions with this type of loan because the property qualifies—not the borrower.

Investors are told all the time to just go get a hard money loan. This way, your credit and assets will never be a factor in the decision AND you can close fast.

This was very true back in the old days when a rich guy would loan an investor 65% of the value of the property just by looking at the house and doing some quick comps. The rich guy would not require a credit check and could close quickly with cash. The rich guy did this because he charged big fees (5% or so in points) and high interest rates (10-18%). And he figured that there was plenty of equity in the place if he ever had to foreclose on the investor. Sometimes the old rich guys made these loans because they WANTED to foreclose on the properties!

It's rare today to find a true, old-fashioned asset based loan. Most hard money lenders today prefer to be called private money lenders and will require some sort of qualification for the borrower in addition to the property. Sure, the credit score requirement will be lower than a conventional lender but be prepared to disclose some information to the private money lender.

For example, here are the products and requirements of our most popular hard money fix&flip loans:

70% LTV Program

- 15% interest only payments

- 3 points origination
- Minimum credit score of 640
- Full subject-to appraisal is required to determine ARV.

Today the real advantage of using a hard money loan instead of a conventional loan lies in the fact that the hard money loan LTV is based on the value of the property subject-to the repairs being made instead of the as-is value. Conventional lenders have the "lesser-of" rule which states that the loan amount will be the lesser of the sales price or the appraised value.

Obviously as an investor buying fix up properties, your sales price will be significantly lower than the value of the property.

My opinion, in case you were wondering, is to use hard money to fund the acquisition and repairs, then do a conventional rate and term (no cash out) refinance to cut your holding costs in half and/or greatly improve your cash flow.

Rate Secrets

QUICK SECRET NO. 6

Use yield spread premium to pay some closing costs or buy down the interest rate.

Who has the best rates? Wholesale, Correspondent or Retail? Wholesale, Correspondent and Retail are the three origination channels in residential mortgage lending. The best rates may be a relative thing but I will give you some information that may help you with your decision.

If you just walk into a strip mall office of a lender like Countrywide or Washington Mutual, you are walking into a retail origination office. Their secondary marketing office each day publishes a rate sheet for them with all of their available loan programs and corresponding rates. It is generally accepted that these rates are higher than the rates the same institutions offer to their wholesale brokers or correspondent lenders.

I worked in secondary marketing at a correspondent lender and each morning we would publish a rate sheet for our internal loan officers or originators. This was a national home builder. We would download the correspondent rate sheet from the lenders we sold to each morning and then MARK THEM UP by a certain percentage that varied by loan product. We would do this before ever releasing the rate sheets to our own internal loan officers so the par rate that they were offering to their borrowers was not a par rate at all. It had premium built into the rate already.

Even if the customer asked to see the rate sheet, they would think they were getting a par rate because that's what the rate sheet said—but they were paying mark up on that rate. Additionally, we would not have to disclose that rate mark up on the HUD1 settlement statement because as correspondent lenders we funded the loans in our own name, not the name of the ultimate lender like Countrywide or Washington Mutual.

If you want to be sure you are getting a wholesale rate and want to have proof of that, then you should be working with a wholesale mortgage broker. Ask to see the rate sheet from the actual lender—not the broker's internal rate sheet. And if the rate is marked up and the broker is collecting yield spread premium, it will be listed on the HUD1 settlement statement. Look around the 800 lines. It will say POC (paid outside of closing) broker premium somewhere around in there if it is being paid to the broker. It will not be listed in the borrower's or seller's column but on one of the actual 800 lines.

The Biggest Secret of All—Yield Spread Premium

Yield Spread Premium or YSP is the real secret in mortgage finance. This is the premium that the mortgage lender or bank pays the broker to sell you a higher rate. The higher the rate the broker can sell you, the higher the commission on the "back end" of the deal.

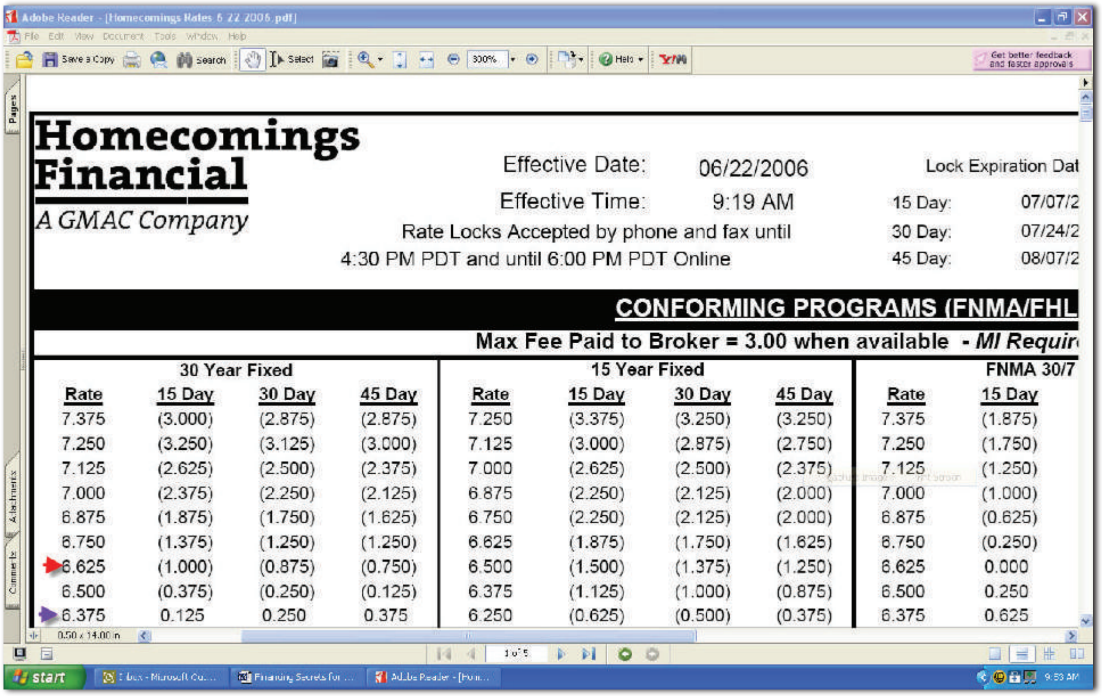
To understand rates and their corresponding price, you must travel back with me to high school math where we learned about bond pricing. Remember par, premium and discount? The rates that lenders offer can be priced at par, premium or discount. Let's say that the table below is sample pricing for Acme Funding. Acme sends these rate sheets to lenders and brokers all over the country saying *"Hey – here's what our rates are today!"*

30 Year Fixed	
RATE	**PRICE**
6.000	99.000
6.125	100.000
6.250	101.000

What this means is that if I offer a rate of 6.000 to my borrower, then I have to pay a point (1.000) in discount in order to get that rate. On a $200,000 loan that means we're bringing an extra $2000 to the closing table. If I offer my borrower a rate of 6.125 then it's a wash. He doesn't have to bring any extra to the table and I don't make any extra commission from the lender to sell this rate. This is this PAR rate.

Now, if I can get my borrower to agree to a rate of 6.250 then this is a PREMIUM rate—higher than the going rate—so the lender is paying me a commission of a point (1.000) on the deal. I make $2000 extra commission.

Here's what a real rate sheet looks like.



Homecomings Financial
A GMAC Company

Effective Date: 06/22/2006
Effective Time: 9:19 AM
Rate Locks Accepted by phone and fax until
4:30 PM PDT and until 6:00 PM PDT Online

Lock Expiration Dat
15 Day: 07/07/2
30 Day: 07/24/2
45 Day: 08/07/2

CONFORMING PROGRAMS (FNMA/FHL

Max Fee Paid to Broker = 3.00 when available - *MI Requir*

30 Year Fixed				15 Year Fixed				FNMA 30/7	
Rate	15 Day	30 Day	45 Day	Rate	15 Day	30 Day	45 Day	Rate	15 Day
7.375	(3.000)	(2.875)	(2.875)	7.250	(3.375)	(3.250)	(3.250)	7.375	(1.875)
7.250	(3.250)	(3.125)	(3.000)	7.125	(3.000)	(2.875)	(2.750)	7.250	(1.750)
7.125	(2.625)	(2.500)	(2.375)	7.000	(2.625)	(2.500)	(2.375)	7.125	(1.250)
7.000	(2.375)	(2.250)	(2.125)	6.875	(2.250)	(2.125)	(2.000)	7.000	(1.000)
6.875	(1.875)	(1.750)	(1.625)	6.750	(2.250)	(2.125)	(2.000)	6.875	(0.625)
6.750	(1.375)	(1.250)	(1.250)	6.625	(1.875)	(1.750)	(1.625)	6.750	(0.250)
6.625	(1.000)	(0.875)	(0.750)	6.500	(1.500)	(1.375)	(1.250)	6.625	0.000
6.500	(0.375)	(0.250)	(0.125)	6.375	(1.125)	(1.000)	(0.875)	6.500	0.250
6.375	0.125	0.250	0.375	6.250	(0.625)	(0.500)	(0.375)	6.375	0.625

You can see in the example above that Homecomings is the lender. Look at the 30 Year Fixed box above and you can see a list of rates offered from 6.375% all the way up to 7.375%. The purple arrow shows you that 6.375, on a 15 day lock, costs .125 in discount. If you wanted this rate today, you would have to pay .125% of the loan amount to get it. On a $200,000 loan that's $250.

If the broker can sell you the 6.625% rate then she can actually make one point (1%) in Yield Spread Premium on this deal.

Now what if you had a broker who was trying to sell you a rate of 7.375? That broker is making 3% in YSP—a whopping $6000 on a $200,000 loan.

YSP is required to be disclosed on the HUD1 settlement statement if the broker you are using is a wholesale broker, meaning they fund the loan in the lender's name, Homecomings Financial, not their own.

If they are a correspondent lender, this means that they actually fund your loan in their own name, Acme Funding, from a line of credit and then they sell the closed loan to the lender. If this is the case, then they DO NOT have to disclose the YSP on the HUD1 settlement statement. You never know at that point how much extra profit they have made by selling you a higher rate. To protect yourself, ask your mortgage broker to show you the rate sheet. They won't want to and they'll probably tell you that it's private, just for internal use, for mortgage professionals only, etc., but if they want to show you they can. There is no law prohibiting it. So, ask and the answer you get will tell you a lot about the broker you're working with and the rate that you're being offered.

Now I want to stress that YSP is not always a bad thing. Sometimes it can actually save you money!

Mortgage brokers have to be compensated for their work so they must be paid somehow. I personally tell all my investor clients that I must make 1% on each loan that I do. It is up to the client to tell me where to get my paycheck—either on the front through origination or on the back through YSP. Sometimes, it is less expensive to pay me with YSP—especially if it is a fix and flip—since it reduces the buyer's out of pocket costs. If you end up paying .250 more in rate and you're only keeping the property six months then it's no big deal and can even increase the profitability on your flip if you finance the origination with YSP. On a $200,000 loan the difference between a payment at 6.000 and 6.250 is only $32.33 a month. For six months you only end up paying $193.98 by financing the origination instead of paying 1% at closing. You save $1806.02!

Sometimes, you can even have the seller pay your broker and I show you how in the case study in the next section.

Seller Concession Secrets

May times, in order to entice a buyer to purchase a house, sellers will offer special incentives. These incentives are called "seller concessions" or "seller contributions" and they are essentially using proceeds from the sale to offset closing costs. The size of seller concessions is limited by the lender.

Here's the Fannie Mae rule about seller contributions:

> Seller contributions are permitted as long as the total contribution (including buydowns, non-recurring closing costs and prepaids) does not exceed the percentages as indicated below:
>
> **Primary Residence and Second Home**
>
> - If LTV is > 90% maximum contribution is 3%
> - If LTV is < 90% maximum contribution is 6%
> - If LTV is < 75% maximum contribution is 9%
>
> **Investment Property**
>
> - Maximum contribution for all LTV's is 2%

NOTE: Contributions must be calculated based on the CLTV when a mortgage is subject to subordinate financing for purposes of determining whether it complies with the maximum contribution limits.

So you can see that once again investors get the shaft! Just kidding—there are many conventional loan programs that will allow up to 6% seller contributions for investors. Just make sure you know the rule about your specific loan program before you write the offer to ensure you are maximizing the seller contributions on your deal. And remember this is a % of the purchase price—not the loan amount!

But you should also be careful because you don't want to get so much that the lender starts to question the value of the property. If seller concessions go beyond program limits, a lender might think that the house is overpriced. Yes, a house may have "sold" for $100,000, but if the seller had to give up $10,000 in concessions, what's the house really worth, $100,000 or $90,000? A lender would likely say $90,000. In this case, either the buyer must come up with more cash, the owner must lower the sales price, or there must be some combination of concessions.

Case Study—Seller Paid Origination

You are making an offer on a duplex that is listed for $180,000. The property has been on the market for a while and you think that the seller will be happy to offer some "concessions" or seller contributions in order to get the deal done. You know that your broker will charge 1% origination or $1800 on this deal if you offer full asking price, so figure your maximum offer and then ask the seller to also kick in $1,800 in closing costs. The seller won't actually have to give you $1,800 cash; it just gets deducted from his proceeds at the closing table.

Make sure you don't increase the sales price or your maximum offer in order to get this concession, though, or you are just financing it.

Interest Rate Buy Down Secrets

An interest rate buy down is a way to use yield spread or discount points to arrive at a specific interest rate for the life of the loan. The most common buy down is the 2-1 buy down. In the past, for a buyer to secure a 2-1 buy down they would pay 3 points in order to pay a below market interest rate during the first two years of the loan. At the end of the two years they would then pay the old market rate for the remaining term.

For example, if the current market rate for a conforming fixed rate loan is 8.5% at a cost of 1.5 points, the buy down would cost a total of 4.5 points giving the borrower a first year rate of 6.50%, a second year rate of 7.50% and a third through 30th year rate of 8.50% and the cost would be 4.5 points.

In today's market, lenders have designed variations of the old buy downs. Instead of charging higher points to the buyer in the beginning, they increase the note rate to cover their yields in the later years. For example, if the current rate for a conforming fixed rate loan is 8.50% at a cost of 1.5 points, the buy down would give the buyer a first year rate of 7.25%, a second year rate of 8.25% and a third through 30th year rate of 9.25%, or a three quarter point higher note rate than the current market and the cost would remain at 1.5 points.

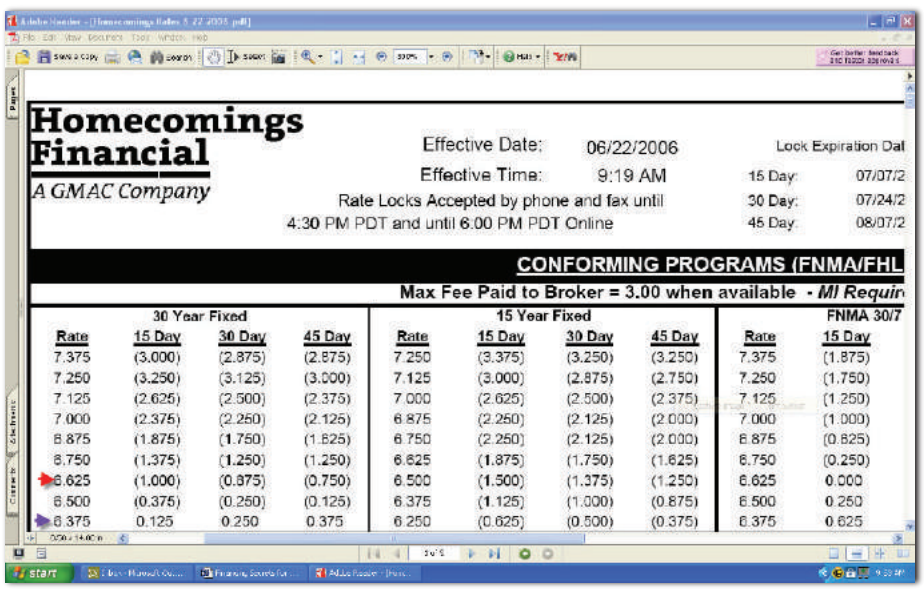
Another common buy down is the 3-2-1 buy down which works much like the 2-1 buy down, with the exception of the starting interest rate being 3% below the note rate. Another variation is the flex fixed buy down programs that increase at six month interval rather than annual intervals.

As an example, for a flex fixed jumbo buy down at a cost of 1.5 points, the first six months rate would be 7.50%, the second six months the rate would be 8.00%, the next six months rate would be 8.50%, the next six months rate would be 9.00%, the next six months the rate would be 9.50% and at the 37th month the rate would reach the note rate of 9.875% and would remain there for the remainder of the term. A comparable jumbo 30 year fixed at 1.5 points would be 8.875%.

Buy downs are complicated and I don't use them much on investor loans but it's another tool for you to have if the situation warrants.

Rate Lock Secrets

Rates on a loan have to be locked in before you can close the deal. On a rate sheet, rates are quoted with various time frames. For example, going back to our Homecomings rate sheet you can see different pricing for that same 6.625% rate on the 30 year fixed depending on whether we lock it in for 15, 30 or 45 days. The main thing to remember here is that time is money—the longer you lock the more expensive it is. If I lock in that 6.625% rate for 15 days I make 1% in YSP premium. If I lock that same rate for 45 days then I only make .750.



Homecomings Financial
A GMAC Company

Effective Date: 06/22/2006
Effective Time: 9:19 AM
Rate Locks Accepted by phone and fax until
4:30 PM PDT and until 6:00 PM PDT Online

Lock Expiration Dat
15 Day: 07/07/2
30 Day: 07/24/2
45 Day: 08/07/2

CONFORMING PROGRAMS (FNMA/FHL

Max Fee Paid to Broker = 3.00 when available - *MI Requir*

30 Year Fixed				15 Year Fixed				FNMA 30/7	
Rate	15 Day	30 Day	45 Day	Rate	15 Day	30 Day	45 Day	Rate	15 Day
7.375	(3.000)	(2.875)	(2.875)	7.250	(3.375)	(3.250)	(3.250)	7.375	(1.875)
7.250	(3.250)	(3.125)	(3.000)	7.125	(3.000)	(2.875)	(2.750)	7.250	(1.750)
7.125	(2.625)	(2.500)	(2.375)	7.000	(2.625)	(2.500)	(2.375)	7.125	(1.250)
7.000	(2.375)	(2.250)	(2.125)	6.875	(2.250)	(2.125)	(2.000)	7.000	(1.000)
6.875	(1.875)	(1.750)	(1.625)	6.750	(2.250)	(2.125)	(2.000)	6.875	(0.625)
6.750	(1.375)	(1.250)	(1.250)	6.625	(1.875)	(1.750)	(1.625)	6.750	(0.250)
6.625	(1.000)	(0.875)	(0.750)	6.500	(1.500)	(1.375)	(1.250)	6.625	0.000
6.500	(0.375)	(0.250)	(0.125)	6.375	(1.125)	(1.000)	(0.875)	6.500	0.250
6.375	0.125	0.250	0.375	6.250	(0.625)	(0.500)	(0.375)	6.375	0.625

Since rates change often—sometimes even several times a day—choosing just the right time to lock in a rate is important. I remember working at the mortgage company in Secondary Marketing during the refinance boom of 2000-2001. The securities traders would tell us just the right time to lock in our rates on our own refinances. They didn't tell the customers that—just the employees! It was great having my own private insider.

The rates that are the most volatile are the agency fixed and ARM rates. Since investors usually are using non-conforming and sometimes even sub-prime programs, we don't have to worry as much since these rates don't change as often. Still, I will pay attention to the monthly economic indicators as they are released and make sure I have all the loans in my pipeline locked before the Fed raises interest rates again. The point here is that if you are using an agency program to finance any of your properties, investment or otherwise, make sure to work with your broker to lock in a rate at the appropriate time.

If for some reason your loan is not closed by the rate lock date deadline, then you will either have to re-lock at a higher (market prevailing) rate or extend the lock for a few days for a fee. Either way, if you miss your deadline you pay so make sure you have enough time to close the loan by the deadline.

Secrets of the Good Faith Estimate

The Good Faith Estimate is a disclosure document that you sign to give you an ESTIMATE of the fees associated with your loan. It will also show closing costs, insurance and tax reserves, your estimated monthly loan payment and the amount you will need to bring to or get back at closing. Folks, the Good Faith Estimate is just that—an estimate. We lenders do the best we can to get as close to the real figures but sometimes we are off. I figure if I am within a $100 or so then I've nailed it.

Sometimes things happen that are beyond our control—like a loan payoff coming in higher than expected or a delayed closing that has us ponying up a full month of interest. Believe me, as a broker I hate surprises just as much as my clients do.

The main sections of the GFE are Items Payable in Connection With Loan (Section 800), Items Required by Lender to be Paid in Advance (Section 900), Reserves Deposited with Lender (Section 1000), Title Charges (Section 1100), Government Recording & Transfer Charges (Section 1200), Additional Settlement Charges (Section 1300) and Total Estimated Funds/Payment. You should note that the GFE looks a lot like the actual HUD1 settlement statement you will get at closing.

The line items contained in section 800, Items Payable In Connection With Loan are usually the ones that should get scrutinized the most carefully. The section numbers can change based on the loan origination software your broker is using but you get the idea.

801: Loan Origination Fee

This is the point(s) you pay a lender to originate your loan. I usually charge one point on each loan I do. If I am getting my point in yield spread premium this line will show 0.00.

802: Loan Discount

This shows any discount points you have to pay to buy the rate down.

803: Appraisal Fee

This fee is the charge for the appraisal. If you have already paid for the appraisal outside of closing (POC) then this will show 0.00.

804: Credit Report:

This is the fee that the lender is passing on to you for the credit report(s) he had to pull. At the time of this writing in Colorado (it can vary by state) the cost for a single applicant tri-merge through Equifax is $11.83 and a joint report is $19.86. Watch for mark up here.

805: Lender's Inspection Fee

This is charged sometimes if a lender has a requirement to inspect a property prior to closing. It isn't used much.

806: Mortgage Insurance Application Fee

If you have MI on your loan there could be a fee here. If you have a loan below 80% LTV or a combo loan (80/20) to avoid MI obviously this should be 0.00.

807: Assumption Fee

If you are assuming an existing loan there could be a fee here of usually 1%.

808: Mortgage Broker Fee

This is the fee you pay to a mortgage broker to originate your loan. Sometimes if I am brokering a private loan and that private lender charges an origination fee then I will put my broker point here. Usually the lenders do not charge origination in conventional residential transactions so my point just goes in the Loan Origination Fee line item and this shows 0.00.

809: Tax Related Service Fee

Lender fee, usually small, for handling tax related matters.

810: Processing Fee

This is the charge for processing the loan – collecting your application, running credit, collecting pay stubs, bank statements, ordering appraisal, title, etc.

811: Underwriting Fee

Lender fee that pays for the underwriter to approve and issue conditions on your loan.

812: Wire Transfer Fee

The fee charged, usually by escrow, for wiring money around.

813: Lenders Rate Lock In Fee

This is a fee charged by the lender for locking in your loan. Brokers are never charged a fee to lock in a loan with a lender so watch this.

814: Application Fee

Some brokers and lenders charge an application fee. I personally do not charge an application fee and would refuse to pay one to apply for a conventional mortgage unless it was going to be credited to me at closing. On commercial and some private money applications, though, it is a requirement.

Make sure you scrutinize your good faith estimate carefully and ask questions. An honest broker will be happy to answer and even negotiate any fees that are negotiable.

Appraisal Secrets—It's All in the Approach

An appraisal is an opinion of value or the act or process of estimating value. This opinion or estimate is derived by using three common approaches, all derived from the market.

- The cost approach to determining value is to estimate what it would cost to replace or reproduce the improvements as of the date of the appraisal, less the physical deterioration, the functional obsolescence and the economic obsolescence. The remainder is added to the land value.
- The comparison approach to determining value makes use of other "benchmark" properties of similar size, quality and location that have been recently sold. A comparison is made to the subject property. This is the most common approach.
- The income approach to determining value is of primary importance in ascertaining the value of income producing properties and has little weight in residential properties. This approach provides an objective estimate of what a prudent investor would pay based upon the net income the property produces.

Then, after thorough analysis of all general and specific data gathered from the market, a final estimate or opinion of value is given.

Secrets of As-Is vs. Subject-To

This is an important distinction for real estate investors. "Subject To" in an appraisal sense means that the property is worth "x" amount subject to certain things being done.

The term "subject-to" can be used interchangeably with "as-repaired". The conventional rule of lending states that the lender will make a loan for the LESSER OF the purchase price or the appraised value. Many investors come to me with their bank-owned and foreclosure deals and expect a conventional lender to loan on the value of the house. They are excited because they are getting the property for significantly less than it's "subject-to" value. I have to be the one to burst their bubble and drop the "lesser of" rule on them. Here's an example of a bank owned scenario that I see often:

- Purchase Price: $125,000
- As-is Value: $125,000
- As-repaired value: $200,000
- Max loan amount is the lesser of the purchase price ($125,000) or the appraised value ($200,000.)

This is the benefit of using a rehab loan or private money loan. These loans, like traditional construction loans, will loan on the subject-to or as-repaired value. The lesser rule doesn't bind us in the case and can go as high 80% of the subject-to or as-repaired value. Same example:

- Purchase Price: $125,000
- As-is Value: $125,000
- As-repaired value: $200,000
- Max loan amount is 80% of the appraised value ($200,000.) or $160,000.

In this case you should have enough to roll in your closing costs and fund the repairs. Sweet! The bottom line is that "Subject-To" items need to be completed in order to give the property full value.

No Appraisal Loan Secrets

Occasionally, there are lenders that will approve a loan and NOT require you to get an appraisal. This most often happens for two reasons:

1. You are refinancing at a low LTV and the value that you have stated is equal to the assessed value or,
2. You are getting a 2nd mortgage or a home equity line of credit and the lender is just running an automated valuation model (aka as a desktop appraisal or AVM) that verifies your stated value. It doesn't happen a lot but sometimes you'll get lucky!

Deferred Maintenance—This SHOULD be a Secret!

> What is Deferred Maintenance? First, it just means that something was supposed to be fixed in the property and the owner put it off. And in real estate terms it also means that since required maintenance was neglected, it's affected the value of your property. Maintenance was deferred and for lenders it is an issue.

Deferred Maintenance usually means something more than just cosmetic issues. It means big stuff like the roof needs replacing or the electrical system doesn't work. Or, it could mean the existence of a bad foundation. It means bad stuff—stuff that needs to be fixed before any real value can be placed on the property.

Let's say that you are making an offer on a house that might have foundation problems due to some visible cracks both inside and outside the home. You hire an inspector and sure enough, the foundation has problems and it will cost about $7,500 to fix. Many sellers usually prefer to reduce the sales price by $7500 instead of fixing it. That might be okay if you, the buyer, are paying cash for the property. But it won't work if the appraisal states that there is $7500 worth of deferred maintenance and you need financing. Lenders won't lend on property with deferred maintenance until it is fixed.

Sometimes you may get lucky and have a lender that has a threshold tolerance. I had an appraisal for one of my clients come back with about $1500 in deferred maintenance one time and the underwriter approved it because it was less than $2000.

QUICK SECRET NO. 7

Make sure there is no deferred maintenance listed on the appraisal. Lenders hate this! If your appraiser is going to address it at all, just say that there are cosmetic improvements that need to be made.

Loan Processing Secrets

Processing is another big mystery of mortgage financing. Most lending institutions charge a processing fee. I charge $450.00 and sometimes borrowers will ask me to waive the fee calling it a junk fee. I never waive the processing fee because I pay a professional loan processor to process my files. The broker and the processor work together closely to get a file to closing. As a broker, it is my responsibility to get business, or loan origination, through marketing and referrals. Once I have originated the loan, it's my responsibility to consult with my clients by helping them select the right loan products for their needs.

My client and I usually go over the transaction itself figuring out what the goal is both for acquisition and exit. That will help me narrow down the loan programs and features. Next, I'll set the loan file up in my origination software and I'll price out the deal with lots of different investors or lenders and I will decide where to send the loan based on the best pricing and terms available. Once I have priced out the loan, I forward a good faith estimate to my client and at that point I'll electronically turn the whole file over to my processor, letting him know the rate we agreed on with the client and the designated lender for this file.

The first thing the processor does is make sure I haven't made any mistakes. He'll check my calculations for DTI, make sure we have all properties listed properly in the REO section of the application and if it all looks good, he'll generate all of the application documents and disclosures. These are the papers you need to sign to begin the loan process. The required disclosures for us are:

- Good faith estimate (GFE)
- Truth in lending (TIL)
- Borrowers signature authorization
- Borrowers certification and authorization
- Federal disclosure notices
- Equal credit opportunity act

- Fair lending notice
- Mortgage loan origination agreement
- Right to receive the appraisal
- Servicing disclosure statement
- Tax transcripts request (4506)
- Patriot Act disclosure

You can see samples of all of these disclosures in the appendix. While these application and loan documents are out to the client for signatures, the processor will begin working on the file immediately. What they typically do is order a preliminary title commitment, the appraisal and evidence of insurance from your hazard insurance carrier (you don't have to actually pay that policy in advance, but we have to have a paper in the file saying that you will have coverage for the property once it closes).

In addition to the application documents and disclosures, the processor will also need the income and asset verification documents such as W2's, bank statements, pay stubs and business licenses. Once all this documentation is in, the processor will put the loan file together in a certain order requested by the lender; this is called the stacking order. You can imagine sometimes the loan files are very thick, especially when we include taxes. Underwriters don't want to waste time digging through a messy file looking for documents. Unfortunately the mortgage industry is not one of those industries that have gone paperless. I look forward to that day and hope that I can figure out my scanner by then. In the meantime, we will have to deliver the physical loan package via courier or FedEx. We have a few lenders that allow us to submit files via fax and even one that will allow document uploads via website, but they are the exception—not the norm.

Once we send the file to the lender, there is another person on their side who will take that loan file and input pertinent data about that loan into the software system they use for processing. This is called "logging in a loan" or "loan setup". It takes about 24 hours for this initial process. Next, the file goes to the underwriter. It is the underwriter's job to make sure our loan file submission conforms to the loan program's set written guidelines. These guidelines are set by the agency like Fannie Mae or Freddie Mac, or by whatever ultimate conduit or correspondent lender they will be selling this loan off to in the secondary markets.

There are written guidelines about loans that dictate what is acceptable and what is not acceptable. I've included a set of Fannie Mae Conforming Fixed guidelines in the appendix so you can get a sense of what the underwriter deals with. It is the underwriter's responsibility at the lender to actually take the information about you and your deal and match it up against those guidelines. For example, if we have chosen a loan program that has a maximum loan to value of 80% they'll want to make sure that our deal doesn't have a loan to value of 90%. They will also look at your income and if this particular loan program that we are asking for has a maximum debt to income ratio of 50%, you don't want to submit a loan that has a debt to income ratio of 54% because it will get declined.

Underwriting on the lender's side usually takes anywhere from 24 hours, if it is the beginning of the month and they aren't busy, to 3-5 days if it is a busy lender or it is toward the end of the month. They will generate what is called a conditional loan authorization and it will have a list of conditions or stipulations that they will fax to our processor. This is all the extra work they will need to do on your loan file in order to get that file to closing. Here are some typical conditions from an actual conditional loan approval that came from an underwriter to us recently (you can also see an actual approval notice in the appendix).

- 65-003: full appraisal with income approach completed subject to review. Review ordered 11-02-2006 estimated return time is 3 days.
- 65-007: borrower to sign and date 4506T. Lender to execute must receive results back prior to funding.
- 66-115: final 1003 to send to closing for signatures.
- 66-158: verbal VOE with employer verified through directory.
- 66-432: flood certification required - lender to provide.
- 66-001 cash to close not to exceed $1692.00 or additional assets must be verified. Currently $8959.00 verified.

The underwriter will usually sign this and fax it to the processor. When the processor gets this conditional loan approval, the first thing they do is quickly review it to make sure it isn't a denial notice. If it is not a denial, then this is essentially a conditional loan approval that is saying your loan is approved subject to the following conditions being satisfied or you providing us additional documentation to clear these stipulations.

Now it becomes the processor's responsibility to obtain additional documentation from the borrower to clear all of the conditions/stipulations. For example, on condition 65-007 the processor will generate a 4506T, which is a request for tax transcripts, and will email it or fax it to you, get you to sign it and fax it back because they will need to send that in to the lender. When they say they must receive results back prior to funding, it means that the lender will actually order a copy of your tax transcripts and will verify that the income we disclosed on the application or W2 for the prior year matches up to what was actually filed with taxes. If there are any issues with regard to the borrower reporting something that isn't completely accurate, that will give us a "heads up" that we need to start looking for another lender because if these don't match the deal will not fly with this lender.

Condition 65-003, full appraisal with income approach completed subject to review, means that the lender will order a review appraisal. Lenders usually have appraisers on staff to actually take a look at the appraisals we send in just to make sure everything is on the up and up and that the value is there. Sometimes they will run a desktop appraisal which is also known as an automated valuation model or AVM and if the value comes back OK they will sign off on it.

Occasionally, if the value doesn't come back, they will actually pull sales comparables themselves through the MLS system or they will go visit the property. That is why it can take up to three (3) days to clear a review appraisal condition. This is a big drag when you are trying to close something fast. On high LTV investor loans this happens quite often. The verbal verification of employment (VOE) is something the lender will do, so don't quit your job before the loan closes! Don't laugh – it's happened before. The flood certification is something the lender will order. All it does is verify that your property is not in a flood zone.

On this deal, the processor needs to take a good look at the good faith estimate to make sure that all of the fees are accurate and our cash to close doesn't exceed that $1692 figure. If it does, we need to make sure you have additional verifiable assets in order to get us enough verifiable cash to close.

So, this is, in a nutshell, what a processor does. This list of conditions is actually very small. I have seen conditions before on high LTV non-owner occupied deals where there are sometimes up to 15 conditions that need to be cleared and it requires the processor to do a lot of detailed work and coordination to obtain documents and additional signatures; even fighting sometimes with underwriters in order to get your loan closed. The loan processor does a great deal of work on your behalf in working with the underwriters to get your loan through to closing. That is why there is a fee associated with it and why very few people will waive that fee (or they'll say they will but hide it somewhere else) because somebody has to do it.

Loan Underwriting Secrets

Now let's talk a little bit more in depth about what an underwriter does on the lender's side. It's not very politically correct, but I look at the underwriter as our enemy. They are the only thing that stands between us and the money! Sometimes it seems like the underwriter's job is to look at the information we have given them and pick it apart in any way that they can to try to uncover any untruth that they can. That isn't their actual job description (at least I don't THINK it's the actual one) but sometimes when we are on the other side of it, it sure feels as though they will grasp at anything they can in order to deny our loan or make us provide ridiculous documentation.

Underwriters have to be very knowledgeable about literally hundreds of loan programs especially if they work for a big lender who is doing a lot of volume and selling a lot of loan products to the agencies and whole loan buyers. As real estate investors we are hoping that the lender we are working with, who is offering these great investor programs, has an underwriter that is very well versed in these programs and knows exactly what their ultimate investor guidelines will and won't allow so we have a better opportunity of closing our loan with the lender quickly.

I hate it when I get a conditional loan approval back and I can tell the underwriting has been outsourced or they have someone that isn't familiar with loan programs because they will have outrageous conditions