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New Research: Homebuyer "Preapproval" Letters Often Virtually Worthless

by Kenneth R. Harney

A new national research study confirms what many Realtors know only too well: "Preapproval" and "prequalification" letters presented by would-be buyers of homes often are faulty and cause problems later in the transaction.

Over half of all realty agents interviewed for a statistically-representative national poll said faulty lender or mortgage broker preapprovals are a major reason why sales transactions break down before closing.

The agents identified Internet-based lenders' preapprovals as the worst: fully 39 percent of their letters are "invalid" -- issued without any direct evaluation of the buyers' credit reports, income or assets. Roughly one out of three of all preapprovals issued by mortgage brokers also are based on the borrower's word, not on confirmed facts. One out of every five preapprovals issued by national lenders are in the same category.

The new study, conducted by Washington DC-based market research firm Campbell Communications and sponsored by the lending trade newsletter Inside Mortgage Finance, polled 1,717 realty agents around the country.

Tom Popik, a principal at Geosegment Systems Corp., designer of the statistical sample, said faulty or outright bogus preapprovals have been a growing issue for Realtors. In many markets, agents won't entertain offers from bidders who don't have some form of preapproval letter to demonstrate their financial capacity to afford and finance the house they want to buy.

Yet with growing numbers of mortgage customers using subprime and "alternative" mortgage financing, a rising number of preapproval letters are based on little more than "stated income," stated assets, and little or no check of credit files, said Popik.

When such bidders later apply for a mortgage, they often don't qualify for the rate or program or loan amount they need to swing the deal. At that point, said Popik, the sales transaction may jump off the tracks, with the buyer left searching for financing and the seller sitting with an unsold house that's been off the market for weeks.

John Marcell Jr., the incoming president of the California Association of Mortgage Brokers and an active Realtor, says preapprovals based on unconfirmed information "are totally useless." Functioning as a realty broker within his firm, Compass Realty of Upland, CA., Marcell says he never accepts a bidder's preapproval letter unless it contains guarantees from the issuing lender or loan officer that the information was indeed verified.

Otherwise, he said, "we go to the mortgage broker and say, look, we've got to see the W-2s, we've got to see the bank statements," and some indication of credit standing.

In today's hot markets, "we just don't have the time to waste looking at preapprovals based on thin air," said Marcell.

What should be in a preapproval: It needs to be explicit about what information has been checked and evaluated -- credit, employment, cash on hand, etc -- and what has not. And it must be explicit about whether the borrower has been preapproved to close on a mortgage in a specified maximum amount at a specified interest rate, subject only to an appraisal.



Why a Real Estate Appraisal?

There are many reasons why you need a real estate appraisal. Reduce property taxes, probate, estate planning, divorce settlements are some. The most common one is to obtain a mortgage. Most lenders are required by federal and state laws and current banking regulations to obtain an appraisal for most loans secured by real estate. As of Jan. 1, 1993, all appraisals made for mortgage loans from federally insured lenders and other federally related transactions must be made by a licensed or certified appraiser.

What is an Appraisal?

An appraisal is an objective supported opinion of value of an adequately described piece of property made by an appraiser who has sufficient knowledge, training and experience to accurately estimate its value. In this detailed and time consuming report, appraisers use comparable sales together with information about the property being appraised, its neighborhood and community along with the local and national economy, to support the appraised value. Look Objectively not Subjectively. The most important thing you can do when previewing is to look at the house as if empty: four walls, floors and a roof. Don't let the current owners' furniture and decor influence you.

Important Tip!

If you are buying a house with the owner carrying the paper (loan), it is well worth the cost to hire an appraiser to make sure you don't pay more than it is worth. For your protection many real estate agents will write in a purchase contract: this contract is contingent upon the property appraising for the sales price.

Thinking of buying or selling a home in the near future, please call

**ANTHONY
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for a personal interview and property assessment with no obligation.

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SEPTEMBER AT A GLANCE...



5 Labor Day

11 Grandparents Day

16 Mexican Independence Day

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How is Value Established?

The value of a house is based upon recent sales of the similar neighboring homes in the market as well as rentals and listing data. Ideally, appraisers want to use sales of properties of the same size, age, room count, condition and with similar amenities and external influences. This rarely happens though, so adjustments have to be made, based on what people will pay extra for.

Examples: extra square footage, bedrooms, fireplace, upgrading, parking facilities, swimming pool, lot size, location and so on. To help get a better picture, this information is entered on a form, a value for differences is established and comparisons are made to the subject property. A minimum of three verified closed sales with photos are required to establish a value.

Houses Appraise for More When:

- Well maintained inside and out.
- Located in a good school district.
- Additions are done with the proper building permits.
- Additions conform with and fit well into the existing house.
- Properties throughout the neighborhood are well maintained.
- Not over improved or the largest house on the block.
- Style of the house conforms with those in the neighborhood.
- Zoning changes are not expected or there is not a mixed use.

Remember: Location, location, location. You can change everything about a house except it's location.

What is Poor Location?

- Located on a feeder street.
- Under an airport flight path.
- In or near a gang territory.
- Center of night life activities.
- In a rundown block or neighborhood.
- Next to a school or school yard playground.
- Next to apartments or commercial property.
- In close proximity to a freeway, expressway or railroad.
- Next to a gas station, near a municipal garbage or toxic - waste dump.
- Odors from factories, farms and processing plants are - - routinely noticed.
- The city is affected by the closing of a major employer.

Think about Selling - When You are Buying.

Location is a big factor in a home's appraised value. This is most notably felt at the time you sell or refinance. What seems like a bargain when you buy might turn into a real headache when you try to sell. Drive around the neighborhood and note any adverse conditions. You may think you can live with something adverse for the price, but when it's time to sell you might find buyers won't.

Important Tip!

Adding onto your house = Always obtain a building permit. A 600 square foot addition built without a permit is given no value on an appraisal. When it is time to sell or refinance, the frustrations of the building permit process will be worth it. Always save copies of the final permit sign offs and keep with your house papers.

Buying a House with an Addition?

Verify that it was built with a permit prior to closing the sale. Don't just accept the sellers word. Get copies of the permits before final sign off. Should you want to refinance or sell at a later date, and the appraiser cannot verify the addition being permitted, no value should be given. The result: no new loan or worse . . . no sale.

Tip!

A one bedroom house or condominium doesn't appreciate as well and is harder to sell.

Work with An Agent

An advantage of working with a real estate agent is that they can provide you with sales information of similar properties to better guide you on how much to offer. Your agent can provide recent sales "comps" for similar homes in the neighborhood.

Finding the list prices is also important. Comparing the list prices with the sale prices tells you exactly what percentage of the list price sellers are getting.

**Contact me for a Free
Market Analysis of
your home.**

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