Refi Roadmap: A Locked Rate Isn't a Closed Loan

By: Julian Hebron | Mon, Aug 15 2011, 11:27 AM

Rates are bouncing around near **record lows** set last October and consumers are looking to seize the opportunity. There's always a rush by consumers and loan agents to lock rates on dips, and that practice is all the more prevalent when extreme daily rate swings raise the sense of urgency.

But before you take the ready-fire-aim approach, remember the old saying: haste makes waste. Just because a rate is locked doesn't mean the loan will close. Here's how you can make sure that it does.

Let Lender Run Your Credit Score: Credit bureau scoring models know people shop for mortgages, so more than one mortgage-related credit run in a 30 day window won't reduce your score. Many critical loan approval factors are built into a credit report, so a lender should run your credit before the rate lock---even if you've worked with that lender before. Your rate is predicated on the credit score, and scores fluctuate daily as you use credit cards. Credit reports also show current balances on housing and all other debt, and these balances can impact qualifying. Credit reports also show any derogatory items on your credit history, including recent creditor mistakes you may not know about---these are common, and you're guilty of creditor mistakes until you prove you're innocent. Most lenders can help here, but it takes time so running credit should be first in the process.

Tell Lender About Job, Income, Asset Changes: If you're working with a lender for the first time, of course you must provide a full financial profile along with paystubs, tax returns and bank statements to back it up. But if you're working with a lender you've already worked with, *never* assume the documentation process is any different. Tell them everything when you talk about rates. Have you changed jobs or titles? Did you not get your bonus this year? Or was it bigger? Did you spend all your savings on a vacation or new car? Or will you in the next 60 days? All banks approve loans based on your debt-to-income ratio, and these factors all go into the calculation. The debt comes from the credit report and tax returns, and the income comes from paystubs, tax returns and bank statements.

Provide All Documentation Immediately: Provide this documentation right away even if a busy loan agent doesn't ask for it right away. The only exception to this rule is if the loan agent explicitly tells you they're doing a special refinance that doesn't require documentation because of some certain bank or government program.

Your Property Must Qualify: It's not enough for your credit score and debt-to-income ratio to qualify you. The property must also qualify. First, there must be enough equity in your home. Due to appraisal rules that prevent loan agents from pre-screening home values with appraisers, you usually have to pay for an appraisal up front to find out if you have sufficient equity. Second, the lender may require any big deferred maintenance issues like rotting wood, chipping paint, water damage or signs of water damage to be fixed before the loan closes---this is another timing issue that affects rate locks, so tell your lender if you have maintenance issues. And if you're in a condo, the condo building must have at least 51% owner-occupancy, a healthy budget with no (or at least well-explained and documented) special assessments, no litigation, no single owner holding more than 10% of units, and no more than 20% commercial space (or 25% for FHA).

Don't Forget Your Second Mortgage!: If you have a second mortgage, the second mortgage holder must agree to 'subordinate' behind a new first mortgage before the new mortgage can close. Whether or not the second mortgage is with the lender handling the refi, this subortination review and approval adds time to the process, sometimes weeks. As such, see 'Is Your Rate Locked For Long Enough' below. And zero-balance Home Equity Lines of Credit (HELOCs) follow these same rules. Even if there's a zero balance, the HELOC holder must approve the subordination.

Incorrect Loan Balances Blow Rate Locks: Setting your refi loan amount is related to credit reports and the 'Cost Or No-Cost Refinance' section below. Your credit report will show your existing loan balance, and if you choose a refi with closing costs, you need to choose whether you're paying cash or adding costs to the new loan. If loan agents are locking rates too quickly, here are a couple ways it can blow up the process: (1) they forget to account for existing loan payments you just made or will make during the refi process, then they find out when you're signing final papers and you have to restart---which can blow your rate lock, or (2) they assume your property will appraise for a certain amount and if your value comes in low, they have to redo the loan amount---which can cause you to have a higher rate or fees, or you might have to pay your loan down in order to qualify.

Cost or No-Cost Refinance?: If you think rates will drop more, it's best to do a no-cost refinance so that you can refinance again later without having fees wash out the lower-rate benefit. If you think rates are as low as they can go, it's best to do a refinance with normal fees ($2500-

4500 depending on your market) and perhaps 'buy your rate down' by paying tax deductible points (a 'point' is 1% of your loan amount). On a no-cost transaction, lenders offset your closing costs by offering a slightly higher rate, usually .125% to .25% higher.

What Is The Rate Outlook?: The U.S. and global economies are in uncharted territory given mass post-crisis government stimulus spending, so even the best market oracles don't know how rates will play. But here's what we do know: rates drop when mortgage backed securities (MBS) rise, and MBS are at **all-time highs** because they're one of the best safe havens for global investors rattled by market uncertainty. This is why rates are at record lows. MBS are priced for a very weak economic outlook. Any signs of improvement will cause MBS to sell and rates to rise.

Getting Rate Quotes: Even the best rate websites like MortgageNewsDaily aren't a substitute for a rate quote. As noted in the 'Cost or No-Cost' section, there's a direct relationship between rates and fees, so a rate quote will depend on your objectives and it can only be provided to you by a lender. Always insist on a full written term sheet displaying the rate, term (e.g., 30yr fixed), every single line item closing cost, total monthly costs including insurance and taxes, and total cash-to-close or cash-in-hand at closing. Lenders are required by Federal law to give you a three-page Good Faith Estimate but this form is a joke because it doesn't show you all of your line items, nor your total monthly cost, nor your cash-to-close. So make sure your lender shows this to you in some written format before you lock a rate.

Is Your Rate Locked For Long Enough?: Banks are busy during these rate dips and quoted rates can only be locked for a certain number of days. Ask your loan agent when they expect to close your loan, and if their quoted rate lock is enough time to get the deal done. Also refer back to the 'Provide All Documentation Immediately' section above, so you can hold the loan agent's feet to the fire if the delays are on their end and not yours.

Your Rate vs. Headline Rates: Every Thursday Freddie Mac publishes a rate survey from the previous week. This is source material for virtually all media. In addition to the fact that those rates are expired by the time you're reading about them, there's lots of **fine print** the headlines don't catch including: those rates are only for loans to $417k, single family homes only, owner-occupied only, and most of those loans have .7% to .8% in points (aka extra fees). Rates on this website are **more timely**, but again, a rate quote is based on your profile and your property profile so it must come from a lender to be specific.

What If Rates Drop More During Loan Process: When you lock a rate, you're setting that rate then the market will go up or down. It's very much like buying a stock. The main difference is that lenders have what they call 'renegotiation' policies if rates drop after you've locked. All renegotiation policies are similar in that rates have to drop significantly for you to be able to capture some of that drop after you've already locked a rate. Bottom line: renegotiations don't let you capture the entire gain because you've already made a commitment. So as an example, if you locked a rate at 4.75% and the quoted rate for that same unlocked loan a week later dropped to 4.5%, most lender renegotiation policies will give you half of the gain which would put you at 4.625%.

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