Qualifying for a Mortgage

Purchasing a home and taking out a mortgage may be the biggest investment you'll ever make. Here are some great tips to help prepare for the process.

What to Do

Plan Ahead

The most common factors that hurt your ability to get a mortgage are:

- Low credit score
- Inadequate income (documented income)
- Not enough savings
- High debt-to-income ratio

You'll need to look at these factors and address any shortfalls well in advance of applying for a loan. This may mean waiting several months or even a year or two before you apply.

Your Credit Score

As a matter of course, lenders look at your credit report and credit score. Regardless of the lender, the higher your credit score, the better the financing. So review your credit report and look for inaccuracies. Inaccurate information can affect your score. You can request a free copy of your credit report at www.annualcreditreport.com. If you find inaccurate information, contact the credit bureau that is showing the erroneous information.

If you have derogatory information on your credit report, develop a plan for improving your report. This may mean paying down credit card debt and other installment loans. If you have a loan on a depreciating asset like a recreational vehicle, you may want to consider selling it to eliminate the debt altogether. If you have payment delinquencies of 30 days or more, start making timely payments. After a several month period, your credit score will begin to improve.

Your Income

Your income level is used to determine how much house you can afford. The stability and dependability of your income is also a factor. Evaluate your sources of income. Earned income from salary and wages is generally viewed more favorably by lenders than income from tips and commissions. If your income is mostly from sources regarded to be less reliable, you may be required to have a larger down payment, or look for a home that is less expensive.

Your Savings

You will likely need a down payment. While the Federal Housing Administration (FHA) allows borrowers to put down as little as 3.5% of the purchase price, conventional mortgage loans usually require a down payment of 10% to 20%. Although you can now write off Private Mortgage Insurance (PMI) on your tax return, putting 20% down on a mortgage avoids PMI altogether.

Lenders like to see bank statements that show you've been accumulating savings for a down payment over an extended period of time. Large, one-time deposits into your savings account are viewed less favorably and may raise questions.

Your Debt-to-Income Ratio

Your debt-to-income ratio (DTI) is a representation of your cash flow. It shows lenders what percentage of your gross monthly income is spoken for to pay your fixed expenses. A high debt-to-income ratio is viewed negatively by lenders because it means less "wiggle room" between your monthly debt and income.

Calculation: Monthly Debt Payments ÷ Gross Monthly Income = DTI%

Your DTI ratio is the total of your mortgage interest, principal, insurance payment, property taxes; all recurring debt payments, such as auto loan/lease payments and credit card payments, divided by your gross monthly income. The generally-accepted recommendation is for a ratio of 36% or lower.

Housing Cost Ratio

Another ratio lenders look at is your housing cost ratio (HCR). Lenders typically require home loan applicants to have a housing expense ratio of 28% or lower. Why? Because the lower the ratio is between your housing costs and your gross monthly income, the higher the probability that your home is affordable. This applies to existing homeowners, too. The generally-accepted recommendation is for a ratio of 28% or lower.

The housing cost ratio is your total mortgage interest, principal, insurance payment and property taxes divided by your gross monthly income.

Calculation: Mortgage Payment ÷ Gross Monthly Income = HCR%

Other Things to Do

Understand How the Process Works

A mortgage loan may be the largest loan you'll ever obtain. You should do as much research on the process as possible. Three good sources for information about a loan are:

www.michigan.gov/difs

www.hud.gov

www.consumerfinance.gov/

Know How Much House You Can Afford

Use an online "Mortgage Calculator" to get a rough estimate of what you may be able to afford. Your loan officer will determine how much you can actually afford, as there are other factors they take into consideration besides the monthly payment. Once you have arrived at a loan amount, your loan officer will issue you a preapproval letter so you can start shopping for a home.

Where to Turn

Other valuable sources for information:

www.consumer.ftc.gov

www.freddiemac.com

www.zillow.com

www.bankrate.com

www.mortgagecalculator.org