Mortgage and Real Estate Glossary and Types of Real Estate Loans

Olen Soifer, March 29, 2010-03-29

There are many types of real estate loans on the market today. Each type is designed to accommodate the needs of different borrowers. It is the job of a professional mortgage originator to match an appropriate loan to each borrower. What follows is a list of the most common real estate loans and the most important mortgage and real estate terms.

1003 URLA - The Uniform Residential Loan Application, which is the primary document in a loan package. Originated by Fannie/Freddie, it is now, truly, "universal", even being used in commercial loans, etc, for which it was not designed and is not necessarily suitable. When there are multiple borrowers, unmarried borrowers are placed on individual applications, but a married couple can be on one application.

1004 Transmittal - A loan summary that is most often used on conventional loans, but also on some other loans as well. This is not a borrower document. It is meant to be a summary of the loan for the underwriter. In residential loans, when there are multiple 1003 applications, the figures from the individual applications are combined into a combined transmittal. Many lenders have their own submission sheets.

Acceleration Clause - A clause in a mortgage that provides for the entire balance of unpaid principal and interest to be immediately due and payable (such as failure of the borrower to keep the property insured or failure to pay real estate taxes).

Acknowledging a Document - Commonly called "notarizing", that is an incorrect term. The acknowledgement consists of a statement from a Notary Public (or lawyer, etc) stating that they personally witnessed someone signing a document; that they took reasonable precautions to positively identify the signer; that the person was signing the document voluntarily; that they were sober and of legal age.

Adjustable Rate Mortgage (ARM) - A mortgage whose rate is allowed to be adjusted up or down, periodically, as a pre-specified index varies. A "fully indexed rate" = the current index + the margin. Some ARMs have an artificially low initial rates (ie: less than the index + margin) "teaser rate". Until they began to fall out of favor, adjustable rate mortgages (ARM) made up about half of all new real estate loans. With an ARM, the interest rate changes throughout the term of the loan, and the monthly payments can go up or down, accordingly, as the index varies. Common index rates are the prime rate, the 11th District Cost of Funds Index (COFI); the Prime Rate; the London Interbank Offered Rate (LIBOR) and various Treasury Bill and Certificate of Deposit rates. The margin is set by the lender and does not change. ARMs come with lifetime interest rate caps, and usually an annual cap.

Alienation Clause - A/K/A as the "Due on Sale" clause, this clause provides for "acceleration" if the pr opertyissold.

Amortization - The payment of principal in periodic mortgage payments

(Fully) Amortized Loan - This is the modern mortgage loan, were the borrower makes equal monthly payments which are part principal and part interest. By the end of the mortgage term, all due principal & interest, all principal & interest will have been paid, generally with a constant principal & interest payment. The payments start with a larger proportion of interest at the beginning of the loan term and

gradually shift to a larger proportion of principal toward the end of the payment series.
Assignments - The action of transferring one's rights in a contract, mortgage, etc.

ARV - After Rehab Value - The is the attainable sales price after a rehab. It is not necessarily the sum of the price & all rehab costs, which could exceed the ARV.

Balloon (Partially-Amortized) Mortgage - This is a short-term loan with a final or balloon payment due at the end of the term. Monthly payments are usually calculated over a long term, which could range from 10-30-years, called the amortization period. But, because the term is shorter than the amortization period, there is a remaining principal balance at the end of the term. The borrowers must refinance the loan, at or prior to the end of the term, to avoid having to make the balloon payment "from their pocket".

Balloon Payment - Remaining principal that is still owed, and due, at the end of a mortgage term

Blanket Loan - A blanket loan involves more than one property offered as collateral.

BPO - Broker Price Opinion; a non-appraisal estimate of market value by a real estate broker, formerly referred to as a CMA, comparative market analysis.

Bridge (Interim or Swing) Loan - A bridge or interim loan is a short-term loan that spans the gap between two other loans. Bridge loans may used by buyers between the purchase and resale of an investment property to allow them to take advantage of a favorable opportunity to "buy low" and "sell high". Obviously, that can present a problem if the anticipated resale, or closing of the "takeout loan" does not occur as planned, and the bridge loan involves fairly high interest rates, as is usually the case.

Budget Loan - The budget loan is one which includes some of the standard housing costs, the real estate taxes and insurance, with the principal and interest payments (PITI for short). This helps some borrowers budget for these expenses. Most home mortgages require PITI payments, though (for an initial fee, or a higher interest rate) some lenders will allpw the borrower to pay taxes and insurance themselves. When the lender pays those expenses, the borrower pays money for the expenses into escrow so that the lender has the money readily available for the expenses when they are due. On residential, and some other loans, it is traditional for the escrow account to have a buffer of two months over the amount needed to cover the payments made out of the escrow account. Thus, when the lender is collecting monthly insurance escrows to allow the payment of the annual insurance premium, the lender will have 14 months of escrow just prior to making the payment.

"Cap Rate" (capitalization rate) - A market figure (expected profit for a particular type of property, in a particular area) that is divided into a property's NOI to return the market value. The "cap" rate represents the appropriate rate of return on an investment in commercial real estate, as if that investment (cash and funding) had been made with all-cash. Alternatively, the actual "cap rate" is the current NOI divided by the property value (or price as if paid for with all cash).

Cash-Out Refinancing - This is a new loan which replaces an old loan, giving the borrower extra cash out ofthedeal.

CMBS-REIMC - Commercial Mortgage Backed Securities & the Real Estate Investment Mortgage Conduit loans the provide funding for, allowing Wall Street to invest in mortgages

Commercial Mortgage Numbers -

Potential Gross Income & Effective Gross Income (PGI & EGI) - These are the maximum potential income from a property and the actual gross. PGI would be actual gross if a property

was completely rented and there was no collection loss. In actuality, it is rare to receive PGI. EGI deducts vacancy and collection losses from the potential income to give an actual figure.
Operating Expenses - These are all of the costs associated with an income property, which the owner is responsible for paying. In leases, this does not include taxes and insurance. But, from the owner's standpoint, it includes all expenses the owner pays for.
Net Operating Income (NOI) - This is the income left out of the EGI after deducting the operating expenses.
After Debt Service Income (ADS) - This is what is left of NOI after deducting mortgage expense.
After Tax Income (ATI) - The net profit after operating expenses, debt service and taxes.
Debt Service Coverage Ratio - The ratio between EGI and Operating Expenses (including debt service and management costs). In general, the DSCR should be between 1.2 and 1.5, but there are loans available (at higher rates and smaller LTV) for DSCR's as low as .5 or so.

Conforming Loan - Conforming loans "conform" to the standards of the two major secondary mortgage market lenders (Fannie Mae and Freddie Mac), including being at or under those loan's size limits..

Construction Loan - A construction loan is generally a short-term, higher interest loan, where the lender usually advances money in stages, "draws", as the construction progresses. When the construction is finished, a permanent mortgage "takes out" the construction loan. Construction loans are often based on the prime rate. Popular these days are "One-Close", "construction-to-perm" loans that automatically roll over into a permanent loan when the construction is done and only involve one closing and one set of closing costs.

CTV: (Construction) Cost to Value - The maximum amount of construction costs that a lender will lend.

Credit Risk Considerations - The opposite of mitigating circumstances, these are considerations that, in the eye of the lender, increase their risk when lending. They could include limited credit history; a combination of high DTI and minimal assets, etc.

Cross-collateralization - Like a blanket mortgage, the pledging (hypothecation) of more than one property as security for a mortgage. However, while a blanket mortgage pledges all properties owned at once, cross-collateralization may pledge a property being purchased, along with one already owned.

Debt Service Coverage Ratio (See DSCR)

Debt to Income Ratio (See DTI)

Deed in Lieu of Foreclosure - A lender, when their borrower is deeply in default, may agree to accept a deed from the borrower in exchange for stopping a foreclosure action. This saves them time and money but there are a couple of reasons why this may not be good for the borrower: First, the foreclosure action, even if not completed, will still show up on credit reports. Second, if the lender experiences a loss when they resell the property, they may still be able to obtain a deficiency judgment…meaning the borrower owes money on property they no longer own.

Delinquency vs Default - A delinquency indicates a usually curable lateness; whereas a default is a situation that may or may not be cured…at the discretion of the lender.

Draws - See Construction Loans

DSCR – The ratio between the net income on a rental property (before accounting for the mortgage payment) and the mortgage payment. That is, the gross income, less expenses (except for mortgage payment), divided by the mortgage payment. If the net income is exactly equal to the mortgage payment, the DSCR will be 1. Usually, lender want to see a DSCR of between 1.2 and 1.5.

DTI - This is the ratio of the borrowers monthly debt and their gross income. On some loans (conventional and FHA), two ratios are calculated: One is the bottom ratio that only includes the PITI mortgage payment and the other is the PITI plus all consumer debt payments that appear on the credit report. (See primary and secondary ratios.) On most other loans (except VA), only the second ration is used. VA uses a sort of second ratio but also adds in something to the payment to cover utilities, maintenance and the borrowers income tax. Plus, VA requires a certain minimum cash to be left over each month.

Earnest Money - Money put in escrow to show a buyer is serious about a real estate purchase. Usually credited toward the purchase price but can be lost if buyer defaults on the purchase

ECOA - The name of a law, The Equal Credit Opportunities Act, and a disclosure in a loan package. ECOA makes it illegal to discriminate in the extension of credit. Most borrowers who feel that they have been discriminated against would file a complaint with HUD. But, other agencies are also in a regulatory position, such as the Comptroller of the Currency (National Banks) and the Office of Thrift Supervision (Savings Associations and Federal Savings Banks).

Equity - The difference between a property's value and the debt owed on it

Escrows - Money paid into a special holding (ie: trust) account and held until certain conditions or instructions are met. Earnest money, for example, is often escrowed until settlement, and then credited to the purchase price of real estate. On "budget mortgages" monthly payments exceeding the principal & interest are paid to a lender to be disbursed as future payment of taxes &/or insurance become due.

"FAIR" - The Fair Lending Notice provides a disclosure that it is illegal to discriminate in home financing including discrimination based on the racial character of the neighborhood that includes the subject property, unless the lender can demonstrate that granting the loan would be a bad business practice.

"FAIR" - Also refers to a recent federal law that requires that all residential loan officers be licensed, even if their state did not previously have licensing requirements. All must take a course, pass an exam, be fingerprinted and registered with the US Government. The course and exam includes a universal federal portion, and another portion based on each states laws and regulations.

FICO: Refers to the Fair Isaac Company & the credit scores they issue. Credit scores can generally range from 350 to 850. The assumption is that higher scores indicate higher credit-worthiness.

First Mortgage - A/K/A the superior, primary loan is the mortgage with the earliest filing date.

Fractured Condo's - Condominium projects that have been partially sold, and partially rented out by the developer-owner, usually because the leased units were unsalable and the option was to leave them sitting vacant.

Fully Amortized - Each succeeding payment pays more to principal and less to interest because the interest is based on the (decreasing) remaining principal balance.

Graduated payment mortgages - GPM mortgages have payments that gradually increase (over 2-5 years) at a predetermined rate, either by setting dollar or rate increases. GPM's may involve negative amortization for part of the mortgage term in which the payments are less than they increase to eventually. The intent is to give borrowers a break on the payments in the beginning of the loan without having the uncertainty that is inherent in adjustable rate mortgages, because GPM's rise at pre-disclosed rates and intervals.

Gross Lease – A lease that includes real estate taxes, insurance and maintenance. Utilities may or may not be included in a gross lease, and maintenance would usually not include the cost of repairs when the damage is the fault of the tenant, as opposed to normal “wear and tear”. (See, also, Lease Terms).

Hybrid Mortgage - Hybrid mortgages start out as ARMs and are convertible to fixed rate loans, and vice versa.

Hypothecation - The pledging of real estate as collateral for a loan. The loan is initiated with the note, which is the actual “IOU”, and the hypothecation is accomplished by the mortgage. In the world of commercial lending,

Hypothecation - may refer to a type of loan in which the collateral for the loan is the cash flow from another loan or mortgage. This is somewhat similar to bond securities that are based on, and derive income from loans. But, in the case of bonds, they are often based on a pool of mortgages, whereas a hypothecation loan derives it income, usually, from a single other loan/mortgage.

Improvements - In real estate and mortgage jargon, improvements do not refer to upgrades or rehabs to properties. Rather, the term refers to everything that modified, or was added onto, the originally vacant land. Thus, improvements include grading and fill, roads or other paving, fences, landscaping, utilities and other site items in addition to the actual building structures erected on the property. Hence, tax bills will usually show two components of value…the land, and the improvements.

Index - The component of an adjustable mortgage rate that "floats"

Installment Sale - A type of seller financing which combines an interest-only loan with principal payments paid in installments over two or more tax years. The seller benefits by deferring profit tax and the buyer benefits by deferring payments on the principal.

Interest-Only Loan - Interest-only loans do not include the repayment of any principal for a given time period. The borrower pays only the interest while the loan balance remains unchanged. Some home equity lines of credit are set up as interest-only loans for a given time period (such as 5 years) and then convert to conventional amortized loans.

Jumbo Loan - A/K/A a non-conforming mortgage, this is a loan that may meet all other conforming loan standards, but is larger than the conforming limits set by FannieMae and FreddieMaC.

Liquid Assets - Cash and assets that can be converted to cash easily (excludes REO, artwork, jewelry, etc)
Short Refinances & Short Sales: Refers to refinances or sales in which the mortgage refinance or sales price is for an amount less than the principal owed to the lender. These transactions may, or may not, let the mortgagor (borrower) "off the hook" for the lender's deficiency (loss)

Lease Terms -

> <u>Market Rent vs Contract Rent</u> - The market rent is what a property should rent for, based on the averages in the area, if place for rent today. This contrasts with the actual contract rent on the lease.
> <u>Gross Building Area</u> - The total floor area of a building…as compared to the <u>Gross Leasable Area</u> which is the actual area that can be leased. The difference may reflect common entry areas, utility rooms, etc.

<u>Gross Lease</u> - Landlord pays for all operating expenses, taxes, insurance & maintenance
<u>Net Lease</u> - Tenant pays for operating expenses & taxes
<u>Double Net Lease</u> - Tenant pays for operating expenses, taxes & insurance.
<u>Triple Net Lease</u> - Tenant pays for operating expenses, taxes, insurance & maintenance.
<u>Bondable Lease</u> – A triple lease in which the tenant is also responsible for replacing the structure if destroyed, condemned, etc.
<u>Common Area Maintenance Fees</u> - The "pro-rata" share of expenses of trash removal, landscaping, common area cleaning and maintenance, etc, that is charged to each tenant of a building.

Loan to Cost Ratio - Sometimes used by commercial lenders, this ratio takes into consideration that size of the requested loan and the cost to build or replace the property, particularly the improvements.

Loan to Value Ratio (See LTV)

LTV - The ratio between a loan amount and the value of the property. The "V" in LTV is always the lower of the sales price or value of residential property, but commercial property may allow "after rehab value" or value based on NOI and market capitalization rate.

Lockout - Restriction & Restricted period during which pre-payment is forbidden, even with a PPP.

Margin - The fixed component of an ARM rate that is added to the current index to give the rate

Mitigating Circumstances - These are conditions that offset derogatory conditions when underwriting a loan. For example, somewhat diminished asset reserves may be offset by higher than required income and a low DTI ratio.

Negative Amortization - When negative amortization occurs, it means that the mortgage payment was not
larger enough to pay all interest due. Compare to a fully amortizing payment, which would pay all principal and interest over the term of the loan; and an interest only payment, which pays no principal but does pay all due interest. The negative amortization (unpaid interest) is added to the principal balance. In other words, with negative amortization, the balance goes up after each payment, not down.

Net Lease – (See, also, Lease Terms) A lease in which various expenses are the responsibility of the tenant. If there are multiple tenants, the expenses are paid in proportion to the percentage of the property that each tenant rents. In virtually every net lease, though the tenant may have to pay nearly every expense, the landlord is still responsible for the building structure, roof, etc. Net leases include the following types:

(Single) Net Lease – Tenant pays for real estate taxes
Double Net Lease – Tenant pays for real estate taxes & insurance
Triple Net Lease – Tenant pays for real estate taxes, insurance & maintenance

NWTL: Net Worth to Loan - The ratio of net worth that a lender requires compared to the loan that the lender will make to a borrower. In general, lenders prefer borrowers to have a net worth equal to the proposed loan amount, or up to 50% more (NWTL of 1.5).

NOI - Net Operating Income; The profit, before taxes and debt service, on income property

No-Interest (Islamic) Loan - Some lenders have developed certain types of no-interest loans to meet the needs of Islamic buyers, whose religious beliefs forbid charging interest.

Open End Loan - This is a type of home equity loan or second mortgage which provides a line of credit.

Package Loan - A package loan is a budget loan which includes personal property, such as appliances.

PITI - Principal, Interest, Taxes & Insurance; the components of a fully amortized ("budget") mortgage payment which includes payment of tax and insurance escrows in the payment

Points - These are loan fees, each full point being 1% if the base loan amount.
Also called Discount Points, the implication is that the points lower the interest rate. Paying more discount points should lower the rate, and paying less discount points would increase the interest rate. However, there is no standard relation to how much one discount point relates to a particular rate increase or decrease.
The payment of Discount Points will lower the interest rate for the whole term of the loan. It is also possible to pay points to "buy down" the rate, but then they are not called discount points, and the bought-down rate is only for the initial periods of the loan…anywhere from the first month or few months to the first few years.
"Bips": This is slang for Basis Points,(each of which is equal to 1/100 of a normal percent "point")

Primary Ratio - In residential mortgages: he proposed mortgage PITI, principal, interest, taxes and insurance, payment divided by the borrower's gross monthly income (as adjusted). (See DTI)

PPM/SCOR - The Private Placement Memorandum and a standardized form version permissible in a number of states, SCOR, are disclosure documents used for exempt (from SEC registration) securities offerings. While these can be large documents, they are still much smaller, and less costly, than a full securities registration disclosure.

PPP: Pre-Payment Penalty - A fee paid when a mortgage is paid off (ie: refinanced) earlier than agreed. A soft prepayment penalty is only required in the event of a refinance. A hard penalty is required even if the property is sold. A Yield-Maintenance PPP will be as large as the full amount of interest that would have been garnered if the prepayment never occurred.

Proving a Document - Most documents cannot be filed into the public unless they were acknowledged when signed (signed in front of a Notary Public - often, incorrectly, called "notarizing".) It often happens that one party, or the other, resists signing a document in front of a notary. A way around this is for a witness, who signed AS witness when a document was signed, to go before a Notary Public and swear, under oath, in an affidavit, to all of the things that a Notary would have attested to had the acknowledgement been made at the time of the original signing. This is called "Proving a Document". The affidavit, when filed with the original document, makes the original document eligible for filing.

Purchase Money Loan - This used to refer only to loans financed by the seller to allow someone to buy a home. The term is becoming generalized to refer to any purchase mortgage as opposed to refinances.

REO - Real Estate Owned. Could refer to other real estate properties owned by a borrower as assets; or property taken back, & owned by a bank, which is being sold

Reg/Form D - Regulation D & Form D; The part of the Securities Act of 1933, as amended, which provides for exemptions from securities registration for private offerings; and the form that is filed (now electronically) instead of the registration. "Reg D" generally prohibits public marketing of the offerings and limits the offerings to defined "accredited" investors who have minimum income or asset requirements.

Reverse Mortgage - Designed for senior citizens who are equity-rich and cash-poor, reverse mortgages give the homeowner the opportunity to take out equity from their home without incurring mortgage payments and the equity taken out is generally tax-free. The equity may be taken out as a lifetime fixed monthly check, a lump sum, as a line of credit or a combination of methods.. When the homeowner dies, moves, sells the property or refinances it, the loan must be paid off (including any accrued interest). The older the homeowner is, the larger would be the monthly payment. Like life insurance, actuarial table play a part here. Fortunately, the mortgage balance, even with accrued interest, can never be higher than the value of the property at the time the loan is originated. The homeowner may also decide to sell the house and receive the leftover cash. Reverse mortgages can provide real benefits, but some predatory lenders have scammed unsuspecting seniors with huge up-front loan fees. Properly designed, a reverse mortgage can change lives for the better.

SBA - Like FHA & VA residential loans, these are loans insured by the government, but made by private lenders. SBA loans are insured by the Small Business Administration. Some allow as little as 10% down payment.

Second Mortgage - An additional mortgage that is in second position or subordinate to the first mortgage. These may be a fixed or adjustable rate mortgage at a higher rate than the first mortgage (to eliminate MI) or they may be a home equity loan or home equity lines of credit.

Secondary Ratio - In residential mortgages: The proposed mortgage PITI, principal, interest, taxes and insurance, payment, AND the borrower's monthly credit debt payments, divided by the borrower's gross monthly income (as adjusted). (See DTI)

Short Refinances & Short Sales - Refers to refinances or sales in which the mortgage refinance or sales price is for an amount less than the principal owed to the lender. These transactions may, or may not, let the mortgagor (borrower) "off the hook" for the lender's deficiency (loss)

Simple (Daily) Interest loan - A complicated type of loan that requires that payments be made exactly on the same date each month.

Shared Appreciation Mortgage (SAM) - In this type of loan, the lender gives the borrower a lower interest rate in exchange for a 30 to 60 percent share of the property's future appreciation. The more appreciation the borrower agrees to share with the lender, the lower the interest rate. SAM's are making a comeback in some areas because of rising home prices and mortgage rates.

Straw Buyer - A person who acts as the buyer, with the intent to transfer the property to the actual person who intends to possess the property. Not illegal, in & of itself, but it IS a crime when the straw buyer obtains a loan and then transfers the property without paying off the loan, or if the straw buyer lied about their intent to occupy the property

Take-Out Loan - See Construction Loans (also can replace a bridge loan).

Term (Straight) Loan - The term, or straight loan was widely used prior to the Great Depression of the 1930s. Borrowers paid the interest in a lump sum at the end of each year. The principal was due at the end of the loan period, which could be as short as one to five years.

Title Bringdown - The process of updating a title commitment, usually to verify the absence of subcontractors liens during a construction loan's term (before each "draw")

Wraparound Loan - In this arrangement, a buyer purchases the property with the seller's existing loan still in effect. The seller continues to make payments on the original loan and the buyer obtains a new loan that "wraps around" the first loan.