DIVORCE MORTGAGE PLANNING, CREATING BETTER OUTCOMES FOR DIVORCING HOMEOWNERS

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- **Presenter: Jeffrey Cruz, CDLP**
- **Date: 5/10/2024**

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Affordability and the San Antonio Housing Market

The San Antonio market is experiencing affordability challenges regarding qualifying for homeownership. Today we see an increase in household creations nationally and of in Texas. While at the same time builders new home production plummeted from 2010 to 2020 as a result of several factors including higher bank regulations that have reduced lending opportunities for small builders, market conditions from the 2007 and 2008 housing and financial crisis, and the subsequent increase in compliance and the creation of the CFPB that over regulated and pushed small community banks out of the market. These banks were a funding source for builders. As a result, the combination of these two occurrences it has contributed to a reduction in inventory available.

Interest rates are at 20 years highs, coupled with home price appreciation that was aggravated by the rush to purchase during COVID and high competition amongst the growing population against a lower inventory market.

The combination of these factors has reduced the affordability index in San Antonio to its lowest level in over13 years. Affordability is measured by a family purchasing a home at the median price, at the median income with the current average market interest rate. (Texas A&M Univ RE Research Center)

Solutions to affordability

1. Proper planning early in the divorce process.
2. Helping our clients understanding their personal economy through education. Helping our clients understand their personal economy and what they can and cannot afford, allows us to plan within the marital settlement agreement to be sure they are set up for success.
3. Loan assumption is an option. Both legal and qualifying assumptions our options that a client can consider keeping their existing interest rate and house payment. If both parties are amicable, then doing nothing may be suitable at this time.
4. Solution based lending- Reverse Mortgages for “Grey Divorce”

Questions to consider as a Family Law Professional

- If a client has a home, how do you determine value?
- How would you handle it, if one spouse wants to keep the house but cannot refinance and the other spouse wants to buy a new home?
- How would you handle it when spousal support is based on the other party’s fluctuating income or irregular pay?
- How would you handle spousal support vs a lump sum payout?
- How do you evaluate the real property and the home equity mortgage options?

The answer to these questions may have significant consequences when mortgage financing is needed.

What is Divorce Mortgage Planning

- Divorce Mortgage Planning is a holistic approach to the process of evaluating mortgage options in the context of the overall financial objectives as they relate to divorcing situations.
- The role of the CDLP® is to help integrate the mortgage selected into the overall long and short-term financial and investment goals, to help minimize taxes, to minimize interest expense, and maximize cash flow.
- **Our mission is to help divorcing homeowners make more informed decisions regarding their home equity solutions and mortgage financing opportunities during and after the divorce.**
- A CDLP® does **NOT** give legal or tax advice!

The Intersection of Divorce, Real Estate & Mortgage Planning

- When the home is on the martial balance sheet, these four pieces of the puzzle really are intersecting and often overlapping. This example only takes into consideration a fraction of possible overlaps and the need for a very knowledgeable and strong professional divorce team.
- It is not as simple as one spouse retaining the house or just simply selling it – there is a lot more involved in the overall picture. And the areas of overlap, they affect not only the divorcing couples, but it really allows us to visualize the impact the house, family law, tax, and financial planning, among other things – how they impact each member of the professional divorce team also. Whether it is the attorney, financial planner, or the divorce mortgage planner.
- As divorce professionals, it is imperative that we really acknowledge how the home can impact multiple faucets of not only the divorce itself but life after divorce.

How the CDLP helps the Divorce Settlement Process

- This process is much more valuable and involved than just calling a traditional mortgage lender to take a loan application and refinance the house. You cannot think traditionally when working with divorce.

How the CDLP is different than the limited perspective of a traditional Mortgage Lender

- Traditional loan officers only see the mortgage planning aspect when working with clients in divorce. However, working with the CDLP, they will see things other traditional loan officers do not see. It is not what you look at it is what you see that matters. Identifying potential tax pitfalls, understanding when a QDRO may be required and the implications that can have on qualifying income. Understanding temporary orders and the impact of timing it can have on income qualifications are just a few of the considerations CDLP has the vision and perspective to create the absolute best outcomes for divorcing homeowners.

The Journey of the Divorcing Homeowner

Divorce Mortgage Planning is broken down into a 5-stage process including Discovery, Initiation, Planning, Execution and Closure.

My discovery phase is very similar to your financial disclosure and discovery phase. I am conducting a needs assessment of my client, what they need and want, what that looks like to them, etc. This is where I start building my analysis and Divorce Mortgage Planning and Real Property Detail Report. This report is a very comprehensive and dynamic divorce mortgage plan that develops into an executable plan as negotiation and settlement progress. It also provides you and the entire divorce team valuable information you need to know regarding the real property involved.

Divorce mortgage planning runs parallel to the divorce process from financial disclosure and discovery all the way through the final order of divorce.

I want to make sure that my initiation phase in conducted in coordination with the legal team and that I have a full understanding of the current situation and our client is financially prepared to move to the actual planning stage.

The actual planning stage is where negotiations and settlement all come together. We are formulating the strategic blueprint of the solutions and options available to meet our client needs and goals. Why negotiate and settle on something that is not executable – and this includes the language used in the settlement agreement as well. It is important to remember that what may be available as a legal option may not be available as a mortgage option.

Once we have a final plan that is acceptable to the client, we can then execute the agreed upon plan in alignment with the settlement agreement and then close the new mortgage financing in compliance with the court order.

4 Phases of Divorce Mortgage Planning

Vetting the House. Qualifying Income. Consumer Debt Analysis. Home Equity Solutions.

There are many aspects to vetting the house. Whether it is the property ownership, tax status, the value, and equity available, existing liens. We need to really examine the details of the property because not only are the details important to you as the divorce professional, but the details of the property may determine what type of mortgage financing is available or not available and this has nothing to do with credit scores and income. Additionally, reviewing a C.L.U.E report to identify potential insurance claims that may be in question.

We have to analyze the various income sources which may consists of employment, support income, or no income and what we can do to create legal income with financial and tax planning, how is the marital or individual debt being evaluated and distributed during the divorce and then how can we help the divorcing homeowners make a more informed decision regarding the home equity solutions.

Are their credit concerns that need to be identified and managed to make available options that may be required if future financing is of concern.

Qualified Income

What may be available as a legal option, may not be available as a mortgage options. Qualifying income is one of the most important aspects of creating mortgage solutions to accomplish the client's goals of homeownership.

When considering what is qualified income, the basis of evaluation is around stability and consistency.

To qualify for financing forcing homeowner who is borrowing money must have qualified an income. Challenges can exist with those returning to work after a large employment gap. Often there may be waiting periods to create qualifying income that need to be considered one suggesting timelines and objectives within the marital settlement agreement. Specialized knowledge can reduce the time required to create job stability and consistency in income.

Employment with variable pay can present challenges when it comes to counting what is qualified income and can often bring into question consistency of income. Self-employed comes with two years required to be considered qualified income.

Lump Sum Payment-although lump sum payment can be of great benefit from the aspect of accumulating assets. It cannot present challenges when it comes to qualifying income. There are certain options that may be available to create qualified income from the lump sum payment. Sometimes revocable trust can be an option, 72 T distributions are also an option but can provide less flexibility and have restrictions. Asset based programs that land solely on the amount of assets held by the borrower or another option. QRDO can also be used as a source of qualified income however may not be taxed advantaged.

Support Income-

- Both child support and spousal support our common sources of income that can be considered qualified income assuming they meet the 6 / 36 rule. In order to count support payments as qualifying income, there must be proof of receipt for six months prior to mortgage commencement. Additionally, support limits must continue for a minimum of 36 months after mortgage commencement. However, processing time would indicate it is a best practice to consider greater than 36 months to build any buffer of delays in processing times. Failure to accommodate the 6/36 rule can create conflicts for the borrowing spouse regarding their timeline goals for homeownership.
- Beware of "netting out" support. Always separate out support payments from any other obligations that are to be paid by the paying spouse. Commingling the house payment along with other obligations and muddy the waters for a mortgage underwriter which will cause them to give no credit to any of the income since there is not clarity as to the true amount of Support to the borrowing spouse.
- Separate the amount of support payments per child specifically addressing how much support per child rather than grouping them into one lump sum. This is particularly important if one child is turning eighteen within the 36-month timeline. Without separation of the amounts per child,

underwriting will not allow any of the income is qualifying income due to lack of clarity on how much the remaining child support amount will be.
- The six-month stability rule starts once payments have begun. This includes temporary orders. However, if the final orders are executed and the amount is higher than the original temporary orders, the six-month timeline will start over. Again, this is valuable information to identify potential pitfalls or delays in the planning aspect for mortgage qualifying and home ownership for the borrowing spouse.
- Paper Trail-all mortgage processes and information required a clear path and paper trail. Support payments must be documented from once spouse to the other. We must prove they support payments came from paying spouse and I received by the borrowing spouse. Payments are administered through the office of the attorney general this simplifies the process. However, if payments are made directly from one account to the other, we will need at least one statement from the pain spouse to show proof that came from them. Additionally, if payments are made into a joint account and then retrieved from the orange house, this can present underwriting challenges since borrowing spouse is getting support payments from an account she does not hold solely.

Equity Buyout and the Marital Home

An equity buy-out is a process of acquiring the equity ownership of an existing legal owner of real property. Acquiring the equity ownership in the marital home from an ex-spouse is most commonly done by refinancing the existing mortgage.

The two types of refinances are either a Rate/Term refinance or a cash-out refinance. Rate/Term refinances typically have better terms with regards to lower interest rates and access to more equity. A cash-out mortgage, on the other hand, may carry a higher interest rate and typically only allows the borrower to access up to 80% of the home's value, which can present a problem when the goal for the refinance is to actually access the equity.

The divorce settlement agreement needs to be structured in such a way that the divorcing borrower can refinance as a Rate/Term – equity buyout. The loan structure will allow the divorcing borrower to access the equity in the home without the higher pricing adjustment or even the ability to refinance at all.

In order for an equity buyout to be classified as a rate/term refinance it must meet the following requirements:

- The equity buyout must be addressed in the homestead or real estate section of the marital settlement agreement – meaning it must be addressed independently. It may not be included an addendum that identifies all marital assets and the equity distribution absorbed into the total division of the marital estate.

- Absolutely no cashback is allowed to the borrower for debt consolidation, attorney fees, etc. Literally, not one penny can be due to the borrower at closing – even if it is the result of overestimated fees.

- The borrowing spouse must have been on title for the previous 12 months. This is a key factor if for example the mortgage and title were held in the husband's name and the wife was awarded the marital home and needs to refinance the home. Even though the court order makes her a Successor of Interest which then allows her to refinance the home even if she is not on the current mortgage, again the court cannot dictate which category of refinancing is applicable.

Marital Debt

Ordered assignment of debt, contingent liability needs to be described in clarity on the marital settlement agreement. Mortgage loans, student loans in any data obligation that will be addressed in the MSA this piece specific as to who is responsible for making payment.

Specifics regarding the amount to be paid, the duration in which payment will be made and what is included in the payment. For example. If a mortgage is going to be assigned clarity on who is sponsible for paying the principal and interest, property taxes and homeowners' insurance and homeowners association dues.

If debts are going to be shared by each spouse, these specific amounts need to be addressed in the marital settlement agreement. If clarity is not provided as to the exact amount, a mortgage underwriter will be unable to determine the amount that should be calculated in the borrower's debt to income ratio. As a result, the entire liability will be counted against them which could prevent or hinder qualifying and derail the goals of both parties and objectives contained in the MSA.

Case Study

- Wife moved out of marital home and currently renting.
- To receive $2000/month in child support, kids are 9 & 11 years old.
- To receive spousal support of $3500/mo., for 30 months
- Recent employment for past 10 months earning $4700/mo.
- To receive cash buyout of $420,000
- She wants to buy the house she has been renting for a purchase price of $425,000 (current owners getting divorced and will put the house on the market in Sept)

Total Income: $8400/month

New house payment est. @ $3230/mo. w/20% Down Payment

Case Study Analysis

- Wife moved out of marital home and currently renting.
- To receive $2000/month in child support, kids are 9 & 11 years old- Not Qualified due to lack of stability based on plans to purchase within 6 months.
- To receive spousal support of $3500/mo., for 30 months-

Not Qualified due to lack of continuance. Must be 36 months or greater.

- Recent employment for past 10 months earning $4700/mo. Qualified due to prior work history.
- To receive cash buyout of $420,000
- She wants to buy the house she has been renting for a purchase price of $425,000 (current owners getting divorced and will put the house on the market in Sept)

Total Qualified Income: $4700/month

New house payment est. @ $3230/mo. w/20% Down Payment

Income needed to qualify $7300/mo.

45% Max DTI leaves her short income to qualify by $2700/mo.

Potential Solutions

- To receive $2000/month in child support, kids are 9 & 11 years old- Check with selling party to extend closing date/choose different property.
- To receive spousal support of $3500/mo., for 30 months- Extend term of support to 40 months for new monthly amount of $2700/mo.
- Recent employment for past 10 months earning $4700/mo. Qualified.
- To receive cash buyout of $420,000- Using asset qualifying loan option

Total Qualified Income: $4700/month

New house payment est. @ $3230/mo. w/20% Down Payment

Income needed to qualify $7300/mo.-Obtained (+/-) with employment income and combination of the other 2 options.

The Divorce Mortgage Planning and Real Property Report

One of the most valuable reports that a CDLP® can provide the divorce team with is the CDLP® Divorce Mortgage Planning and Real Property Detail Report (DMPR).

This report provides the divorce team with details about the real property, including ownership status, deed type, property tax, valuation, ATROS, homeowner insurance, existing mortgage(s), equity status, and more.

Additionally, this report breaks down the financial details of the proposed borrowing spouse, including income and debt analysis from a mortgage planning perspective. This is valuable information to the divorce team because not all income sources may be qualified income from a mortgage planning and approval perspective.

Depending on whether the divorcing homeowners are looking to refinance or purchase post-divorce, the DMPR provides up to four finance scenarios and options to address various equity buy-out options and/or purchase scenarios.

The CDLP® Divorce Mortgage Planning and Real Property Detail Report provides all divorce team members with an enormous amount of information invaluable to helping the divorcing homeowners make more informed decisions regarding their home equity solutions.