Pre-qualified vs. Pre-approved

As you begin shopping around for a home loan you will most likely run into the terms "pre-qualified" and "pre-approved". There are some key differences between these two terms that can be confusing to home buyers, and it is important to know what each means.

Pre-qualification is a non-binding agreement between the bank and the borrower where the bank has estimated how much money it could loan you based on your income, assets, liabilities and expenses. Typically the lender will not investigate your credit or ask for documentation to verify your income or debts. While this means it is easier to get pre-qualified than pre-approved it is much riskier since the agreement is not binding and there is a chance the bank won't approve your loan after you have made an offer on a house. It can also mean that you could lose out on your dream home because a seller will accept an offer from a pre-approved buyer than a pre-qualified buyer.

Pre-approval means that the bank has reviewed written evidence of your income, assets, expenses, credit and liabilities and has agreed in a time-limited agreement to fund your mortgage. Pre-approval is much preferred to pre-qualification because it allows you to shop for a home as if you were a cash buyer. It also gives you the ability to negotiate a sale price, especially if the seller cannot find another pre-approved or cash buyer for the home.

Typically, to give a pre-approval a bank will review your w-2's (or tax returns if you are self employed), will verify your employment, and will pull a copy of your credit report. Because the bank will be reviewing your credit report it is important that you know what is in there and do what you can to remove any negative notations before applying for a loan. For advice on how to proceed with this please read our article on improving your credit score