

How come my friend got a lower interest rate than I did?

by Dave Muti

How is my interest rate determined?

As a mortgage planner that works with clients from all walks of life, I am often asked “how come my friend got a lower rate.” In fact, I was just asked the question by a repeat client of mine last week. She called to ask why her girl friend had a lower rate than she did. I always try and explain why this might be. The usual answer is that the client (complaining about their friend’s lower rate) is comparing apples to oranges. In that particular circumstance she was mistaken about the “type” of mortgage her friend had and upon questioning she understood the difference. My client who just purchased her new home was recently separated, had no job, never worked and she could not prove her alimony as it was not part of a property settlement agreement. We were able to accomplish this using a “no documentation-jumbo” program. Her friend was gainfully employed and was able to verify her earnings as well as her assets. This example is easily distinguished but many people are under the impression that if we both have a 30-year fixed rate mortgage we should have the same rate. The problem with this assumption is that there are a multiple of factors that are missing from the equation. True you and your friend might have the same “type” of mortgage be it a 30-year fixed, 5/1 ARM or some other type but how your rate is determined is much more complex than the “type” of mortgage you have. Some determining factors that go into a person’s interest rate are: credit score, documentation type, the size of the loan, the loan to value, is it a cash-out refinance, when was it locked, type of property, location of property and several others. So you can see that even if it is the same “type” of loan and the rate was locked on about the same time, rates may still be drastically different. Let’s break down each factor so you have a better understanding on what affects YOUR interest rate assuming you and your friend have the same “type” of mortgage.

The first factor to consider is “when” did the other person “lock in” his/her interest rate. Unlike years ago, today interest rates on mortgages can change weekly and even daily. Just look at any interest rate chart (beyond the scope of this article) and you will see what I mean. The next factor that goes into the determination of your interest rate directly corresponds to your credit scores. In the industry we refer to these as FICO scores. Without getting into too much detail here, the higher your score the lower the rate offered to you will be. The magic number you want to stay above is 720. Anything below this could have a negative effect on your rate.

The location of your property plays a minor roll in determining

your rate. For instance mortgage rates in the state of New York are generally 1/8 to ¼ percentage point higher than the same “type” of mortgage in New Jersey. In addition, the type of property you are mortgaging will affect your rate. The best rates are reserved for owner occupied, full documentation, single family residences. From this starting point your interest rate may increase if it is a multiple family dwelling, investment property, vacation home or one located in a high rise condo complex.



Next on the list of things that may affect your interest rate is the size of the loan. Is it a conventional or jumbo amount? As of 2006 the thresh hold for going into the jumbo market from the conventional market is a loan at or above \$417,100. Each year this figure goes up slightly and it is announced usually in November for the following year. Anything above this amount falls into jumbo pricing up to \$750,000. Loan amounts above this figure will fall into the super jumbo market and rates may be even higher.

Next on the list of factors is one we refer to as LTV. This acronym references the Loan-To-Value of a mortgage. A 75 LTV would exist for a \$300,000 mortgage and a property that is valued at \$400,000. You can figure out your LTV simply by dividing your loan amount by the value of your property. Once you get over an 80LTV your interest rate may again increase. If you have two loans that total more than this 80 percent number we refer to that as a CLTV or Combined Loan-To-Value. If you are buying or refinancing a home with 10% down, one mortgage at 80% and a second mortgage at 10% you would have a CLTV of 90% and your rate will be higher than a person with only one mortgage at 80%. The last and sometimes biggest factor to consider is the “type of documentation” required for you to get your mortgage approved. Sometimes you are required to supply what seems like your first born and other times you don’t have to supply anything.

The type of “loan documentation” helps mortgage lenders decide on the type of mortgages and/or the amount that a specific borrower can get approved for. This is where the experience of your mortgage planner really comes into play. Your mortgage planner should be able to recommend the most suitable loan documentation type that fits your circumstances and financial needs while being

mindful of the headache for you in finding the correct documents to provide to the lender. In many cases each time you provide less information to the lender the interest rate may increase. The reason that the rate may increase is that the lender is providing you with money and they do not have all of the information as to their risk level in providing you with a mortgage. The higher their risk is perceived to be, the higher the interest rate they will charge. In addition, as you provide less information to the lender they may limit "how much" they are willing to lend. Sometimes there is a direct correlation between the size of the loan, the LTV and documentation type. As documents are reduced, the size of the loan and the LTV will often be lowered.

Lenders each have their own set of criteria and your mortgage planner will know which ones to seek out and shop for your approval. While there are sub categories of each documentation level depending upon the ultimate lender, below is an overview of the most common. Most of the different levels will require a 2 year continuous employment history in the same industry unless stated otherwise.

Full Documentation

This is just what it sounds like. The lender will want to see EVERYTHING about you. While these loans may have the lowest interest rates compared to other documentation types they may not always be the best alternative. Not only will the lender verify your employment, your income (30 days worth of pay-stubs) and all of your assets (2 months worth of statements) they may also want to see your income tax returns (personal and business if self employed) and W-2's for the past two years. This can be a burden as the lender will want to see all the pages of each document. Many clients choose to go with a lesser intrusive documentation type because they don't want to be bothered with finding ALL of the correct documentation and/or because they are self-employed, their tax returns are complicated and/or we have determined that we can get them the same rate as a full document loan by a lesser documented type.

Stated Income – Verified Assets

Under these types of programs, you can "state" what your income is on the application but the lender will not actually verify what you make. Some lenders will require that you certify on an IRS form that the amount you state is what you report on your tax returns and others do not. These types of loans work well for clients who are self employed and/or are commissioned sales people with sporadic earnings. While the borrower does not have to provide tax returns and pay stubs, the lender will verify the place of employment as well as require copies of all the statements for the assets disclosed on the application as they do under a full documentation loan.

Stated Income – Stated Assets

Under these types of programs, you "state" what your income is on the application and you "state" what your assets are. Here the lender will not verify the income or assets that you state.

They may, like above, require that you certify on an IRS form that the amount you state as your income is what you report on your tax returns. Disclosure of employment is required. Your place of employment will be verified by the lender and that you have worked there for as long as you stated on the application. No asset documentation is required or verified.

No Ratio

Under this program income is not disclosed, stated or verified. The lender will however verify the place of employment as well as require copies of all statements for the assets disclosed on the application for verification as they do under a full documentation loan.

No Income and No Asset

The income and assets are not disclosed, stated or verified on the application. Disclosure of employment is required and it will be verified by the lender that you work there and have for as long as you stated on the application. Income will not be discussed or verified during this process.

No Documentation

This is just what it sounds like. In essence the lender will provide you with a mortgage based upon the fact that you ask for it and you have a good credit score. And you do not have to have a job. What a country! This is often used when a client is not working or if they do not have a 2-year continuous employment history. The interest rate will be higher than the other types of documented loans discussed above.

As you can see the rate you are quoted is much more complex than what you read in the paper that day or saw on-line at various mortgage sites. Your rate is a delicate balance of LTV, credit score, documentation type as well as the other factors outlined above.

Hopefully this article provided you with information on what YOU need to know before you ask "why is my friend's rate lower" and what goes into the determination of your interest rate. If you are in the market to purchase a new home or refinance your existing loan make sure the person you are dealing with is able to provide you with a detailed explanation of the program he or she is quoting you. Take the time to research, read and then sit down to discuss different options available with a qualified Mortgage Planner to make sure you are in the right program for YOUR circumstances.



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