Want to Get a Mortgage? Think Like a Lender

Coldwell Banker Bain

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When applying for a home loan, it may help to know what the bank is looking for. Improve your chances for success by understanding these key components.

Shopping for a house is usually the fun part of home buying. Applying for a mortgage? Not so much. But knowing the factors that influence a bank's decision will put you in a stronger position when you apply for a mortgage. With luck, knowing how to think like a lender will take some of the anxiety out of the process for you.

Debt ratios

Lenders put a lot on the line when they finance a house and they don't like to lose money. To minimize their risk, lenders comb through a mini-mountain of documents that paint a portrait of a borrower's financial situation. Current expenses, credit and payment history, proof of income all weigh in. To size up your indebtedness, lenders consider two important ratios.

- Lenders use the **housing ratio** (sometimes called the "front-end ratio") to look at your anticipated monthly housing costs, including mortgage principal, interest, property taxes, homeowner's insurance and condo fees, if applicable. Ideally, this figure should be less than 28% of your monthly gross income.

- Using the **debt-to-income ratio** (sometimes called the "back-end ratio"), lenders consider all your other monthly debts (credit cards, student loans, car loans, alimony, child support) plus other housing expenses and look for a total that's no more than 36% of your gross income.

Higher-earning borrowers may have ratios closer to 40% and 50%, but the 28/36 rule is standard.

Loan-to-value ratio

Another indicator lenders use is the loan-to-value ratio. This figure compares the value of your loan to the value of your home. To calculate LTV, divide loan amount by appraised value or purchase price of your house. For example, if you borrow $160,000 on a $200,000 home, your LTV is 80%. Borrowers with lower LTVs are considered a lesser risk because they have more equity in their homes and therefore will qualify for better (i.e., lower) mortgage rates.

Credit report

When you apply for a mortgage, lenders will look closely at your credit rating, also called your credit score or FICO score. This number, between 300 and 850, is derived from information in

your credit report and indicates how likely you are to repay your debt. Your FICO score – FICO stands for Fair Isaac Corp., the company that created credit scores in the 1980s – plays a major role in whether you will get a home loan, as lenders consider borrowers with FICO scores above 650 to be good credit risks. Thus, the higher your FICO score, the better your credit rating and the greater likelihood of getting a mortgage at the lowest interest rates.

Down payment

After carefully scrutinizing a lot of facts and figures, your lender will, at some point, turn to you and say, “Show me the money,” meaning the down payment required to secure your loan. Lenders love down payments that are at least 5% of your home’s purchase price. There are a number of mortgage programs, particularly for first-time home buyers, that come with down-payment help and lower thresholds. But if you put down less than 20% you’ll have to pay private mortgage insurance, or PMI, which protects the lender against losses. PMI, folded into your mortgage and paid monthly, disappears when the equity in your home hits 20%.

Automatic underwriting

For a lot of buyers, applying for a mortgage is terrifying. But it needn’t be. In fact, many lenders use technology to take the guesswork out of a buyer’s qualification and to speed the process. An automated underwriting system, or AUS, is a complex software program that looks at your debt ratios, credit score and other factors to quickly determine if you qualify for a loan. You’ll still need to be vetted by a human underwriter to get full loan approval, but this is a huge first step on the path toward your new, or first, home.

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