

The Practical Guide to Loan Processing

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By Thomas A. Morgan

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Lending Policies and Procedures, Quality Control and Compliance

Managing the Process from Origination to Post-Closing

Mortgage Management Systems



QuickStart

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"The Practical Guide to Loan Processing"

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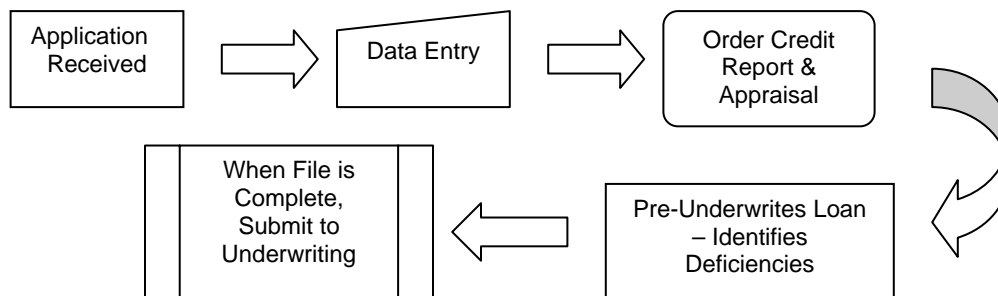
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Introduction

Beginning in 2006, the mortgage industry began to experience an upheaval that would ultimately bring the financial system to that point to its knees. What this is meant is that many mortgage lenders, who previously were able to casually package loan applications, must now diligently meet the most stringent guidelines and documentation requirements imposed since the late sixties. The processor is critical in meeting these requirements. Most mortgage companies and referral sources correctly believe that they live and die based on customer service and service delivery. The loan officer is a big part of this, in that he or she is responsible for taking a good application to start with. While the loan officer is the customer's representative, it is the processor who ultimately has his or her hands on the loan file and can assess what the status of a loan is.

Despite 60 years of automation improvements, the biggest problem mortgage companies report with respect to their operations is incomplete or problematic loan documentation. This is where the human factor in the application process impacts us, because we are relying on people – borrowers, real estate agents, closing agents and loan officers – to provide what we need to complete the loan.

Even if the loan application is perfect, processing is where the home loan sequence can begin to reveal its nightmarish realities. Under normal circumstances, it is the processor's duty to complete the verification process, assure regulatory compliance and prepare the case for presentation to the underwriter, loan committee or other decision maker. It seems simple enough, but here is where the effect known as "I am not sure if this is completely clear" kicks in.



It seems like a simple process. But what seemed apparent to the loan officer isn't so apparent to the processor. If it isn't apparent to the processor, it isn't going to be apparent to the underwriter either. In an ideal situation, the processor and loan officer work together to identify "critical" items which could cause the loan to be denied and ascertain whether they can be fixed. Working together and with the borrower it is unlikely that any adverse information can't be refuted.

Then there are non-critical items - things that the loan can be approved "subject to" or as a condition of the approval - "nickel & dime" conditions. The problem comes when a processor doesn't segregate the level of importance of various documents and mails a simple list of outstanding documents to a borrower. Suddenly an inconsequential bank statement or other innocuous pieces of information are as important to the borrower as a critical document, such as proof that a delinquent account is incorrectly attributed, or the current years' tax return. The

borrower receives the list and puts everything together, except for the critical document, sends it in. The mail gets reviewed a week later and suddenly - nearly 1 month into the loan process - there is a huge problem. Welcome to mortgage banking. This is why a complete application is so important.

Instead of simply acting as a checker of files and a sender of forms, the processor can be much more useful to the customer by taking their expertise and guiding the borrower through the process. This is the role of the processor.

How this position functions is different from company to company. In larger companies the processing role is often segmented into its different parts – file intake, data entry, and file review, pre-underwriting and pre-closing functions – all broken apart. In some companies the processor owns the file from “cradle to grave” and may even generate closing documentation. Whichever role the processor fills, he or she must know all the functions to anticipate issues and to be able to identify what still needs to be done.

In the past mortgage processing training has been passed down from generation to generation and person to person. This has resulted in many different approaches, emphasis on skills that may not apply to all situations, and general misinformation. There are also many “processing guides” whose pages are filled with sample forms and other industry exhibits. We believe you can find these on your own, and have tried to stay away from that in this guide. We tried to include only those things that actually affect the processors job. While it is impossible to describe all facets of a job that touches every phase of the retail mortgage business, we hope that this book will give the reader a strong foundation in understanding the processor’s job.

Chapter 1 - The Duties of the Loan Processor

Job Description - Mortgage Loan Processor

A generic description of the processor's duties might read like this; Assist Customer in obtaining approval by working with loan officer, underwriter and closing; Review Application for completeness at the time of receipt and prior to underwriting; Initiate requests for all documentation needed to support approval.

Specific Duties

- Receive loan application after registration
- Review against loan plan specifications for accuracy
- Enter into computer assisted processing program
- Generate Loan Application (1003, 2900), Transmittal Summary (1008, 2900 WS, 1802), Appraisal Request (2800)
- Generate Disclosure Documents Appropriate to Registered Loan Program
- Order and review credit report
- Order and review appraisal
- Compile case in Stack Order
- Enter Loan into Logs
- Initiate contact with customer requesting additional documentation
- Track outstanding documents and follow up with customer, loan officer, referral source
- Update Status daily as to incoming and outgoing documents
- Ascertain readiness for loan underwriting
- Pre-Underwrite case against checklist to identify problem areas prior to submission to underwriting
- Evaluate deficiencies and notify customer, loan officer and referral source of critical issues.

General Description of Duties

The loan officer, if there is one, performs the role of "field underwriter". However he or she should work with the processor to determine what information is needed prior to submitting a loan to an underwriter. The loan officer should not burden the processor with the duty of trying

to qualify a borrower. Items which are generally “critical” in the determination of approval are those which materially impact the borrower’s income, assets or credit history. Specifically, the file should not be submitted with critical information missing, unless it is done as a referral for judgment as to whether they missing information can be resolved. Information, which is required in order to satisfy compliance or to complete standard documentation requirements, is not critical and should not arrest the loan submission.

The Career Path of the Processor

Loan processors normally follow one of two paths as they progress in their careers. The natural graduation of credit skills, documentation review and process management leads to a career in underwriting, operations and operations management. A smaller percentage of processors extend their careers into sales and sales management. In this capacity, they use their ability to review documentation, anticipate problems and work with support staff to deliver excellent customer service. Many processors who transition into origination quickly outperform their non-processing skilled counterparts.

The Division of Duties between Processor and Loan Officer

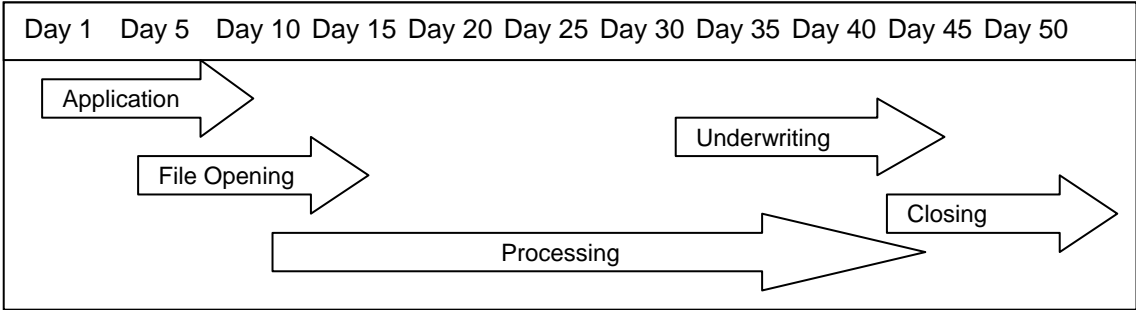
While there is overlap between the loan officer and processor, there should be a clearly defined separation of what a processor should do and what a loan officer should do. The duties that are specifically assigned to a processor are listed in the job description. There are times that a loan officer may perform some of these functions in order to expedite the file’s process. However, there are duties that the loan officer is supposed to perform that a competent processor may be able to execute. A processor should not be expected to perform these, but may concede to the loan officer and assist with guidance.

Task	Description
Interest Rate Lock-in	The loan officer will generally lock-in a borrower’s interest rate when he or she gives the borrower an interest rate guarantee. When the file is in process, however, the loan officer may ask that the processor submit an interest rate lock-in request. <u>The risk for the processor</u> is that pricing mistakes can be extremely expensive. The processor may be blamed, or used as a scapegoat, for errors in pricing that the loan officer should have been aware of. If the processor can complete the lock-in request by simply making a phone call, on-line, or by faxing a request, this may be done under the loan officer’s direct supervision. Confirmation should be immediately communicated back to the loan officer, particularly if there is any deviation in price at all.
Loan Registration	Program Selection and Registration should be performed by the loan officer. If the loan officer requests that the processor change the program, and this can be done easily, then the processor can accommodate that change. Again, the program change may affect pricing, and the processor needs to immediately send notification of program change to the borrower and the loan officer.

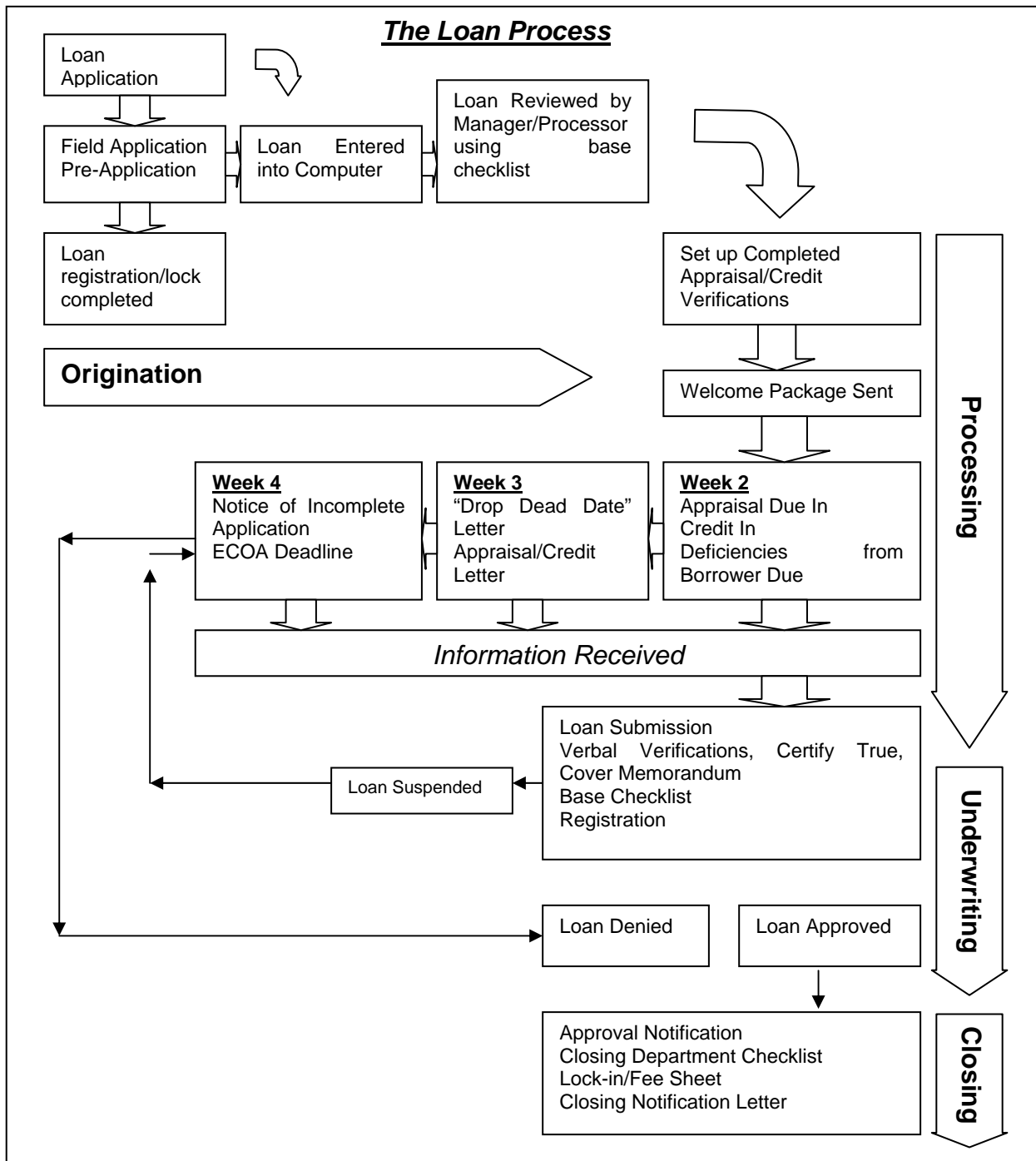
Task	Description
Qualification, Pre-and Re-Qualifying	<p>If the borrower has not initially been qualified – that is, there is no evidence that the loan officer provided evidence that the borrower is eligible for the loan, the processor should return the loan file to the loan officer once the initial loan set up is completed. If, upon reviewing the loan file, there are substantial differences in the information that was used to qualify the borrower, the file should be returned to the loan officer to resolve the issue.</p> <p>It is not the processor’s responsibility to “fix-up”, or otherwise repair poor quality loan submissions. This can take an inordinate amount of time and the processor is not qualified or compensated enough to perform these duties.</p> <p>The processor may assist in the process by suggesting solutions to problems, or by consulting with an underwriter or other source of knowledge as to potential solutions. The loan officer is paid incentive to have qualified borrowers – the processor is not.</p>
Customer Status Updates	<p>Many referral sources and borrowers prefer to call the processor in order to obtain status updates. There are reasons for this.</p> <ul style="list-style-type: none"> • The processor is in the office and easy to reach with one phone call • The processor has the file in his or her possession and can easily reference the answer to a question • The processor is perceived as being more likely to give a candid answer as to problems <p>To the extent possible, the processor should avoid being involved with substantive conversations with outside parties. These are extremely time consuming, and often worried borrowers and referral sources will call far more frequently than necessary</p> <p>Unless the processor has agreed to speak with referral sources, the real estate agent or other inquirer should speak with the loan officer.</p>

General Time Frames for Application Process

While the loan application process can be executed in a very short period of time, normal data collection periods, or the period of time that the processor has the loan, is the longest part of the mortgage process. In an average 45 to 60 day process, the processor is in possession of the loan file for 80 to 90% of the process.



Process Flow



Chapter 2 – Mortgage Industry Overview

The Mortgage Business

The mortgage business today is the product of 70 years of evolution in process, technology and products. Despite this evolution, the roles personnel play in the process remain relatively unchanged. The loan originator, loan officer, or other advisor still is the primary interface between the customer and the company. This is true even though there are many business models that alter the way in which the customer deals with the loan officer. The functions of the loan process – processing, underwriting, and closing – have all been affected by automation, but still exist to support the completion of the loan process.

Types of Lenders/Primary Originators

The way different types of mortgage businesses operate is a function of the funding mechanism, or the way that loans are sold.

Entity	Description	Features
Mortgage Bankers – including banks, savings banks, credit unions	Traditional mortgage banking firms use funds borrowed on “warehouse” lines of credit to make loans. These loans are sold to investors as 1.) “whole loans” – which means that the individual loan is sold, along with the right to collect and remit payments (referred to as “servicing”) or 2.) “mortgage backed securities” where a number of similar loans are “pooled” together. The securities are sold, but the mortgage banker keeps the right to collect the monthly payments (“servicing retained”).	Strengths – able to control funding process and some approval issues. Can also broker loans if needed for competitive purposes. Weaknesses – on retained loans pricing is less optimal at origination.
Mortgage Brokers	Mortgage brokers do not make loans. They work with other lenders – wholesale mortgage bankers and banks (sometimes referred to as “investors”) – who offer their products at “wholesale pricing”. The mortgage broker fulfills the origination and processing functions and submits individual loan requests to the wholesaler. The wholesaler, who is often a mortgage banker or bank, approves and closes the loan.	Strengths – able to be price competitive with small margins, able to place many different types of loans giving borrower more choices and better chance of approval. Disadvantage – no control over approval and funding.

Mortgages are made by different types of lending entities. Referred to as primary originators they are small and mid-size traditional mortgage bankers and finance companies who fund loans by borrowing money from a temporary credit facility (warehouse line of credit) and resell the loans to secondary market “investors.” They may also be large, generally bank owned national mortgage bankers performing mortgage banking functions but funding loans from their own cash. Mortgage brokers are also primary originators. They are almost exclusively small, privately owned companies who “sell” or broker individual borrower’s loan packages prior to closing. This is known as wholesaling, brokering or table funding. Brokers do not lend money. Other primary originators include smaller local banks or savings banks (known as “thrifts”); and Credit Unions who originate loans either for resale or for their own portfolio.

The Mortgage Broker Business

Mortgage brokers are individuals or companies that do not underwrite, approve or fund loans. Mortgage brokers contract with wholesale lenders who approve, fund and prepare closing documentation. Mortgage brokers usually work with at least several, but often hundreds of different wholesalers. This business model allows the loan officer of a mortgage broker to seek out the best rates and terms – and can pass the most competitive rate on to the borrower. In addition, the mortgage broker has the ability to seek through the hundreds of products available to find specialty products that help borrowers with unusual circumstances or special needs. A borrower working with a broker may find a competitive advantage if the broker passes these benefits through to the consumer. The broker will select a lender and then work with the borrower to obtain all the necessary documentation to consummate the loan – referred to as processing.

Since the broker doesn’t actually approve loans, prepare closing documentation, or provide funding, a potential disadvantage facing a borrower is that the wholesaler’s service may not be as responsive as a direct lender’s. Since the broker is the intermediary between the wholesale lender and the public, the public may never learn the identity of the final lender until closing. Since the wholesaler is insulated from the public in this way, the borrower has no recourse for service with that wholesaler. In addition, until the loan is funded, the wholesaler may continue to add loan contingencies creating delays.

Brokers earn money by adding fees to the wholesale cost of loans. The net cost to a borrower would be competitive with the price of a retail lender, depending on the margin that the broker is trying to achieve.

<u>Rate</u>	<u>Wholesale Cost</u>	<u>Broker's Margin</u>	<u>Net Price</u>	<u>Borrower Cost</u>
6.750	102.00	1.50	100.500	-0.500
6.625	101.50	1.50	100.000	0.000
6.500	101.00	1.50	99.500	0.500
6.375	100.50	1.50	99.000	1.000
6.250	100.00	1.50	98.500	1.500
6.125	99.50	1.50	98.000	2.000
6.000	99.00	1.50	97.500	2.500

Retail Lending

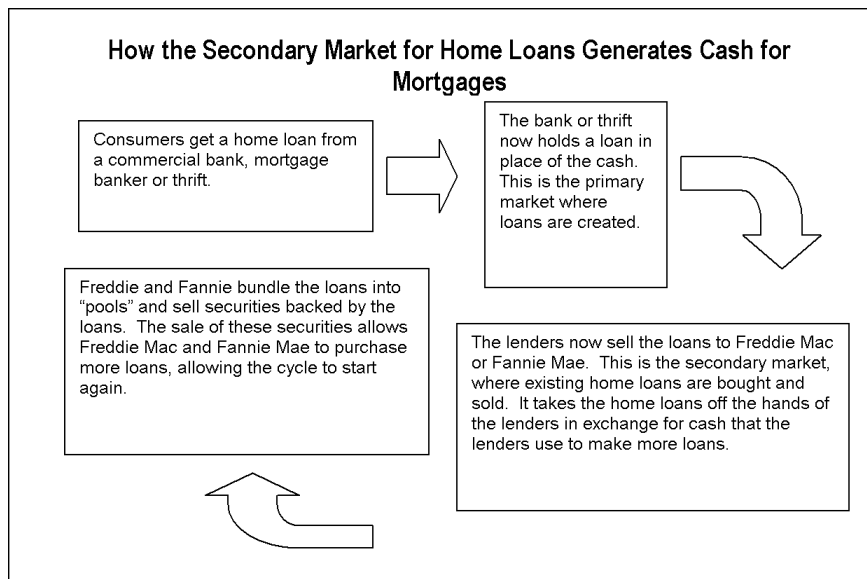
In retail lending, the lender approves, closes and funds the loan, in addition to the functions that a mortgage broker conducts – taking the application, collecting borrower documentation, preparing the file for underwriting (referred to as processing). The advantage for a borrower in working with a direct retail lender is that the lender controls the entire process, so issues with service delivery, problems with contingencies, and pricing can be dealt with directly. One potential disadvantage of working with a direct retail lender is that some lenders only offer the loan products offered by the mortgage company, bank, credit union, or thrift with whom the loan officer is employed. However, many direct lenders do make selected specialty products available to meet their customer’s needs on a brokered basis.

Servicing (collecting payments from borrowers and forwarding the interest to the investor) can be retained on many loans. This is a long term income source fundamental to the business plan of mortgage bankers.

The Secondary Market

Loans are packaged into “pools” or groups of loans and sold in the financial markets – known as the secondary mortgage market – in the form of mortgage backed securities. The issuers of these securities become the vehicle through which financial investors receive their money – names like FHLMC (Federal Home Loan Mortgage Corporation or “Freddie Mac”), FNMA (Federal National Mortgage Association or “Fannie Mae”), and GNMA (Government National Mortgage Association or “Ginnie Mae”) are all examples institutions that bundle loans for re-sale.

A loan is referred to as “conforming” if it is eligible for sale to FNMA or FHLMC. Conventional loans are loans that are not related in any way to the government. Conventional non-conforming loans are loans that are ineligible for sale to FNMA/FHLMC. These loans may be “jumbo”, or larger than the maximum conforming loan amount. They may not meet FNMA/FHLMC standard underwriting guidelines. The future of FNMA and FHLMC is



uncertain with respect to Federal oversight. Because of the government’s involvement they are more readily saleable and command a better price in the secondary market. As a result, rates for non-conforming loans may be higher. FHA, FmHA, RHD and VA loans are included in GNMA securities, and also command a better price than conventional loans because of the government insurance.

Understanding Rates, Points and Lock-ins

Lock Option	Description	Protects Against
Lock-in	A lock in fixes a borrower’s interest rate and point options for a specific period of time. If a lock in expires prior to the borrower’s closing the borrower receives the market interest rate or the original interest rate, whichever is HIGHER. If a borrower decides to guarantee the rate and point option, the loan officer must assure there is sufficient time to process and close the loan under that lock term. The benefit of locking in is that there is certainty in the final interest rate.	Rates rising dramatically
Float	A float is a deferral of the decision to fix the interest rate. Regardless of whether interest rates increase or decrease, the borrower can lock in at those rates in the future. The benefit of floating is that the loan application can be processed and approved prior to locking in – the borrower can then execute an “immediate delivery lock” for 5, 7 or 15 days, which can be substantially better pricing than the 60 day lock-in	Rates falling or staying the same
Float Down Lock	The borrower can cap or lock in their interest rate at a current rate. If rates decline within a specific period of time prior to closing, the borrower can “re-lock” at a lower interest rate. The benefit of the Float Down Lock In is that the borrower is protected against dramatic fluctuation in rates.	Rates Rising or Falling Dramatically

Pricing for mortgages, as well of the types of loans offered, is derived from the secondary market. Rates are dynamic and lenders often change their pricing more than once a day. To protect borrowers from changing interest rates lenders offer interest rate protection. This is referred to as a “lock-in”. The lock-in is set forth to the customer in a rate agreement that specifies the interest rate, fees and points and the expiration date. Rate lock-ins are offered for as few as 5 days to as long as 270 days. Borrowers may choose to defer the lock-in option which is referred to as a “float”. Floating rates are not guaranteed. Customers should be informed that a loan rate is not guaranteed until the Interest Rate Lock-In Agreement is completed.

In this example, see that the price increases as the lock in period extends. This is because there is more risk to the lender for longer interest rate lock periods.