

Pre-Qualified Vs. Pre-Approved - What's The Difference?

By Brian O'Connell^[1] on February 26, 2009

Ralph Waldo Emerson, American essayist and poet, once said that the future belongs to those who prepare for it. This is sage advice for home buyers who need to lay the necessary groundwork to buy the home of their dreams.

Without good preparation, many buyers get lulled into the mistaken notion that if a lender pre-qualifies^[2] them for a mortgage^[3] this means that they have been pre-approved^[4] for a home loan. Unfortunately, there's a world of difference between these two terms. If you've ever been confused by the two, we'll bring you up to speed on how these terms differ - and why a misunderstanding can mean disaster for borrowers.

The Skinny on Pre-Qualified

Getting pre-qualified is the initial step in the mortgage process, and it's generally fairly simple. You supply a bank or lender with your overall financial picture, including your debt, income and assets. After evaluating this information, a lender can give you an idea of the mortgage amount for which you qualify. Pre-qualification can be done over the phone or on the internet, and there is usually no cost involved. Loan pre-qualification does *not* include an analysis of your credit report^[5] or an in-depth look at your ability to purchase a home.

The initial pre-qualification step allows you to discuss any goals or needs you may have regarding your mortgage with your lender. At this point, a lender can explain your various mortgage options and recommend the type that might be best suited to your situation. (For more, see *Mortgages: How Much Can You Afford*^[6].)

Because it's a quick procedure, and based only on the information you provide to the lender, your pre-qualified amount is not a sure thing; it's just the amount for which you might expect to be approved. For this reason, a pre-qualified buyer doesn't carry

the same weight as a pre-approved buyer who has been more thoroughly investigated. (To read more, see *Shopping For A Mortgage*^[7].)

The Skinny on Pre-Approved

Getting pre-approved is the next step, and it tends to be much more involved. You'll complete an official mortgage application (and usually pay an application fee), and then supply the lender with the necessary documentation to perform an extensive check on your financial background and current credit rating^[8]. (Typically at this stage, you will not have found a house yet, so any reference to "property" on the application will be left blank). From this, the lender can tell you the specific mortgage amount for which you are approved. You'll also have a better idea of the interest rate you will be charged on the loan and, in some cases, you might be able to lock-in a specific rate.

With pre-approval, you will receive a conditional commitment in writing for an exact loan amount, allowing you to look for a home at or below that price level. Obviously, this puts you at an advantage when dealing with a potential seller, as he or she will know you're one step closer to obtaining an actual mortgage.

The other advantage of completing both of these steps - pre-qualification *and* pre-approval - before you start to look for a home is that you'll know in advance how much you can afford. This way, you don't waste time with guessing or looking at properties that are beyond your means. Getting pre-approved for a mortgage also enables you to move quickly when you find the perfect place. When you make an offer, it won't be contingent on obtaining financing, which can save you valuable time. In a competitive market, this lets the seller know that your offer is serious - and could prevent you from losing out to another potential buyer who already has financing arranged.

Once you have found the right house for you, you'll fill in the appropriate details and your pre-approval will become a complete application.

Getting Committed

The final step in the process is what's called a "loan commitment"^[9], which is only issued by a bank when it has approved you, the borrower, and the house in question. This means the home should be appraised^[10] at or above the sales price. The bank may also require more information if the appraiser brings up anything he or she feels should be investigated (i.e. structural problems, accessibility issues, outstanding liens^[11] or litigation in progress). Your income and credit profile will be checked once again to

ensure nothing has changed since the initial approval. (For more, see *Understanding Your Mortgage*^[12].)

A loan commitment letter is issued only when the bank is certain it will lend, so the commitment date on your purchase contract should be closer to closing than to the date of your offer. (The seller can ask to see that letter as soon as the date has passed, so beware of anyone who tries to put an early commitment date into your contract).

One Last Word

Be warned. Pre-approved and pre-qualified are not the same thing, so don't assume that the bank will provide your loan until you have the former. The mistake could cost you your new home!

1. <http://www.investopedia.com/contributors/198>
2. <http://www.investopedia.com/terms/p/prequalification.asp>
3. <http://www.investopedia.com/terms/m/mortgage.asp>
4. <http://www.investopedia.com/terms/p/preapproval.asp>
5. <http://www.investopedia.com/terms/c/creditreport.asp>
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