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The Perfect Loan File

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The media has it all wrong – securing mortgage approval and satisfying credit underwriting guidelines are not the difficulties plaguing mortgage consumers. It's in meeting the rigorous documentation requirements that most people fall flat. The good news is, the fix is simple. Just scan, photocopy, fax, and deliver every aspect of your financial life. Then, shortly before closing, check everything again.

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Mortgage consumers who enter the mortgage approval process ready to battle their chosen mortgage lender will come out with a nightmare story to tell. As the process, requirements, and guidelines are the same for everybody, your mindset is the game-changer. Accepting the redundant documentation necessary for lender approval will make everyone's life easier.

When I was a kid, my father occasionally issued directives that I naturally thought were superfluous, and when asked why I needed to do whatever it was he wanted me to do, his answer was often: “Because I said so.” This never seemed to address my query but always left me without a retort, and I would usually comply. This is exactly what consumers should do during the mortgage approval process. When your lender requests what seems to be over-documentation and you wonder why you need it, accept the simple edict – “because I said so.” You will find the mortgage approval process much less frustrating.

So, what’s the perfect loan? Well, it’s one that (a) pays back the lender and (b) pays back the lender on time. Underwriting the perfect loan is not the goal that mortgage lenders aspire to today.

The real goal is the perfect loan file.

Mortgage lenders have suffered staggering losses and gone out of business because of the dreaded loan repurchase. As mortgage delinquencies increased, FannieMae and FreddieMac began to audit mortgage loans they had purchased and discovered substandard and fraudulent underwriting practices that violated representations and warranties made, stating these were high quality loans. Fannie and Freddie began forcing the originating lenders of these “bad” loans to buy them back. So a small correspondent mortgage lender is forced to buy back a single mortgage loan in the amount of $250,000. This becomes a $250,000 loss to a small mortgage business for a single loan, because it will never be repaid.

It doesn’t take many of these bad loan buybacks to close the doors on many small mortgage operations. The lending houses suffered billions of dollars of losses repurchasing loans from Fannie and Freddie, and began to do the same thing for loans they had purchased from smaller originators.

The small and medium sized mortgage originators that survived created underwriting guidelines and procedures to eliminate the threat of future loan repurchase losses. The answer? The perfect loan file.

It’s no longer necessary to have excellent credit, a big down payment and stable employment with income sufficient to support your debt service to guarantee your loan approval. However, you must have a borrower profile that meets the credit underwriting guidelines for the loan you are requesting. And, more importantly, you have to be able to hard-copy-guideline-document your profile.

Every nook and cranny of your financial life has to be corroborated, double- and triple-checked, and reviewed again before closing. This way, if the originating lender has created a loan file that is exactly consistent with published underwriting guidelines and has documented while adhering to those guidelines, the chances are that your loan will not be subject to repurchase.

Borrowers also need to prepare for processing and underwriting. Processors and underwriters are the people trained and charged with gathering (processors), all of your required-for-approval financial documents, and then approving (underwriters), your loan. You can assume these people are well trained and very experienced, as they are tasked with assembling and approving a high-quality-these-people-will-pay-us-back loan file. But just how do they go about that?

The process begins with the filter – the loan originator (a.k.a loan officer, mortgage consultant, mortgage adviser, etc.) – tasked to match the qualifications of a particular mortgage deal to the appropriate underwriting guidelines. It is the filter's job to determine if a loan scenario is approvable and to gather the documentation to support that determination. It is here, at the beginning of the approval process, where the deal is made or broken. The rest of the approval process is just papering the file.

The filter determines whether the information provided by the borrower can be validated and documented. This is simple, since most mortgages are approved by automated underwriting engines such as Desktop Underwriter, and the automated approval generates a list of the documents needed to paper the loan file. An underwriter can, at this stage, request additional supporting documentation evidence at their discretion, as not all circumstances neatly fit into the prescribed underwriting box. If the filter creates a loan file with accurate information, then secures the documentation resulting from the automated underwriting findings, the loan will close uneventfully.

So, let's begin with the pre-approval call. Mortgage pre-approval is typically accomplished with a telephone interview. A prospective borrower calls a mortgage rep (filter), and the questions begin. There will be lots of questions as this critical phase of the process is akin to the discovery period in a trial – you'll need to disclose everything. Expect to answer queries on what you do for a living, how long you've been employed in your current field, and what your salary is. If there is a co-borrower, they will have to answer the same questions.

Every dollar in checking, savings, investments and retirement accounts, also known as assets to close, as well as gifts from relatives and non-profit grants, has to be accounted for. Essentially everything appearing on a borrower's asset-radar-screen has to be documented and explained.

If you were previously a homeowner and sold your home in a short sale, or if you own a home now and plan to keep it as an investment or rental property, there are new and specific underwriting guidelines created just for you. In these cases, full disclosure of your credit and homeownership past can potentially eliminate unforeseen mortgage approval woes. For instance, FannieMae has a new underwriting guideline called "Buy-and-Bail," for current homeowners' planning on keeping their existing home as an investment/rental property. Properties not meeting the 30% equity test for "Buy-and-Bail" result in additional asset requirements to purchase a new home. Buyers with a short sale history may have to wait two to three years before they are eligible for mortgage financing again. Full vetting of your previous mortgage life will save you the dreaded we-have-a-problem call from your mortgage lender.

It all comes down to your proof. If the lender asks for a specific document, give them exactly what they are asking for, not what "should be OK," – because it won't be. This is where the approval process tends to go off the rails, when the lender asks for specific documentation and the borrower supplies something else. Here, too, is where both sides get frustrated. So if the lender asks for a bank statement and there are 5 pages for that bank statement, send them all 5 pages, and not just the summary. If you send them the summary page and they ask again, don't complain that the lender keeps asking for the same thing when you never sent it in the first place. This may sound elementary, but the vast majority of mortgage approval process woes stem from scenarios just like this.

The reason the mortgage approval process is now so rigorous is simple. Avoiding defaults and loan buybacks has become the primary goal of mortgage lenders. Higher standards are reducing loan defaults, which should mean fewer foreclosures in the future. Government data shows that less than 2% of loans originated in 2009, that were resold to Freddie Mac and Fannie Mae went into default after 18 months, down from more than 22% default rates for 2007 loans.

So when your lender requests specific documents from you, give it them just "because they said so."

You can thank my dad for that.

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