4 C's of Lending

Version 2.1

- Credit - Cash - Capacity - Collateral

- Online Recording - Main Site 4 C's -

$Cash

- Down Payment plus closing costs and prepaids
- Down Payment requirements
- Acceptable Sources of down payment

If you buy a car and put $2,000 as a down payment no one really cares if you saved, borrowed or found the money on the way to the car dealership. With a mortgage it is different, you have to verify you have sufficient funds to cover the down payment and closing cost in order to buy the house.

Every lender will require that you submit two months bank, investment account and retirement account statements. The lender will then review the statements to make sure there are no large non-payroll deposits. I had a borrower recently who needed $8,000 to close and they had a $7,500 deposit into their account the day before the applied. If there are large deposits you will have to source these large deposits by getting a copy of the check that was deposited and providing a written explanation.

Down Payment Plus Closing Costs and Prepaids

Many first time home buyers are surprised that they need to have a down payment plus closing costs. Closing costs are kind of like paying sales tax when you buy something at a store but they are much higher. Your lender can give you a complete breakdown on your closing costs and prepaids.

Closing costs consist of inspection fees, processing fees, points, appraisal, title insurance, closing fees, recording fees, credit report, flood certification, and surveys. Points are a percentage of your loan amount. As an example the interest rate is 4.5% with 0 points.

You can pay .50 points or $500 on a $100,000 loan and the rate is 4.375%. Or you could get a credit back of .50 points at 4.625% which would be applied to your closing costs. The rates and points are constantly changing, so if the market moves a little higher it may cost you .125 points to get 4.5%.

Many lenders set one rate for the day unless there is a significant change in the market which would result in a rate change during the day.

Prepaid items are items that you pay in advance. This consists of:
1. Your homeowner’s insurance policy which you pay for the first year.
2. Interest from the date of closing until the end of the month.
3. Any deposits for future taxes and insurance into your escrow account.

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Down Payment Requirements

There are basically 4 mortgage programs available. Rural Development and VA require 0 down. FHA requires 3.5% down and Conventional requires 5% down. There are some slight variations as some states have bond programs that may require less down. In Michigan for example, there is a program for first time home buyers that allows the borrower to invest only 1% of the purchase price

Some cities or counties also offer grants or second mortgages for homeowners that can be used for either down payment, closing costs or prepaids.

You can structure your purchase agreement requesting the seller to pay a portion or all of your closing costs and prepaids. Most programs limit what the seller can pay to 6% of the sales price. Conventional loans require the borrower to invest a minimum of 5% of the purchase price and the seller can pay up to 3% of the sales price in buyer's closing costs and prepaids. If the borrower is putting 10% down on a conventional loan the seller can pay up to 6% of the sales price in buyers closing costs and prepaids. The other way to cover all or a portion of your closing costs and prepaids was discussed above where you pay a slightly higher rate and get a credit for the points. This is known as premium pricing. Your lender can run detailed options for you.

You will need to verify any funds that you pay prior to closing. The lender will want to verify your earnest deposit (this is the check you write to your realtor when you submit your offer on a home to make it a legal binding contract) by providing a copy of the front and back of the cleared check or a printout from your bank account showing this check cleared your account. The same would go for inspections if you paid those prior to closing.

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Acceptable Sources of Down Payment

1. Cash verified in bank accounts, money market, and brokerage accounts.

2. Secured borrowed money. If you borrow money on an asset that the lender can document you own, such as a retirement account, vehicle titled in your name, or another property you currently own.

3. Gifts as long as the donor signs a gift letter. Gifts are acceptable for VA, RD, FHA for all closing costs and any down payment. Conventional loans with less than 20% down have additional criteria with gifted funds.

On conventional loans with less than 20% down the private mortgage insurance companies require you to have 5% or 3% of your own funds. Some private mortgage insurance companies will accept a gift for the total downpayment and closing costs if the borrower's credit score is at a certain level and the ratio or your total debts to your income is at an acceptable level. If the borrower has 3% of their own funds they will allow a gift for the remaining 2% plus closing costs with fewer restrictions.

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