Mortgage

Know differences between prequalification, preapproval

Mortgage market
Jim DeBoth

A good way to get ready for the house hunting and buying process is to get prequalified for your home loan. A better way is to get preapproved. Many people assume that the two terms are the same and can be used interchangeably, but this is not true.

"It's a qualitative difference," explains Doug Duncan, chief economist and a senior vice president for the Mortgage Bankers Association — an industry trade association. "If you are preapproved, you are qualified. If you're prequalified, you are not necessarily approved."

Preapproval is a higher degree of readiness than prequalification. Telling real estate agents with whom you are dealing that you are preapproved may help close a deal, or at least convince a seller that you are a serious buyer.

"You don't have to tell the amount for which you are approved," he adds.

As we'll see later, there are a number of reasons for keeping that information to yourself.

"Being prequalified means that a lender has taken a quick look at the data you have provided and said, based on that data, that you will likely be approved for a home loan of a certain size," Duncan said. "The reason that the approval is considered only likely is that the lender has not checked any of your financial information to make sure that it is accurate. The lender is going only by the information you supply. Being preapproved, however, means that a lender has assessed your qualifications. The lender has actually checked your information and said that you are approved to take this loan out now."

The benefit of getting preapproved is that you know exactly how much of a home loan you can get even before you go out house hunting. This means you'll know which houses are in your price range and which ones are not.

Duncan adds that just because you know what your limits are — the maximum amount of the loan you are approved for plus whatever down payment you can make — doesn't mean that you have to borrow that much. You may end up with a smaller house. You don't need to borrow your approved limit.

It's obviously easier to get prequalified than it is to get preapproved. When you talk to a lender, the lender asks how much you make, how much you owe, and what credit cards you have. The lender then makes some quick calculations and right there on the spot, you are prequalified. As long as all the information you have given is accurate and there are no bad marks on your credit history or other complications — like having a lien against you, or being self-employed — you can get a loan for a set figure.

The problem here is that the borrower might not remember everything correctly. We all forget things from time to time.

Getting preapproved, however, takes a bit more time, but it is a lot more binding on the part of the lender. The lender will check your credit report and might also want to verify your income and expenses.

"It is a more formal process," explains Duncan. "In fact, the lender is doing everything that would be done if you were actually asking for a loan."

Duncan says that getting preapproved is in the best interest of the Realtor because it takes a lot of hassle out of the process. The deal will go more quickly and more smoothly. It's in the best interest of the consumer because you are not dependent on the Realtor for advice on getting the loan.

Talk to the real estate agent about real estate. Talk to lenders about loans. It's always best to talk to more than one lender. The big difference between being prequalified and being preapproved is what happens when you find the house you want and formally apply for the loan.

If you're prequalified, then you are starting from scratch. You have to supply all the normal information and the lender has to check it out. The amount of time it takes to get it approved will be based on your own credit history and finances.

"If you have been preapproved, getting the loan formally approved could take only a few minutes since the only information the lender needs in terms of your application is the amount you need to borrow," Duncan said.

If you want to borrow more than the original preapproved amount, however, it will take more time, and the terms of the loan could be different. A lender might, for example, have been willing to loan you $200,000 at today's rate, but if you want $220,000, the rate might increase a fraction, or the lender might ask for an extra point.

Getting preapproved does not mean that the deal will close immediately, however. Even if you are preapproved and the loan falls within the approved amount, the lender still has to have the property appraised and do all the other paperwork that is tied to the property itself: the title search and such.

Duncan has one extra bit of advice. If you have been preapproved for a specific amount, let's say $200,000, you might not want to let either the real estate agent or the seller know about it during either the searching or negotiation processes.

In terms of the house-hunting process, if you tell an agent you can afford a $200,000 home, the agent is not going to show you much — if anything — that costs less. And if the owners know that you are capable of going to $200,000, they will be less likely to drop the price. It's better to tell them that you are preapproved, which tells them that you are a serious buyer and that this could be a quick deal — and then quote the figure you are willing to pay, which is not always the one they are asking.

"It's like when the car salesman asks you how much you are willing to spend," Duncan observes. "You can be pretty sure that you'll end up spending that much. One of the main purposes of getting preapproved is the sense of security that comes from knowing just how much you can spend — not how much you have to."

Jim DeBoth is president of Interest.com — a national publisher of mortgage rates and information. Consumers can view additional mortgage information on the Internet (www.interest.com).