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Best Practices to be Followed for Getting Home Loan Easily

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Annotation. House prices in India have been growing exponentially over the years. This has not dettered the common man's quest for owning a house. In colloquial Hindi there is phrase to describe this basic need of a human being and that is ‘Roti, Kapda aur Makaan’. Banks have been the go to place for seeking a home loan. Whenever he/she approaches a bank, getting a loan approved seems to be a complex exercise. In order to ensure that the loan application is not rejected, we should understand the loan origination process. In this article we would explain the loan origination process, focusing specifically on home loans. These processes are followed by all of the banks. Thereafter, we would discuss on some best practices which can be followed by borrowers for getting the home loan approved easily.

Keywords: Risk mitigation, Loan application process, Property appraisal, Credit rating, Fixed obligations to Income ratio, Loan to value ratio, Underwriting.

Introduction-

A house, a vehicle or higher education; these are dreams for many. Over the last couple of decades these dreams have been turning into reality for many Indians and credit for it goes to the credit given by banks. Especially housing market in India has seen a major demand surge in last 2 decades, largely due to home loans. In earlier days, people used to save money for years and then purchase a house of their own. Now people who have just started their careers are also purchasing a house. The increased demand, especially in urban areas, has also led to skyrocketing of real estate prices. Home loan has become a necessity considering these high prices. However, getting a home loan is not easy and in many cases the application gets rejected for various reasons. Borrowers try to scout for their relatives, neighbors or friends in banks for getting loans. The loan application process looks like solving a puzzle for them which involves filling up multiple forms, submitting numerous documents and signing blindly at many places. They are ignorant about the guidelines that the bank has to follow in order to minimize the risk for themselves while giving out a loan.

Loan origination process-

Risk mitigation is the sole reason behind these processes. Just as in-case of common man, whenever a relative, friend or colleague would approach them for some monetary loan they would give it easily (based on their capability) as they have known them for many years. However, they wouldn't give it to an unknown person if he/she asks for a loan of the same amount. Inherently they are doing a risk analysis and in-case of an unknown person they are not sure whether he/she would refund their money. In-fact they will not loan to a friend or relative who they know is financially imprudent. Similarly when someone approaches a bank for any loan, they are not known to the bank. Even if a bank personnel may know the customer but the bank doesn't. The guidelines are framed in such a way that its person agnostic irrespective of who sits in approving chair. Submission of all documents to the bank enables it to know the customer better. These documents establishes identity (ADHAAR, PAN), income (salary slips, Income tax return statements), any assets (bank statements, collateral records) etc.

The loan applications follow a set of processes. The loan file passes through multiple individuals in various roles in the bank. Once submitted the file would move to an officer who would process the file. He would check whether all documents have been submitted and all requisite details are captured in the form.

They have to be doubly cautious and check for fraudulent documents and information given in the application form. Banks engage third party agencies as well to do valuation of the property. The objective is to analyze whether the property has been over valued or not. There are instances when builders overprice the house and in others they do it in collusion with buyers so that the buyer can get more loan amount. Appraiser is engaged to identify such instances; the appraiser visits the property and checks the condition. They also compare the price with the selling price of similar properties in the locality. Along with it they check for all regulatory clearances of the property. They do so independently of builder/seller of the property. Thereafter, they would submit their report to the bank.

Banks would also do verification of income I.e. it would verify whatever income has been quoted by the borrower is their actual income. So representatives would also visit the office/organization wherein the borrower works. They would ascertain whether the borrower is actually working in the organization as stated in the application and also the income. By doing so it also ensures that the income stated would suffice for timely repayment of EMIs.

It's used to calculate Fixed obligations to Income ratio (FOIR) i.e. comparing the total monthly income of the borrower with total monthly outflows related to debt, rent, utility bills. Suppose a person has a lot of credit card loans and a total 60% of his income goes towards repayment of EMIs along with his other fixed expenses like utility bills. In such cases additional home loan would add to his monthly debt repayment. In such cases there would be a high chance that the person would default on his loan repayment. Banks are comfortable in giving loans wherein the FOIR is around 40-55 %. In this scenario the borrower would have sufficient income left to take care of their other daily needs and other financial exigencies apart from loan repayments.

After completion of appraisal and other verifications, the reports are submitted back to the bank.

The loan file is then moved to underwriters. These underwriters are qualified individuals who go through the loan file, do risk assessment and give a decision on the loan to be approved.

Borrowers have to understand that this exercise is similar to a scenario wherein two equally known friends of the person asks for a loan and they have equal needs. One of them has stable income and would be able to pay it back while other may not have stable income or financially mature behavior. Generally in this scenario the person would prefer to give the loan to the friend who has a stable income. Basically he does a risk assessment; by judging between two friends and analyzing who would be able to pay back thereafter deciding whom to give the loan. Similarly the underwriter's role is to identify people who would be able to pay back the loan.

They study the capacity of the borrower to repay based on their employment and income. This is done by verifying the source of income and calculating FOIR ratio which was discussed earlier.

Then they judge the capital available with the borrower. It means total assets of the borrower. Whether he/she would be able to pay the down-payment and other expenses related to the loan. This is assessed through the account statements of the borrower and other assets (like existing properties, investments etc.) details.

Thereafter they assess collateral I.e. the property to be kept as security with the bank. If the borrower is unable to pay back the loan then the bank would take possession of it and try to sell it off to recover the unpaid amount. So if the property price is less than the loan amount then the bank would be at loss. So always the loan amount is less than the collateral value preferably between 75-90% of value of property. This is as per RBI guidelines based on valuation of the property.

There are a couple of reasons for it. If they give 100% loan then the borrower would not have any amount invested in property. They can simply service the EMI as if paying rent and one fine day they would walk away and default. The bank would be left with the property. No bank wants to take possession and sell property as it's not their primary business. Selling involves waiting period and additional costs for banks. If the borrower would have paid some down-payment then there would be less of a chance of the borrower just walking away. Secondly the gap between loan and value of property can cushion if there is any depreciation in property value. This is true for other collateralized loans as well such as in the case of gold loans, the loan amount is not 100% of the value of gold pledged.

The key aspect that an underwriter considers is the credit rating for a borrower. The higher credit rating means more likelihood that the borrower will pay back. There are credit rating agencies which come up with these ratings based on the past borrowing history of the person. Some of the key credit rating bureaus in India are CIBIL (Transunion), Equifax, Experian & CRIF. Basically the rating agencies use complex algorithm in lay terms, say a complex logical formula which considers the past borrowing history and comes up with ratings based on certain factors. First being the repayment history. If the borrower paid earlier loans diligently then there is a high chance that he will pay back this loan and the opposite would be if the borrower has defaulted in earlier loans then there is a chance of him defaulting in this as well.

Length of earlier credits is also a factor that is the longer the credit history, the better for the borrower. Here the rating agency has observed the repayment behavior for a longer period of time and hence can better predict the future behavior of the borrower.

So a borrower who has paid EMIs sincerely for 8 years would have higher ratings than a borrower who has paid back for 2 years.

Thirdly, recently availed new credits are also considered. If the borrower has not taken many loans earlier but recently has taken many loans then it’s a red flag for the lender. It would look like the borrower is in high financial need recently.

Credit enquiries also affect the credit ratings, if recently a number of lenders have requested for credit scores of the borrower then it would have negative impact on the ratings. Akin to recent credits, it would be considered as borrower is shopping for a loan and is not getting through different lenders. However, here it’s to be considered that if the borrower himself/herself have requested for credit score then it won’t affect the credit scores.

Finally the underwriter approves or rejects the loan. In some cases they can ask for additional documentation or clarification. Suppose the borrower had a good repayment track record and in between for 2-3 months he defaulted and later paid back. The underwriter can try to understand from the borrower if it was due to some genuine reason like health issue for which borrower was unable to work or was between changing jobs etc.

In-case of rejection they will let the borrower know about the reason for rejection. If approved then they will proceed with closure I.e final document signing and then disbursement of loan. So this whole process takes couple of weeks to complete in some cases up to 30 days.

In some cases the existing customers of the banks get some preferences in case of home loans in form of reduced documentation or a favorable interest rate.

Having considered the loan origination process detailed above the following points need to be taken care of before applying for a home loan, this would decrease the chance of rejection:

- People should check their credit scores at regular intervals, it would definitely mean spending some money but it would prevent any surprises during the loan application process.
- Should ensure diligent repayment of existing credits. Do not neglect the small ones, if possible can payoff small credits. It would also help in lowering the DTI ratio while applying for home loan.
- Do not apply for multiple credit cards as it can lead to debt trap if not managed properly and would result in default. Thereby resulting in lower credit scores.
- Need not max out on all the credit cards as it would affect the credit rating as well.
- If someone is planning for a home loan then he/she should avoid applying for multiple loans before that unless with a justified reason, else it would raise a red flag for the lender.
- Should ensure all the KYC documents are in order.
- Ensure that all recent income proofs, salary statements and ITRs are in proper order. There is no mismatch in details. Especially for self-employed individuals, they should ensure that all their recent financial documents and documents of their business venture are available.
- One should check that the property he/she is trying to purchase is approved by local authorities' guidelines and also approved by lender. They should also do due diligence regarding the ownership of the property i.e. is the seller actually owner of the property and has right to sell it.
- While applying for a loan, it should be properly checked that there is no discrepancy between the information in application form and the documents provided.
- Do check with multiple banks regarding their loan features/plans. Compare them and analyze to choose the best one based on eligibility. If needed seek help. After being sure of a plan, apply with the concerned lender. Without analysing and just applying with multiple banks will affect credit ratings.

Conclusion-

Banks always want to give loans as they are its bread and butter but before approving they want to make sure that they will get back the loan amount without any defaults. Many times people succeed in duping the banks and default on loan repayment. As a result the whole financial system under the aegis of RBI has got extra cautious. If someone is interested to get a loan and move into a new house then he/she should ensure that their house is in order in the perspective of credit ratings & documentation.

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