Glossary of Mortgage Terms

Adjustable-rate mortgage (ARM). A mortgage in which the interest rate is adjusted periodically based on changes to an index. Typically, an ARM has a cap on the rate. For example, the ARM may state that the rate cannot go up or down more than 2% per year and/or more than 8% over the life of the loan.

Amortization. The process of structuring a loan so that you pay off the outstanding balance over a period of time, with part of the payment going to the principal and part going to the interest.

Annual percentage rate (APR). This is the rate that reflects the actual annual cost of the loan. It differs from the stated interest rate of the loan in that it includes interest and other charges.

Appraisal. A professional assessment of the fair market value of the property, based on features and condition of the home and the sale price of comparable homes in the area.

Appreciation. An increase in property value.

Assessed value. The value that a public official has placed on the property for determining property taxes. This is not necessarily consistent with the market value.

Balloon mortgage. A mortgage that usually offers low payments in the initial period, which may last several years. At the end of the initial period, the balance must be repaid or refinanced.

Clear title. A title that is free of any defects such as liens or questions about ownership of the property.

Closing. Also called a settlement, this is the final step in the purchase, where the transfer of property becomes final.

Closing costs. Costs involved in transferring ownership of the property, not including the mortgage. Closing costs may be paid by the buyer and/or seller and may include loan origination fees, discount points, appraisal fee, survey, title insurance, legal fees, real estate professional fees, prepayment of taxes and insurance and transfer taxes.

Conforming loan. A loan that does not exceed Fannie Mae and Freddie Mac's loan limits. Conforming loans generally have lower interest rates than nonconforming (jumbo) loans. For conforming loan limits, see http://www.fanniemae.com/aboutfm/loanlimits.jhtml.

Contingency. A clause in a contract that spells out certain conditions that must be fulfilled before the contract is executed.

Deed. The document that legally transfers ownership from one party to another.

Default. Failure to make mortgage payments on time or to comply with other conditions of the loan, usually over the course of 60 to 90 days. Once in default, the lender can start proceedings to foreclose on the property.

Delinquency. Failure to make mortgage payments on time, but not yet in default.

Depreciation. A decrease in property value due to wear and tear, market conditions or other factors.

Down payment. The amount of money paid up front, usually a percentage of the market value.

Equity. The owner's financial interest in the property, usually calculated by subtracting all outstanding mortgage loans from the current market value.

Escrow. Funds paid by the borrower and held by the lender or a third party until needed to pay taxes and/or insurance. Escrow accounts can also be set up for other purposes, such as repairs.

Fannie Mae and Freddie Mac. Federally chartered corporations that purchase mortgages from primary lenders, thus enabling the lenders to make more mortgage loans.

Fixed-rate mortgage. A mortgage with an interest rate that does not change for the life of the loan, so payments for principal and interest remain the same.

Foreclosure. A legal process whereby the lender can sell the property to cover the loan of the defaulting borrower.

Jumbo loan. A mortgage with a loan amount exceeding the conforming loan limits; not eligible to be purchased, guaranteed or securitized by Fannie Mae or Freddie Mac. Generally, interest rates are higher on jumbo loans than on conforming loans and it may be more difficult to qualify for the loan.

Lien. A legal claim on property which must be settled before the property is transferred or sold.

Loan-to-value (LTV). A percentage calculated by dividing the amount borrowed by the price or current value of the home.

Mortgage insurance (also called private mortgage insurance, or PMI). Insurance that protects the lender if the borrower defaults on the loan. Usually the borrower must pay for mortgage insurance if the down payment is less than 20% of the purchase price. The cost of insurance is typically added to the monthly mortgage payment.

Negative amortization. This occurs when the monthly payments do not cover the interest due, thus increasing the principal loan balance.

Origination fee. A fee imposed by a lender to cover loan processing expenses.

PITI. Principal, interest, taxes and insurance; these typically make up the monthly mortgage payment.

Points. A point equals 1% of the loan amount. Points may be charged by the lender upfront in return for a lower interest rate, or they may be charged to cover the loan processing costs.

Prepayment penalty. A payment that must be made on some mortgages if the loan balance is repaid ahead of schedule.

Principal. The amount borrowed.

Refinancing. Paying off one loan with another; generally in order to get a lower interest rate or better terms.

Title. A legal document establishing the right of ownership; also known as a deed.

Title search. A check of the public records to be sure there are no liens or other claims against the property and that the seller is the recognized owner of the property.

Transfer tax. Any state or local taxes that may be due when the title passes from one owner to another.

Truth in Lending Act. A federal law obligating a lender to give full written disclosure of all fees, terms and conditions associated with the loan.