

The Pre-Qualification & Pre-Approval Processes

Now that you know you want to buy a house, how do you know how much you can afford and if you can qualify for a loan? The way to get started is to go through the pre-qualification and pre-approval process with a lending specialist.

Pre-Qualification versus Pre-Approval

1. Pre-Qualification is how much money a bank will lend you based on your income, assets, and debts. Pre-Qualification is typically done over the phone with a lending specialist. This is the first step to get started in the buying process. The lending specialist will do a minimal credit review over the phone which means discussing your credit background. When you begin the Pre-Approval process the lending specialist will actually check your credit but during Pre-Qualification they will simply gather basic information regarding your financial and credit situation.
2. Pre-Approval is a more formal process and includes completing a loan application on-line and providing documentation regarding income and assets. During the Pre-Approval process the lending specialist will ask for authorization to check credit in order to analyze debt ratios. Pre-Approval is typically done when you start looking for houses with a real estate agent or prior to writing an offer.

What Factors Affect What I Can Afford?

There are three factors that affect how much you can afford when you decide you want to buy a home.

1. The down payment - do you have enough liquid cash to make a down payment?

Most loans today require a down payment between 3.5% - 20%. Contrary to what many people think, there are still loans that have lower down payment requirements depending on the type and terms of the loan. Keep in mind, if you are able to come up with 20-25% down you will eliminate mortgage insurance.

Mortgage Insurance (also known as PMI or **home-loan insurance**) is an insurance policy which compensates lenders or investors for losses due to the default of a mortgage loan. Mortgage insurance can be either public or private depending upon the insurer. (Wiki)

2. Your ability to qualify for a loan - as mentioned earlier this is determined during the Pre-Qualification & Pre-Approval Process
3. The associated closing costs on your home.

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How Much are Closing Costs?

You will be required to pay fees for acquiring the loan and other closing costs. These fees must be paid in full at the closing unless you are able to include them in your financing. Typically, closing costs will range between 3-6% of your mortgage loan. In some cases, Buyers will request the Sellers contribute up to 3% of sale price towards the Buyer's Closing Costs & Pre-paid Expenses.

What Does my Monthly Mortgage Payment Include?

Most lenders require that your monthly payment range between 29-36% of your gross monthly income. Your mortgage payment to the lender includes the following:

- The principal on the loan (**P**)
- The interest on the loan (**I**)
- Property taxes (**T**)
- The homeowner's insurance (**I**)

This is what we call **PITI** and your total monthly PITI and all debt (from installments to revolving charge accounts) should range between 36-45% of your gross monthly income. These key factors determine your ability to secure a home loan: Credit, Assets, Income and Debt Ratios.