

# Finance Glossary

Here are some helpful definitions that may assist you during the lending process.

## A

### **Adjustable Rate Mortgage (ARM):**

Based on a pre-determined schedule, the interest rate on an ARM fluctuates according to certain movements in the financial market. The "adjustable period" is the length of time between interest rate changes on an ARM. ARM's offer attractive initial interest rates that are usually lower than current fixed rates; however, the rate can change up or down as market conditions fluctuate. Interest rate changes are usually based on an index, for example, the one-year Treasury index plus a margin, and payments are subject to a limit or "cap" at each adjustment period. There is usually a limit on how much the rate may increase or decrease over the entire term of the loan.

### **Amortization:**

Reduction of debt by regular payments of principal and interest in equal installments, sufficient to payoff a loan by maturity.

### **Annual Percentage Rate (APR):**

Cost of credit the consumer pays each year throughout the loan duration. The APR includes interest, service charges, points, loan fees, mortgage insurance, and other items.

### **Appraisal:**

Evaluation of the current market value of property. The person who performs the evaluation is the "appraiser."

### **Assessed Valuation:**

Dollar value assigned to a property for the purpose of assessing taxes.

## B

### **Balloon Mortgages:**

Require repayment in full at the end of a specified period of time, usually 5 or 7 years, but the monthly payments are typically based on a 30-year term.

### **Balloon Payment:**

Final payment on some mortgage loans or other loan types that is substantially larger than the preceding payments.

**Borrower:**

Person(s) who receives funds in the form of a loan and holds responsibility for repaying the loan, including interest.

**Buydown:**

Subsidy that reduces the monthly payments on a mortgage loan. The buydown may be paid by the seller.

**C**

**Cap:**

The limit on how much an interest rate or payment can change on an adjustable rate loan. The cap may occur at specific adjustment dates, or it may be set over the life of the loan.

**CC&R's:**

The covenants, conditions, and restrictions document that states the use, requirements, and restrictions of property.

**Closing Costs:**

Expenses paid at closing, which can include fees for obtaining a mortgage, transferring the real estate title, lawyer fees, survey charges, title search and insurance costs, and costs to file the deed and mortgage.

**Collateral:**

Property pledged to a lender until a loan is repaid. For example, real estate property is the collateral for a mortgage loan. If the borrower defaults, the lender has the legal right to seize the collateral and sell it to payoff the loan.

**Commitment:**

Agreement between a lender and borrower when money will be loaned at some future date. The lender holds available credit open for the borrower. The borrower is required to comply with certain conditions when he is ready to get the loan.

**Contingency:**

Condition that must be met before a contract is binding.

**Conventional Loan:**

Residential mortgage loan with a fixed rate and term, payable in fixed monthly installments usually over a period of 30 years or less. A conventional loan is not insured by a government agency.

**Conversion Clause:**

Provision in some adjustable rate mortgages that permit the mortgagor to change the loan to a fixed rate. An extra charge may be incurred for the conversion feature.

**Convertible Loan:**

Loan which permits the mortgagor to change from an ARM to a fixed rate loan.

**CRV (Certificate of Reasonable Value):**

Document that establishes the maximum value and loan amount for a VA or FHA guaranteed mortgage.

**Credit Rating:**

Evaluation of an individual's credit history.

**Credit Report:**

Report with the credit rating that provides credit information on the prospective buyer.

**D****Debt-to-Income Ratio:**

An individual's total liabilities measured against their income. This ratio is used by a lender to assess a borrower for a mortgage loan.

**Deductible:**

Portion of an insurance claim which the policy owner is required to pay prior to the insurance company making a payout.

**Deductibles:**

Term used to describe items that get special tax treatment when filing income tax.

**Deed:**

A seller transfers ownership of property to the new owner through a deed, which includes a legal description of the property.

**Down Payment:**

The up-front cash the buyer pays toward the purchase of a home. Difference between the mortgage amount and the sale price.

**E**

**Earnest Money:**

Deposit toward the down payment delivered by the purchaser to the seller or escrow agent to bind the real estate sale and is usually non-refundable, except in limited circumstances.

**Earnest Money Contracts:**

Also a "sales contract" or "earnest money contract." States that a seller agrees to sell certain real estate and a purchaser is buying it under the terms and conditions stated in the document.

**Escrow:**

Documents or funds held by a third party until conditions of a contract are met.

**Escrow Account:**

Account into which the borrower's monies are deposited so that the lender can make periodic payments on items such as taxes, hazard insurance, and mortgage insurance premiums. The lender holds the funds in a trust and pays these items as they become due.

**F**

**Federal Housing Administration (FHA):**

Federal agency that insures private lenders against loss on residential mortgages. FHA provides mortgages that have lower down payment requirements than conventional loans. The agency is a division of the U.S. Department of Housing and Urban Development.

**Fixed-Rate Loans:**

Provide competitive interest rates that remain constant through the life of the loan and offer the security of fixed monthly payments throughout the loan term. Unlike an ARM, the interest rate never fluctuates.

**G**

**Graduated Payment Mortgage:**

Fixed rate, fixed schedule loan that starts with lower payments. Payments increase annually for a few years and then change again to a fixed rate.

**Government Loans:**

Are insured or guaranteed by a federal government agency and include FHA (Federal Housing Administration) and VA (Veterans Affairs) loan programs.

**H****Hazard Insurance:**

Insurance policy that pays for losses on a home resulting from certain hazards, such as fire damage.

**I****Index:**

An indicator upon which interest rate changes may be based, i.e., one-year Treasury bills, cost of funds index, etc.

**Interest:**

Cost of borrowed money, usually expressed as an annual percentage rate of the loan.

**L****Loan-to-Value Ratio (LTV):**

Loan amount expressed as a percentage of the market value of a property. For example, a loan for \$85,000 on a home that costs \$100,000, has an LTV of 85%.

**Lock-In Rate:**

When a lender makes a loan commitment at a pre-set rate, they are locking in, or guaranteeing, that rate for a certain period of time (such as 45, 60 or 90 days). The lender may charge a fee for a lock-in rate.

**M****Margin:**

Set number of percentage points that a lender adds to the index to calculate an adjustable rate mortgage's interest rate at each adjustment time.

**Mortgage:**

Debt instrument in which a borrower (mortgagor) gives the lender (mortgagee) a lien on property as security for the repayment of a loan. The borrower has use of the property, and the lien is removed when the obligation is fully paid.

**Mortgage Company:**

Company that originates mortgage loans for homebuyers. The mortgage company may sell its mortgages to other investors.

**Mortgage Insurance:**

If a borrower fails to fully repay a loan, mortgage insurance pays the lender a portion of the financial loss. The protection offered by mortgage insurance can significantly reduce the amount required for down payment.

**Mortgage Life Insurance:**

This insurance automatically pays the outstanding debt on a mortgage if the mortgagor dies. As the mortgage balance decreases, the amount of insurance coverage also declines.

**Mortgagee:**

Financial institution lending money for a mortgage loan. The property being purchased serves as security for the loan.

**Mortgagor:**

Person who borrows money for a mortgage loan.

**N**

**No Doc Loan:**

Some loans offered by mortgage companies do not require any income or employment documentation. These loans usually require a higher interest rate.

**O**

**Origination Fee:**

Fee that pays for the work required to prepare and service a mortgage application. The fee is usually 1% of the loan amount.

## **P**

### **P.I.T.I.:**

Principal, interest, taxes, and insurance are the four major components of a mortgage payment.

### **Points:**

Up-front fee charged by the lender, separate from interest. A point is usually 1% of the loan amount. "Points" or "discount points" are a one-time fee charged by the lender. They are payable in full at Settlement.

### **Prepays:**

Payment of a portion of annual real estate taxes and insurance premiums due at Settlement.

### **Prepayment Penalty:**

Fee paid by a borrower when a mortgage that doesn't have a prepayment clause is repaid before its scheduled maturity. Not all mortgages carry a prepayment penalty. To find out if your loan has this penalty, ask your mortgage company.

### **Principal:**

Face amount of a loan minus interest. Principal is also the remaining balance of a loan minus interest.

### **Private Mortgage Insurance (PMI):**

If the borrower defaults on a mortgage, PMI protects the lender against loss. PMI is handled by a private insurance company.

## **R**

### **Real Estate Settlement Procedures Act (RESPA):**

Federal law requiring lenders to provide information about known or estimated Settlement costs to home mortgage borrowers.

## **S**

### **Servicer:**

The loan Servicer is responsible for collecting payments from the mortgagor. Frequently, the servicing is "released" to a company specializing in loan servicing. As a result, the homebuyer may be required to send his/her mortgage payment to a company other than the one from which the mortgage was originally obtained.

**Settlement:**

Also known as "closing" or "close of escrow," this is the final step where ownership of the home is transferred. All obligations and legal procedures are fulfilled, including delivery of a deed, financial adjustments, signing of promissory note, and disbursement of funds for closing the sale or loan transaction.

**Settlement or Escrow Agent Attorney:**

The settlement agent or attorney oversees that all documents pertaining to the sale of a home have been completed properly. At settlement, the agent explains the documents to the buyer and seller, obtains signatures, and records the documents.

**Settlement Statement:**

Also called "HUD-1 Settlement Statement." Financial disclosure statement giving an account for all funds received and expected at Settlement.

**Single-Adjustment Loans:**

Sometimes marketed under the name "Two-step(r)," have a fixed rate for 5 or 7 years and then adjust to a new interest rate for the remaining 25 or 23 years.

**T**

**Title Insurance:**

Provides financial protection for the mortgagee or mortgagor against losses in the event of defects in the real estate title.

**V**

**Veterans Administration (VA):**

Guarantees home mortgage loans for honorably discharged veterans or their surviving spouses, reducing risk for all or part of the purchase price.