

Adjustable rate mortgage (ARM): A mortgage that does not have a fixed interest rate. The rate changes during the life of the loan in line with movements in an index rate, such as the rate for Treasury securities or the Cost of Funds for SAIF-insured institutions. ARMs are also known as adjustable-mortgage loans (AMLs) or variable-rate mortgages (VRMs).¹

Annual percentage rate (APR): A measure of the cost of credit, expressed as a yearly rate. It includes interest as well as other charges. Because all lenders follow the same rules when calculating the APR, it provides consumers with a good basis for comparing the cost of loans, including mortgages.²

Amortization: The gradual repayment of a mortgage loan by making regular payments over time. To be “fully amortizing,” payments must cover both the principal amount and interest due on the loan for the given period. An amortization schedule is an established timetable for making payments.³

Balloon mortgage: A mortgage with monthly payments based on a 30-year amortization schedule, with the unpaid balance due in a lump sum payment at the end of a specific period of time (usually 5 or 7 years). The mortgage contains an option to “reset” the interest rate to the current market rate and to extend the due date if certain conditions are met.⁴

Binding mandatory arbitration (BMA): A clause in a loan contract that requires the borrower to use arbitration to resolve any legal disputes that arise from the loan. Mandatory arbitration typically means borrowers lose their right to pursue legal actions, including any appeals, in a court of law.⁵ To learn more about mandatory arbitration, visit www.responsiblelending.org/issues/arbitration.

Cap: A limit on how much the interest rate or the monthly payment may change, either at each adjustment or during the life of the mortgage.⁶

Conversion clause: A provision in some ARMs that allow the borrower to change the ARM to a fixed-rate loan at some point during the term.⁷

Forbearance: The lender’s postponement of legal action when a borrower is delinquent. It is usually granted when a borrower makes satisfactory arrangements to bring the overdue mortgage payments up to date.⁸

Fixed-rate mortgage: A mortgage with payments that remain the same throughout the life of the loan because the interest rate and other terms are fixed and do not change.⁹

Good faith estimate: The Real Estate Settlement Procedures Act (RESPA) requires the mortgage lender to give borrower a good faith estimate of all the closing costs within 3 business days of submitting the application for a loan, whether the borrower is purchasing or refinancing a home. The actual expenses at closing may be somewhat different from the good faith estimate.¹⁰

Hybrid loan: A loan with a combination of interest rates. There are two different types of hybrid loan: those that begin as ARMs and convert to a fixed rate and those that begin as a fixed-rate loan and convert to an ARM. A common type of hybrid is the “2/28” ARM, which comes with an initial short-term fixed interest rate for two years, followed by rate adjustments, generally in six-month increments for the remainder of the loan’s term.¹¹

Home Mortgage Disclosure Act (HMDA): Enacted by Congress in 1975, HMDA requires most mortgages lenders located in metropolitan areas to collect data about their housing-related lending activity, report the data annually to the government, and make the data publicly available. Initially, HMDA required reporting of the geographic location of originated and purchased home loans. In 1989, Congress expanded HMDA data to include information about denied home loan application, and the race, sex, and income of the applicant or borrower. In 2002, the Federal Reserve Board amended the regulation that implements HMDA (Regulation C) to add new data fields, including price data for some loans.¹²

The Home Ownership and Equity Protection Act (HOEPA): Enacted as a part of the Truth-in Lending Act, HOEPA prohibits extending credit without regard to a consumer’s repayment ability. HOEPA identifies a high-cost mortgage loan through rate and fee triggers, and it provides consumers entering into these transactions with special protections. HOEPA applies to closed-end home-equity loans (excluding home-purchase loans) bearing rates or fees above a specified percentage or amount.¹³ Visit the Board of Governors of the Federal Reserve System for more information: <http://www.federalreserve.gov/events/publichearings/hoepa/2006/default.htm>.

Interest-only mortgage: In a nontraditional, interest-only (IO) mortgage, the borrower is required to pay only the interest due on the loan for the first few years during which time the rate may be fixed or fluctuate. After the IO period, the rate may be fixed or fluctuate based on the prescribed index; payments consist of both principal and interest.¹⁴

Loan servicing: The tasks a lender performs to protect a mortgage investment, including collecting monthly payments from borrowers and dealing with delinquencies.¹⁵

Loan flipping: “Loan flipping” refers to the practice of encouraging borrowers to rapidly refinance loans. Loan flipping may result in a loss of equity and an increase in monthly payments because refinancing involves fees and often these charges are refinanced into the amount of the loan.¹⁶

Loan modification: A permanent change in one or more of the terms of a mortgagor’s loan, allows the loan to be reinstated, and results in a payment the mortgagor can afford.¹⁷ For more information on loan modifications, visit HUD at www.hud.gov/offices/hsg/sfh/nsc/faq/m.cfm.

Loss mitigation: A process to avoid foreclosure; the lender tries to help a borrower who has been unable to make loan payments and is in danger of defaulting on his or her loan.¹⁸

Negative Amortization: Occurs when monthly mortgage payments do not cover all the interest owed. The interest that is not paid in the monthly payment is added to the loan balance.¹⁹

Partial claim: Under the Partial Claim option, a mortgagee will advance funds on behalf of a mortgagor in an amount necessary to reinstate a delinquent loan (not to exceed the equivalent of 12 months PITI). The mortgagor will execute a promissory note and subordinate mortgage payable to HUD. Currently, these promissory or “Partial Claim” notes assess no interest and are not due and payable until the mortgagor either pays off the first mortgage or no longer owns the property.²⁰ Visit HUD’s website to learn more about partial claims, www.hud.gov/offices/hsg/sfh/nsc/faqpc.cfm.

Payment-Option Adjustable-Rate Mortgage: A payment-option adjustable rate mortgage—also known as a flexible-payment ARM, pay-option ARM, option ARM, or PO—is considered nontraditional in that it allows the borrower to choose from a number of payment options. For example, the borrower may choose either a minimum payment option each month based on an introductory interest rate, an IO payment option based on the fully indexed interest rate, or a fully amortizing principal-and-interest payment option based on a 15- or 30 year loan term plus any required escrow payments. The minimum payment option can be less than the interest accruing on the loan, resulting in negative amortization. The IO option avoids negative amortization but does not allow principal amortization. After a certain number of years, or if the loan reaches a certain negative amortization cap, the required monthly payment amount is refigured to require payments that will fully amortize the outstanding balance over the remaining loan term.²¹

Piggyback loan: Also known as a simultaneous second-lien loan, a lending arrangement where either a closed-end second lien or a home equity line of credit is originated at the same time as the first-lien mortgage loan, usually taking the place of a larger down payment.²²

Points and fees: Costs to borrowers that are not directly reflected in interest rates. “Points” or “discount points” are fees calculated as a percentage of the loan principal; one point equals one percent of the principal. Fees may include compensation to a broker, charges by the lender, and third-party charges for appraisals, title insurance, etc. High points and fees are frequently the hallmark of a predatory loan, and they can disguise the real cost of credit when they are financed rather than paid outright at a loan closing.²³

Preforeclosure sale: A procedure in which the borrower is allowed to sell his or her property for an amount less than what is owed on it to avoid a foreclosure. This sale fully satisfies the borrower’s debt.²⁴

Predatory lending: A term for a variety of lending practices that strip wealth or income from borrowers. Predatory loans typically are much more expensive than justified by the risk associated with the loan. Characteristics of predatory loans may include, but are not limited to, excessive or

hidden fees, charges for unnecessary products, high interest rates, terms designed to trap borrowers in debt, and refinances that do not provide any net benefit to the borrower.²⁵ Learn more about predatory lending at www.dontborrowtrouble.com/en/anti_predatory.html.

Prepayment penalty: A fee charged by a lender when a borrower pays off a mortgage before all payments are due, often to refinance the loan at a more affordable rate. Prepayment penalties vary in size and how long they remain in effect.²⁶

Real Estate Settlement Procedures Act (RESPA): RESPA requires that consumers receive disclosures at various times in the transaction and outlaws kickbacks that increase the cost of settlement services. RESPA is a HUD consumer protection statute designed to help homebuyers be better shoppers in the home buying process, and is enforced by HUD.²⁷ For complete information about RESPA, go to www.hud.gov/offices/hsg/sfh/res/respamor.cfm

Reduced documentation: A reduced-documentation loan feature is commonly referred to as a “low doc/ no doc,” “no income/no asset,” “stated income,” or “stated assets” feature. When applied to mortgages, a lender sets reduced or minimal documentation standards to corroborate a borrower’s income and assets.²⁸

Regulation Z: The Federal Reserve Board of Governors has adopted Regulation Z to implement the Truth-in-Lending Act. The regulation has specific requirements giving some borrowers the right to rescind certain loans and very specific requirements about how banks must disclose rescission rights. The regulation also includes very detailed requirements for calculating and disclosing annual percentage rates for many loans.²⁹ Visit the Federal Reserve Board of Governors at www.federalreserve.gov/events/publichearings/hoepa/2006/default.htm for more information.

Steering: The practice of encouraging borrowers to accept higher-cost sub-prime loans even when they qualify for a more affordable prime loan.³⁰

Truth-in Lending Act (TILA): Congress enacted the Truth-in-Lending Act (TILA) to allow consumers to assess the true cost of credit, and encourage free competition between lenders. One of the key provisions of TILA is the requirement to disclose a loan’s annual percent rate. Overdraft loans have been exempted from this requirement, allowing financial institutions to charge high interest rates without disclosing them.³¹ (See Regulation Z.)

Underwriting: A lender’s process for assessing the risk involved in making a mortgage loan to determine whether the risk is acceptable. Underwriting involves an evaluation of the value of the property and the borrower’s willingness and ability to repay the loan.³²

Yield spread premium: A payment a mortgage broker receives from a lender for delivering a loan with an interest rate higher than the minimum rate the lender would accept for that particular loan.³³ Learn more about yield spread premiums at the Center for Responsible Lending’s website: www.responsiblelending.org/issues/mortgage/ysp.html.