Mortgage Glossary

Common terms used in the mortgage process

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Adjustable-Rate Mortgage (ARM): Interest rates on adjustable rate mortgages can go up or down causing your mortgage payment to adjust accordingly. The interest rate is usually set for a specific period of time and then can adjust every year thereafter. The adjustments depend on a money index plus a margin. The lender determines the money index and the margin and there is usually an annual cap and a lifetime cap. The terms of an ARM must be disclosed on the loan estimate and the adjustable rate rider.

Amortization: A fully amortizing loan is repaid in equal installments over a certain period of time. (Usually 30 years) In the first few years since the principal balance is higher most of the payment goes towards interest and as the loan is paid down more and more of the payment goes towards principal.

Annual Percentage Rate (APR): APR is the total cost of the mortgage expressed as an annual percentage rate. It is the note rate plus any closing costs and/or mortgage insurance premiums that are considered to be finance charges. All lenders are required to disclose the APR.

Appraisal: The appraisal is a valuation of the property to determine its fair market value based on comparable sales in close proximity to the subject property. This is required. The lender needs to make sure the property meets minimal property standards and they need to make sure they have sufficient collateral for the loan. Note: This is not the same as the home inspection which determines the condition of the property.

Appreciation: The value of a property usually increases over time. The housing market and also the economy play a big role in overall appreciation. Other factors contributing to appreciation is the location and the condition of the property. Note: Houses can also depreciate in value.

Association Dues: If you buy a condominium or a townhome, you will be responsible for paying association dues as well as your PITI. Dues are due each month and cover the common areas of the association, such as yard maintenance, snow removal, trash removal and maintenance for the exterior of the building. If you buy in an association, review the association docs carefully to determine what the dues cover and what they don't cover.

Assumption: Most Government insured loans such as FHA, VA and USDA loans are assumable to qualified buyers. This is where a new buyer submits paperwork and if approved can take over the existing mortgage on the property. This assumption feature can be a great selling tool, if the rate is low and we are in a higher interest rate environment.

Patty McLain
Loan Officer | NMLS #460419
pmclain@bayeq.com
M - 612.801.6339
F - 763.201.5687
bayeq.com/patty-mclain

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Automated Underwriting (AUS): Automated underwriting is a computer-based program that lenders use to make an initial decision on loan approvals. This can be (LP) loan prospector or (DU) desktop underwriter. Note: A live person known as the underwriter must cross check and review the information provided to AUS to make sure everything matches and to make sure nothing was omitted.

Closing: The closing or settlement is when the final loan documents are signed and notarized and the property ownership is legally transferred from the seller to the buyer.

Closing Costs: Consist of lender fees, title fees, third party fees, a small realtor broker fee and government fees. These costs are itemized on the loan estimate and then disclosed again on the Closing Disclosure. Closing costs can vary from lender to lender, however once a lender discloses their fees on the loan estimate, the lender must honor those fees unless there is a valid change of circumstances.

Closing Disclosure (CD): Lenders are required to provide the borrowers with the CD at least 3 business days prior to closing. The CD will disclose the final costs of the transaction, the final payment, the note rate, the APR and any other key features of the loan.

Condominium: A type of property ownership in which the owner holds title to an individual living unit and shares ownership of the common areas. These can be apartment style living or townhome style living.

Contingency: A condition on the purchase agreement that must be met to make the contract legal and binding. For example, a current home owner can offer to purchase a new home contingent on the sale of their current home or a buyer can purchase a home contingent on the home inspection.

Conventional Mortgage: Conventional loans are not insured or guaranteed by the federal government. If you have 20% down you should not have to pay mortgage insurance. If you have less than 20% down, the lender usually requires mortgage insurance from a private mortgage insurance company.

Correspondent Lender: A correspondent lender is a lender who has the ability to sell mortgage loans to a number of different banks and/or other mortgage companies. A correspondent lender (based on the individual contracts with each bank and/or mortgage company) usually can act on your behalf throughout the entire loan process from application to processing to underwriting and closing.

Deed-in-Lieu of Foreclosure: The mortgage servicer agrees to accept the deed to the property in lieu of foreclosure when a borrower in default can no longer continue to pay for the mortgage. For the most part this is still considered a foreclosure.

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Depreciation: The value of a property may decrease. This can occur in a bad housing market and in a bad economy.

Discount Points: One discount point = 1% of the loan amount. Discount points allow the borrower to buy the market interest rate down in order to get a lower interest rate over the life of the loan. Basically, points are prepaid interest in exchange for a lower rate over the life of the loan. Note: 1 discount point will not buy the rate down a full 1%.

Down Payment: Down payments are usually a percent of the purchase price. The minimum down payment required varies based on which mortgage type you choose. Some programs still allow zero down but for the most part a minimum of 3 to 5 percent is required.

Earnest Money: A portion of the down payment is required up front to finalize the purchase agreement. This money is paid to the Real Estate Company that represents the seller. The earnest money is deposited in good faith to show the buyer's commitment to purchase the property. The earnest money will be credited towards the buyer's down payment at closing. The amount of earnest money can be negotiated with the seller.

Equity: The difference between the current value of the property and the amount owed on the mortgage. Equity should increase as the mortgage is paid down and as the property increases in value.

Escrows: On all government loans and on conventional loans with less than 20% down, escrows for taxes and home owner's insurance are required. The lender can collect a certain amount of money up front for future payment of taxes and insurance. Each month they also collect 1/12 of the home owner's insurance, 1/12 of the property taxes and the monthly mortgage insurance. When taxes and insurance are due, they draw from your escrow account and pay those on your behalf. The escrow money is yours but the lender maintains control to make sure the property taxes, home owner's insurance and mortgage insurance are paid when due.

Fixed-Rate Loan: The interest rate on a fixed-rate mortgage loan will not change throughout the life of the loan. Therefore, the principal and interest portion of the payment cannot change either.

Foreclosure: The legal process by which a mortgage lender takes possession and ownership of a property because the loan is in default. This process can take up to 12 to 18 months thereby giving the property owner time to bring the loan out of default.

Four C's of mortgage lending: These are the things that most mortgage companies look at when approving loans. These include Credit, Cash, Capacity to pay and Collateral.

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Home Equity Loan or Second Mortgage Loans: You can get a first and second mortgage when you purchase the property to avoid mortgage insurance and/or you can get a second mortgage or a home equity loan later on down the road as the equity builds in your property. This can be a great financial tool as you build equity but you are using your house as collateral for the loan.

Home Inspection: A home inspection determines the overall condition of the property. Most home inspectors are licensed. The home inspector will look for any defects in the property and will provide the buyer with his/her report on the property and its mechanicals. If the home inspector finds major defects with the property, you can either re negotiate with the seller to fix some of the defects, or ask for a price reduction, or you can cancel the purchase agreement. The inspection is not required by a lender, but is highly recommended.

Home Warranty: Home warranties can vary greatly but they usually cover repairs for major things like electrical, plumbing and heating and most of the major appliances. Some sellers will pay for a 1 year home warranty to assure a smooth transfer and peace of mind to the new buyer

Housing Expense Ratio: Your Housing Expense ratio is the percentage of your gross monthly income being spent on your house payment. This is important on USDA loans, some FHA loans, and some loans with down payment assistance. With some loan programs, your monthly housing expenses should not exceed 29% of your gross monthly income.

Joint Tenancy: A form of ownership under which owners have equal interest and sole interest in the property. If one owner dies, the surviving owner(s) automatically inherit that share.

Loan Estimate (LE): Lenders must provide an LE to borrowers within 3 business days of receiving the full residential mortgage application. The LE summarizes the key information about the loan, including interest rate, APR, monthly payments and total closing costs, as well as estimated prepaid items for taxes and insurance. The LE has to disclose any unusual or risky features of the loan such as whether the loan carries any prepayment penalty, or has an adjustable rate feature.

Loan to Value (LTV): The loan-to-value ratio is calculated by dividing the loan amount by the lower of the appraised value or the purchase price.

Mortgage or Deed of Trust: The Mortgage or Deed of Trust is the recorded evidence of the promise to repay the loan; if the loan is not repaid as promised, the lender may take over the property.

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Mortgage Banker: Is a loan officer who originates loans with a mortgage company that is affiliated with a bank. This Mortgage banker could act as a correspondent lender as well. The Mortgage Bankers don't have to be individually licensed in each state, however they have to have a NMLS number.

Mortgage Broker: A mortgage broker is usually individually licensed and originates loans, but may send those loans to the investor they plan to sell the loan to for processing, underwriting and closing.

Private Mortgage Insurance: Insurance companies provide coverage for lenders on conventional loans with less than 20% down. If loan goes into default the mortgage insurance company will pay a claim to the mortgage company. The borrower pays the monthly mortgage insurance premium, or borrower can pay a signle premium at closing rather than monthly.

Multiple Listing Service (MLS): A listing of properties for sale maintained by local members of the National Association of Realtors®.

Note: The Note is signed by the borrower(s) at closing and is the formal promise to repay the mortgage loan according to the terms specified in the Note.

Note Rate: Interest rate which lender uses to calculate principal and interest.

Origination Fee: Lenders may charge origination points/fees on certain loans but all fees must be disclosed on the LE. Each point is 1% of the loan amount.

PITI: A mortgage payment includes four parts The Principal and Interest to repay the mortgage debt, 1/12 of the real estate taxes and half of the home owners insurance and the mortgage insurance if applicable. Total payment.

Pre-Foreclosure Sale: Also called a "short sale." Under this arrangement, the mortgage servicer allows you to sell the home for less than is owed on the house and you sell short. The servicer may also agree to accept the proceeds from the sale of a home and forgive the negative balance.

Prepayment Penalty: If the borrower makes additional principal payments and/or pays off the loan too early, that borrower could incur a prepayment penalty. These penalties are no longer allowed in most states.

Prepaids: Consists of prepaid interest, one full year of home owner's insurance, and about five months of property taxes, and an additional 3 months of home owner's insurance. Note: Prepaids are strictly regulated.

Prepaid Interest: Daily interest from the date of closing until the end of that calendar month. This is paid at closing. Note: first mortgage payment will not be due until the first of the following month after closing.

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Rate Lock-In: A written agreement under which the lender locks in and/or guarantees the interest rate and fees for a certain period of time extending to at least the closing date.

Refinance: Pays off existing first mortgage with a new mortgage.

Cash Out Refinance: Getting a new loan to pay off a first and second mortgage if applicable and/or taking additional equity out.

Second Mortgage: Second mortgages are secondary loans against the property. They could be used to purchase a property along with a first mortgage or it could be a second mortgage at any time down the road.

Servicing: This is who collects your house payments when and if the loan servicing is sold. Often times mortgages are traded and sold in the secondary market. Please Note: if your loan is traded or sold, the terms on your mortgage can not change. The only thing that changes is who you send the payments to.

Sole Ownership: Under sole ownership, title to the property is held in one person's name.

Joint Tenants: Married couples may hold title as "joint tenants." When one spouse dies, the property is automatically inherited by the surviving spouse.

Tenants in Common: If one owner dies, that 50% ownership may go to his / her heirs, rather than to the surviving owner(s).

Title: A legal document showing the ownership of a property.

Title Insurance For the Lender: Title insurance for the lender is usually required. Protects the lender against any losses resulting from disputes over ownership of the property. The borrower has the option to purchase owner's title insurance to protect their interest in the property.

Total Debt Ratio The total debt ratio is calculated by dividing the borrowers total monthly debt (car loans, student loans, minimum payments on credit cards, and their new housing expense) by their gross monthly income. This usually needs to be below 50%.

Townhouse Ownership: One owns an individual townhouse unit inside a larger building and share's any common areas.

Transfer of Servicing: At any point, the lender or servicer collecting the mortgage payments may transfer the servicing of your loan to someone else. The terms of the mortgage cannot be changed and borrowers will get notified in advance.

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