

# The Mortgage Professional

## Did Automated Underwriting Kill Pre-Qualification?

Since 1996 the acceleration of the use of fast, automated underwriting has reduced the loan officer's perceived need to manually pre-qualify and re-qualify potential borrowers. The theoretical benefit of the electronic underwriting engines is that they take away the subjective nature of the loan evaluation and approval process resulting in a more consistent and fair decision process. The benefit to the lender is that, in principle, loans approved in advance of processing have a lower cost because time and money are not invested in non-feasible transaction. Unfortunately, the reliance on Automated Underwriting has had a predictable but unintended consequence:

### Loan Officers Have Stopped Pre-Qualifying Borrowers

Pre-Qualifying is the process of analyzing what a borrower can afford before he or she enters into a purchase agreement. Qualification is different – the borrower already has a property, and the loan officer determines if the borrower can afford the specific property. Pre-Qualifying means the borrower hasn't found a property yet and is relying on the loan officer for advice as to how much he or she can borrow.

What is overlooked in this process, whether Pre-Qualifying or simply qualifying a borrower, is that the process is a part of the overall needs analysis for the customer. It is through the qualification discussion that the loan officer can advance all of the options the customer has. It is this contemporaneous, on the spot analysis that allows the loan officer to demonstrate competency and help guide the customer to a loan choice that really suits their needs. It is also true that the more time the borrower spends on the phone with the loan officer, the better the loan officer's chance of getting the loan.

### Pre-Qualification is the First Step in Needs Analysis

Proper Qualification of the borrower is tantamount to this process. The first thing the borrower needs to understand is the difference between pre-qualification and pre-approval.

A sales pitfall, that is not unique to loan officers, is the assumption that the borrower knows, or is familiar with, most of the information they will encounter as a borrower. In fact, no one likes to admit that they are

### HUD Rules Encourage Brokers to Transition to Lenders

Our Industry has waited over 2 years to see what HUD's final RESPA rule would look like. According to lawyers from Kirkpatrick & Lockhart, a Washington firm, on December 16, 2003, two days after Secretary Mel Martinez resigned and Deputy Secretary Alphonso Jackson replaced him, HUD sent a final RESPA rule to the Office of Management and Budget ("OMB"). OMB must take action by March 15, 2004

The proposed rule primarily would affect three areas: (1) mortgage broker compensation; (2) the GFE; and (3) the bundling of settlement services. First, it would require enhanced disclosure of mortgage broker compensation, including that: (1) lenders reflect their payments to brokers, including yield spread premiums, as **credits to the borrower**; (2) borrower payments to reduce interest rates equal the discount in loan price and appear as payments to the lender on the GFE/HUD-1; (3) brokers describe their services and inform borrowers that they do not offer loans from all funding sources or guarantee the lowest price; (4) brokers explain the trade-off between higher interest rates and lower up-front costs on the GFE; and (5) the GFE itemize direct and indirect broker and lender compensation and provide a total figure for the broker and lender.

Lenders are not subjected to this law the way brokers are, we expect a flood of brokers transitioning to lender status.

MortgageManuals.com provides the operational support and products to aid in this transition.

ignorant about something. This is particularly true of borrowers who have experienced the loan process several times. If you are a loan officer you know that it may take months or even years of constant exposure to the mortgage business to really understand the home financing options, and process. As a result the loan officer should treat every application or pre-qualification interview as an opportunity to educate the customer. This is true from the simplest detail, such as explaining decimal and fraction equivalency.

In the situation of the pre-qualification the physical calculations should be revealed to the borrower in the way that the loan officer is actually walking through the math him or herself.

Loan Officer Question	Description
Thank you for taking the time to speak with me. Are you purchasing or refinancing?	We want to identify the transaction type before we proceed. Generally, borrowers do not have to be pre-qualified to refinance. For refinances we will proceed to product selection questions shown below.
<p>Have you found a property yet?</p> <p><b>Yes</b></p> <ul style="list-style-type: none"> <li>• Sales Price? How much are you putting down?</li> <li>• How many points is the seller paying?</li> <li>• Any closing cost contributions?</li> <li>• What is the settlement date?</li> </ul> <p><b>No</b></p> <p>Do you understand that, if you do not have a property that you have a contract on, you can't really lock into an interest rate? This is still the best time to discuss financing options.</p>	<p><u>Yes</u> - If the borrower has found a property, identify whether they have written an offer, received offer acceptance.</p> <p><u>No</u> - If they have not found a property the borrower needs to understand that they will not be able to lock an interest rate in yet.</p>
The first step in making sure we select the best product for your needs is to make sure you are able to afford the payments. We call this pre-qualification. Do you have a moment to do this now? I really must insist on doing this because if there is a problem with obtaining financing I will be held accountable.	For purchases, we need to make sure the borrower can afford the property. The borrower may "push back" at this point. "I'm just trying to check interest rates" or, "I'm not ready to apply" are objections. You must insist on this step being completed. If the borrower completely refuses to accede, then utilize "reverse pre-qualifying" in the step below
<p>The first step in pre qualifying is to determine</p> <p>1.) <u>(If property is selected)</u> if your income is sufficient to afford the monthly payments</p> <ol style="list-style-type: none"> <li>a. Based upon your income your housing ratio is _____%</li> <li>b. Now analyzing your debts your total debt ratio is _____%</li> </ol> <p>2.) <u>(If property is not selected)</u> how much loan you can afford.</p> <ol style="list-style-type: none"> <li>a. Based upon this analysis you can afford \$____. We also need to make sure that your debts do not substantially change the computation.</li> <li>b. Based upon this you qualify for \$_____</li> </ol> <p>Does this information meet your expectations?</p>	<ol style="list-style-type: none"> <li>1.) If the borrower agrees, then you qualify him or her first to income, then total debts, sharing your results as you make the calculations. Obviously, if you have exact information for real estate taxes you will use those.</li> <li>2.) Upon completion you can discuss the benefits of pre-qualification, and offer a pre-qualification letter. <ol style="list-style-type: none"> <li>a. They use the letter to show the agent they are serious and suitable</li> <li>b. You can tailor the letter to meet the terms of any offer they make.</li> <li>c. The letter brands them to you</li> </ol> </li> <li>3.) The calculations may reveal that the ratios are too high for standard guidelines (28/36) or that the borrower cannot qualify for as large a loan as they want. This is EXACTLY what you WANT to reveal.</li> </ol>
<p><u>Satisfied</u> - Now that you know that your qualification profile is in line with the financing you are seeking you should understand that the pre-qualification letter is limited. Do you know what a Pre-Approval is?</p>	<p>Pre-Approval is an actual approval, where a pre-qualification is my opinion as a professional loan officer and does not include a review of your application documents by an underwriter. The benefits of pre-approval are</p> <ul style="list-style-type: none"> <li>• Write cash offer – better chance of getting house</li> <li>• Faster closing – all that's left is appraisal and title</li> <li>• Better Price – less uncertainty for seller</li> <li>• Financial Privacy – no seller disclosures</li> <li>• Less Hassles – negotiate your contract <b>after</b> the loan paperwork</li> </ul>
<p><u>Dissatisfied</u> - Since we have a shortfall with results of pre-qualification, you should know that we have several solutions for you to help you qualify for more. Would you like to discuss these?</p>	<p>Choices:</p> <ol style="list-style-type: none"> <li>1.) We can utilize lower start rate or easier qualifying loans to try and make the ratios fit guidelines better</li> <li>2.) Our Automated Underwriting is much more flexible and aggressive than standard ratios allow. If you apply with us, we can evaluate your case electronically. This can mean you can afford what you want without having to change programs</li> </ol>

<b>Loan Officer Question</b>	<b>Description</b>
I understand that you aren't ready to provide this information yet. I still need to make sure you are suitable for the transaction you are proposing. I can do this in a process we call <i>Reverse Qualification</i> . Do you mind if I do this now? What is the sales price you are looking at? What is the down payment? Based on this information you should have income of \$_____ a year to afford this property. Is this what you earn? Is it more or less?	Often, a borrower will resist pre qualification, or giving income and debt information thinking the loan officer is trying to trick him or her into revealing more information than they are ready to. This does not mean that the borrower should be allowed to avoid this segment. The reverse qualification allows the loan officer to expose qualification problems without getting income figures initially. If the borrower has sufficient income, you can proceed. However, if the borrower has more income than what is needed, the loan officer should demonstrate the maximum qualification first. If the borrower has less income than needed, follow the instructions for Dissatisfied above.

Now that the Pre-Qualification Phase of the Needs Analysis is complete, the loan officer can proceed to determine program suitability. You can't really proceed to a detailed needs analysis without this.

Today, most loan officers are abdicating this part of the process to Desktop Underwriter – by trying to get the borrower to volunteer enough information that the loan can be analyzed. If the borrower agrees, the outcome is still the same – too much information has been given unilaterally – that is from the borrower to the loan officer, so that the loan officer must stop the information gathering and needs analysis to give an interest rate quote. By not engaging the borrower in the calculations, neither the loan officer nor the borrower has a strong enough grasp of the options to make a decision beyond selecting the lowest priced provider for the product discussed for the purposes of the pre-qualification.

### *Discussion of Fixed Rate Options*

One of the reasons we want to lay out the broadest panoply of loan programs is to educate the customer, of course, but also to guide the customer away from a pure rate discussion. Interest rates are abstractions. Borrowers ask what the interest rate is because they have been trained to do this by the media. As loan officers we are conditioned to answer this question. The problem is

On any given day someone else will probably have a lower rate and/or point quote – or another loan officer will lie about the actual rate they offer. We are perpetuating the borrower's belief that asking about the interest rate is the most appropriate question. The borrower thinks if one rate is good a lower rate is better.

By comparing many different products and features the borrower will see that there are more important aspects of the comparison than the rate.

<b>Loan Officer Questions</b>	<b>Description</b>
Purchase - Do you currently own your home? If yes, what kind of loan do you currently have? What is your current payment? Are you going to sell your current home?	These are all situational questions designed to give you a sense of what the experience level of the borrower is. Most borrowers have some familiarity with a fixed rate regularly amortized loan.
Are you familiar with the different types of fixed rate loan? A fixed rate loan protects you against rates going up. Obviously, a 30-year loan would give you the longest protection, but had you considered a shorter term? Had you thought about a 25 year loan, 20, 15 Year. The interest savings can be substantial	Walking the customer through the monthly payments for the various maturities, and then showing the customer the interest savings over the life of the loan can move the borrower away from 30 year loans
One of the features of the fixed rate loan is the ability to pre-pay the principal in part. Do you understand how this works?	Illustrate the effect of a monthly prepayment on the term of the loan, and then show the savings over the life of the loan by multiplying the number of months the loan term is reduced by the monthly payment. Determining the balance at a time in the future, and determining the effect of a single prepayment can perform the same calculation.
This is similar to the bi-weekly mortgage, where instead of making twelve monthly payments, you make 26 bi-weekly payments amounting to an extra payment a year. Do you see how this works?	Since most lenders do not offer a true bi-weekly loan, explain the features of the bi-weekly plan, and that the borrower can achieve the same effect by making an extra payment a year.

Loan Officer Questions	Description
One of the features of a fixed rate loan is the ability to permanently discount the interest rate by paying points. Have you considered paying points? Are you going to be in this property at least _____ months? If not, you should really consider an alternative to a long term fixed rate because you are paying for insurance you don't need. Have you heard of a balloon loan?	Determine the breakeven period by comparing the cost upfront by the monthly savings. Use this as a leading question to determine whether the borrower is really suited towards a long term fixed rate, or whether they would be better served with a shorter-term loan – like a fixed balloon. If the borrower doesn't think they will be in the property for long enough to justify paying points, they should take a long term fixed rate loan.
If you were looking at a shorter-term stay, have you thought about which Adjustable Rate Mortgage might best suit your needs? Do you understand how ARMs work?	Describing the 4 components of the ARM, and explain the ARM interest rate change. To determine the appropriate maturity, perform an average interest rate comparison using the worst case scenario
If you were renting, and you are considering buying you may notice that the payment for the mortgage is significantly more than what you were paying in rent? Had you looked at the tax benefits of your proposed purchase?	Perform a tax savings comparison for the borrower showing them the after tax mortgage payment – or what the equivalent rental payment would be.

**Prescription Without Diagnosis is Malpractice**

We have often joked that the loan officer who quotes an interest rate without performing the pre-qualification and needs analysis is like the doctor who prescribes a medicine without seeing the patient. There are other pitfalls of not conducting a thorough needs analysis; the borrower may want a loan for a boat – do you offer boat loans. More often, the un-qualified borrower will take the rate quote the loan officer has given and find a property, write a contract and come back to you with the deal – and finds out, too late, that he or she doesn't qualify.

Once this exhaustive review is completed, you can quote interest rates and be comfortable in the knowledge that you have added value for the customer, had time to create a bond, and given them the best alternatives for their situation. If they end up shopping around again, then they will probably get what they deserve.



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