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Pre-Approvals vs. Pre-Qualifications in the Home Buying Process

One of the first things a savvy home shopper does PRIOR to starting a serious home search is to explore mortgage options. An experienced realtor will encourage buyers speak with a lender and get "**pre-approved**." This benefits all parties involved by ensuring that prospective buyers can actually qualify for a mortgage on the homes they're interested in. Failure to do so can cause frustration and disappointment for any agents or buyers who naively regard today's stringent mortgage process as a minor detail to be addressed after a sales contract is accepted. No one likes surprises during the purchase process!

Two terms that are often (and incorrectly) used interchangeably are "**pre-qualified**" and "**pre-approved**". While their exact meanings will vary by lender, in most cases a pre-qualification is far less desirable and less clearly defined.

A **Pre-Qualification** typically means a buyer has spoken with a lender (who may or may not have pulled a credit report) and verbally discussed employment, liabilities, payment histories, and assets. Actual verification of assets, income, and credit may not occur with a pre-qualification, and an automated underwriting system (Desktop Underwriter or Loan Prospector in most cases) likely has not been run. While better than nothing, a Pre-Qualification remains entirely dependent on a far more thorough process of verification and examination of a borrower's credit, assets, and income. At best, it's a "probably."

A **true Pre-Approval**, on the other hand, entails a strict review of the client's credit, down payment capacity, income, and asset documentation. Credit reports are thoroughly dissected, rather than just credit scores verified. Veteran loan officers run prospective buyers through underwriting engines if they have any doubts concerning debt ratios, derogatory credit items, or employment history/income verification. Once the system returns an approval, it too needs to be read in detail, as it will list specific requirements for final loan approval. A lender who bases his pre-approval on mere credit scores and underwriting engine approval without fully examining it, risks his reputation and the satisfaction of the other parties involved.



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Unfortunately, the ambiguity between Pre-Approvals and Pre-Qualifications can cause mismanaged expectations. **For example**, a client that came to me recently, saying he was pre-approved with another lender, and that his salary was \$X/yr. He had already identified a home and written a sales offer. His debt ratios were tight, but, based on the information he provided, he met Fannie Mae's requirements. Once his W2, paystubs, and tax returns were received, it became apparent that his "salary" included a number of incentives and other non-guaranteed items. When I said we'd need to verify that the extra income was likely to continue with his employer, his comment was "the other loan officer didn't ask me to break my income down." He also had two liabilities on his credit report that didn't show monthly payments, and needed to be determined. When asked about those, he remarked that the prior lender hadn't mentioned them. Ideally, these issues are caught early enough in the process to address them, if not, they can result in extra processing time that delays closing.

If **all parties involved** are aware of the distinction, it **helps everyone** play their role to the best of their ability. The listing agent who calls the mortgage originator to ask if the buyer's income and asset docs have been examined clearly understands the differences between pre-qualifications and pre-approvals. Conversely, the originator who contacts the realtor can better manage expectations by clearly defining their pre-qualification or pre-approval process. Even clients, armed with this information, can request a thorough pre-approval rather than a cursory pre-qual, and play a role in ensuring the best possible handling of their transaction.