MORTGAGE TERMS

Most businesses in today's world have industry-specific terminology. Here are some of the most frequently used words in the mortgage lending business and their definitions.

Adjustable-Rate Mortgage (ARM): A mortgage with an interest rate that changes periodically, according to an index that is selected when the mortgage is issued. The initial interest rate is lower than that for fixed-rate mortgages but monthly payments can go up or down when the rate is adjusted.

Annual Percentage Rate (APR): A stated interest rate that reflects all of the financing costs of a mortgage. The APR includes points, origination fees and other finance charges, in addition to the interest on the mortgage and includes them all in an early interest rate. The APR is usually higher than the interest rate alone and allows you to compare different types of mortgages based on the annual cost for each loan.

Appraisal: An estimate of the market value of the property, made by a qualified appraiser.

Caps: Consumer safeguards for adjustable-rate mortgages that limit the amount monthly payments can increase. An interest rate cap limits the amount the interest rate can change, while a payment cap limits the increase in monthly payment to a specific dollar amount.

Closing: The meeting between the buyer, seller and escrow officer, in which the property and funds legally change hands.

Closing Costs: The costs and fees associated with the change in ownership of the property and with obtaining your mortgage. They are assessed at the closing and include insurance, taxes, and other fees.

Credit Report: A report that documents a borrower's credit history and current status.

Debt-to-Income Ration: The ratio, expressed as a percentage, which results when a borrower's monthly payment obligation on long-term debts is divided by his or her net effective income or gross monthly income.

Down Payment: The amount of money paid to the seller when a home is purchased, which is the difference between the purchase price and the mortgage amount.

Escrow: A special account set up by the lender in which money is held to pay for taxes and insurance. An escrow officer is the third party who carries out the instructions of both the buyer and seller to handle the paperwork at closing.

Fixed-Rate Mortgage: A mortgage with an interest rate that remains constant for the life of the loan. The most common fixed-rate mortgage is for a term of 30 years but there are also terms of 20, 15 and 10 years.

Index: An economic indicator or interest rate, which is the basis that determines changes in the interest rate of an Adjustable Rate Mortgage (ARM). ARM rates are adjusted to reflect changes in the index.

Loan-to-Value Ratio (LTV): Percentage that reflects the relationship between the amount of the mortgage loan and the appraised value and or sales price of the property.

Margin: The amount a lender adds to the index to establish the actual interest rate on an ARM.

PITI (Principal, Interest, Taxes and Insurance): The four components that for most homeowners are included in the monthly mortgage payment. Principal and interest are the portions of the payment assigned to repay the mortgage itself; taxes and insurance are set up by your lender into a special escrow account to pay for homeowners insurance and property taxes.

Points (Loan Discount Points): Prepaid interest on a mortgage that is usually paid at the time of closing. Each point is equal to one percent of the total amount of a mortgage. Most lenders offer mortgages with several combinations of points and interest rates. Generally, the lower the interest rate, the more points you will pay at settlement.

Principal: The amount of debt, not including interest, remaining on a loan. It is also the face amount of the mortgage.

Private Mortgage Insurance (PMI): An insurance policy paid by the borrower that protects the lender from non-payment of the loan. It is usually required if you make a down payment that is less than 20% of the appraised value of the home.

Title Insurance: An insurance policy that insures against errors in the title search.

Underwriting: The process of determining whether to make a loan based on credit, employment, assets, etc., to a loan applicant.