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Glossary of Finance

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Terms mostly associated with Finance and Loans listed in green.

- A -

Acceleration Clause - A provision of a mortgage or note which provides that the entire outstanding balance will become due and payable in the event of default.

Accrued Interest - Accrue; to grow; to be added to. Accrued interest is interest that has been earned but not due and payable.

ARM (Adjustable Rate Mortgage) - A mortgage in which the interest rate is adjusted periodically, based on the movement of a financial index. The interest rate charged is calculated based on an Index (which changes over time + Margin (which remains constant during the loan term). The result of adding those two factors together is known as the "fully indexed rate" which is charged if the interest "rate cap" for that period is not exceeded. Traditional ARMs have initial "teaser" interest rates that are much lower than the fully indexed rate, and usually have initial adjustments after 6 or 12 months. This differs from "short term fixed rate ARMS" which have initial rates of 3, 5, 7 or 10 years before the rate is adjusted.

Amortization - Repayment of loan by periodic installments (payments). With loans other than "negative amortization" or "interest only" loans, a portion of the payment is the interest charged and the payment portion above the interest earned will be applied to the principal balance. As these payment portions are applied to the principal balance, the balance declines and for a "fully amortized loan" – the principal balance will be zero at the end of the loan term.

APR (Annual Percentage Rate) - The annual percentage rate refers to the total cost of the loan, expressed as a yearly rate. It is a standard and required method of disclosing to consumers the effective costs of obtaining financing (that is, the note rate plus certain closing plus "points"). This enables consumers to more easily compare the total const of borrowing money. The actual rate charged on a loan is known as the "note rate" and will always be lower or equal to the annual percentages rate.

Application Fee - That part of the closing costs pre-paid to the lender at time of application to cover initial expenses.

Appraisal - An estimate of a property's value by a professional appraiser that is expert at estimating property values. Appraisals are usually conducted by using either a capitalization (income) approach, a cost to build the property new (cost approach) – or more often by using a comparable sales (market) approach - The estimated value pertains to the value of a property as of a given date. Most lenders require appraisals before granting a loan to a borrower, and most .

Appraisal by Market Approach (Sales Comparison Approach) – The subject property is compared with comparable properties and then adjustments are made to how the subject property compares to the comparable properties. Adjustment categories include size, bedroom and bathroom count, age and condition of properties, location of properties, views, amenities, etc. .

Appraisal by Cost Approach - Adding together all parts of a property separately appraised to form a whole: e.g., value of the land considered as vacant added to the cost of reproduction of the building, less depreciation.

Appraisal by Income Approach – Estimated income, expenses and net operating income (profit) are determined for the subject property by using actual rent rolls if available and by comparing income streams of similar properties to the subject property, adjustments to net income can be made. Estimated net income (profit) on the subject property is then used with average capitalization rates of similar properties in order to determine an estimated value.

Assets (liquid asset) – As it relates to real estate or finance, a liquid asset is anything which has a cash value. Some examples of liquid assets include: Checking, savings and certificates of deposit (CD) accounts, 401(k) and IRA accounts, Bonds, Mutual funds, etc. Lenders will verify assets to ensure the borrower has enough to cover the down payment and closing costs, plus enough for reserves to cover the mortgage payments for a certain amount of time. Gifts from family members are often considered by lenders to be liquid assets.

Assumption of Mortgage - The taking of title to property by a grantee, wherein the grantee assumes liability for payment of an existing note or bond secured by a mortgage against a property and becomes personally liable for the payment of such mortgage debt. The purchaser takes over mortgage payments for the balance of the loan, assuming primary liability. Unless specifically released by the lender, the seller (borrower on the previous loan) remains secondarily liable.

- B -

Balloon Payment Mortgage - A mortgage with periodic payments that do not fully amortize the loan. The outstanding balance of the mortgage is due in a lump sum at the end of the term. Balloon loan types include interest-only payments and payments which cover interest and principal during the initial period.

Blanket Mortgage - A mortgage covering more than one property. A blanket mortgage is often used for subdivision financing.

Bond - The evidence of a personal debt which is secured by a mortgage or other lien on real estate.

Bridge Loan (Interim Financing) - A short-term loan secured by the equity in an as-yet-unsold house, with the funds to be used for a down payment and/or closing costs on a new house. There is no payment of principal until the house is sold or the end of the loan term, whichever comes first. Interest payments may or may not be deferred until the house is sold.

Building Loan Agreement - An agreement whereby the lender advances money to an owner primarily in the erection of buildings. Such funds are commonly advanced in installments as the structure is completed.

- C -

Cap (interest rate) - The maximum interest rate increase allowable on an adjustable rate mortgage. Does not result in negative amortization. See Negative amortization.

Cap (payment rate) - The maximum payment amount increase allowable on an adjustable rate mortgage. May result in negative amortization. See Negative amortization.

Closing Costs - Expenses (over and above the price of the property) incurred by buyers and sellers in transferring ownership of a property. Also called "settlement costs." Common closing costs include appraisal fees, loan origination points, lender fees, title insurance, escrow company fees and building inspection or pest inspection fees, and prorated charges for interest, property tax and property insurance. . The specific costs you'll need to cover depend on your location and property type. Closing costs usually range from 2% – 5% of the total loan amount (not including origination points).

Closing Disclosure - Replaces the HUD-1 Settlement Statement. It is the final disclosure generated by the lender for use in comparing the Loan Estimate against the final costs and fees for the loan scenario. It includes the loan amount, interest rate, closing costs and credits associated with the transaction. Lenders are required to provide the Closing Disclosure to all borrowers at least 3 days before final loan documents can be signed.

Closing Statement - A financial disclosure giving an account of all funds received and expected at closing, including the escrow deposit for taxes, hazard insurance and mortgage insurance for the escrow account.

Commitment - An agreement, pledge or promise or affirmation agreement. Frequently in writing, between a lender and a borrower to loan money at a future date, subject to certain conditions.

Conforming loan – Loan which conforms to Fannie Mae and Feddie Mac underwriting guidelines. Such guidelines include maximum loan amount depending on property type and property location, occupancy requirements, debt to income ratios, credit history, asset and reserve requirements and property condition and use requirements,.

Conventional Mortgage - Any mortgage loan that is not insured by FHA, guaranteed by VA, of funded by a government authorized bond sale or grant.

Credit Repair – the process of improving a borrower's credit score. This can be done by the borrower themselves or through an agency which specializes in that service. Typically credit repairs on done to correct information that was incorrectly reported by creditor9s) to the credit buraus. Such corrections can improve borrower's credit scores.

Credit Report (and Credit Scores) - The report to a prospective lender on the credit standing of a prospective borrower. The report identifies current loan and revolving balances owed by the borrower and credit terms of previous loans or revolving accounts. Can also show collection accounts, tax liens, judgements etc. Most credit reports can include credit scores assigned to each borrower by one of three credit reporting agencies for the perceived risk of that borrower (the higher the credit score, generally the better loan terms offered by a new lender).

- D -

Debt Capital - Money borrowed for a particular business purpose.

Debt Ratios (Debt to Income Ratios): Guidelines used by lenders to determine how much of a loan a home buyer qualifies for. Often referred to as debt-to-income ratios (or DTI). The DTI is equal to borrowers Total fixed (recurring) monthly debts on credit report plus proposed mortgage payments (piti) divided by Total gross monthly income for all borrowers. Typical maximum debt ratios allowed for conventional conforming financing is 43-49%, and DTI of 38-45% for most non-conforming financing.

Debt Service - Annual amount to be paid by a debtor on an obligation to repay borrowed money.

Default - Failure to fulfill a duty or promise, or to discharge an obligation; omission or failure to perform any acts. As it relates to a real estate loan, such a state may lead to foreclosure.

Defeasance Clause - The clause in a mortgage that permits the mortgagor to redeem his or her property upon the payment of the obligations to the mortgagee.

Deficiency Judgment - A judgment given when the security for a loan does not entirely satisfy the debt upon its default.

Discount Points (points)- Optional closing costs paid "buy" a lower interest rate. One discount point is equal to 1% of your loan amount and on average, one discount point can buy a 30-year fixed rate down by .25%. Points are paid at closing.

Documentary Evidence - Evidence in the form of written or printed papers.

Down Payment: The difference between the sale price of a property and the mortgage amount. Many loan programs require 20% down payment unless Private Mortgage Insurance (PMI) is allowed for that program. Loan programs are available with down payments as low as 3% (FHA loan) or 5% (conventional conforming loan). The down payment is paid at closing, less any amount already paid for the earnest money deposit.

- E -

Encumbrance (also Incumbrance) - Any right to or interest in the land interfering with its use or transfer, or subjecting it to an obligation. Examples are outstanding mortgages, easement rights or unpaid property taxes.

Equity - The value which the owner has in real estate over and above the mortgages against it. When the mortgage and all other debts against the property are paid in full, the owner has 100% equity in his property.

Equity Loan - Junior loan based on a percentage of the equity.

Escrow Funds (Impound Account) - Funds and/or deed left in trust to a third party. Generally, a portion of the monthly mortgage payment is held in escrow by the lender to pay for taxes, hazard insurance and yearly mortgage insurance premiums.

Extension Agreement - An agreement which extends the life of a mortgage to a later date. Can also refer to extending purchase contingencies such as: loan contingency, appraisal contingency, inspection contingency.

- F -

Fair Lending: Federal law which requires lenders to not discriminate (deny loans or offer worse loan terms) to minority groups, or those who live in less wealthy areas.

First Mortgage - A mortgage that has a primary lien against a property.

Fixed-Rate Mortgage - A mortgage with an interest rate and monthly payments that remain constant over the life of the loan. Borrowers often choose fixed rate mortgages for the stability provided by the constant monthly payments.

Foreclosure - A legal procedure whereby property pledged as security for a debt is sold to pay the debt in the event of default in payments or terms by a borrower.

- G -

Grace Period - Additional time allowed to perform an act or make a payment before a default occurs.

Graduated Payment Mortgage (GPM): A fixed rate loan with monthly payments that start low, increasing by a fixed amount for a specific number of years. After that period, the payments typically remain constant for the duration of the loan.

- H -

HUD-1 Form Closing Statement (Real Estate Settlement Statement): A breakdown of transaction costs for Buyer and/or Seller. For purchase transactions, includes sales price, earnest money deposit, fess for both buyers and sellers, and the items from this list for refinance loans: Loan amount, points, closing costs, pro-rated expenses of interest, property taxes and insurance, etc. This estimate is helpful for buyers and refinance clients to be able to determine the amount of money to bring into escrow / title for the transaction to close. This form is helpful for sellers to estimate the proceeds from their sale.

- I -

Installments - Parts of the same debt, payable at successive periods as agreed; payments made to reduce a mortgage.

Interim Financing (Bridge Loan): A short-term loan secured by the equity in an as-yet-unsold house, with the funds to be used for a down payment and/or closing costs on a new house. There is no payment of principal until the house is sold or the end of the loan term, whichever comes first. Interest payments may or may not be deferred until the house is sold.

Interest Rate - The percentage of a sum of money charged for its use, charge based on principal balance.

- J -

Judgment - A formal decision issued by a court concerning the respective rights and claims of the parties to an act or suit.

Junior Mortgage - A mortgage subordinate to a previous mortgage. Aka "Second Mortgage".

- K -

- L -

Land Contract: When the buyer agrees to make payments directly to the seller at pre-negotiated terms. The seller agrees to deed the property to the buyer upon completion of the agreement. The buyer becomes the owner of equity in this type of sale. (Also see *Owner Financing*.)

Lender - is an individual, a group (public or private), or a **financial institution** that makes funds available to a person or business with the expectation that the funds will be repaid**.**

Lien - A legal right or claim upon a specific property which attaches to the property until a debt is satisfied.

Loan: Money lent from one party (often a bank) to a borrower, usually with interest charged on the loan balance.

Loan Estimate: Disclosure required within 3 days of loan application that lists all of the costs and fees associated with a particular loan scenario. The Loan Estimate replaces the Good Faith Estimate (GFE). This disclosure is required to be delivered to all borrowers within 3 days of loan application and must list all of the costs and fees associated with a particular loan scenario. The Loan Estimate replaces the Good Faith Estimate

(GFE), and the "LE" must be acknowledged by all borrowers before collecting fees from the borrowers and before ordering an appraisal.

Loan-To-Value Ratio: The relationship between the amount of the mortgage and property value, usually shown as a percentage. For a refinance loan, the appraised value is sued. For a purchase loan, the lessor of the purchase price and appraised value is used.

Loan Term – The number of years which a borrower must pay on the loan before it will be paid off, or before another event will take place (such as a balloon payment due date). Common examples of mortgage terms are 40, 30, 20, 15 and 10 years.

- M -

Mortgage - An instrument in writing, duly executed and delivered, that creates a lien upon real estate as security for the payment of a specified debt, usually on an installment basis.

Mortgage Commitment - A formal indication by a lending institution that it will grant a mortgage loan on property in a certain specified amount and on certain specified terms.

Mortgage Note: A written promise to pay a debt at a stated interest rate during a specified term. The agreement is secured by a mortgage.

Mortgage Reduction Certificate - An instrument executed by the mortgagee, setting forth the present status and the balance due on the mortgage as of the date of the execution of the instrument.

Mortgagee (Lender)- The party who lends money and takes mortgage to secure the payment thereof.

Mortgagor (Borrower) - A person who borrows money and gives a mortgage on the person's property as security for the payment of the debt.

- N -

Negative Amortization: A loan in which the outstanding principal balance goes up instead of down because the monthly payments are not large enough to cover the full amount of interest due. Also called deferred interest.

Notice of Default - A public notice filed with a court that states that the borrower of a mortgage is in default on a loan. The lender may file a notice of default when a mortgagor falls behind on their mortgage payments, and it contains various information about the borrower, lender, property, the nature of the default and other pertinent details. A notice of default is often considered the first step toward foreclosure.

- O -

Origination Fee: A fee charged for the work involved in the evaluation preparation and submission of a proposed mortgage loan. Usually charges as "points"

Owner Financing: A purchase in which the seller provides all or part of the financing.

- P -

PITI: An acronym for payments to lender that cover principal, interest, taxes and insurance on a property.

Points (discount points): A fee paid to the lender on closing day to increase the effective yield of the mortgage. A point is one percent of the amount of the mortgage loan.

Prepayment Clause - A clause in a mortgage which gives a mortgagor the privilege of paying the mortgage indebtedness before it becomes due.

Prepayment Penalty: A charge paid to the lender by the borrower if a mortgage loan is repaid before its term is over.

Pre-Approval - A commitment made by a lender to extend credit provided that specific conditions are met. Usually the letter will identify maximum purchase price, loan amount and other details about a borrower's ability to qualify for a loan. Pre-approvals are issued after analyzing a borrower's income, assets and credit and is a stronger verification of an borrower's ability to qualify for a loan than a pre-qualification. Making an offer with a pre-approval can improve a buyers likelihood of having the purchase offer accepted by the seller. This is not a guarantee or commitment by a lender to extend credit.

Pre-qualification - Usually doesn't include analysis of borrower's income, assets and credit which may mean they aren't considered to be as strong as pre-approval letters. Buyers are more likely o have an offer accepted by a seller if they present an offer with a pre-approval or a pre-qualification letter since they are an assessment of a buyer's ability to secure a loan based on specific lending guidelines and buyer representations made. This is not a guarantee or commitment by a lender to extend credit.

Prime Rate: The interest rate charged by banks to their preferred corporate customers, it tends to be an estimator for general trends in short term interest rates.

Principal (loan) - The amount borrowed or remaining unpaid. Also, the portion of the monthly payment that reduces the outstanding balance of a mortgage.

Private Mortgage Insurance (PMI): Insurance written by a private mortgage insurance company to protect the lender against losses caused by mortgage default. This is commonly required on loan transactions involving less than a 20% down payment or equity position. Upfront (at closing) premiums are required to cover the initial loan period and some loans allow that premium to be included in the loan amount. After the initial premium is paid, a lower "renewal" rate is charged on the loan balance and is paid with the monthly mortgage payment. PMI is required for the life of the loan on an FHA loan, but for a conventional loan PMI may be waived during the loan term if the LTV is reduced to below 80% and subject to additional borrower requirements.

Property Taxes – Property taxes are charged by local and county governments to cover expenses incurred or anticipated for public services provided to the populace in that region. The amount charged is based on a particular rate times the assessed property value. California has maximum annual increases (not often lower than the actual appreciation of the property) while other states offer no such annual caps, and instead reassess property values each year and raise the property taxes accordingly.

Proration - Allocation of closing costs and credits to buyers and sellers.

Purchase Money Mortgage - A mortgage given by a grantee in part payment of the purchase price of real estate.

-Q -

Qualifying Ratios (Debt Ratios): Guidelines used by lenders to determine how much of a loan a home buyer qualifies for. Often referred to as debt-to-income ratios (or DTI).

- R -

Reconciliation - The final stage in the appraisal process where the appraiser reviews the data and estimates the subject property's value.

Refinancing: Repaying a debt with the proceeds of a new loan, using the same property as collateral or security. Common motivations for a refinance loan: obtaining a lower interest rate; lowering the monthly payment; decreasing the remaining loan term; changing loan types (such as from an adjustable-rate mortgage to a fixed rate mortgage); obtaining cash proceeds from the equity of the property.

- S -

Second Mortgage - A loan issued on property that is already encumbered by an existing mortgage (ie: the first mortgage). The second mortgage is subordinate to the first.

Secondary Mortgage Market - The market wherein home loans are sold by the lender after closing to Fannie Mae, Freddie Mac or a variety of other institutional investors.

Seller Concessions - Certain closing costs paid by the seller and identified in the purchase offer and agreement. Common seller concessions include fees for pest inspections and/or fumigation, lender fees, origination points, escrow or title insurance fees. Limitations on the percentage of closing costs allowed to be paid by sellers vary by property type and lender program.

Subordination Clause - A clause which permits the placing of a mortgage at a later date which takes priority over an existing mortgage. A new loan (such as a new second mortgage) can also subordinate to an existing lien (first mortgage) so that the loan terms of the first mortgage can remain. The first mortgage lender must agree to that new second mortgage

Surety - One who guarantees the performance of another; guarantor.

- T -

Title Insurance Policy - A policy of insurance which indemnifies the holder of the policy for any loss sustained by reason of defects in the title (even those which may have occurred prior to purchase). Title insurance protects lenders and buyers for claims to the property not listed on the "preliminary title report". Title insurance is a common closing cost paid at closing and is required by lenders and different policy coverages are paid by both the buyer and seller.

Title Insurance Report (Preliminary Title Report) - A report which lists encumbrances and liens on a property. The report is used as the basis for identifying the losses the insurance provider will cover for the policy holder (usually the buyer or the lender).

Truth-In-Lending: Federal law which requires lenders to disclose the terms and conditions of a mortgage, including the APR, based on certain charges incurred by the borrower. If the charges were $0, the APR would be equal to that actual interest rate on the loan.

- U -

Underwriting: The process of evaluating a loan application to determine the risk involved for the lender.

Usury - On a loan, claiming a rate of interest greater than that permitted by law.

- V -

- W -

- X -

- Y -

- Z -

Reg Z - Regulation Z is part of the Truth in Lending Act (TILA), which Congress passed in 1968 (people often use the two terms interchangeably). It's designed to protect consumers against misleading and predatory lending practices and to promote transparency.