THE VA LOAN TRAINING MANUAL

SAMMAMISH MORTGAGE

WHY GET A VA LOAN?

YOU MAY ALREADY KNOW THAT YOU CAN USE YOUR VA ENTITLEMENT TO BUY A HOME WITH NO DOWN PAYMENT.

THAT FEATURE BY ITSELF IS A GAME CHANGER, BUT THERE ARE SOME OTHER REASONS WHY THE VA LOAN IS SUCH A GREAT DEAL.

Insurance	Closing Costs	Price Range
Rates	Rebates	Appraisal
Owning	Fees	LTV vs DTI
Preapproval	Payments	Final steps

NO MORTGAGE INSURANCE

Lenders are always conscious of risk. When they agree to loan you a large sum of money, they are asking themselves, "What happens if these people don't make their payments?" Even though you may have a flawless payment record for every account you have ever had, lenders are still asking themselves this same question.

One of the most important risk factors lenders consider is the "Loan To Value Ratio." This refers to the relationship between the value of the house and the size of the loan. A $300,000 home with a $240,000 loan has an LTV of 80%. The same home with a loan of $285,000 has an LTV of 95%. Statistically, the lender figures that a buyer with a smaller down payment is more likely to default than one with more cash involved. So they require mortgage insurance when there's a smaller down payment.

Mortgage insurance—which the buyer pays for each month—protects the lender if there is a default. It can add $200 per month or more to the cost of that $285,000 loan.

VA loans work differently. They are not insured. They are guaranteed by the VA. That means that even if a veteran borrower goes into default, the VA steps in and makes sure the lender doesn't take a loss. There is no mortgage insurance on a VA loan—even if the loan is 100% of the purchase price of the home.

LOWER RATES

VA loans have lower rates than conventional mortgages—generally about .5% lower than for conventional loans.

Easy Refinance if Rates Drop

If rates happen to drop, you can refinance your VA loan with no appraisal, almost no paperwork and very low cost, with a Rate Reduction Refinance Loan.

Easy Qualifying

Getting approved for a VA loan is quite a bit easier than for a conventional loan. They are more forgiving of “dings” on credit reports than conventional loans.

Are You Qualified?

The amount of time you need to have served to be eligible depends on when you served. It could be as little as 90 days if you were deployed during a time of active conflict, such as the Gulf War (1990-present). You should contact us with your own circumstances to find out for sure. Most categories of discharge other than “dishonorable” are acceptable.

Finally, if you are the spouse of a service member who died in the line of duty or as the result of a service-connected disability, you’re eligible.

There are other criteria for qualification, like credit profile and income, but we’ll get into those parts later.

WHY SHOULD YOU OWN YOUR HOME?

The first answer to this should be obvious: home ownership is the American Dream. Most of us long to put down roots—and owning our own home lets us do just that.

When you own your home, you are not subject to the whims of a landlord, who may decide that he can be making more money—so he raises your rent. Or, worse, he decides he wants to sell to take his profit. And you have 30 days to find a new place to live.

Owning your own home carries some significant tax benefits. Most homeowners will be able to write off mortgage interest and property taxes on their state and federal tax returns, potentially saving thousands of dollars a year.
(**You should check with your tax advisor for the details**).

As a homeowner, you will build up equity in two ways: first, with each monthly payment, you'll be reducing the balance of your mortgage. Even though you will be paying mostly interest in the early years, you'll move a $300,000 mortgage down to $270,000 in the first five years—$30,000 in savings!

THE SECOND WAY

The second way you will build equity is through appreciation. There is no guarantee that your home will increase in value as the years go by, but history tells us that it's highly likely. That means that if your $300,000 home appreciates at a modest 3% per year, it will be worth close to $350,000 in five years. Add to that the lower loan balance, and you have close to $80,000 in equity. And you started with zero.

Finally, there is "pride of ownership." You may have the nicest landlord in the world, but he or she won't be inclined to put any unnecessary money into the property. This means "apartment" grade carpet, rather than the luxurious kind that makes you want to walk around barefoot. Or the best appliances and cabinets. The goal of owning rental property is ultimately to make a profit. Most landlords are reluctant to put any money into their properties that they don't absolutely have to. When you own your home, you decide what will go into the property.

HOW TO START?

GETTING STARTED

Once you have decided to get started, you should begin by contacting a lender. That is where we come in. We will help you get your documents together and guide you through the process.

You need a document called a Certificate of Eligibility (COE). In most instances, we will be able to get this from the VA online. In some cases, though, you'll have to provide more information so they can process your request. For that, you'll need your DD-214 (Certificate of Release or Discharge from Active Duty). If you are currently on active duty, you'll need a document from Personnel called a Statement of Service. The VA usually issues the COE within a few days.

If you receive any disability money from the VA, you will have some additional benefits available to you. Your COE will have a notation recognizing that you have a "service connected disability." If this is the case, you will be exempt from having to pay the VA Funding Fee. More about this in a few pages, but for now, be aware that this will save you several thousand dollars on your loan.

The next step is to get preapproved.

PREAPPROVAL

It's a lot harder to sell a home today than it was just a few years ago. Because of this, sellers want to be reasonably sure the deal will go through before they accept your offer. That's where preapproval comes in.

Preapproval means that the lender has gone through all your paperwork and has decided that you're an acceptable risk even before you've selected a property to buy. It takes just a short time to go through the process. Once we have preapproved your application, we write a letter certifying that we have gone through all your paperwork, and we're just about ready to give you the money. Without a preapproval in hand, most sellers won't even give your offer a second look.

You'll provide two years' tax returns, a current month's pay stubs, two months' bank statements and your photo ID. We'll pull credit from the three major credit bureaus and put everything together in a loan application package.

Once a seller accepts your offer, we will update your pay stubs and bank statements. As we process and underwrite your loan, we will be coordinating with the real estate agents, the title company, the appraiser and other companies involved in completing your purchase.

More about that later.

The credit report is a critical part of your loan application. It tells a lender who is considering lending you a large sum of money that you handle your financial affairs properly.

Your credit report will list the accounts that are currently active: car loans, student loans, credit cards and mortgages, if you have any. The report will list the dates the accounts were established, the current balances and the monthly payments.

If you have made any of your payments more than 30 days past the due date, this information will be recorded as well. The credit report will list the number of late payments, how late they were and when they occurred. Late payments stay on your report for seven years. There are “credit repair” companies that promise to remove bad credit—for a fee. They do this by repeatedly disputing derogatory information, hoping that a creditor will accidentally neglect to update the information. If the information is correct in the first place, there is a high likelihood that it will return to your report even after it has been temporarily removed by disputing it.

If, on the other hand, an account has been reported incorrectly, it is not difficult to correct the record.

The credit bureaus use the information in your credit report to calculate a three-digit number called a FICO score ranging from 300 to 850. Each of the three credit bureaus (Experian, Equifax and TransUnion) has its own slightly different formula for calculating your score. Higher is always better, but you need at least a 580 score to qualify for a VA loan.

What if your score is below 580? Are you forever stuck in low-FICO hell? Not at all. The first thing you should know is that your credit score is constantly changing—and the older a negative entry is, the less effect it has on your score. A 30-day late payment may drop your score by 40 points if it happened a month ago. A year from now, it will reduce your score by 25. After two years, the impact may be just 10 points.

Credit cards can lower your score even if you faithfully pay on time. If the balance on any credit card exceeds about 30% of the high credit limit, it starts to pull your score down. You can increase your score quickly by paying down these accounts. If you have a credit card with a $3,000 limit and a balance of $2,800, you could be losing 30 points on your score. Paying the balance down to $1,000 could raise your score by that much.

The most important thing for you to realize is that you don't have to be perfect. Even if your credit report shows some battle scars, you shouldn't be discouraged. Because your loan will be guaranteed by the VA, the lenders are a lot easier on you than for other types of loans.

CLOSING COSTS

While it's true that your VA home loan won't require a down payment, there are some costs that you will have to cover. These costs can be a shock if you're not expecting them. I'll talk about some ways of handling closing costs in just a bit.

Non-recurring vs. Prorations and Prepaids

There are two kinds of closing costs. The first, "non-recurring closing costs," are those items that are only paid once, at closing. These include title and escrow fees, lender fees (underwriting, processing, document preparation), appraisal, notary, recording and a few other miscellaneous costs.
The second category, "prorations and prepaids," are items that you will pay for as long as you own the home.
The prepaid items include your first year's insurance policy and prorated interest.

Normally, you pay interest on your mortgage for the previous month when you send in your payment. This is called “interest in arrears.” If you close escrow on your home on March 15, you won’t make a payment until May 1. That payment will cover the interest on your loan for all of April. But you’ve had the use of the lender’s money for the second half of March—so they’ll collect interest in advance from the day you get the money to the end of the month.

You will also deposit money into a separate account, called an “escrow account” or “impound account.” The lender will hold your money in this separate fund to pay your property taxes twice a year and renew your insurance annually. You will pay 1/12 of your annual tax bill and 1/12 of your insurance premium each month with your mortgage payment. The lender will take care of the taxes and insurance from that account. The amount of your initial deposit depends on the month you close escrow. It could be as few as 2 months’ taxes or as many as 9. It’s still your money; the lender just has control of it for paying the taxes and insurance.

Your total closing costs will vary depending on the price of your property and the time of year you close. To give you a rough idea, though, you can figure that for a $300,000 property, total closing costs (including the initial deposit to your impound account) will be between $7,000 and $10,000.

This is a large number—especially when you are not rolling in cash. There are several ways of dealing with closing costs when you don’t have the money to pay them out of pocket.

The first is to ask the seller to pay the costs for you. While this may seem like a tall order, it happens often. Sellers are often willing to assist a buyer with closing costs if they are getting the cash they need out of the sale.

You should be aware, though, that when the seller agrees to pay some or all of your closing costs, they are really adding the closing costs to the cost of the property. Every seller looks at the cash they will receive at close of escrow, and paying your costs for you would mean they'd receive less cash for the sale. So, they increase the price of the property to compensate. If you pay $8,000 more for the property because the seller is paying all your closing costs, your monthly payment will increase by about $40.

The second approach is to have the lender pay your closing costs.

RATES AND REBATES

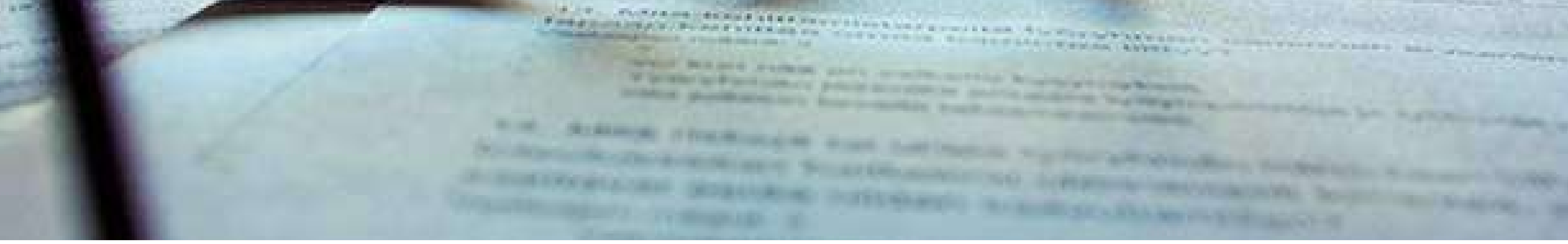
Not everyone is aware that lenders often pay buyers to borrow money from them. It is not at all unusual for a lender to give a cash credit of $8,000 or more for a $400,000 mortgage.

This may seem like some sort of a scam—or at least an offer with a big "gotcha" in the fine print, but there is none. It has to do with the way lenders actually handle mortgages.

The first thing you should realize is that the lender who gives you a mortgage is going to sell that loan to an investor. The investor pays the bank more than the face amount of the mortgage. They will hold it for a long time, so they will get their rate of return over a period of years, as you make your monthly payments. The price they pay the bank for your loan depends on the interest rate you have agreed to pay. The higher the rate, the more the investor pays for the loan. The bank gets a premium price because of the higher interest rate you selected, and they give you the excess in the form of a rebate at close of escrow.

If a 30 year VA loan has a rate of 3.75% with no points (one point is equal to one percent of the loan amount), you could choose a 4.25% rate to get a rebate from the lender. Raising the rate .5% above the no-points rate will typically get you a lender rebate of around 2% of the loan amount. If your loan amount is $400,000, your rebate would be $8,000. That will often cover all your closing costs.

It is always up to you to decide whether you want the lowest rate available with higher closing costs, or a slightly higher rate with lower (or no) closing costs. The difference in payment is not as great as you might think; for a loan amount of $400,000, your payment would increase by about $115 a month—but you receive a rebate at closing of around $8,000.



THE VA FUNDING FEE

Your VA loan will be guaranteed by the Department of Veterans Affairs. This means that the lender making the loan to a veteran is protected from loss if the veteran defaults on the loan. This guarantee serves the same purpose as mortgage insurance on conventional loans—it limits the lender's risk. Without that, the lender won't make the loan.

For conventional loans, that protection comes at a price. If you were to buy a $400,000 home with a 3% down payment ($12,000), you could expect to pay between $340 and $480 each month for mortgage insurance, depending on your credit score. A VA loan doesn't require mortgage insurance—but there is something called the Funding Fee. This helps cover VA's cost of administering the VA Home Loan Program.

For most veterans, the funding fee will amount to 2.15% of the base loan amount for their first use of the program, and 3.3% for subsequent uses. For a $400,000 home, the first-use funding fee would amount to $8,600. While the funding fee is a cost, it is not an out-of-pocket cost, since it is typically added to the base loan amount; so a $400,000 purchase would carry a loan amount of $408,600.

For those veterans who have some form of service-connected disability—even 10%—the VA waives the fee altogether. If you receive a monthly check from the VA, you probably qualify for the exemption. Your DD-214 will note whether you have a service-connected disability.

PAYMENT

You will get a statement from your mortgage company each month. The payment will be made up of the interest on your loan, a little bit to reduce the principal, your taxes and your homeowner's insurance.

For example, you'd pay property taxes in California twice a year—in November and in March. The lender will collect 1/12 of the total tax bill with each monthly payment and pay each installment of taxes as it comes due.

Insurance works the same way: you'll pay 1/12 of the annual premium each month with your mortgage payment, and the lender will renew your insurance each year when it comes due.

Property taxes can change a little each year, so your mortgage payment may change a little from one year to the next. This isn't because the lender is trying to pull a fast one on you; it's because of changes in your property tax bill.

A big portion of your monthly payment is interest on your mortgage and property taxes. If you bought your home for $300,000 and your rate is 3.75%, you'll pay about $11,000 in interest in the first year of ownership. You'll also pay about $3,800 in property tax. You'll be able to deduct both items from your income tax—close to $15,000 in deductions. That can save you a bundle. Talk to your tax adviser for specifics.

MAKING YOUR OFFER

You should keep in mind is that many home sellers are reluctant to accept an offer with a small (or no) down payment. This is not a rational position, since they will receive the same amount of cash regardless of your down payment—but it is a fact of life nonetheless. If you are trying to buy in a competitive market where there are offers from multiple buyers on each property, you should recognize that you may not get the first home you offer to buy. Persistence is key.

When you make an offer, you will attach a check payable to the title company. This is called an "earnest money deposit." It shows the seller that you are serious. In legal terms that money is called "consideration," and is necessary to create a valid contract when the seller accepts your offer.

You are not risking a single penny of this money. The check will not be deposited until your offer is accepted by a seller, and if your loan does not go through for some reason, you'll get the money back.

You should make as large a deposit as you can. This can help assure the seller that you are serious—even if you plan to buy with no money out of your pocket. If you structure your purchase to cover all the closing costs, you will receive the entire amount of your deposit back at close of escrow.

The second thing you should do is write a personal letter to the seller. Yes, I know this sounds corny, but it does increase your odds of the seller's accepting your offer. Buying and selling a home is a personal, emotional process. Your letter may well convince the seller to accept your offer instead of someone else's.

You will make your offer in writing. Your Realtor will handle the details for you. The offer will spell out the exact terms under which you are willing to buy the property: price, loan amount, deadline to complete the transaction (typically 30-45 days from the time the seller accepts your offer) and outlining who will pay which fees.

Your Realtor will include the preapproval letter we have given you, the personal letter you write to the seller (optional, but highly recommended) and your check payable to the title company.

You're not under any obligation to offer the seller's asking price. If he thinks he can get more than what you are offering, he may give you a counter offer for a higher price. Every aspect of the transaction is potentially subject to negotiation until you and the seller finally agree to price and terms in writing. Your Realtor should be highly skilled in this process.

Once you and the seller have come to an agreement and everyone has signed the offer and counter offer (if any), you are "in contract." Your Realtor will give you copies of the signed ("executed") contract and will deposit your earnest money with the title company.

Now you are in escrow.

MORE EXPENSIVE HOMES

In general, the VA will guarantee loans up to $417,000. There are many areas that are considered "high cost areas," like Seattle and San Francisco, where the guarantee is higher.

What if you can qualify for a more expensive home, say, $1 million? You won't be able to get a loan for 100% of the home's value with a VA loan, but you will be able to get a very large loan. VA will guarantee a loan for the maximum county limit—let's say $625,500—plus 75% of the excess. The amount the VA would loan you would be $906,375. That means your down payment would be less than 10%—with an interest rate below the prevailing market and no mortgage insurance.

APPRAISAL

The lender needs to know that the property you're buying is worth what everyone says it is. An appraisal accomplishes that. Here's how it works.

An appraiser, who is licensed by the state, will make an appointment to visit the property. He will inspect public records about the property, measure its dimensions and take photos. He will also look for significant defects related to health and safety. The appraiser is primarily looking for things like exposed wiring, badly peeling paint or other problems that could represent health and safety problems with the property. The VA wants to be sure that you get a home not only with very good financing, but one that is sound.

After the appraiser has taken measurements and photos, he will use that information to describe the property in a standardized way: living space, room count, amenities, lot size, etc. Then he will find at least three similar, comparable properties ("comps") that have sold within the last six months. He will describe these properties in the same way. Then he will make dollar adjustments to each of the comps to compensate for differences in living area, room count, conditions and amenities. He does this to make them the equivalent of the property you are buying. He calculates the estimated value of your home using all this information.

In most cases, the appraiser's opinion of value will be the same as the price you have agreed to pay. If he determines that the property is worth less than you have agreed to pay, you have some choices.

First, you can walk away from the deal. You will get your deposit back (although you will still have to pay for the appraisal—about $475).

You could negotiate a lower price with the seller. If you have agreed to pay $300,000 but the appraiser says the property is worth $290,000, you can ask the seller to drop his price to the lower figure. They are not obligated to do so, but they are generally aware that a low appraisal can indicate that their asking price was too high in the first place.

In some cases, you may negotiate a price with the seller that is somewhere between the originally agreed price and the appraised value. Your loan amount will be based on the lower of the appraised value or the purchase price. This means that you would have to come up with some additional cash to make up the difference between the appraisal and the agreed price.

How the lender approves your loan

Once you have given all your paperwork to us, we will organize everything and enter the information into your loan application. Once the application is complete, we will send you an email with a link to our secure server, where you will be able to sign most pages electronically. There are a lot of forms besides the application, so signing electronically is quick and easy. There are a few documents that you will print out, sign manually and fax back to us or upload directly to our secure server.

Now that your application is complete and you have an accepted offer, we will be busy behind the scenes. We will enter your information into the VA Information Portal and order the appraisal through the same system. We will upload a copy of the signed purchase agreement, so the appraiser knows what value we are hoping for. He will also know all the terms of the sale.

The title company will send us a copy of the Preliminary Title Report. This will give us the legal description of the property, the property taxes and any liens that may be attached—such as the loan the seller will be paying off when you buy the home.

When we have a complete loan package, we will transmit the entire file to the underwriter to review. He or she is looking at several numbers.

LOAN TO VALUE RATIO (LTV)

The LTV is the size of the loan as a percentage of the property's value. The lender will use the lower of the agreed purchase price or the appraised value. For your VA loan, it will probably be 100%.

DEBT TO INCOME RATIO (DTI)

This figure tells the underwriter how much of your income is being used to pay debts, including your mortgage. If the total payment on your new $300,000 home is $1,800 and you owe another $400 a month in car payment and credit cards, your total debt is $2,200. If your gross income is $5,000 per month, your DTI is 44%.

Although the process to approve a VA loan is slightly more complicated than using DTI, a good rule of thumb is that your total debt can go as high as 50% of your gross monthly income. In some cases, an underwriter may approve you for a larger amount—but do you really want to spend more than half your monthly gross income on payments?

Once the underwriter has reviewed your file and has looked over all your documents, she will issue a "conditional loan approval." This means that your loan is approved, but there are certain conditions we must satisfy before we can draw your loan documents and close escrow. These conditions may be routine, such as asking for an updated pay stub, or a question about the appraisal—which the appraiser would address.

When the underwriter has signed off all the conditions, we will order your loan documents for signature. These will be sent directly to the title company, where the escrow officer will put them together with other documents involved in the transaction. In all, you'll sign a stack of papers about an inch thick.

The escrow officer will put the signed documents together into a "funding package." The lender will review it, and wire funds into escrow. Certain documents are recorded with the county that day or the next (it depends on what time the title company receives the lender's funds) and you get the keys to your new home.

You will receive a monthly statement from the lender detailing your exact monthly payment, including property taxes and insurance. Your first payment typically will be due more than 30 days after close of escrow—so if you closed escrow on March 15, you wouldn't make a payment until May 1.

One piece of advice: you will have a 15-day grace period before the lender hits you with a late charge (4% of the payment), but your life will be simpler if you set up an automatic payment with your bank. That way, you won't even have to think about making the payment on time.

NEXT STEPS—MOVING FORWARD

You're now well equipped to obtain a VA loan.
Here's what to do next.

1 **Get your documents together.**
You'll need two years' tax returns, a current month's pay stubs and a recent bank statement. Even if you plan to buy your home with no cash out of your pocket, you'll still need to be able to show the lender that you have some liquid cash available.

2 **Decide what your maximum payment is.**
You may qualify for a higher payment than you want to make; knowing the maximum payment you are comfortable making will determine the price of the home you'll be looking for.

3 **Find a Realtor you like.**
He or she will help you identify the kind of properties you should be looking at, what areas will meet your needs and what kind of home you can expect to buy with your loan prequalification. You should let the Realtor know that you have already been preapproved; this will show them that you are serious about your search. They don't get paid until your purchase goes through, so they are very careful about how they spend their time.

Once you have gotten to this stage, you are ready to look at homes and make an offer. Don't get discouraged if your first offer doesn't get accepted. The market today is very competitive, and there are often multiple offers on each home. You have to persevere.

It will be worth the trouble—
we promise.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