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Know Your Mortgage Terminology

Every part of the home purchase process has its own special terminology. The loan process can be even more daunting for those of us who are math impaired – you are expected to understand how to understand how loans are calculated in addition to understanding the vocabulary. To get you started on the language of lending, here are some of the top terms you will here:

Adjustable Rate Mortgage (ARM Loan): The key word here is 'adjustable'. Adjustable Rate Mortgages are often attractive to first time homebuyers who can't afford quite as much house today, but expect to have increased earning power in the future. ARM loans often have lower interest rates for the first few years, so the mortgage payments are lower. Homebuyers should be very clear about how and when the interest rate and monthly payments increase, and plan finances accordingly.

Annual Percentage Rate (APR): This is the annual rate that includes the interest rate you were quoted by your lender plus any other loan costs (points, loan origination fees, etc.). The APR will be higher than the advertised interest rate because these other loan costs are included in the total.

Closing Costs: This is an umbrella term for a number of costs due at the close of ecrow. Some are paid by the seller, some by the buyer. From the buyer's side, these costs may include pro-rated property taxes, loan origination and processing fees, escrow and title services and insurance fees. As a rule of thumb, if you are financing your purchase your closing costs will be in the ballpark of 3-3.5% of the purchase amount; if you are paying all cash, your closing costs will be in the ballpark of 1.5-2% of the purchase amount.

Conventional Loan: Bank loans, typically requiring 10-20% downpayment.

Escrow: A home is said to be 'in escrow' when it is in contract and is in the process of changing ownership from seller to buyer. The escrow officer holds the funds during the transaction, and ensures the funds (loan, earnest money deposit, any credits) are distributed to the proper parties according to the contract when the purchase is complete. In Northern California, Escrow and Title functions are combined in the same companies.

FHA loan: The Federal Housing Administration is a federal agency that insures first mortgages, enabling lenders to lend a very high percentage of the sale price, typically requiring as little as 3% down. FHA requires homes to be in habitable condition as a prerequisite for purchase.

Fixed Rate Mortgage: A kind of mortgage where the interest rate stays the same for the whole term of the loan. These are typically 15, 20 or 30 year loans. Fixed Rate loans are attractive because they provide buyers with the ability to plan long term, knowing the monthly payments will remain the same through the life of the loan.

Loan to Value Ratio (LVR): For the purchase of a home, this refers to the amount of money borrowed, in relation to the value of the home being purchased. If you were purchasing a home valued at $100,000, with a loan of $85,000, your LVR would be 85%. LVR is important to pay attention to: if your LVR is more than 80% you will be required to purchase private mortgage insurance (PMI).

Lock-In: Once you've been preapproved for a loan, and made an accepted offer on a home, you will be waiting for the loan underwriters to complete their detailed work and fund your loan. During this time you will be in close contact with your lender to decide when to lock in a loan rate. The lock in is a guarantee that the loan you get will have the rate you locked. This is an important step in a market where interest rates are rising more than falling.

Points: In the lending world a point = 1% of the loan amount. There are two kinds of points to know about and keep track of, and both (if used) are paid at closing. Origination points are sometimes added to cover loan processing expenses – the cost of originating your loan. Discount points are used to buy down or discount the interest rate on your loan. If you wanted to reduce your loan interest rate from 5.5% to 4.5% on a $500,000 loan, you'll pay one point up front, or an additional $5,000.

Private Mortgage Insurance (PMI): PMI is a policy to protect your lender from loss in the event that you default on your loan. Your PMI is a monthly cost added onto your mortgage payment. PMI is required whenever you have financed an amount larger than 80% of the value of the home you are purchasing. The good news: once you have gained 20% equity in your home, you can and should contact your lender to discontinue PMI coverage, and reduce your mortgage payment.

Title Insurance: A home has a title to the property in the form of a deed. Title insurance is issued by the Title company, and it insures that the home's title is able to be legally passed from the seller to the buyer. Title insurance also protects the buyer against any future claims to the property by other parties.

VA loan guarantee: The Veterans Administration is a federal agency that guarantees repayment of first mortgages taken by qualifying US military veterans. Veterans may borrow 100% of the purchase price of the home, and are exempt from most of the costs and fees associated with the purchase. The VA lender will require the seller to complete any repairs to the property at the seller's expense.