



Mortgage Tips

Pre-approval letters and loan approval



Pre-approval letters

As you begin searching for the home you have been dreaming of, it is important to think about the loan that will help you make this dream a reality. It is important to get pre-approval letter from a bank before beginning the hunt for your dream home. This will prevent your dream from turning into a nightmare. No one wants to find the perfect home and then have their loan application denied. Not only do pre-approvals help to determine the price range you can afford so that you are not wasting your time looking for a home that is out of your price range, but they also give you a bargaining tool when making an offer to the seller.

When you are pre-approved for a mortgage, a lender has looked closely at your credit report and income in order to determine that you qualify for a loan. The lender will tell you which loans you qualify for, the maximum amount you are eligible for and possible interest rates that are available to you. Pre-approval letters are formal agreements between the buyer and lending institution that offer a guarantee of loan approval for a specific amount. The financial institution issuing such a letter may or may not charge for this service. Keep in mind that even with a pre-approval letter, your bank may deny the loan on the specific house you wish to purchase. As one example, banks will deny the loan for a specific property if the appraisal is significantly less than the sale price.

Loan approval

As you begin the process of buying a home, it is imperative that you understand loan procedures and the factors that determine loan approval. This is an overview of what lenders are looking for when reviewing your credit report.

What is your FICO?

A FICO score is a credit score developed by Fair Isaac & Company to help lenders determine the risk involved in lending money to any person applying for a loan. It is widely accepted by lenders as one of the most important components helping determine eligibility as well as specific amounts, rates and terms that can be offered. FICO scores range from 300-850. The higher your score, the less risk involved in lending to you and thus increases the likelihood of obtaining a loan. Also, a higher score directly translates to lower interest rates. There are approximately 30 factors that influence your credit rating. Some of these factors, such as your payment history, weigh more heavily on eligibility than others. Every factor's importance varies by person and can change individually as your credit history lengthens. Also, keep in mind your score can change daily as new credit is established or debt is paid off. All factors can be grouped into 5 main categories.

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Payment history: Do you make your payments on time? Since this determines approximately 35% of your score, it is certainly in your best interest to make all payments on time! Your payment history includes credit cards, car payments, mortgages, student loans and other loan types. Other public records on file, such as a bankruptcy, will be calculated in this group as well. If you have been late on payments, information such as how recently these payments were made and how much time elapsed between the due date and pay date will also factor into your score.

Outstanding debt: How much debt do you have? All outstanding balances for credit cards, car loans, mortgages, etc. will determine about 30% of your score. How many of these accounts have balances? For example, if you can possibly pay down significantly or pay off credit card debt, you'll be in much better shape during loan approval. Eliminating some avenues of credit can demonstrate your willingness and ability to responsibly pay back new loans.

Credit history: How long have you been establishing your credit? Specifically, how long have your current accounts been opened and how long has it been since you used each of them? This usually determines approximately 15% of your score. If no credit history exists, you should begin by establishing credit accounts and be sure to keep them spotless. The less history that exists, the less the loan amount you'll likely be able to obtain.

Pursuit of new credit: Each time you apply for credit, there is an inquiry into your current credit score. If you recently applied for a VISA card, Nordstrom account and car loan, you may want to hold off applying for a home loan for a few months. Each inquiry may slightly reduce your FICO score and may portray you as someone overindulging in credit. This usually accounts for approximately 10% of your total score.

Types of credit in use: The number of accounts (ATM cards, car loans, credit cards) you have determines approximately 10% of your final score.

Other factors that determine loan approval

Now, a great FICO score will not be the only determining factor in loan approval. Some additional factors that figure into the approval process include the following:

Income: Your current income will be a significant determining factor in loan approval. Pay stubs for several previous months as well as W-2 forms for the previous year will be requested to help determine your ability to repay the loan.

Employment history: Your employment history can tell a lender much about your stability. If you're constantly switching jobs, it could raise a red flag.

Down payment: Being able to provide a down payment can be extremely useful in the loan approval process. It means the amount borrowed will be less than the total cost to purchase the home. In some cases, depending on the amount of the down payment, your monthly payments can significantly drop.