Demystifying the Mortgage Underwriting Process

By Anna Burgess Yang

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Submitting your mortgage application kicks off a flurry of activity behind the scenes. Your application will move into a process called underwriting, which can often feel like a black box. You'll receive requests for additional information, some of which may send you digging through your financial records or online banking.

During underwriting, your lender (the bank, credit union, or private lender) is working to determine your creditworthiness. Each lender has a risk tolerance based on factors such as your income or the amount of debt you have. The underwriter works closely with the loan officer to verify everything on your application and assess the risk.

You can expect a lot of back-and-forth during underwriting, either with your loan officer or directly with the underwriter. It can feel overwhelming! As you go through the process, it helps to understand why the underwriter makes certain requests.

Financial information the underwriter needs from you (and why)

Mortgage applications, no matter which lender you use, collect some standard information about your employment, your assets, and how much you're currently paying for your rent or existing mortgage. You may have even uploaded some documentation with your application.

The underwriter uses the information on your application and ensures that 1) it's accurate and 2) it meets the lender's underwriting standards. To do this, the underwriter will collect additional information from you.

A lender wants to know, first and foremost, that you can afford the monthly payments on your mortgage. This is primarily determined based on your income, your monthly payments on the new mortgage and your other debts, and your past history of making timely payments.

Verification of information

The underwriter will verify your employment based on your pay stubs. You'll need to provide copies of several recent pay stubs proving your income. If your loan has a co-applicant (such as a spouse), you'll provide paystubs for both parties. The underwriter may take an additional step and contact your employer to verify the validity of your pay stubs. Employers are used to doing this: your HR department can often fill out a form for the lender or confirm your annual salary.

If you're self-employed, most lenders will require copies of your filed tax returns for the past two years. Some lenders require tax returns regardless of self-employment.

Additional documentation may be required if you receive child support, alimony, or have other income, such as owning a rental property.

You'll also need proof of your assets, such as bank or brokerage account statements. This is a particularly important step if you're buying a home because the lender needs to verify that you have the funds for the down payment. The underwriter may request two or three months of statements.

If the underwriting process drags out (which can happen), the underwriter may request updated paystubs or bank statements later in the process. This is done to confirm that your information hasn't changed.

Credit check

The underwriter will pull your credit report, which shows your history of repaying your debts, as well as your credit score. Credit bureaus (Equifax, Experian, and Transunion) calculate your credit score based on a lot of factors, such as on-time payments, how much you owe, and how long you've been making payments.

Your credit report will also show all your existing debts, such as your credit cards, student loans, or car payments. Some debt is good: it shows you can make timely payments on your obligations. However, too much debt is considered a higher risk.

You'll only need to provide your social security number to the underwriter and the underwriter will obtain your credit report and review it. You're entitled to receive a copy of your credit report, so you can verify its accuracy. Mistakes can happen and information can be reported incorrectly to the credit bureaus, impacting your overall credit score.

The underwriter may ask you questions about your credit report. For example, your credit report shows inquiries from other lenders. Let's say you recently thought about buying a car, but decided not to go through with it. An inquiry from a car dealer would show up on your credit report. The underwriter will want to know if you took out a car loan that isn't appearing on your credit report yet.

If you have to explain anything on your credit report, the underwriter may ask you to provide a written explanation, which will be kept with your loan file.

Debt-to-income ratio

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The front-end ratio

Next, the underwriter will calculate your total housing payment as a percentage of your gross monthly income. The housing payment includes the principal and interest on the loan you're applying for, your real estate taxes, and your homeowner's insurance. It also includes any homeowner's association (HOA) fees, condo fees, and additional insurance, such as flood insurance or private mortgage insurance.

The total housing payment divided by your gross monthly income is expressed as a percentage. This is known as the front-end ratio, top ratio, or housing ratio.

For example, if you earn $7,500 monthly and your housing expenses are $1,500, your housing ratio is 20%.

The back-end ratio

The underwriter will then look at the total payments you're making on all loans and credit cards. This, combined with your housing payment, is your total monthly debt. If you pay child support or alimony, those are also included.

The underwriter is trying to determine if you have enough income to pay all of your obligations. If you have credit cards, it will include the minimum amount that you have to pay monthly. Your total obligations don't include living expenses like groceries, utilities, or child care.

Your total debt payment divided by your gross monthly income is known as the back-end ratio, bottom ratio, or total ratio.

In the same example, if your housing expenses are $1,500, and you have other debts of $1,000, your total debt is $2,500 per month. That, divided by your gross monthly income of $7,500 is a back-end ratio of 33%.

Lenders don't like either ratio to be too high. Ideal ratios are 28% for front-end and 36% for back-end, though some lenders will go higher.

Financial information the underwriter needs from third parties

While you're busy gathering everything the underwriter needs, some other activities are happening in the background.

The underwriter will request an appraisal and title insurance for your mortgage – both of which are necessary to fully assess the risk of the loan.

Property appraisal

A property appraisal is a third-party assessment of your home's value. The underwriter will request an appraisal from a lender-approved list of licensed appraisers in your area.

The appraiser will come to your home (or the home you're buying) and walk through it, noting its condition. Then, the appraiser will research similar homes nearby that have recently sold. These are known as "comparables." The appraiser will look for homes with a similar number of bedrooms or lot size. The age of the home and interior finishes can also impact the appraisal.

After the appraiser has done research, a property appraisal will be submitted to the lender with your home's appraised value. Each lender has a maximum loan amount based on the home's value, known as the loan-to-value (LTV). For example, if the lender's maximum LTV is 80% and the appraised value is $400,000, your loan cannot exceed $320,000.

The appraisal confirms that your requested loan amount is within the lender's limits.

Title search and insurance

When you take out a home loan, the lender files a lien on your property (which is the mortgage). If, for some reason, you stopped paying on the loan, the lender can start a foreclosure process and take possession of the property.

Your lender is one of many entities that can file liens and start foreclosure proceedings. Government entities can file liens for unpaid taxes. Contractors can file liens for unpaid invoices related to work on the property. Some homeowners also have multiple mortgages (such as home equity line of credit).

The entity to file a lien first takes priority if there is a claim against a property. The value of the lien doesn't matter. Lenders want to verify that they are in "first" position, so that they have first priority in the event that they need to start foreclosure proceedings. This verification is known as a title search.

A title company will search public records for any outstanding liens. The title company will then issue the search results to the lender. If there are any liens, the lender will either work with you to clear them up or may deny the loan.

The title company will then issue title insurance once the loan has closed and the new mortgage is filed. If the title company made a mistake and missed something in the search, the title insurance protects the lender by covering any losses that the lender might incur.

What happens next

The underwriting process can take several weeks to several months, depending on how quickly the underwriter can collect the information. The lender must also wait for the appraisal and title search to be completed.

Once the lender reviews your financial information, they will approve or deny the loan. The lender may also issue a conditional approval, meaning you must meet certain conditions before the loan can be fully approved. The conditions might be additional documentation or a letter explaining something on your credit report. The loan would still need to meet appraisal and title insurance requirements, even if you're approved based on your financial information.

It can feel like a long haul to get through underwriting. Underwriters are very detailed and will pour over your documentation, asking lots of questions. The faster you reply, the faster you can complete this step and move on to closing on your new loan.

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