



Seeking a Mortgage in Today's Market Is Not Easy

By Aleksandra Todorova
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WITH FALLING HOUSING PRICES, relatively low interest rates and an abundant inventory of properties to choose from, you'd think buying a home these days would be a breeze.

That's until you start shopping for a mortgage. Stung by the subprime mortgage crisis, lenders have tightened their requirements considerably, giving even the most creditworthy borrowers a hard time when it comes to qualifying for a new mortgage or refinancing an existing one.

"Financing has become the single most important factor for home buyers and sellers," says Anthony Marguleas, owner of real estate brokerage Amalfi Estates in Pacific Palisades, Calif. Marguleas recently represented several sellers who had been preapproved for loans with a 10% down payment. But as they moved toward closing they were told that, due to a change in lending requirements, they would need to put 20% or even 25% down to gain approval.

"Lenders are changing their guidelines every day and making them more restrictive," Marguleas notes. He now asks that all new clients have a mortgage preapproval that's no more than a few weeks old. "If they show a preapproval from three months ago, it may no longer be valid," he explains.

While real estate and mortgage brokers may resent this more stringent lending landscape, lenders counter that things are simply getting back to the way they should be. "To me, it's like it was back in the 1980s," says Steve Jacobson, president of Fairway Independent Mortgage Corporation, a Madison, Wis.-based lender. "When you sat with someone 20 years ago, you had to discuss four things: job stability, cash, credit and income. All four had to make sense for a loan to work."

Now, if you lack in one area (say, your credit score isn't great or your assets are insufficient) you'd have to make up for it in others (with a higher down payment, for example). Here's what it takes to get approved for a loan in this environment.

A healthy credit score

The almighty FICO score¹ has long been crucial to people's ability to borrow. During the real estate boom, however, the ready availability of subprime loans ensured that even borrowers with scores in the 500s could qualify for a mortgage. "A few years ago, you could get a 100% stated-income loan with a 640 FICO score," says A. W. Pickel, president of LeaderOne Financial, a Overland Park, Kan.-based mortgage lender. (Stated-income loans don't require borrowers to show proof of income, such as tax forms and pay stubs.) One company, he says, even offered such loans to home buyers with scores as low as 580.

The bar for what's considered a healthy score is decidedly higher today, making it difficult for consumers with mediocre credit to qualify for a mortgage they can afford. "To be a successful borrower today at the best possible rate available, you have to have a FICO score of at least 700 or 720," says Keith Gumbinger, vice president of mortgage research firm HSH Associates.

Earlier this month, Fannie Mae issued a directive requiring lenders to adjust loan pricing by 0.5% to 2.75% of a loan's value based on a borrower's credit score, says Bruce Brown, president of First Security Mortgage Company, a Liberty, Miss.-based mortgage lender. Those with scores of 720 or more can qualify for the cheapest rates and no fees. But with scores between 700 and 719, borrowers will have to pay an additional 0.5% of the borrowed amount in the form of a fee or a higher interest rate. That's an added \$1,000 fee on a \$200,000 mortgage, or a rate increase that would be equivalent to that amount.

This makes boosting² your credit score even more imperative. "These [cost] adjustments are done in 20-point increments so if you jump your score by as little as 20 points, the cost savings are significant," Brown says.

A sizable down payment

Forget about 100% financing. Today, even a 5% or 10% down payment may be insufficient, especially if you live in a declining market and your score is lower than 620. That's because mortgage insurers have stopped insuring loans for 100% financing, Brown explains, and have significantly limited insuring 95% financing for borrowers with low credit scores. (Private mortgage insurance is required for anyone who puts down less than 20%.)

If you're buying a condo, be ready to cough up even more. Sean Burton, chief operating officer of CityView, a Los Angeles-based real estate investment firm, says condo buyers today are not only required to put down as much as 20%, but often have to prove they have enough money in the bank to cover three to six months' worth of living expenses. "The combination of doubling the down payment and requiring reserves has pushed many people out of the market," he says.

Flawless documentation

Even people with perfect credit are required to submit documentation detailing every aspect of their financial lives, from their income to the dollars and cents in their bank accounts. So-called stated-income-stated-asset loans, where borrowers weren't required to verify their income, assets and other financials, are now history, Brown says, no matter how perfect your credit. "Even people who were being treated like the kings and queens of credit before are now being treated like everybody else," he notes.

Credit Crunch Consequences

The real estate bust has greatly transformed the mortgage lending environment. Here are three changes that will affect borrowers in the months ahead.

Cumbersome appraisals

With home values plummeting throughout the country, investors who help finance mortgages are scrutinizing appraisals like never before, says Bruce Brown, president of First Security Mortgage Company. "You've got people who are creditworthy and can get approved for a loan, but the investors may look at the appraisal and deny the loan or make the appraiser jump through a lot of hoops to justify it," he explains.

Typically, appraisers are required to show so-called comps (recent sales of comparable homes) from the past 12 months. But now, investors are often requiring comps that are just six months old. That could be a problem for lower-density areas or ones where few similar homes have sold in the required time frame.

Appraisals are also getting costlier, since most lenders now bring in a second company to review each appraisal and make sure the value is accurate, says Marve Stockert, executive director of the Illinois Association of Mortgage Professionals. "We're seeing, in some cases, anywhere from \$50,000 to \$100,000 price adjustments," he notes. "A property that comes in appraised at \$400,000 may come in, after the review, at \$300,000." The cost of the review, roughly \$125 to \$255, is often passed along to the consumer in the form of additional fees, Stockert says.

Re-financing snags

Looking to refinance? If you have a second mortgage, like a home equity loan or line of credit, you may be required to pay it off before you can proceed with a refinancing. That's because during refinancing, a second loan automatically comes into first position, meaning that in the event of a default, the secondary lender has first dibs on the property's equity. Second-loan lenders, therefore, have to agree to subordinate their loans, or move them back into second position, Brown explains. (In the event of a default, the secondary lender will get repaid only after the first collects what they're owed.) Problem is, with declining property values, many lenders are refusing to subordinate because they fear they'd be left empty-handed if the home is foreclosed. "That's very rampant right now," Brown says.

FHA loans are back in vogue

FHA loans, which are guaranteed by the government and allow low or no down payments, were largely ignored during the real estate boom. The relatively low limits on the amount that these loans would finance excluded borrowers in high-price markets like New York and California. Attaining an FHA loan was also cumbersome, requiring more documentation and a stricter appraisal. Needless to say, many folks chose the faster, easier route: a 100% subprime loan, says A.W. Pickel. "They were more interested in moving fast and believed the hype out there that prices would keep rising forever and they could re-fi out of it," he notes.

Now, however, subprime loans are all but extinct, and thanks to the Economic Stimulus Act of 2008, FHA loan limits are as high as \$729,750. (The limits vary by county. Find yours here³.) "Just for that reason alone you'll see more people doing FHA financing," says Jacobson. So far this year, 20% of the loans his firm has extended are FHA loans, compared with only 12% last year.

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