Mortgage terminology.

Adjustable Rate Mortgage (ARM).
A mortgage on which the interest rate, after an initial period, can be changed by the lender. While ARMs in many countries abroad allow rate changes at the lender's discretion ("discretionary ARMs"), in the US most ARMs base rate changes on a pre-selected interest rate index over which the lender has no control. These are "indexed ARMs". There is no discretion associated with rate changes on indexed ARMs.

Alternative documentation.
Expedited and simpler documentation requirements designed to speed up the loan approval process. The documentation modifications can range from the modest, such as substituting payroll stubs for tax returns, to no documentation whatever. Borrowers looking for the latter should expect to pay at least 30%, and more likely 40% down.

Amortization.
The repayment of principal from mortgage payments that exceed the interest due. The payment less the interest equals amortization -- which is the same as the reduction in the loan balance. If the payment is less than the interest due, the balance rises, which is negative amortization.

Amortization schedule.
A table showing the mortgage payment, broken down by interest and amortization, the loan balance, and perhaps other data.

Application.
Solicitation of a loan by a borrower through the provision of a written request that includes information about the borrower, the property and the requested loan. In a narrower sense, the application refers to a standardized federal application form called the "1003" which the borrower is obliged to fill out.

Application fee.
A fee that some lenders charge to accept an application. It may or may not be refundable if the lender declines the loan.

APR.
The Annual Percentage Rate, which must be reported by lenders under Truth in Lending regulations. It is a comprehensive measure of credit cost to the borrower that takes account of the interest rate, points, and flat dollar charges. It is also adjusted for the time value of money, so that dollars paid by the borrower up-front carry a heavier weight than dollars paid ten years down the road. However, the APR is calculated on the assumption that the loan runs to term, and is therefore potentially deceptive for borrowers in short time applications.

Approval.
Acceptance of the borrower's loan application. Approval means that the borrower meets the lender's qualification requirements and also its underwriting requirements. In some cases, especially where approval is provided quickly as with automated underwriting systems, the approval may be conditional on further verification of information provided by the borrower.

Assumable mortgage.
A mortgage contract that allows, or does not prohibit, a creditworthy buyer from assuming the mortgage contract of the seller. Assuming a loan will save the buyer money if the rate on the existing loan is below the current market rate, and closing costs are avoided as well. A loan with a"due-on-sale" clause stipulating that the mortgage must be repaid upon sale of the property, is not assumable.

Automated underwriting.
A computer-driven process for informing the loan applicant very quickly, sometimes within a few minutes, whether the applicant will be approved, rejected, or asked for additional information. The quick decision is

based on information provided by the applicant, which is subject to later verification, and other information retrieved electronically including information about the borrower's credit history and the subject property.

Balance.
The amount of the original loan remaining to be paid. It is equal to the loan amount less the sum of all prior payments of principal.

Balloon mortgage.
A mortgage which is payable in full after a period that is shorter than the term. It therefore has a balloon that must be repaid or refinanced. On a 7-year balloon loan, for example, the payment is usually calculated over a 30-year period, and the balance at the end of the 7th year must be repaid or re-financed at that time.

Balloon.
The loan balance remaining at the time the loan contract calls for full repayment. as in 5/20 2/28 5/15

Biweekly mortgage.
A mortgage on which the borrower pays half the monthly payment every two weeks. Because this results in 26 (rather than 24) payments per year, the biweekly mortgage amortizes before term. a very popular option paying off a 30 yr. mortgage in 24 years

Bridge loan.
A short-term loan, usually from a bank, that "bridges" the period between the closing date of a home purchase and the closing date of a home sale. To qualify for a bridge loan, the borrower must have a contract to sell the existing house.

Cap.
A pricing option exercised by the borrower at the time of the application wherein the rates and points prevailing at the time cannot rise if market rates rise, but they can decline if market rates decline. A cap costs the borrower more than a lock because it is more costly to the lender. Caps vary widely in terms of how often the borrower can exercise (usually only once), and exactly when the borrower can exercise. Do not confuse with interest rate increase caps and payment increase caps.

Cash-Out refinance.
Refinancing for an amount in excess of the balance on the old loan plus settlement costs. The borrower takes "cash-out" of the transaction.

Closing costs.
Costs that the borrower must pay at the time of closing, in addition to the down payment and points. Also referred to as "settlement costs"

Conforming mortgage.
A loan eligible for purchase by the two major Federal agencies that buy mortgages, Fannie Mae and Freddie Mac.

Conversion option.
The option to convert an ARM to an FRM at some point during its life. These loans are likely to carry a higher rate or points than ARMs that do not have the option.

Correspondent.
A lender who delivers loans to a wholesaler against prior price commitments the wholesaler has made to the correspondent. The commitment protects the correspondent against pipeline risk.

Credit Report.
A report from a credit bureau containing detailed information on an individual's credit history.

Credit Score.
A single numerical score, based on an individual's credit history, that measures that individual's credit worthiness. Credit scores are as good as the algorithm used to derive them.

Cumulative interest.
The sum of all interest payments to date or over the life of the loan. This is an incomplete measure of the cost of credit to the borrower because it does not include up-front cash payments, and it is not adjusted for the time value of money. See effective rate.

Current index value.
The most recently published value of the index used to adjust the interest rate on indexed ARMs.

Deferred interest.
See negative amortization.

Discount.
See points.

Down-payment.
The difference between the purchase price of the property and the loan amount, expressed in dollars, or as a percentage of the price. For example, if the house sells for $100,000 and the loan is for $80,000, the down payment is $20,000 or 20%. The loan amount used in this calculation does not include any prepaid finance charges that are included in the loan. For example, if the $80,000 loan in the example above includes a $1,000 up-front mortgage insurance premium, the down payment is $21,000.

Due-on-sale clause.
A provision of a loan contract that stipulates that if the property is sold the loan balance must be repaid. This bars the seller from transferring responsibility for an existing loan to the buyer when the interest rate on the old loan is below the current market. A mortgage containing a due-on-sale clause is not an assumable mortgage.

Effective rate.
A term used in two ways. In one context it refers to a measure of interest cost to the borrower that is identical to the APR except that it is calculated over the time horizon specified by the borrower. The APR is calculated on the assumption that the loan runs to term, which most loans do not. uses the term in this way. In most texts on the mathematics of finance, however, the "effective rate" is the quoted rate adjusted for intra-year compounding. For example, a quoted 6% mortgage rate is actually a rate of .5% per month, and if interest received in the early months is invested for the balance of the year at .5%, it results in a return of 6.17% over the year. The 6.17% is called the "effective rate" and 6% is the "nominal" rate.

Equity.
The difference between the value of a home and the outstanding loan balance on the home.

Fees.
The sum of all up-front cash payments required by the lender as part of the charge for the loan. Origination fees and points are expressed as a percent of the loan. Junk fees are expressed in dollars.

FHA mortgage.
A mortgage on which the lender is insured against loss by the Federal Housing Administration, with the borrower paying the mortgage insurance premium. The major advantage of an FHA mortgage is that the required down payment is very low, but the maximum loan amount is also quite low. While it varies from area to area depending on local prices, in many areas the maximum is below $250,000.

First mortgage.
The first-priority claim against the property in the event the borrower defaults on the loan.

Fixed rate mortgage (FRM).
A mortgage on which the interest rate is specified in the loan contract and remains unchanged throughout the term of the mortgage.

Float.
An option which the borrower may exercise at the time of the application to allow the rate and points to vary with changes in market conditions rather than to "lock in" those prevailing at that time. The borrower may elect to lock at any point but must do so a few days before the closing.

Fully amortizing payment.
The monthly mortgage payment which, if maintained unchanged through the remaining life of the loan at the then-existing interest rate, will pay off the loan over the remaining life. On some ARMs the mortgage payment may not rise whenever the interest rate increases, or the payment increase may be limited by a payment increase cap. In such case, the payment is not fully amortizing -- if maintained it will not pay off the loan at term -- and at some point it will have to be raised to make it fully amortizing.

Fully indexed interest rate.
The current index value plus the margin on an ARM. Most ARMs have initial interest rates well below the fully indexed rate. If the index does not change from its initial level, after the initial rate period ends the interest rate will rise to the fully indexed rate after a period determined by the interest rate increase cap. For example, if the initial rate is 4% for 1 year, the fully indexed rate 7%, and the rate adjusts every year subject to a 1% rate increase cap, the 7% rate will be reached at the end of the third year.

Good faith estimate.
The list of settlement charges that the lender is obliged to provide the borrower within three business days of receiving the loan application.

Graduated payment mortgage (GPM).
A mortgage on which the payment rises by a constant percent for a specified number of periods, after which it levels out over the remaining term and amortizes fully. For example, the payment might increase by 7.5% every 12 months for 60 months, after which it is constant for the remaining term at a fully amortizing level.

Graduation period.
The interval at which the payment rises on a GPM.

Graduation rate.
The percentage increase in the payment on a GPM.

Hazard insurance.
Insurance purchased by the borrower, and required by the lender, to protect the property against loss from fire and other hazards. It is the second "I" in PITI.

Historical scenario.
The assumption that the index value to which the rate on an ARM is tied follows the same pattern as in some prior historical period.

Homeowner's equity.
See equity.

Housing expense.
The sum of mortgage payment, hazard insurance, property taxes, and homeowner association fees.

Housing expense ratio.
The ratio of housing expense to borrower income, which is used (along with the total expense ratio and other factors) in qualifying borrowers. See qualification requirements.

Initial interest rate.
The interest rate that is fixed for some specified number of months at the beginning of the life of a mortgage. On an ARM, the initial rate is sometimes referred to as a "teaser" because it is below the fully indexed interest rate.

Initial rate period.
The number of months for which the initial rate holds. On ARMs this period can range from 3 months to 10 years, but on an FRM the initial rate holds for the life of the loan.

Investor.
A borrower who owns or purchases a property as an investment rather than as a primary residence.

Interest due.
The portion of the mortgage payment which goes toward interest on the loan, expressed in dollars. It is computed by multiplying the loan balance at the end of the preceding period times the annual interest rate divided by 12 (on a biweekly mortgage it is divided by 26). It is the same as interest payment except when the total mortgage payment is less than the interest due, in which case the difference is added to the balance and constitutes negative amortization.

Interest payment.
The dollar amount of interest paid each month. It is the same as interest due except when the total mortgage payment is less than the interest due, in which case the interest payment is less than the interest due; the difference is added to the balance and constitutes negative amortization.

Interest rate.
The rate charged the borrower each period, by custom quoted on an annual basis. A rate of 6%, for example, means a rate of 1/2% per month. For a monthly payment mortgage the rate divided by 12 is multiplied by the balance at the end of the preceding month to determine the monthly interest due.

Interest rate adjustment period.
The frequency of rate adjustments on an ARM after the initial rate period is over. The rate adjustment period is sometimes but not always the same as the initial rate period. As an example, using common terminology, a 3/3 ARM is one in which both periods are 3 years while a 3/1 ARM has an initial rate period of 3 years after which the rate adjusts every year.

Interest rate index.
The specific interest rate series to which the interest rate on an ARM is tied, such as "Treasury Constant Maturates, 1-Year," or "Eleventh District Cost of Funds." All the indices are published regularly in readily available sources.

Interest rate ceiling.
The highest interest rate possible under an ARM contract; same as "lifetime cap." It is often expressed as a specified number of percentage points above the initial interest rate.

Interest rate floor.
The lowest interest rate possible under an ARM contract. Floors are less common than ceilings.

Interest rate increase cap.
The maximum allowable increase in the interest rate on an ARM each time the rate is adjusted. It is usually 1 or 2 percentage points.

Interest rate decrease cap.
The maximum allowable decrease in the interest rate on an ARM each time the rate is adjusted. It is usually 1 or 2 percentage points.

Jumbo mortgage.
A mortgage larger than the maximum eligible for purchase by the two Federal agencies, Fannie Mae and Freddie Mac, currently $227,150 (see Non-conforming mortgage). However, some lenders use the term to refer to programs for even larger loans, such as, e.g., greater than $500,000.

Junk fees.
Fees charged the borrower by the lender for a wide variety of services, actual and hypothetical, expressed in dollars rather than as a percent of the loan amount.

Lien.
The lender's right to claim the borrower's property in the event the borrower defaults. If there is more than one lien, the claim of the lender holding the first lien will be satisfied before the claim of the lender holding the second lien, which in turn will be satisfied before the claim of a lender holding a third lien, etc.

Loan amount.
The amount the borrower(s) promise to repay, as set forth in the mortgage contract. It differs from the amount of cash disbursed by the lender by the amount of points and other credit charges.

Loan-to-value ratio.
The loan amount divided by the lesser of the selling price or the appraised value. Also referred to as LTV.

Lock.
An option exercised by the borrower, at the time of the loan application or later, to "lock in" the rates and points prevailing in the market at that time. The lender and borrower are committed to those terms, regardless of what happens between that point and the closing date.

Lock period.
The number of days for which any lock or cap holds.

Margin.
The amount added to the interest rate index, ranging generally from 2 to 3 percentage points, to obtain the fully indexed interest rate on an ARM.

Maturity.
The period until the last payment is due.

Maximum loan amount.
The largest loan size permitted on a particular loan program. For programs where the loan is targeted for sale to Fannie Mae or Freddy Mac, the maximum will be the largest loan eligible for purchase by these agencies. On FHA loans, the maximums are set by the Federal Housing Administration, and vary somewhat by geographical area.

Maximum loan to value ratio.
The maximum allowable loan-to-value ratio on the selected loan program.

Maximum lock.
The maximum period for which the lender will provide a rate/point commitment on any program. The most common maximum lock period is 60 days, but on some programs the maximum is 90 days; only a few go beyond 90 days.

Minimum down-payment.
The minimum allowable ratio of down-payment to sale price on any program. If the minimum is 10%, for example, it means that you must make a down-payment of at least $10,000 on a $100,000 house, or $20,000 on a $200,000 house.

Monthly housing expense.
The sum of the monthly mortgage payment (which includes principal and interest), taxes and insurance.

Monthly debt service.
Monthly payments required on credit cards, installment loans, home equity loans, and other debts but not including payments on the loan applied for.

Monthly total expenses.
Monthly housing expense plus monthly debt service.

Mortgage broker.
The person who offers the loan products of multiple lenders, termed wholesalers. A mortgage broker counsels on the loans available from different wholesalers, takes the application, and usually processes the loan. When the file is complete, but sometimes sooner, the lender underwrites the loan and funds it. In contrast to a correspondent, a mortgage broker does not fund a loan.

Mortgage insurance.
Insurance provided the lender against loss on a mortgage in the event of borrower default.

Mortgage insurance premium.
The up-front and/or annual charges that the borrower pays for mortgage insurance. There are different mortgage insurance plans with differing combinations of monthly, annual and up-front premiums.

Mortgage payment.
The monthly payment of principal and interest made by the borrower.

Mortgage program.
A bundle of characteristics of a mortgage including whether it is an FRM, ARM, or Balloon, the term, the initial rate period on an ARM, whether it is FHA-insured or VA-guaranteed, and if is not FHA or VA whether it is "conforming" (eligible for purchase by Fannie Mae of Freddie Mac) or "non-conforming".

Negative amortization.
A rise in the loan balance when the mortgage payment is less than the interest due. Sometimes called deferred interest.

Negative amortization cap.
The maximum amount of negative amortization permitted on an ARM, usually expressed as a percentage of the original loan amount (e.g., 110%). Reaching the cap triggers an automatic increase in the payment, usually to the fully amortizing payment level, overriding any payment increase cap.

No change scenario.
The assumption that the value of the index to which the rate on an ARM is tied does not change from its initial level.

Non-conforming mortgage.
A mortgage that does not meet the purchase requirements of the two Federal agencies, Fannie Mae and Freddie Mac, because it is too large or for other reasons such as poor credit or inadequate documentation.

Non-Permanent resident alien.
A non-citizen with a green card employed in the US. As distinct from a permanent resident alien, which lenders do not distinguish from US citizens. Non-permanent resident aliens are subject to somewhat more restrictive qualification requirements than US citizens.

Origination fee.
An up-front fee charged by some lenders, expressed as a percent of the loan amount. Should be added to points in determining the total fees charged by the lender that are expressed as a percent of the loan amount.

Payment adjustment interval.
The period between payment changes on an ARM, which may or may not be the same as the interest rate adjustment period. Loans on which the payment adjusts less frequently than the rate may generate negative amortization.

Payment increase cap.
The maximum percentage increase in the payment on an ARM at a payment adjustment date.

Payment decrease cap.
The maximum percentage decrease in the payment on an ARM at a payment adjustment date.

Payment rate.
The interest rate used to calculate the payment, which is usually but not necessarily the interest rate.

Payment shock.
A very large increase in the payment on an ARM that may surprise the borrower.

Payoff month.
The month in which the loan balance is paid down to zero. It is the same as the term on most loans.

Pipeline risk.
The lender's risk that between the time a commitment is given to the borrower and the time the loan is closed, interest rates will rise and the lender will take a loss on selling the loan.

PITI.
Shorthand for principal, interest, taxes and insurance, which are the components of the monthly housing expense.

Points.
An up-front cash payment required by the lender as part of the charge for the loan, expressed as a percent of the loan amount; e.g., "3 points" means a charge equal to 3% of the loan balance. It is common today for lenders to offer a wide range of rate/point combinations, especially on fixed rate mortgages (FRMs), including combinations with negative points. On a negative point loan the lender contributes cash toward meeting closing costs. Positive and negative points are sometimes termed "discounts" and "premiums," respectively.

Pre-approval.
A commitment by a lender to make a loan prior to the identification of a specific property. It is designed to make it easier to shop for a house. Unlike a pre-qualification, the lender checks the applicant's credit. See What Is a Pre-qualification?

Premiums.
See "points".

Pre-payment.
A payment made by the borrower over and above the scheduled mortgage payment. If the additional payment pays off the entire balance it is a "pre-payment in full"; otherwise, it is a "partial pre-payment."

Pre-payment penalty.
A charge imposed by the lender if the borrower pays off the loan early. The charge is usually expressed as a percent of the loan balance at the time of pre-payment.

Pre-qualification.
Same as qualification.

Principal.
The portion of the monthly payment that is used to reduce the loan balance.

Processing.
What the lender does with your loan application. Processing involves compiling and maintaining the file of information about the transaction, including the credit report, appraisal, verification of employment and assets, and so on. The processing file is handed off to underwriting for the loan decision.

Qualification.
The process of determining whether a customer has enough cash and sufficient income to meet the qualification requirements set by the lender on a requested loan. It is sometimes referred to as "pre-qualification" because it is subject to verification of the information provided by the applicant. Qualification is short of approval because it does not take account of the credit history of the borrower. Qualified borrowers may ultimately be turned down because, while they have demonstrated the capacity to repay, a poor credit history suggests that they may be unwilling to pay.

Qualification ratios.
Requirements stipulated by the lender that the ratio of housing expense to borrower income, and housing expense plus other debt service to borrower income, cannot exceed specified maximums, e.g., 28% and 35%. These may reflect the maximums specified by Fannie Mae and Freddie Mac; they may also vary with the loan-value ratio and other
factors.

Qualification rate.
The interest rate used in calculating the initial mortgage payment in qualifying a borrower. The rate used in this calculation may or may not be the initial rate on the mortgage.

Qualification requirements.
Standards imposed by lenders as conditions for granting loans, including maximum ratios of housing expense and total expense to income, maximum loan amounts, maximum loan-to-value ratios, and so on. Can be viewed as a quantifiable subset of underwriting requirements, which is more comprehensive and takes account of the borrower's credit record.

Rate.
See Interest Rate.

Rate/point options.
All the combinations of interest rate and points that are offered on a particular program. On an ARM, rates and points may also vary with the margin and interest rate ceiling.

Rate protection.
Protection against the danger that rates will rise between the time a borrower applies for a loan and the time the loan closes. This protection can take the form of a "lock" where the rate and points are frozen at their initial levels until the loan closes; or a "cap" where the rates and points cannot rise from their initial levels but they can decline if market rates decline. In either case, the protection only runs for a specified period. If the loan is not closed within that period, the protection expires and the borrower will either have to accept the terms quoted by the lender on new loans at that time, or start the shopping process anew.

Recast payment.
Raising the mortgage payment to the fully amortizing payment. Periodic recasts are sometimes used on ARMs in lieu of negative amortization caps.

Required cash.
The total cash required of the home buyer to close the transaction, including down-payment, points and fixed dollar charges paid to the lender, any portion of the mortgage insurance premium that is paid up-front, and other settlement charges associated with the transaction such as title insurance, taxes, etc. The total required cash is shown on the Good Faith Estimate of Settlement that every borrower receives.

Scheduled mortgage payment.
The amount the borrower is obliged to pay each period, including interest, principal, and mortgage insurance, under the terms of the mortgage contract.

Second mortgage.
The second-priority claim against a property in the event that the borrower defaults on the loan. The lender who holds the second mortgage gets paid only after the lender holding the first mortgage is paid.

Servicing.
Administering loans between the time of disbursement and the time the loan is fully paid off. This includes collecting monthly payments from the borrower, maintaining records of loan progress, assuring payments of taxes and insurance, and pursuing delinquent accounts.

Simple interest mortgage.
A mortgage on which interest is calculated daily based on the balance at the time of the last payment. The daily interest is thus the same during the period between payments.

Standard mortgage.
An FRM with a single rate and level payments that fully amortizes over its term.

Subordinate financing.
A second lien on the property securing the loan at the time of closing. This arises when there is a second lien on the property at the time the new loan is taken out, and the new loan does not pay it off.

Swing loan.
See Bridge loan.

Temporary buy-down.
A reduction in the mortgage payment in the early years of the loan in exchange for an up-front cash payment provided by the home buyer, the seller, or both. As an illustration, a 2-1 buy-down on an 8% loan results in a payment in year 1 calculated at 6%, in year two the payment is calculated at 7%, and in year 3 and thereafter it is calculated at 8%. The up-front cash payment must be large enough to cover the difference between the reduced payments made in the first two years by the borrower and the regular payment calculated at 8% received by the lender.

Term.
The period used to calculate the monthly mortgage payment. The term is usually but not always the same as the maturity. On a 7-year balloon loan, for example, the maturity is 7 years but the term in most cases is 30 years.

Total interest payments.
The sum of all interest payments to date or over the life of the loan. This is an incomplete measure of the cost of credit to the borrower because it does not include up-front cash payments, and it is not adjusted for the time value of money. See Effective Rate.

Total expense ratio.
The ratio of housing expense plus current debt service payments to borrower income, which is used (along with the housing expense ratio and other factors) in qualifying borrowers. See qualification requirements.

Underwriting.
The process of examining all the data about the borrower(s), property, etc. to determine whether the mortgage applied for by the borrowers should be issued.

Underwriting requirements.
The standards imposed by lenders in determining whether a borrower qualifies for a loan. These standards are more comprehensive than qualification requirements in that they include an evaluation of the borrower's creditworthiness.

VA mortgage.
A mortgage on which the lender is insured against loss by the Veterans Affairs Administration. The major advantage of a VA mortgage is that the required down payment is very low, and maximum allowable loan amounts are higher than on FHA loans, but only veterans are eligible.

Waive escrows.
The borrower has the right to pay taxes and insurance directly. This is in contrast to the standard procedure where the lender adds a charge to the monthly mortgage payment that is deposited in an escrow account, from which the lender pays the borrower's taxes and insurance when they are due. On some loans lenders will not waive escrows, and on loans where waiver is permitted lenders are likely either to charge for it in the form of a small increase in points, or restrict it to borrowers making a large down payment.

Wholesaler.
A lender who provides loans to borrowers through mortgage brokers or correspondents. The mortgage broker or correspondent initiates the transaction and takes the borrower's application.

Worst case scenario.
The assumption that the index to which the rate on an ARM is tied rises to 100% in the second month and remains there. The resulting rise in the interest rate will depend on the interest rate increase cap and the interest rate ceiling.

Wrap-around mortgage.
A mortgage on a property that already has a mortgage, where the new lender assumes the payment obligation on the old mortgage. Wrap-around mortgages arise when the current market rate is above the rate on the existing mortgage, and home sellers are frequently the lender. A due-on-sale clause prevents a wrap-around mortgage in connection with sale of a property.

3/2 Down payment.
Programs offered by some lenders under which a borrower who is able to secure a grant or gift equal to 2% of the down-payment will only have to provide a 3% down payment from their own funds. This can be a good deal for a cash-short borrower.