

# 8 big mortgage mistakes and how to avoid them

*You can borrow too much or prepare too little. You can misjudge terms or overestimate your credit. With so much at stake, it's no wonder so much can go wrong.*

By Liz Pulliam Weston

Applying for a mortgage can be a daunting experience.

It's not enough that you're agreeing to take on the biggest debt of your life, one that represents two to three times your annual income. You're also confronted with piles of paperwork, flurries of fees and a tidal wave of terms, from amortization to title insurance, whose meaning is fuzzy at best.

"Whether it's a professor at Stanford or a ditch digger," said San Francisco mortgage broker Leon Hunting, "most people don't understand the loan process." In this confusing and pressure-filled atmosphere, it's easy to make some mistakes. Here are some common ones that lenders and mortgage brokers see, and what you can do to prevent them.

## **Not fixing your credit**

Mortgage brokers say they're confounded at the number of buyers who apply for a mortgage with their fingers crossed, hoping their credit will allow them to qualify for a loan.

Before you even think about applying for a mortgage, obtain copies of your credit report and your FICO credit score. Your FICO score is the three-digit number that's used in 75% of mortgage-lending decisions. You can order your FICO score on the Web for a fee of \$14.95, which includes a copy of your credit report.

Doing this at least six months in advance should give you plenty of time to challenge any errors on your report and ensure that they're removed by the time you're ready to apply for a loan. You can also see the legitimate factors that are hurting your score and do something about them, such as paying off an overdue bill or paying down credit card debt.

## **Not looking for first-time home buyers' programs**

These programs, typically sponsored by state, county or city governments, often offer better interest rates and terms than you'll find among private lenders, said

mortgage consultant Diane St. James. Some are tailored for people with damaged credit, while most can help people with little saved for a down payment. You can also call the housing agencies for your state, county and city to see what they offer.

### **Not getting pre-approved for a loan**

Many first-time borrowers confuse being "pre-qualified" with being "pre-approved." Pre-qualification is a pretty casual process, where a lender tells you how much money you probably can borrow based on how much money you make, how much debt you already have and how much cash you have for the down payment.

Getting pre-approval, by contrast, is a much more rigorous process and involves actually applying for a loan. You typically submit tax returns, pay stubs and other information. The lender verifies the information and checks your credit. If all goes well, the lender agrees in writing to make the loan.

In a hot or even warm real estate market, the house hunter who is only pre-qualified is a cooked goose. Home sellers and their agents give much more weight to offers being made by buyers who already have a loan lined up.

### **Borrowing too much money**

Many people take out the biggest loan they possibly can, figuring that their incomes will eventually increase enough to make the payments comfortable. But few first-time buyers have any clear idea of how expensive homeownership can be. Not only will you shell out more for mortgage payments than you probably did for rent, but you'll also need to cover property taxes and homeowners insurance, as well as higher bills for utilities, maintenance and repairs than you faced as a renter.

Lenders are perfectly willing to let you overextend, knowing that you'll probably forgo vacations, retirement savings and new clothes for the kids rather than default on your mortgage.

"Mortgage money ... is way too easy to get," said Ted Grose, president of the California Association of Mortgage Brokers. "People tend to overbuy ... and that can really stress family life. It's also a formula for foreclosure.

Instead of going to the edge of affordability, consider limiting your housing costs -- mortgage payments, property taxes and homeowners insurance -- to 25% or so

of your gross income. That's a much more sustainable level for most people, financial planners say, than the 33% lenders are typically willing to give you.

### **Not shopping around for rates and terms**

Mortgage broker Allen Jackson, sees too many borrowers with decent credit getting stuck with loans meant for people with poor credit. So-called "subprime" loans are often more profitable, so less ethical mortgage brokers may push them.

If the borrower doesn't know what the prevailing interest rates are for someone with their credit standing, Jackson said, they can easily pay thousands of dollars more than they need to. You can see a listing of loan rates by credit score at MyFico.com, and a comprehensive listing of prevailing rates and fees can be found on websites.

Even people with a few dings on their credit can often qualify for better loans than they're typically offered, said Grose of 1st Mortgage Advisors. He believes most of the people being shunted into government loan programs, such as Federal Housing Administration (FHA) loans, would pay less if they used mortgages now being offered by private-sector lenders.

### **Paying junk fees**

Lenders can boost their profits by adding on a variety of fees. Some may be legitimate, some may be inflated and others may be pure fluff. Lenders may charge for "document preparation," for example, when all that involves typically is having a computer spit out a form. Or they may charge \$150 for a credit check that cost them \$15.

The time to challenge junk fees is not when you're about to sign the loan papers. Use a mortgage broker or call a number of lenders to compare their loans. Ask about the interest rate, the "points" charged to get that rate (each point is 1% of the total loan amount) and any other fees the lender charges. Then you can compare terms.

Once you've selected a lender, you'll be given a good-faith estimate of closing costs, which should include any fees being charged. Ask about each fee, and try to negotiate down the ones that seem excessive.

If the lender won't negotiate, "take that estimate to someone else," St. James said. "I'll bet they can beat it."

Unfortunately, this doesn't absolutely guarantee you won't face junk fees when it comes time to sign the loan. Many borrowers complain that they still face higher costs than were originally estimated, and so far the federal government has done little to prevent the practice. You can try challenging junk fees at this point, but most likely you'll have to bite the bullet and pay the fees to get your loan.

### **Not planning for closing costs**

The day you're scheduled to get your loan, known as closing, you'll also be expected to write a check for a number of expenses, which typically include attorney's fees, taxes, title insurance, prepaid homeowners insurance, points and other lenders' fees. Together, these are known as closing costs, and the total can be eye-popping: somewhere between 2% to 7% of the selling price of the house.

"Usually, when people see the closing costs, they're like a deer in the headlights," said mortgage broker Huntting. "It's much more than they ever think it's going to be."

Plan for closing costs by getting a good-faith estimate from your lender as early in the loan process as possible. Make sure you have the cash on hand (or rather, in your checking account) and that it doesn't "disappear" before closing because of sloppy bookkeeping or a last-minute emergency.

### **Not having enough cash on hand after closing**

After borrowing too much, and scraping together every last dime for closing costs, many homebuyers have nothing left in the bank to pay for anything unforeseen happening --and something unforeseen always happens.

"It costs so much just to move in," Grose said. "Then the water heater breaks." Some people are so tapped out by the process, Jackson said, that they're not able to make their first mortgage payment on time. That's why "more and more lenders are requiring [borrowers have] three months' reserves after closing," Jackson said.

That's a smart idea for borrowers, anyway. Having three months' reserves, which means a fund equal to three months' worth of expenses, will help you handle the added costs of homeownership with much less stress.

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