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TEL: 778.347.7799 FAX: 604.287.7798 ethellariviere@dominionlending.ca www.ethellariviere.com

Mortgage Q&A: Mortgage Pre-Qualification vs Mortgage Pre-Approval vs Mortgage Approval

Several Canadian banks have launched digital apps that offer potential home buyers easy, hassle-free mortgage pre-qualification in 60 seconds or less. Sounds great, right? The problem is many consumers believe a mortgage pre-qualification is a lot like a mortgage pre-approval or mortgage approval. As a result, prospective home buyers and sellers are left expecting the financial institution associated with the app to lend them hundreds of thousands of dollars to buy a home, despite the fact they simply keyed their names, addresses, contact information and gross income into an app without any verification of the information provided.

Getting Mortgage Approval

Every week, many new home buyers' that just put in an offer to purchase a home discover that their mortgage pre-qualification is meaningless and that they do not have the financing required for the purchase.
Let's get real: A mortgage pre-qualification gives the financial institution warm leads: names, contact information and purchasing timelines. A financial institution would not realistically lend hundreds of thousands of dollars to a person just because you spent 60 seconds on that financial institution's mortgage pre-qualification tool.

Lenders do everything they can to ensure the borrower will repay the loan. A mortgage pre-approval looks at how an individual manages his/her money to determine that person's creditworthiness. The next step in the mortgage approval process assesses the specific person's ability to repay a loan of a certain amount at a set interest rate based on the perceived risk of the borrower(s) and marketability on the home being purchased. Lenders will want to know marketability and life/condition of home being purchased in the event borrowers are unable to make the mortgage payments and must foreclose. Plus, the life/condition of the home will determine the length of time/years to amortize the mortgage over.

Always get a mortgage pre-approval before you start searching for a home and have a mortgage approval in place before you waive your subject to financing condition on the offer - back out of a deal after, and you could be sued by the seller. A mortgage pre-approval will tell realtors what you can realistically afford to buy.
The earlier in the home buying process as possible you consult a Mortgage Broker, knowing what you will need to produce upfront will decrease the feeling of frustration and disappointment down the road for yourself, your Realtor and potential sellers.

Your Broker Your Choice

What is Mortgage Pre-Qualification?

It takes less than 60 seconds because it requests only the most basic information, whether it's submitted to an online app or a financial representative. Mortgage pre-qualification never requires supporting documentation that proves a consumer has a full-time job, is paid salary or hourly nor does it verify your credit score. At best, a mortgage pre-qualification can provide a very loose, broad estimate of a person's home-buying power based on the person's unverified data. Because the applicant typically inputs the information into an online tool, it takes just seconds for the software, not an experienced, professional mortgage underwriter, to pre-qualify a potential home buyer for a mortgage.

If consumers noticed or read the apps' fine print or legal disclaimers, they'll likely see a statement like this one: "This is not a mortgage approval or pre-approval. You must submit a separate application for a mortgage approval or a mortgage pre-approval and a full credit report."
In other words, they're not actually approving or promising you anything.

What is Mortgage Pre-Approval?

In general, it takes two to five business days to investigate an individual's financial circumstances and the risk that a person might represent to the lender. The underwriter will need: all borrowers names that will be on title, addresses for the past two years and contact information in addition to detailed data of income, assets (e.g. stocks, RRSPs, property, vehicles, savings), liabilities (e.g. debt, loans, mortgages) and credit rating and available down payment. Supporting documentation is required to prove all the above including down payment and source of down payment (savings, gift from a relative, RRSP and not for loan proceeds).

Unlike a pre-qualifying app, lenders' underwriters may request a letter of employment, a Notice of Assessment, recent pay stubs, or T4 for the two most recent years as well as documentation indicating the down payment is available. The lender or mortgage broker will also require the consumers' permission to pull credit scores and credit reports from organizations such as Equifax or TransUnion.

A credit score is based on feedback from current and past lenders who report via your credit bureau that you pay your bills in full and on time every month. The credit report includes your name, address, social insurance number and date of birth as well as your credit history, for example, your debts and assets and whether you've ever been sent to collections or declared bankruptcy. Lenders want to know how well or how poorly you manage your money and will be looking for patterns.

A mortgage pre-approval is generally valid for 30 to 120 days at a specific interest rate unless the consumers' circumstances change, for example, employment status, down payment, income or increased debt. For example, a consumer may not realize it, but their probationary status with a new employer, whether it's three, six or twelve months, does matter to lenders. Likewise, a move from a salaried to a contract or self-employed position will also be considered as a higher risk. These changes can impact your pre-approval and decrease funds available, delay funding or decline your application all together.

What is Mortgage Approval?

Once you have identified the home you want to purchase and have an accepted offer, then you need mortgage approval to buy that specific home. Lenders assess the age and condition of the home and consider comparable homes to confirm the price being paid is fair and within market value. Lenders typically do this by requesting an appraisal by a licensed appraiser that is on their approved licensed appraiser list. The cost of an appraisal is approx. $300.00 and is generally at the expense of the buyer.

Another good practice is for the buyer to request a home inspection which a lender usually will not require however it will ensure that there are no obvious material deficiencies with the home that is being purchased. The cost of a home inspection is around $250.00 to $300.00 and again at the expense of the buyer. It is good practice to put a subject removal clause requiring both: satisfactory home inspection and appraisal, especially the subject to appraisal clause as the lender will require verification of market value and life/condition of the subject property being purchase for final mortgage approval and releasing mortgage funds and in reality it is part of the final step of the subject to financing.

Only the mortgage approval accounts for property specifics, such as property taxes, strata fees and valuation of the property so give your underwriter/lender time to ensure the numbers previously used are still valid and that the property is acceptable to the lender. The mortgage approval is valid until the closing date unless the buyers' circumstances change (same as stated above in Mortgage Pre-Approval step).
If you're serious about the home search and purchase process, skip the mortgage pre-qualification apps. Instead, take the time and make the effort to get mortgage pre-approval, then find the home that suits you and then get mortgage approval to close the deal. Then? Enjoy your new home.

Ethel M Lariviere, MBI
MORTGAGE BROKER

TEL: 778.347.7799 **FAX:** 604.287.7798
ethellariviere@dominionlending.ca **www.ethellariviere.com**
APPLY ONLINE: https://ethel-m-lariviere.mtg-app.com

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