

Some 'Preapprovals' Aren't Worth Ink They're Printed With; [FINAL Edition]

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Full Text (793 words)

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A new national study says that too many home buyers are kidding themselves -- and home sellers -- about a crucial step in the mortgage process: Growing numbers of buyers are walking around with worthless "preapproval" financing letters.

As a result, any contract they sign to purchase and close on a house is highly vulnerable to a costly postponement or a blowup.

More than half of the participants in a nationally representative statistical sample of realty agents identified unreliable or bogus preapproval letters as a key cause of breakdowns in transactions. The agents said 39 percent of all preapprovals issued by Internet-based lenders are faulty or "invalid." Nearly 30 percent of mortgage-broker-issued preapprovals are in the same category, along with 1 out of every 5 preapprovals from national lenders. Generally, a preapproval is considered stricter than a prequalification letter, but there can still be problems.

The study, conducted by market research firm Campbell Communications Inc. of Washington, obtained opinions on the mortgage process from 1,717 active real estate agents and brokers across the country. Inside Mortgage Finance, a lending industry trade publication, sponsored the research.

Breakdowns or postponements in sales transactions because of faulty preapproval documents "is a much bigger issue this year than it has been" in earlier surveys of realty agents, said Tom Popik of Geosegment Systems Corp., designer of the study. That's because more buyers today either have dings on their credit files or are using low-documentation and no-documentation loans when they purchase houses. Low- and no-doc loans permit borrowers to simply state their incomes and assets, with little or no verification by the lender.

A faulty preapproval letter may say something to the effect that "we have preapproved Mr. and Mrs. Smith for a 30-year fixed-rate mortgage at 5.5 percent in an amount not to exceed \$500,000." That allows the Smiths to look at -- and bid on -- houses for sale in their area without anybody seeing proof of their actual qualifications.

But what happens when the lender simply relies on Mr. and Mrs. Smith's statements about their income, assets and credit, and issues a preapproval without verifying the information?

"That's where you can get into deep trouble," said John Marcell Jr., a real estate broker and incoming president of the California Association of Mortgage Brokers. He runs Compass Realty and Better Mortgage Brokers Inc., both based in Upland, Calif. Not only does Marcell's loan brokerage firm refuse to issue preapprovals for buyers whose credit files, assets and income have not been verified, but his realty firm won't accept preapproval letters where the information has not been confirmed by the lender or broker issuing the letter.

"In those cases [functioning as real estate agents] we go to the [mortgage] broker and say, look, we've got to see the credit reports, we've got to see the W-2s, we've got to see the bank statements."

Compass Realty also warns the seller on homes it lists whenever preapprovals look dubious. "We caution [the seller] that if you accept the offer on the basis of this preapproval" -- even if it's the highest offer -- "you could run into troubles later on."

What sort of troubles? Mainly an inability of the buyer to pass the letter-issuing lender's own underwriting tests for the amount needed to fund and close the loan. Then the deal often goes off the tracks, and the seller has to put the house back on the market -- a huge waste of time for everybody involved.

Sharon Wilson, executive vice president of Combank Mortgage Co. in Homestead, Fla., says preapproval letters can be valuable, but they have to meet basic standards. Any valid preapproval letter must be explicit about its limitations and conditions. It must disclose, for example, that the amount offered is subject to a full appraisal, formal underwriting and receipt of an acceptable contract. It should state that the interest rate quoted is not locked and could change. No preapproval letters are worth looking at, Wilson added, if the lending institution has not thoroughly checked credit files, income and cash on hand.

"Personally," Wilson said, "as a Realtor I wouldn't even talk to anybody unless they are truly" preapproved and all their financial records have been viewed and verified in advance.

Marcell had another piece of advice for any buyer who gets a valid, verified preapproval and then starts shopping for a house: "Once you get it [the letter], put your life on hold. Don't change jobs, don't buy anything that could affect your credit, don't change a thing."

Otherwise, your credit score and financial profile could change enough to render a once-valid preapproval letter useless for final mortgage underwriting on the house you really want to buy.

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