CONCERNED ABOUT REJECTION?

The joys and anticipation of owning a new home are sometimes crushed when the application for mortgage financing is turned down by the lender. In our economy, it is unfortunate, but some people may go through tough times. When times are hard, the most permanent impact is usually your credit history. A person's credit history is the first thing a lender notices and imperfect credit is usually the reason a loan is denied. If your loan request has been denied, you should understand why the loan was denied and what steps you can take to correct the problem or make sure that it does not happen again in the future. The following information helps you understand the most common reasons for loan denials and corrective measures you can take, and it describes some alternatives that exist especially for low and moderate income home buyers.

POSSIBLE CAUSES FOR REJECTION AND YOUR ALTERNATIVES

Appraised Value Too Low…

One of the factors considered by the lender is the ratio of the loan amount to the sale price or the appraised value of the property, whichever is lower. If the appraisal on the property is substantially lower than the purchase price, the loan-to-value ratio, or LTV, may be higher than the lender will, or can legally, approve. If you have applied for a maximum loan amount, 90 to 95 percent of the purchase price, a low appraisal may make your requested loan too large. Your alternatives in this situation will depend upon the reasons for the low valuation.

If the purchase price is simply higher than the prevailing prices being paid in the general area, you can try to renegotiate the price with the seller down to a level more in line with the market and one which the lender would accept in order to approve your loan. If this is not possible, your only other solution is probably accepting a lower loan amount, assuming you have sufficient funds to cover the additional down payment.

Inadequate Funds…

Based on the financial information and the verification of deposit, the lender may have determined that you do not have enough cash to make a down payment and cover closing costs. Usually, these funds may not come from borrowing. However, a gift from a relative can be used as long as no repayment of the money is expected. Other solutions include getting the seller to take back a second mortgage which would reduce the down payment requirement (assuming you can still qualify with the additional loan payments), or getting the seller to pay some of the closing costs, such as the origination fees. Finally, you could correct this problem by simply waiting, providing you institute a savings program in the meanwhile.

Insufficient Income…

In assessing your ability to repay the requested loan, lenders look at the amount of your monthly income in relation to your proposed mortgage payments and to all of your monthly debt and installment loan payments. Generally speaking, your mortgage payment should not be more than 28 percent of your monthly gross income, and your total debt, including mortgage payments and other installment payments, should not be more then 36 percent. The percentages are slightly higher for FHA loans. These ratios are only guidelines, but if yours are substantially higher, say 35 percent and 42 percent, they are well beyond industry norms and can cause denial of the loan.

Sometimes, particularly if your credit card record is very good, if you can show that you are already carrying that much housing expense through rent or mortgage payments, you may be able to convince the lender to reconsider. This is an example of why full and accurate disclosure on the loan application works in your favor, even though it may not be obvious at the time.

If your personal circumstances have changed since the submission of the loan application let the loan officer know. An impending salary increase or bonus or new employment, for you or your co-borrower, may improve the financial picture presented on the application. These changes, of course, will need to be documented and verified before the lender will reconsider the loan request.

Too Many Debts…

In some cases, it is not only the amount of debt owed by an applicant that prevents qualifying for the loan. Extensive use of numerous credit cards and revolving accounts with evidence of increasing account balances that are close to the card issuers' debt limits may be enough to kill the application. The primary solution to this problem is to pay off some of the accounts to bring down outstanding obligations, as well as the number of creditors.

Unsatisfactory Credit History…

Nothing can be more damaging to your loan request than a history of poor debt repayment practices. If the credit report shows frequent late charges, past due accounts, judgments, or bankruptcy; chances for approval of the loan are slim. Lenders may stretch their guidelines on debt ratios or income requirements, but have little tolerance for a bad credit record. Even low loan-to-value ratios and debt ratios cannot offset an unsatisfactory credit history.

If your loan is turned down because of a poor credit report, you may request a free copy of the report from the credit report company, which will be identified in a notice from the lender. Examine the credit report carefully to see if it is up to date and accurate. The credit bureau must correct any errors in the report. If there are unsettled disputes over certain accounts, it must also include your side of the argument in the report. Even if the name on the report seems to be you, make sure all of the accounts and references apply to you. Many people have the same name, and improper recording of data occurs.

If the adverse items on the report occurred because of illness, marital problems, job layoff, or other temporary circumstances and were confined to a particular period of time, you should have provided the loan officer with a written explanation at the time the loan application was taken or at some other point in the process. If you didn't do it then, do it now. Assuming there has been sufficient time since the problems occurred for you to regain financial stability and demonstrate prompt payment of your obligations, there is a good chance the loan officer will reconsider the loan request. Many lenders look for one year's clean payment record to offset past credit problems. If the credit report is accurate and you have a questionable credit history, you need to start repaying outstanding balances on time in order to reestablish an acceptable record. It may take time, but there is no alternative when this problem stands between you and owning a home.

ALTERNATIVES FOR LOW AND MODERATE-INCOME HOME BUYERS

Many lenders participate in housing programs designed for low and moderate income home buyers who would not qualify for home loans under standard lending requirements. These programs are sponsored by both governmental and private organizations. If you have a good credit history, or have not established a credit history at all, they may provide a source of financing for your home purchase.

Primary sources of special, low income housing programs include state and local housing finance agencies, nonprofit housing assistance groups, the Department of Housing and Urban Development (HUD), and secondary mortgage market operations such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Your loan officer should be able to tell you how to contact local offices of organizations which work directly with borrowers, or you can usually find them in the phone book in the blue government listings under "Housing."

Assistance for low and moderate income home buyers is not only based on direct subsidies but also on relaxation of standard loan approval requirements. For instance, many low income families spend a greater percentage of their income groups. If you can show that you have consistently handled such higher payments and have a good credit record, the lender might approve the loan based on higher debt ratios.

Some potential home buyers have trouble getting a loan approved because they have not established a credit record. There is nothing adverse on the credit report, but there is no record of prompt repayment of loans or charge accounts. If this is your situation, you may be able to qualify based on what is called a "non-traditional credit history." Using this approach, the lender will depend on utility companies, past and present landlords, and other sources which can verify that you have met a regular payment obligation in a timely, consistent manner. If you think such an approach might help you, and the loan officer has not mentioned it, suggest it to the loan officer.

A REJECTION IS NOT YOUR LAST CHANCE

The fact that a lender has rejected your loan application does not mean that you are denied home ownership forever. As has been discussed earlier, there are positive steps you can take to correct the problem. Some problems may be resolved very quickly while others may take longer, but you can turn around most problem situations. Take the time to determine exactly why your loan request was denied, and then take steps to eliminate the cause of rejection.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

- Answers to Credit Problems
- Applying for Credit
- At Home Shopping Rights
- Bankruptcy Facts
- Buried in Debt
- Car Financing Scams
- Charge Card Fraud
- Choosing A Credit Card
- Co-Signing
- Credit and Divorce
- Credit and Older Consumers
- Deep in Debt?
- Equal Credit Opportunity
- Fair Credit Reporting
- Fair Debt Collection
- Gold Cards
- Hang up on Fraud
- High Rate Mortgages
- Home Equity Credit Lines
- How to Avoid Bankruptcy
- Indiana Uniform Consumer Credit Code
- Look Before you Lease
- Mortgage Loans
- Repossession
- Reverse Mortgage Loans
- Rule of 78s – What is it?
- Scoring for Credit
- Shopping for Credit
- Using Credit Cards
- Variable Rate Credit
- What is a Budget?
- What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information.

CREDIT PROBLEMS & MORTGAGE LOANS

Credit Problems Have You Out on a Limb??

DEPARTMENT OF FINANCIAL INSTITUTIONS
Consumer Credit Division
30 South Meridian Street, Suite 300
Indianapolis, Indiana 46204
317-232-3955
1-800-382-4880