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 the 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". Unmarried borrowers are place 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. 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 fa iluretopayrealestatetaxes).

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) - The adjustable rate mortgage (ARM) now makes 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. The interest rate is the sum of an index rate and a margin. Common index rates are the prime rate, the 11th District Cost of Funds Index (COFI), 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. Some ARMs offer reduced initial rates.

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

(Fully) Amortized Loan - This is the modern mortgage loan, were the borrower makes equal monthly payments which are part principal and part interest. 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.

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 30-year period. Borrowers often refinance the loan, before the term is up, to avoid having to make the balloon payment.

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

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 are often used by buyers between the closing dates of a home purchase and a home sale.

Budget Loan - The budget loan includes the standard housing costs, which are the principal, interest, real estate taxes and insurance (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 all 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.

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

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 e xpenses.

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 2.0, 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 advances money in stages as the construction progresses. When the home is completed, a permanent mortgage "takes out" the construction loan. Construction loans are often based on the prime rate. Popular these days are "One-Close" construction 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.

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.

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.

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).

"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.

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

Graduated payment mortgages - GM 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.

Gross Lease – A lease which 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.

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.

Lease Terms -

> Market Rent vs Contract Rent - 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.
> Gross Building Area - The total floor area of a building…as compared to the Gross Leasable Area which is the actual area that can be leased. The difference may reflect common entry areas, utility rooms, etc.
> Gross Lease - Landlord pays for all operating expenses, taxes, insurance & maintenance
> Net Lease - Tenant pays for operating expenses & taxes
> Double Net Lease - Tenant pays for operating expenses, taxes & insurance.
> Triple Net Lease - Tenant pays for operating expenses, taxes, insurance & maintenance.
> Bondable Lease – A triple lease in which the tenant is also responsible for replacing the structure if destroyed, condemned, etc.
> Common Area Maintenance Fees - 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 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.

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

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.

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

Proving a Document - Most documents cannot be filed unless they were acknowledged when signed. 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 had an acknowledgement been made at the time of the original signing. This is called "Proving a Document".

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..

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.

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 - 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)

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.

Take-Out Loan - This is a conventional loan which replaces or "takes out" another loan, such as a construction or 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.

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.