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Mortgage Lending

Presented By:

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FOR THE NORTHERN NEW ENGLAND SCHOOL OF BANKING

TOPICS FOR DISCUSSION

- INTRODUCTION
- HMDA
- PORTFOLIO & SECONDARY MARKET LENDING
- TYPES OF LOANS
- ABILITY TO REPAY & UNDERWRITING
- CONDOMINIUMS
- INVESTMENT PROPERTY
- SELF EMPLOYED BORROWER
- Q & A

INTRODUCTION

Robert P. Gagnon, SVP Mortgage Lending & Business Development

- I have been in Banking way too long
- I am one of the Original 8 at Optima Bank & Trust
- When we first opened I originated and underwrote every mortgage loan (no problems with that right)
- I have a very distinctive laugh
  - You know I'm there without ever needing to see me or by just being within a 10 mile radius of where I am.
- At my core I truly am an introvert……………….no seriously that's true
  - You can call me an experiment gone wrong (black sheep of the family)

Importance of Mortgage Lending

The Importance Of Residential Lending:

- I should stress my perspective, I am an Originator, the slimy sales guy that knows enough to be dangerous
- Homeownership (American Dream)
- Investment In Your Future
- Ability To Find Financing When Things Aren't Perfect
- Still Sound Investments For Your Financial Institutions And Other Investors
- Knowledge of programs and eligibility for these programs so you can guide people to the appropriate product for them and set them up to be successful
- As we get into some of the types of loans you'll find other reasons for the importance of what we do in the arena

HMDA – Home Mortgage Disclosure Act

Remainder of 2017:

- For loans that will close in 2017 the new provisions do not apply, current data collection/recording/reporting/disclosing rules apply

2018

- Collect data under the new rule for submission in 2019
- Submit 2017 data under current rule

2019

- Enforcement provisions are in effect for new rule
- Collect data under new rule
- Submission of 2018 data under new rule

2020

- Quarterly reporting starts and open-end line of credit threshold adjustment is due to be implemented

PORTFOLIO LENDING

- A portfolio lender
  - a bank or other lending institution that makes mortgage loans with the intention of holding the loans in their investment portfolios
  - Useful when a borrower does not qualify for a conventional loan program
  - Fannie Mae, Freddiemac or FHA
  - Typically smaller community banks
  - Often privately held
  - They have more discretion in the way they do business than larger, stockholder driven institutions.

PORTFOLIO LENDING

- To a true portfolio lender, mortgages are also investments in customers and in the communities served allowing for growth and helping to maintain a healthy social and business environment.
- By servicing a consumer's mortgage over the years it can help build a solid, long-term relationship.
- There is also a market for these non-conforming loans
- Selling loans that have seasoned in the portfolio is a strategy to increase liquidity and create "space" to continue to do more of these types of loans

SECONDARY MARKET LENDING

- The secondary market
  - Is made up of investors, such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) which are the largest investors
  - Fannie Mae and Freddie Mac buy large numbers of loans from banks and other mortgage originators
  - Loan are re-package in groups of similar type loans to be sold again as what are known as mortgage backed securities
  - These securities are traded like stocks and bonds
  - You sell these loans one off for a premium which depends on many factors (rate, term, property type, loan to value, etc…)

SECONDARY MARKET LENDING

- Banks at times feel they have too great a percentage of assets invested in mortgage loans
- They will decide to sell some of those loans to other investors
- This helps to hedge risk and to increase liquidity.
- Many institutions use the funds received from selling mortgage loans to make further mortgage loans
- This is beneficial to a bank that needs a larger pool of mortgage funds at a particular time than it can generate from bank deposits or other sources

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Types of Loans

- Fixed Rate Programs (30-year, 25-year, 20-year, 15-year, 10-year)
- Adjustable Rate Mortgages (ARM)
    - 1/1, 3/1, 5/1, 7/1 and 10/1 (What do these mean?)
    - Caps of 2%/6% (What do these mean?)
    - Term and amortization 30-years
- Interest Only Mortgages
    - Fixed rate
    - The borrower only pays the interest
    - Term is usually 5-7 years

Types of Loans

- Purchase
    - Primary
    - Secondary/Vacation
    - Investment (
- Refinance
    - Primary
    - Secondary/Vacation
    - Investment
- Construction Line of Credit
- Construction to Permanent Loans
- Bridge Loans
- Land Loans

Ability to Repay

If you are really into this stuff go read Appendix Q of Reg.Z
(I am keeping it general and keeping the discussion to ATR)
The Eight ATR Underwriting Factors:

1. Current or reasonable expected income or assets (other that the value of the property that secures the loan) that the consumer will rely on to repay the loan

2. Current employment status (if you rely on employment income when assessing the consumer's ability to repay)

3. Monthly mortgage payment for this loan

4. Monthly payment on any simultaneous loans secured by the same property

Ability to Repay

The Eight ATR Underwriting Factors Continued:

5. Monthly payment for property taxes and insurance that you require the consumer to buy, and certain other costs related to the property such as homeowners association fees or ground rent (If a property is on leased land you typically need to match the term of the loan to the term of the lease)

6. Debts, alimony and child support obligations

7. Monthly debt-to-income ratio or residual income, that you calculated using the total of all of the mortgage and non-mortgage obligations listed above, as a ratio of gross monthly income

8. Credit history

JOB OF THE UNDERWRITER

Assessing The Risk Of The Borrower (The 3 C's)

- **Capacity And The Debt To Income Ratio - Can They Pay The Monthly Payment**
  - 45% or lower is typical
  - Tools used – paystubs, tax returns, bank statements
- **Credit And The Score - How Is Your Payment History With Others**
  - Indicative of your handling and managing the repayment of your past bills and helps in the determination of how you will handle the new loan request
  - 620 or higher is typically required, certain factors can change that requirement such as ltv, property type, loan size
  - Tools used – credit report, bank statements
- **Collateral And The Loan To Value - Assessing A Property's Value And Also The Type Of Property Is Very Important**
  - Private mortgage insurance
  - Riskier types of property (investment, condos)
  - Tools used – appraisal report, tax cards, websites

JOB OF THE UNDERWRITER

Typical Information Needed:

- Most Recent 30-days Of Paystubs
- Most Recent Two Years Of W-2s And Tax Returns
- Most Recent Two Months Of Bank Account Statements, Investment Account Statements And Retirement Account Statements
- Purchase & Sales Agreement (If Applicable)
- Automated Underwriting Systems

Case Study 1: Mortgage Loan

Bill & Mary are very excited to be buying their first house. They come to you as a referral from a broker who has worked with you in the past and you did such a great job she is sending another client to you. Bill is the Athletic Director at a local college where he started 3 years ago and loves his job, which is why they have decided to settle down in this area and no longer commute over an hour just because their parents want them to stay close to them. Mary also has been working in this area for 1.5 years and prior to her current job did some part time work while she was looking for about 8 months, she is also at the local college as an administrator in the financial aid department. Their parents aren't thrilled with the move which takes them an hour away but are supportive and willing to help them with whatever they need.

Case Study 1: Mortgage Loan

Case Study 2: Mortgage Loan

Jim & Kelly are looking to buy a new primary residence in a quieter part of town. Their kids are grown and they have no use for all the square footage in their current home which they own.
They have found a condo in town and are excited about moving there, it is right near restaurants, theatres and shops which they love going to.
Jim is a Computer Engineer who has been in the business for 20 years however did just switch employers a little less than a year ago that has more bonus potential but a lower base salary, he has historically received bonus payouts but they have varied quite substantially over the past two years. Kelly is self-employed and works as an interior designer with a lot of real estate brokers you know to stage homes for sale and has been doing it for 7 years.

Case Study 2: Mortgage Loan

Condominiums

- **No more than 15% of the total units in a project may be 60 days or more past-due on their HOA dues**

- **Replacement reserves for capital expenditures are at least 10% of the budget**

- **For investment property transactions in established projects at least 50% of the total units in the project must be conveyed to principal residence or second home purchasers. This requirement does not apply if the subject mortgage is for a principal residence or second home.**

- **The total space that is used for nonresidential or commercial purposes may not exceed 35%. (See guide for additional detail.)**

- **Projects in which a single entity (the same individual, investor group, partnership, or corporation) owns more than the following total number of units in the project: projects with 5 to 20 units – 2 units or projects with 21 or more units – 20% (See guide for additional detail.)**

Condominium Exercise

Review the two condo questionnaires:

1. **Which condo association is most probably secondary market compliant?**

2. **Which condo association most probably doesn't meet secondary market guidelines? Why?**

Condominium Exercise

Review the two condo questionnaires:

1. **Which condo association(s) is most probably secondary market compliant?**

2. **Which condo association(s) most probably doesn't meet secondary market guidelines? Why?**

Investment Property Analysis

- Eligible properties
  - A two to four unit principal residence property in which the borrower occupies one of the units, or
  - A one to four unit investment property

- Limitations on the Number of Financed Properties
  - If the mortgage is secured by the borrower's principal residence, there are no limitations on the number of other properties that the borrower will have financed
  - If the borrower is financing a second home or investment property the maximum number of financed properties is 10

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Investment Property Analysis

- Reserve Requirements (if they own other financed properties other than a principal residence and the subject property)
  - 2% of aggregate UPB (unpaid principal balance), 1-4 financed properties
  - 4% of aggregate UPB, 5-6 financed properties
  - 6% of aggregate UPB, 7-10 financed properties

- Examples of liquid financial assets that can be used for reserves include readily available funds in
  - Checking or savings accounts
  - Investments in stocks, bonds, mutual funds, certificates of deposit, money market funds, and trust accounts
  - The amount vested in a retirement savings account
  - The cash value of a vested life insurance policy

Investment Property Analysis

- Subject Net Cash Flow
  - 2-4 Unit PR, calculate subject net cash flow and include it in total qualifying income(do not subtract PITIA)
  - Investment Properties, calculate subject net cash flow and subtract PITIA
    - if positive add to qualifying income
    - If negative add to liabilities so it is included in the DTIR

Investment Property

DOCUMENTING RENTAL INCOME

Does the borrower have a history of receiving rental income from the subject property	Transaction type	Documentation requirements
Yes	Refinance	Appraisal forms 1007 or 1025 and The borrowers most recent year of tax returns including schedule E Copies of current lease agreements
No	Purchase	Appraisal forms 1007 or 1025 and Copies of the current lease agreement(s)
No	Refinance	Appraisal forms 1007 and 1025 and Copies of the current lease agreement(s)

Investment Property

PARTIAL OR NO RENTAL HISTORY ON TAX RETURNS

If…	Then…
The property was acquired during or subsequent to the most recent tax filing year	The lender must confirm the purchase date using the settlement statement or other documentation If acquired during the year, Schedule E (fair rental days) must confirm a partial year rental income and expenses (depending on when the unit was in service as a rental) If acquired after the last tax filing year, Schedule E will not reflect rental income or expense for this property
The rental property was out of service for an extended period	Schedule E will reflect the costs for renovation or rehabilitation as repair expenses. Additional documentation may be required to ensure that the expenses support a significant renovation that supports the amount of time that the rental property was out of service Schedule E (Fair rental days) will confirm the number of days that the rental unit was in service, which must support the unit being out of service all or a portion of the year
The lender determines that some other situation warrants an exception to use a lease agreement	The lender must provide an explanation and justification in the loan file

Investment Property Exercise

Roger & Mary Monroe

- Let's talk about page 1 of a 1040
- Multiple property owner
- Calculate the total net operating income that can be used in qualifying ratios
- What else do you see that you should pay attention to based on the information on the forms provided

Investment Property Exercise

Roger & Mary Monroe

- **Calculate the total net operating income that can be used in qualifying ratios:**
- **What else do you see that you should pay attention to based on the information on the forms provided:**

The Self Employed Borrower

- Has always been a difficult area due to many factors
  - Writing off as much as they can
  - Not reporting all income to limit tax liability
  - Large swings in net profit year over year
  - Multiple entities used to move money through that need to be dissected to find true income
  - One man/woman shop or a couple and they are not savvy when it comes to tracking income and expenses and their reporting is not truly representative of what they make
- 2 years of historical income reported on Tax Returns

- If Current year is better than historical years and is needed for qualification then a CPA prepared income statement and balance sheet are required

Self Employed Borrower Exercise 1

Bunny Hathaway, Realtor

- **Let's talk about Schedule C**
- **Using the worksheet available calculate the income available to this borrower for qualifying**

Self Employed Borrower Exercise 1

Bunny Hathaway, Realtor

- **Let's talk about Schedule C**
- **Using the worksheet available calculate the income available to this borrower for qualifying *$64,110.92***

Self Employed Borrower Exercise 2

Stanley Kubrick, part owner of Fitness For U & I, LLC

- **Let's talk about the 1065**

- **Using the worksheet available calculate the income available to this borrower for qualifying**

Self Employed Borrower Exercise 2

Stanley Kubrick, part owner of Fitness For U & I, LLC

- Let's talk about the 1065
- Using the worksheet available calculate the income available to this borrower for qualifying

Questions & Answers

Thank You!

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