HOME LOAN GLOSSARY

There is a lot to know when it comes to buying a home. That's why we've rounded up some of the most common terms you'll hear as part of the home buying process. And made them easy to understand.

Adjustable-Rate Mortgage (ARM)
This is a loan that usually starts out with a fixed interest rate for a period of time (usually 1-5 years), and then converts to an interest rate that can change up or down each year.

Amortization term
This is the amount of time – in months – it will take to pay off the home loan. For example, the amortization term for a 30-year fixed mortgage is 360 months (30 x 12 = 360).

Annual Percentage Rate (APR)
This is the cost of a loan on a yearly basis and is shown as a percentage. Unlike an interest rate, the APR includes fees and other costs associated with the loan, giving you a better picture of the actual cost of borrowing.

Appraised value
This is an opinion of how much a home is worth, after an appraiser's evaluation of the property, based on similar home sales data, new construction costs, and the local housing market.

Assets
This is anything you own, like property, or cash in bank accounts, stocks, mutual funds, and more.

Closing costs
These are charges for the process of getting a loan – mostly from third parties – for things like title fees or a home appraisal. Your lender should help you understand them all.

Credit report
This report is prepared by a credit bureau and provides a look at your credit history. It's used by a lender to determine your creditworthiness.

Down payment

This is the part of the house's sales price that you'll pay up front. The money for a down payment can come from the cash you've saved up, the amount you've made off the sale of another home, a gift from a relative, etc.

Equity

This is the value of the home you own after taking away what you owe in loans. If your home is worth $150,000 and your mortgage loan balance is $110,000, you have $40,000 in equity ($150,000 - $110,000 = $40,000).

Escrow

This is an extra amount that gets added to your monthly payment so your lender can pay things like property taxes and insurance costs for your home.

FICO® score

This is a three-digit number, ranging from 300 to 850, that tells a lender how much of a credit risk you might be, based on past credit usage. A higher FICO score typically represents a lower credit risk, which may lead to a better loan rate.

Housing expense ratio

This is just one of the decision-making tools that lenders use to determine if a loan is appropriate for you. It takes a monthly mortgage payment (including principal, interest, taxes, insurance, and other fees) and divides it by your monthly income (before taxes). Typically, the lender wants the result to be no more than 28%.

Interest rate

This tells you how much you're paying to borrow money from a lender. It's expressed as a percentage of the amount of your loan. The lower the interest rate, the less you pay for the money you borrow.

Liabilities

These are the debts you owe to others, like credit card debts, auto loans, medical bills, etc.

Loan-to-Value (LTV)

This is another one of the decision-making tools that lenders use to determine if a loan is appropriate for you. It takes the amount of the loan and divides it by the appraised value of the home. It is key to understanding how much you may be able to borrow, or where you stand with your existing loan. Additionally, when your loan-to-value is 80% or less, you will not have to pay for private mortgage insurance, which can save you quite a bit over the life of the loan.

Mortgage insurance

This protects the lender in case you are unable to pay back your loan. Each mortgage program has different guidelines that determine when you'll be required to have the insurance. Typically, a lender will require it if you are buying a home with less than 20% of the home's value as a down payment. Additionally, the mortgage insurance payment is generally included in your monthly payment.

Pre-approval

This is the process of evaluating your credit, assets, and liabilities to determine how much you'll be able to borrow before you apply for a loan. Most real estate agents will require you to have a pre-approval from a lender before showing you houses for sale.

Principal, Interest, Taxes, and Insurance (PITI)

These are the four parts of your monthly mortgage payment. The principal is the part of the monthly payment that reduces the amount you owe on the house. The interest is the fee you're charged for borrowing money. And taxes and insurance are the monthly cost of property taxes and homeowners insurance.

Rate lock

A commitment that keeps your interest rate from rising over a specified period of time, often from the time you apply for a loan and the time you close.

Underwriting

During this part of the process, an underwriter evaluates different factors to determine if this loan is appropriate for you. Those factors can include your past credit, the money you have on hand and your overall net worth, as well as a judgement on the quality of the house you're looking to buy.