

## Tips for understanding the lending industry

By Ric Spiels

Published Tuesday, July 22, 2008

The Island Packet

In today's real estate market, homebuyers are doing more advanced preparation than ever before. Part of this preparation should be understanding the mortgage lending process and how lenders evaluate potential borrowers.

When evaluating an individual borrower's ability to repay a loan, the lender considers two calculations with regards to proposed and outstanding debt. These calculations are known as debt to income ratios. They are simply the percentage of a homebuyer's income that goes toward mandatory debt payments.

The first is the housing ratio or "front end ratio" as it is sometimes called. This calculation considers all of the borrowers housing expenses; principal and interest on the new mortgage, real estate taxes, homeowners insurance, mortgage insurance, and homeowner's association dues associated with the property.

Housing expenses are often referred to as P-I-T-I, which stands for principal, interest, taxes and insurance. In general lenders like to see the housing expenses that are around 33 percent of the borrower's income.

The second ratio or "back end" ratio, considers not only the housing expense but also all reoccurring debt payments for the borrower. This debt could be revolving credit -- which consists of credit lines and accounts which can be accessed freely by the borrower without the need to reapply for credit.

Revolving accounts are credit cards or open lines of credit at retail stores. It may also include installment debts which are loans with defined payments and duration. A typical example of installment debt is an automobile loan. It is important to note, because installment debt has a definitive number of payments, it is a common practice to exclude installment debt with less than 10 remaining payments from the debt to income calculations.

Ideally, this total debt ratio is around 38 percent of the borrowers income.

Taking the time to review your debt to income ratios is a good idea before making any real estate purchase. To do this, simply total all of your monthly debt payments including the minimum payments on your credit cards. Don't forget to include any non-debt expenses such as alimony or child support in your total. Once you have this total, try to get an estimate of the housing expenses you will face after your purchase.

Now divide the total by your monthly income. This is your total ratio. If it is higher than the 33 percent to 38 percent guidelines mentioned earlier, it does not necessarily mean you will be declined for a mortgage but you will need to have some strength in other areas such as good credit, significant down payment, or asset reserves.

It is not uncommon for borrowers with debt to income ratios in the fifties to be approved. However, it is important for the borrower to feel comfortable with the new payment.

Debt to income ratios are one of the most important factors in qualifying for a mortgage. It is also relatively simple for a potential homebuyer to calculate their own ratios before applying for the mortgage. This simple step can help eliminate some of the uncertainty that inevitably comes with incurring any new debt.

Obviously calculating your ratios is only the first step. As you move along the path to purchasing your home, please consult with a member of the Mortgage Lenders Association of Greater Hilton Head Island.

Our professional members will be able to help you feel comfortable with the lending process.

Ric Spiehs is vice president, mortgage branch manager, of Bank of America on Hilton Head Island and president of the Greater Hilton Head Island Mortgage Lenders Association.