



# Understanding Home Financing

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# Agenda

- ◆ Understanding Mortgage Rates
- ◆ Home Financing Process
- ◆ Tips & Resources



# Understanding Mortgage Rates

- ◆ At macroeconomic level, mortgage rates move in the same direction as interest rates
  - Stock up, bond down, interest rates up
- ◆ Two key tracking indicators
  - 10 Year Treasury Yield
  - 30 Year FNMA Bonds



# Understanding Mortgage Rates

- ◆ Other factors
  - Supply & demand
  - Lenders' niches



# Home Financing Process

## ◆ Finding the right agent

### ➤ Retail Banks

- Easy to find
- Perceived convenience

### ➤ Mortgage Brokers

- Access to multiple lenders
- Ability to do “real-time” shopping

*Interview multiple candidates, Ask for referral*



# Home Financing Process (cont'd)

## ◆ Finding the right program

### ➤ Length of time at current residence

- Fixed vs. ARM
- Long term (30 yrs) vs. shorter term (15 yrs)

### ➤ Financial goals

- Upfront fees – lower monthly payments
- No points & no fees – doesn't mean “FREE”
- Debt consolidation vs. flexibility



# Home Financing Process (cont'd)

## ◆ Decoding underwriting decisions

### ➤ “Balancing the Risk” with 3 C’s

➤ Capacity – willingness and ability to pay back the loan

➤ Credit – Payment history and current balances; willingness to repay

➤ Collateral – Property, or what the lending institution will be left with if the borrower fails to pay



# Home Financing Process (cont'd)

## ◆ Decoding underwriting decisions (cont'd)

### ➤ Capacity – Debt to income ratio

- Housing ratio: mortgage payment, insurance, real estate taxes, HOA fees and other related expenses. Also known as “top” ratio
- Total debt ratio: housing expenses, credit card debt, installment debt, alimony or child support payments. Also known as “bottom” or “backend” ratio
- FNMA guideline: 28 / 36
- More aggressive lenders: 40 / 45-50



# Home Financing Process (cont'd)

## ◆ Decoding underwriting decisions (cont'd)

### ➤ Credit – FICO score

➤ 3 risk based scores: Fair Isaac (Experian), Empirica (Trans Union), Beacon (Equifax)

➤ Ranges: 330-850

➤ 5 categories determining your FICO scores:

✓ Payment History: 35% (300 pts) – frequency, severity, recent information

✓ Balance: 30% (255 pts) – max'd out vs. zero balance

✓ Credit History: 15% (125 pts) – how long, how often

✓ Type of Credit: 10% (85 pts) – credit cards, mortgage, installment

✓ Credit Inquiries: 10% (85 pts)



# Home Financing Process (cont'd)

- ◆ Decoding underwriting decisions (cont'd)
  - Compensating factors to combat high ratios
    - ✓ Lots of reserves
    - ✓ Job stability
    - ✓ Good credit
    - ✓ Housing payment decreasing
    - ✓ Debt being paid down/off
    - ✓ Lower Loan to value





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# How do I increase my FICO score?

- Pay your bills on time. Late payments and collections can have a serious impact on your score.
- Do not apply for credit frequently. Having a large number of inquiries on your credit report can worsen your score.
- Reduce your credit-card balances. If you are "maxed" out on your credit cards, this will affect your credit score negatively. Keep accounts below 50% usage.
- If you have limited credit, obtain additional credit. Not having sufficient credit can negatively impact your score.
- Get started early to build your credit history over time. Open at least 4 accounts and use them for 6 years. Older accounts with longer credit histories are important.



# How do I increase my FICO score?

- Don't have too many inactive accounts, which is a potential liability for lenders. For example, if you have 10 accounts with each one a credit limit of \$4000. Then, you can potentially borrow  $10 * \$4,000 = \$40,000$ .
- If you have too many inactive accounts, don't close them all at once because you will be penalized.
- American Express is not recommended because they have no "credit limit".
- Too many finance company accounts (e.g., 0% interest for 6 months if you buy this furniture today) will damage your credit score.
- Diversify debt type: good mix of department store cards, credit cards, installment loans, open accounts, etc.



# Examples of assessment statements

- ◆ Amount owed on account is too high
- ◆ Level of delinquency on account
- ◆ Too few bank revolving accounts
- ◆ Proportion of loan balances to loan amounts is too high
- ◆ Too many bank or national revolving accounts
- ◆ Lack of recent installment loan information
- ◆ Too many accounts with balances
- ◆ Too many consumer finance company accounts



# What if there is an error?

- ◆ Report the error to the credit bureau:
  - Equifax: 1-800-685-1111  
<http://www.equifax.com/>
  - Trans Union: 1-800-916-8800  
<http://www.transunion.com/>
  - Experian: 1-888-397-3742  
<http://www.experian.com/>



# Other Resources

- ◆ Credit Bureau Risk Factor Reason Codes  
<http://www.bestinservice.com/Resources/ReasonCodes/reasoncodes.html>
- ◆ What in the World is a FICO Score?  
by Amy Debra Feldman  
<http://www.bankrate.com/brm/news/investing/20001004b.asp?prodtype=grn>
- ◆ Understanding Your Credit Score  
The Five Things That Count  
Scores are part of the lending decision  
<http://168.230.129.57/servlet/SiteDriver/Content/1528>