Make Specialty Properties Your Specialty

By **Tisha D. Hartman**, vice president of mortgage banking, Velocity Funding

Use the right package to find a home for these oft-challenging loans

For many mortgage brokers, securing financing on a specialty property presents daunting challenges. But in a market of increasing rates, decreasing originations and wavering consumer confidence, many brokers are more eager to step up to the plate. With only a handful of lenders willing to consider specialty properties on a case-by-case basis, being armed with the right information could be the difference between closing and not closing the loan.

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Specialty Properties

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Typically, a specialty property has physical attributes that do not conform to the area and that cause a limited market appeal. This can include aspects of a property's layout, amenities or usage.

Some examples of specialty properties are:

- **Manufactured, dome and log homes**
- **A-frame homes**
- **Parcels of more than 10 acres**
- **Properties with mixed-use zoning**
- **Two properties on one lot**
- **Rural properties**
- **Co-ops**
- **Dwellings with post-and-pier foundations**
- **Properties that use nonpublic major utilities,** such as solar power
- **Community-living group homes**
- **Properties affected by environmental hazards**
- **Properties with outbuildings, such as barns, stables and workshops**

Lenders consider these properties riskier because it can be extremely difficult — if not impossible — to find comparable properties. And without comparable properties, it is hard to determine a true and accurate value. As such, some lenders will only consider these transactions at significantly reduced loan-to-value ratios (LTVs).

Another reason lenders consider these properties riskier and require reduced LTVs lies in the properties' reduced marketability. When lenders and investors put their money on the line, their primary concern is whether there is a sound exit strategy should the loan default or enter foreclosure.

If a property has uncommon attributes, the pool of interested buyers is significantly reduced. With fewer potential buyers, a property requires longer marketing times. And each month that a lender has to carry all the fees involved in a foreclosure (e.g., taxes, insurance, attorney fees, trustee fees and buyback fees) adds additional cost. This can add up to a substantial amount when compounded by the number of foreclosures on a lender's books at any given time.

When adding all the factors — inaccurate property values, limited marketability and longer marketing times — you get what is commonly referred to in wholesale underwriting as "layered risk."

Because specialty properties are typically outside the delegation and scope of a regular underwriter's authority, a second and sometimes even a third review by senior management often will be required. With this in mind, properly packaging the loan upfront is key.

Compiling a successful package

Although it may seem that financing a specialty property is too difficult to attempt, there are ways to package, submit and close these loans successfully.

As with any exception-based loan, you must have a full package for submission. Because an underwriter, underwriting manager and the lender's appraisal reviewer will review the file, you want to ensure that all questionable areas have been documented and thoroughly addressed at the time of submission. If an issue comes up that hasn't been fully addressed, your package likely will be declined. So take your time in packaging it correctly upfront.

Two keys to a successful loan package for specialty properties are the cover letter and the appraisal. The cover letter should detail the property's issues or special characteristics, the strength of comparable sales, the LTV and most important, the tangible benefit to the borrower and the compensating factors. Be concise and avoid lengthy paragraphs in your cover letter. Instead, stick with bullet points.

The appraisal should include at least two comparable sales, even if they are dated more than six months from appraisal date or located outside the subject property's neighborhood. The appraiser should include a narrative on marketing times and whether the property is common for the area. The lender's decision often will depend on how well the issues are addressed.

Because every lender's approach to specialty properties is different, and because every property has its own challenges, you should do your homework. Call various lenders to see what additional guidelines and documentation requirements they may have.

Underwriting managers typically are the people who will review your file. You might want to begin by contacting them and opening dialogue on the file.

In addition, depending on the lender, these loans often are considered at reduced LTVs, typically 80 percent or less. And as with most exception-based lending, the loan should have at least three strong compensating factors and a tangible benefit to the borrower.

Compensating factors

Compensating factors are integral to exception-based underwriting. These are what lenders use to weigh a loan file's risks versus its strengths. Lenders also use them to determine if they are willing to step outside of their comfort zone and put their money on the line for a property with layered-risk characteristics.

A compensating factor is any known fact that may reduce the lender's overall risk. If lenders determine that there are enough significant compensating factors to outweigh a file's known risk, they will be more inclined to issue a favorable underwriting decision. Here are a few possible compensating factors.

- **An LTV at or below 80 percent:** This mitigates a lender's risk and overall financial loss.
- **Borrowers who have resided in the subject property for more than four years**: This supports long-term vested interest, which indicates the likelihood that borrowers will fight to keep the property from going into foreclosure.
- **Borrowers who have been with the same employer for more than four years:** This supports income stability.
- **Low debt-to-income ratios on full-income-documentation loans**
- **Borrowers with verified three months or more in asset reserves**: This shows that borrowers have enough money saved should an unforeseen situation create a loss of their regular income.
- **Reduced borrower monthly debt obligations by $200 or more**
- **Payoff and relief of borrowers' major financial obligations**, such as tax liens, child-support liens, judgments, mechanics liens and Chapter 13 bankruptcy
- **Combined paid-as-agreed mortgage history of 36 months or more:** Calculated by adding the number of months for all previous mortgages that were paid as agreed, this shows the lender that borrowers have a history of successfully managing their mortgages over a length of time.
- **FICO scores greater than 680 (nonprime) and greater than 780 (prime):** This can be

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Tisha D. Hartman is vice president of mortgage banking for Velocity Funding, an investment-management and mortgage-banking lender. She has more than 10 years of mortgage-banking experience and is a topic expert on the Gerson Lehrman Council of Advisors. She also consults for Wall Street's investment analysts and is working on hosting her own real estate and finance radio talk show. Hartman can be reached at Mrs.Hartman@yahoo.com or at (408) 221-7886.

evidence of borrowers' ability to manage their debt successfully.

Tangible benefits

It is essential to identify what tangible benefits a loan can bring to borrowers. Imagine a loan in which there is no benefit to the borrower. This potentially may indicate predatory lending on behalf of the broker or the lender. There should always be a benefit to borrowers for taking a loan.

Some tangible benefits include:

- **Purchase transactions**, in which borrowers are getting a property in exchange for the loan fees and subsequent interest accrued;
- **Reduced monthly obligations** by an amount that would offset the cost of the closing fees within two years;
- **Total debt consolidation** when the new monthly mortgage payment does not exceed the total monthly payments of all liens being paid off;
- **Going from an ARM to a fixed-rate mortgage;**
- **Paying off a subject lien that has negatively amortizing features;**
- **Reducing the loan term**, such as going from a 30-year to a 15-year loan;
- **Paying off a major financial obligation**, such as a tax lien, judgment, garnishment, past-due child support and Chapter 13 bankruptcy; and
- **Adding borrowers to the title or buying out other vested ownership interest in the property**, which is commonly used in divorce situations, parent-to-child transfers and at the end of a lease that has an option-to-purchase contract.

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By packaging loans with lenders' and underwriters' concerns in mind — and recognizing compensating factors and tangible benefits — you let them know that you have done your homework and know the challenges. You also can better present the reasons you believe the loan is still a viable risk to take.

If you follow these steps, you will find that you not only will set your file up for success, but you also will build credibility with the lender's senior management. This good rapport will pay off in spades on your future specialty deals.