

Are You Really Pre-Approved for a Mortgage?

Most home buyers will hear these terms during their search for a home:

- Pre-Qualified
- Pre-Approved
- Loan Commitment

Sometimes even real estate agents are confused by the terms, so it's no wonder that home buyers and sellers are, too. Although related, the three terms each signify a different level of approval from a lender.

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Pre-Qualified

You can be pre-qualified by a lender, by an agent, by yourself. The term means that someone has taken a general look at your income and expenses and plugged them in to a debt-to-income ratio formula. Loan pre-qualification does *not* include an analysis of your credit report or an in-depth look at your potential to buy a home.

Bottom Line: Pre-qualifying yourself before you start looking for a home will give you a *general* idea of the price range you can afford.

Pre-Approval

When you are pre-approved, it means a lender has looked closely at both your credit report and your income. The lender will tell you the maximum amount of loan they will offer, and which loan programs you qualify for. You'll also have a better idea about your interest rate, or you might lock-in a specific rate.

Bottom Line: Now you can go shopping for a home with confidence about your buying power--but it still doesn't mean the bank will approve the loan. Your income and credit report will be checked again before closing, and the home itself must be approved.

Loan Commitment

The bank will not issue a loan commitment until it has approved both the house and you. The home appraisal must meet the lender's guidelines--usually meaning the home must appraise at or higher than the sales price.

The bank may require more information if the appraiser mentions anything the bank feels should be checked.

- A comment such as "observed a crack in the foundation and basement appears wet," will raise a red flag to the lender--and likely generate a structural inspection (which you must pay for unless the seller agrees to share or absorb the expense).
- If the bank reads "home accessible only with a 4-wheel drive vehicle," you can be sure they'll want to know more about ongoing road maintenance. Where I work, we have thousands of mountain roads that are maintained by groups of home owners. Many lenders verify that there's a written road maintenance agreement before they will lend. Other banks don't seem to care as long as no derogatory comments are made about the road.

Other things that affect a loan commitment:

- The home's title must be cloud-free, meaning there are no problems associated with it (no outstanding liens that can't be paid at closing; no right-of-way problems; no litigation in progress, etc.).
- Your credit profile will be checked again to make sure it hasn't changed in a negative way.

Bottom Line: The loan commitment letter is issued only when the bank is sure it will lend, so the commitment date on your contract to purchase should normally be closer to closing than to the date you make the offer. The home seller can demand to see that letter as soon as the date has passed, so question anyone who tries to insert an early commitment date in your contract.

Since terminology sometimes differs in different regions, ask your lender to explain all of the terms associated with their approval process.