

HERB'S HOME BUYER TIPS

Debt to income Ratios (see example on page 3)

There are two ratios that a lender will be interested in; 1) your housing ratio, also known as your “front end ratio,” and 2) your debt-to-income ratio, also known as your “back end ratio.”

The housing ratio is your gross monthly income (your income before taxes are deducted) divided by your total housing payment. Your total housing payment includes principal, interest, taxes and insurance.

Your debt-to-income ratio is calculated the same as the housing ratio, except all revolving and installment debt is added to the housing payment and divided by your gross monthly income. Revolving and installment debt can include credit cards, student loans, car loans, personal loans, etc.

Ideally, these ratios should be less than 35% for the housing ratio, and less than 45% for the debt-to-income ratio, although today many loans are approved with a borrower having a ratio as high as 55%.

Can I use all of my income?

There are very specific guidelines that must be followed in determining what income is allowable in qualifying for a home loan. For example there are a few situations that prevent you from utilizing your income.

The first is if you have been self-employed for less than two years. Generally speaking you must be able to document that your business has been established for at least two years and have a minimum of one full year's tax return before you are able to use this income. This also includes people who are paid 1099 income (no income taxes deducted by your employer).

Other situations that potentially fall under the two-year rule are individuals who have commission pay or bonus pay as the basis for their income. If you have changed jobs and are in the same line of work with similar payment arrangements, sometimes underwriters will make exceptions.

Herb Alston
COLDWELL BANKER
1801 Lombard Street
San Francisco, CA 94123
(415) 447-8881 Office
(415) 341-8881 Mobile

HERB'S HOME BUYER TIPS

For example: You are currently paid a straight base salary. You get an offer to go to work for XYZ Company, taking a 20% cut in base salary in exchange for commissions that historically for that position would give you a 25% to 30% raise effectively. The problem is that without any history of you receiving commission income, the lender will not allow any consideration for it and worse yet, qualify you off the smaller base salary which is 20% less than your old job.

My Monthly Bills

Monthly obligations that are counted against you when qualifying for a home loan include credit cards, student loans, (even if deferred), auto loans, personal demand loans, and any other revolving, or installment loans. For credit cards, the lender will count your “minimum monthly payment” when qualifying you for a loan.

Items that do not count against you are insurance, (medical, auto, life) utilities and other personal expenses. In addition, installment loans with fewer than 10 payments remaining can be excluded for qualification purposes.



RESIDENTIAL BROKERAGE

Herb Alston
COLDWELL BANKER
1801 Lombard Street
San Francisco, CA 94123
(415) 447-8881 Office
(415) 341-8881 Mobile

HERB'S HOME BUYER TIPS

\$12,000 **Your monthly income**

| | |
|---------------|-------------------------------|
| \$2685 | New mortgage |
| 781 | Property Taxes |
| 600 | HOA dues |
| <u>50</u> | New HO-6 Insurance Policy |
| \$4115 | Total New House Debt |
| 400 | Your current car payment |
| <u>90</u> | Your current credit card debt |
| \$4605 | Total new debt |

\$4605/\$12000 (debt divided by income)

38.37% Debt to income ratio

| | |
|-----------|---|
| \$ 80 | Your monthly auto insurance payment |
| 400 | Your monthly student loan payment |
| 65 | Your monthly gym membership |
| 350 | Your real credit card debt |
| 125 | Your monthly cable bill |
| 85 | Your monthly PGE bill |
| <u>80</u> | <u>Your monthly cellular phone bill</u> |

\$5700 *Total real debt*

\$5700/\$12000

47.5% Debt to income ratio

The above example is of a real buyer who was purchasing a \$795,000 condominium with a \$500,000 down payment. In 2004-7(the hay day) this was a prime borrower and a closed escrow in 21 days. Their real life situation was more like the lower modified numbers. They paid off their credit card debt, essentially lowering their expenses. The loan funded.

Which one of these is you? If all expenses were factored in and you are the lower example the banks today *may* not give you the loan.

If you're the person on the top... you're moving in 45 days!

Herb Alston
COLDWELL BANKER
1801 Lombard Street
San Francisco, CA 94123
(415) 447-8881 Office
(415) 341-8881 Mobile