

Navigating stated income loans

BY PETER MILLER
CTW Features

"Stated income" loan applications are back. This is something of a financial miracle given their history and background.

One reason for the mortgage meltdown between 2007 and 2010 was that lenders widely offered stated-income mortgage applications. You could get financing based on whatever income you claimed, and some borrowers were very creative, thus leading to the term "liar loans."

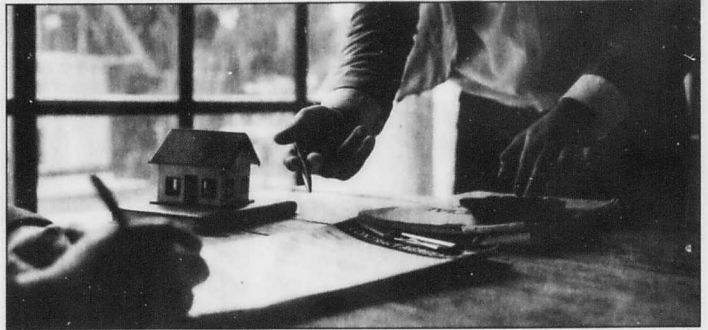
"A liar loan," explains Investopedia, "is a category of mortgage loan that requires little or no documentation of income. Because the lender does not verify income and assets by looking at W-2 forms, income tax returns and other records, such loans are said to be 'liar loans' because lenders simply take the borrower at their word."

Lenders, for their part, often did not have enough verified data to confirm borrower applications. If a credit score looked good, an application could fly through the system — though maybe with a somewhat higher interest rate. Most importantly, stated-income borrowers were not required to get more information before a mortgage was originated.

Huge numbers of foreclosure notices went out during the mortgage meltdown when borrowers could not repay their debts. Many lenders also got into trouble. A total of 140 banks closed in 2009 and 157 were shut in 2010. In comparison — and despite the pandemic — four banks failed in 2020, none were closed in 2021 and 2022, and five were shut in 2023. As of late April, only one US bank has closed in 2024.

One result of the mortgage meltdown was passage of the Dodd-Frank reform legislation in 2010. It was designed to reduce marketplace risk for borrowers, lenders, and mortgage investors.

Dodd-Frank requires that lenders verify the ability of residential borrowers to repay a loan. This is hardly an unreason-



able standard. "Know your borrower" is one of banking's most fundamental rules, surely a lot better than "Howdy stranger, can I get you a sack of unmarked bills?"

It's generally understood that borrowers must provide tax information when applying for a mortgage loan. While this is common practice, it's not required.

Dodd-Frank says, "A creditor making a residential mortgage loan shall verify amounts of income or assets that such creditor relies on to determine repayment ability, including expected income or assets, by reviewing the consumer's Internal Revenue Service Form W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets."

In other words, lenders are not required to use only tax records to verify borrower information. They can use alternative documentation.

"Stated income" loans today are not the same type of application that was one reason for the mortgage meltdown. The term

"stated income" now means financing that substitutes various records for tax information. Documentation is required to verify income and other information.

Who uses stated-income financing? In some cases, it's borrowers who feel their financial situation is not adequately reflected in their tax returns. For example, a self-employed borrower might have deductions that lower their income but are not cash costs. Think of deductions for depreciation or the use of a home office.

Rather than tax returns, a lender who uses stated-income financing might look at the borrower's bank statements to track the ebb and flow of monthly income, to see what's really there — or isn't there.

Is it worthwhile for borrowers to get stated-income financing? There are several issues to consider.

First, how do interest rates, fees, and charges for a stated-income mortgage compare with other mortgage options?

Second, does it make sense to believe that lenders cannot understand tax returns? Even complex returns? Mortgage

underwriters review tax returns every day. It's what they do.

Third, some borrowers worry about privacy issues. That may well be a fair concern, but it must be balanced against the reality that borrowers are asking lenders for a loan, a big loan. You want the money, then you need to provide evidence of the ability to repay.

Every borrower should shop around for the best available price and terms. If you're worried about tax returns and whether they fully reflect your financial situation, speak with loan officers and get their responses. They likely have heard similar concerns before because self-employment is common. According to the IRS, more than 20 million people reported self-employment income in 2022 and you can bet that many of them have mortgage financing.

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