

**California Real Estate Finance**  
**Chapter 10**  
**Real Estate Loan Underwriting**

**Chapter Purpose**

This chapter illustrates how loan officers qualify the borrower's credit, examine their ability to make loan payments as well as the value of the collateral. It presents a borrower's financial statement and defines a credit evaluation. It describes the various approaches to value used by appraisers to estimate the value of the collateral.

All of this effort is made to determine the risks attributable to a specific real estate loan. Does the borrower have a clean record of having paid past debts on time? Does the borrower have the means to make the payments over time? Just in case something unforeseen happens to the borrower, does the property have the value necessary to back up the balance of the loan in the event of a default? The appropriate answers to these question will determine if the loan is granted or not.

**Suggestions to the Instructor**

It would enhance the presentation of the material in this chapter to invite an appraiser to participate in the class. The use of the computer has expanded their abilities to apply probability mathematics to their guesses of how value will fluctuate in the future. An assignment to appraise one of the student's houses would be a practical application of the material.

**Learning Objectives**

Upon completion of this chapter, the student should be able to:

1. prepare a loan application;
2. describe a credit evaluation;
3. determine loan qualifying income ratios;
4. describe the appraisal process;
5. differentiate between the direct sales comparison approach, the cost approach and the income approach to an estimate of the value of real property.

## **Presentation Outline**

- I. Qualifying the Buyer
  - A. The loan application
    1. The financial statement
      - a. assets
      - b. liabilities
      - c. net worth
    2. Date verification
      - a. bank accounts
      - b. employment circumstances
      - c. credit reports
    3. Credit evaluation
      - a. quantity and quality
      - b. what earning are included
        - (1) second jobs
        - (2) child support
        - (3) government entitlement funds
        - (4) divorce terms
        - (5) alimony receipts or payments
      - c. loan qualifying ratios
        - (1) conventional loans are 28% and 36%
        - (2) FHA loans are 29% and 41%
        - (3) DVA loans are 41%
- II. Qualifying the Collateral
  - A. Definition of value
    1. Value in use
    2. Value in exchange
    3. Subjective value
    4. Objective value
    5. Market value
  - B. Appraisers
    1. Staff or fee appraiser
      - a. licensed
      - b. certified
    2. Credentials
      - a. appraiser associations
      - b. appraiser designations
  - C. The appraisal process
    1. Market data approach
      - a. finding comparable properties
      - b. adjusting sales prices
      - c. correlating to the subject property

2. Cost approach
  - a. improvements' replacement cost new
  - b. deduct depreciation
    - (1) physical
    - (2) functional
    - (3) economic
  - c. adds market value of lot
  - d. equals current value of property
3. Income approach
  - a. gross income
  - b. less operating expenses
  - c. equals net income
  - d. divided by market capitalization rate
  - e. equals cash value of property
  - f. gross rent multiplier (GRM)
4. Reconciliation of data
  - a. correlate various approaches
  - b. weighted average technique
5. Opinion of value of subject property