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Mortgage Basics

Application Checklist	Closing Costs	Refinance
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Appraisals	Private Mortgage Insurance (PMI)	

## Application Checklist

### Application Checklist

Below is a list of documents that are required when you apply for a mortgage. However, every situation is unique and you may be required to provide additional documentation. So, if you are asked for more information, be cooperative and provide the information requested as soon as possible. It will help speed up the application process.

### Your Property

- Copy of signed sales contract including all riders
- Verification of the deposit you placed on the home
- Names, addresses and telephone numbers of all realtors, builders, insurance agents and attorneys involved

- Copy of Listing Sheet and legal description if available (if the property is a condominium please provide condominium declaration, by-laws and most recent budget)

### Your Income

- Copies of your pay-stubs for the most recent 30-day period and year-to-date
- Copies of your W-2 forms for the past two years
- Names and addresses of all employers for the last two years
- Letter explaining any gaps in employment in the past 2 years
- Work visa or green card (copy front & back)

If **self-employed** or receive **commission** or **bonus**, **interest/dividends**, or **rental**



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### **income:**

Provide full tax returns for the last two years PLUS year-to-date Profit and Loss statement (please provide complete tax return including attached schedules and statements. If you have filed an extension, please supply a copy of the extension.)

K-1's for all partnerships and S-Corporations for the last two years (please double-check your return. Most K-1's are not attached to the 1040.)

Completed and signed Federal Partnership (1065) and/or Corporate Income Tax Returns (1120) including all schedules, statements and addenda for the last two years. (Required only if your ownership position is 25% or greater.)

If you will use **Alimony** or **Child Support** to qualify:

Provide divorce decree/court order stating amount, as well as, proof of receipt of funds for last year

If you receive **Social Security** income, **Disability** or **VA** benefits:

Provide award letter from agency or organization

### **Source of Funds and Down Payment**

Sale of your existing home - provide a copy of the signed sales contract on your current residence and statement or listing agreement if unsold (at closing, you must also provide a settlement/Closing Statement)

Savings, checking or money market funds - provide copies of bank statements for the last 3 months

Stocks and bonds - provide copies of your statement from your broker or copies of certificates

Gifts - If part of your cash to close, provide Gift Affidavit and proof of receipt of funds

Based on information appearing on your application and/or your credit report, you may be required to submit additional documentation

### **Debt or Obligations**

Prepare a list of all names, addresses, account numbers, balances, and monthly



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payments for all current debts with copies of the last three monthly statements

Include all names, addresses, account numbers, balances, and monthly payments for mortgage holders and/or landlords for the last two years

If you are paying alimony or child support, include marital settlement/court order stating the terms of the obligation

Check to cover Application Fee(s)

### FHA Loans

#### What is an FHA Loan?

The Federal Housing Administration (FHA) was established in 1934 to improve housing standards and conditions and to provide an adequate home financing system through insurance of mortgages. Families that would otherwise be excluded from the housing market were finally able to buy the homes of their dreams.

An FHA loan allows you to buy a house with as little as 3% down, instead of the higher percentages required to secure many conventional loans. Taking advantage of the FHA loan program is a great way for first time buyers, or anyone with a shortage of down payment funds, to buy a home.

The FHA does not make home loans--it insures them. If a home buyer defaults, the lender is paid from the insurance fund. This is a perfect mortgage solution for those starting out or those having a tough time qualifying for conventional loans.

Appraisals

#### What is an Appraisal ?

Appraisal is a document that gives an estimate of a property's fair market value. An appraisal is generally required by a lender before loan approval to ensure that the mortgage loan amount is not more than the value of the property. The appraisal is performed by an "appraiser" who is typically a state-licensed individual trained to render expert opinions concerning property values. In an appraisal, consideration is given to the property, its location, amenities as well as its physical conditions.

#### Why get an Appraisal ?

The most common reason for ordering an appraisal is to obtain a loan on a property. However, there are several other reasons why an appraisal might be needed. Below are just a few:

to establish the replacement cost (insurance purposes).

to contest high property taxes.

to settle a divorce.

to settle an estate.

to use as a negotiation tool (in real estate transactions).

to determine a reasonable price when selling real estate.

to protect your rights in an eminent domain cas.

because a government agency requires it.

lawsuit.

#### What are Appraisal Methods ?

Appraisers use three common approaches when establishing the value of a given property:



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- **Cost Approach:** In this approach the following formula is used to arrive at the property value: Value of the land (vacant), added to the cost to reconstruct the appraised building as new on the date of value, less accrued depreciation the building suffers in comparison with a new building.
- **Sales Comparison Approach:** In this approach the appraiser identifies 3-4 comparable properties in the neighborhood which have recently been sold. Ideally, the properties are close in vicinity (within a 1/2 mile radius of the subject property) and have sold within the last six months. The appraiser then compares the sold properties to the subject property. The factors used in the comparison include square footage, number of bedrooms and bathrooms, property age, lot size, view, and property condition.
- **Income Approach:** In this approach the potential net income of the property is capitalized to arrive at a property value. This approach is suited to income-producing properties and is usually used in conjunction with other valuation methods. The process of converting a future income stream into a present value is known as capitalization.

After thorough exercise of the three approaches, a final estimate or opinion of value is correlated. When evaluating single-family, owner-occupied properties, the sales comparison approach is most heavily weighted by an appraiser.

## Closing Costs

### What happens at closing ?

At the closing, ownership of the newly purchased home is officially transferred from the seller to you. It may involve you, the seller, the real estate agent, your attorney, the lender's attorney, representatives from the title or escrow firm, and a variety of clerks, secretaries, and other staff. It is possible to have an attorney act on your behalf if you cannot attend the meeting (for example, if the house is in another state). Closing can take as little time as an hour to sign all the forms and transfer ownership or it can take several hours, depending on the contingency clauses in the purchase offer (and any escrow accounts that may need to be set up). Much of the paperwork involved in closing (or settlement) is done by attorneys and real estate professionals. You may be involved in some of the closing activities and not in others, depending on local customs and on the professionals with whom you are working.

Before you close on the house, you should have a final inspection, or walk-through, to make sure any repairs you requested have been made and that items which were to remain with the house (drapes, light fixtures) are still there.

In most states, settlement is done by a title or escrow firm to which you forward all the materials and information along with the appropriate cashiers' checks, and the firm will make the necessary disbursements. The real estate agent or another representative of the title company will deliver the check to the seller and the house keys to you.

### Statutory Costs

Statutory costs are expenses you would have to pay to state and local agencies even if you paid cash for the house and did not need to take out a mortgage. They include the following:

**Transfer taxes** are required by some localities to transfer the title and deed from the seller to you.

**Recording fees for deed** pay for the county clerk to record the deed and mortgage and change the property tax billing.

**Pro-rated taxes** such as school taxes and municipal taxes may have to be split between you and the seller because they are due at different times of the year. For example, if taxes are due in October and you close in August, you would owe taxes for 2 months while the seller would owe taxes for the other 10 months. Prorated taxes usually are paid based on the number of days (not months) of ownership. Some lenders may require you to set up an escrow account to cover these bills. If your lender does not require an escrow account, you may want to set up a special account on your own to make sure you have money set aside for these important, and large, bills.

**Other state and local fees** can include mortgage taxes levied by states as well as other local fees.



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### Private Mortgage Insurance

#### What is PMI?

If you make a down payment of less than 20% of the purchase price of the home, mortgage lenders generally require that you take out Private Mortgage Insurance (PMI) that protects the lender in case you default on your mortgage. You may need to pay up to a year's worth of premium for this coverage at closing, which can amount to as much as several hundred dollars. One obvious way to avoid this extra cost is to make a 20% down payment. There are also other ways to eliminate PMI such as 80-10-10 financing which is further described in this section.

#### How does PMI work?

PMI companies write insurance protecting approximately the top 20% of the mortgage against default, depending on the lender's and investor's requirements, the loan-to-value ratio, and the particular loan program involved. Should a default occur, the lender sells the property to liquidate the debt, and is reimbursed by the PMI company for any remaining amount up to the policy value.

#### Could obtaining PMI help me qualify for a larger loan?

Yes. Let's say that you are a family with \$42,000 annual gross income and monthly revolving debts of \$800 (car payment and credit cards) and have \$10,000 for a down payment and closing costs on a mortgage at 7% interest. Without PMI, the maximum price you can afford is \$44,600. But with private mortgage insurance covering the lender's risk, you can buy a house worth \$62,300. PMI has afforded you 39% more house.

#### What does PMI cost?

Costs vary from insurer to insurer, as well as from plan to plan. For example, a highly leveraged adjustable rate mortgage would require the borrower to pay a higher premium to obtain coverage. Buyers with 5% down payment can expect to pay a premium of approximately 0.78% times the annual loan amount (\$92.67 monthly for a \$150,000 purchase price). But the PMI premium would drop to around 0.52% times the annual loan amount (\$58.50 monthly) if a 10% down payment was made on the loan.

#### Credit

#### What is a credit report ?

Your credit payment history is recorded in a file or report. These files or reports are maintained and sold by "consumer reporting agencies" (CRAs). One type of CRA is commonly known as a credit bureau. You have a credit record on file at a credit bureau if you have ever applied for a credit or charge account, a personal loan, insurance, or a job. Your credit record contains information about your income, debts, and credit payment history. It also indicates whether you have been sued, arrested, or have filed for bankruptcy.

#### Do I have a right to know what's in my report?

Yes, if you ask for it. The CRA must tell you everything in your report, including



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medical information, and in most cases, the sources of the information. The CRA also must give you a list of everyone who has requested your report within the past year-two years for employment related requests.

### **What type of information do credit bureaus collect and sell?**

Credit bureaus collect and sell four basic types of information:

#### **Identification and employment information**

Your name, birth date, Social Security number, employer, and spouse's name are routinely noted. The CRA also may provide information about your employment history, home ownership, income, and previous address, if a creditor requests this type of information.

#### **Payment history**

Your accounts with different creditors are listed, showing how much credit has been extended and whether you've paid on time. Related events, such as referral of an overdue account to a collection agency, may also be noted.

#### **Inquiries**

CRAs must maintain a record of all creditors who have asked for your credit history within the past year, and a record of those persons or businesses requesting your credit history for employment purposes for the past two years.

#### **Public record information**

Events that are a matter of public record, such as bankruptcies, foreclosures, or tax liens, may appear in your report.

## Refinance

### **When I should refinance?**

It is often said that you should refinance when mortgage rates are 2% lower than the rate you currently have on your loan. Refinancing may be a viable option even if the interest rate difference is less than 2%. A modest reduction in the loan rate can still trim your monthly payment. For example, the monthly payment (excluding taxes & insurance) would be about \$770 on a \$100,000 loan at 8.5%. If the rate were lowered



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to 7.5%, the monthly payment would be about \$700, a savings of \$70. The significance of such savings in any scenario will depend on your income, budget, loan amount and the change in interest rate. Your trusted lender can help calculate the different scenarios.

### **Should I refinance if I plan on moving soon?**

Most lenders will charge fees to refinance a loan. If you plan to stay in the property for less than a couple of years, your monthly savings may not get a chance to accumulate and recoup these costs. Let's say a lender charged \$1,000 to refinance your loan, but it resulted in a monthly savings of \$50. It would take 20 months (1,000 divided 50) to recoup the initial costs before you start to realize some savings. Some lenders will charge a slightly higher than average interest rate on refinance loans, but waive all costs associated with the loan. The attractiveness of these loans will depend on the interest rate you are being charged on your current loan.

### **How much will it cost me to refinance?**

In addition to an application fee (\$250-350) you will likely have to pay an origination fee (typically 1% of the loan amount). In many cases you will have to pay much of the same costs that you had to pay with your current home loan (title search, title insurance, misc. lender fees, etc.). The sum of these fees could cost you up to 2-3% of the loan amount. If don't have the money to pay for associated loan costs, look for lenders that offer 'no-cost' loans. These loans will charge a slightly higher interest rate, so ask a lender if it would still make sense to refinance using this type of program.

### **What are points?**

Points are costs that need to be paid to a lender in order to receive mortgage financing under specified terms. A point is a percentage of the loan amount (one point = one percent of the loan). One point on a \$100,000 loan would be \$1,000. Discount points are fees that are used to lower the interest rate on a mortgage loan (you are discounting the interest rate by paying some of this interest up-front). Lenders may express other loan-related fees in terms of points. Some lenders may express their costs in terms of basis points (hundredths of a percent). 100 basis points = 1 point (or 1 percent of the loan amount).