

THE MORTGAGE ENCYCLOPEDIA

**An Authoritative Guide to
Mortgage Programs,
Practices, Prices, and Pitfalls**



INCLUDES RE-FI BREAK-EVEN TABLES

JACK GUTTENTAG
"THE MORTGAGE PROFESSOR"

The Mortgage Encyclopedia

**An Authoritative Guide to Mortgage
Programs, Practices, Prices, and Pitfalls**

Jack Guttentag
"The Mortgage Professor"

McGraw-Hill

New York Chicago San Francisco Lisbon
London Madrid Mexico City Milan New Delhi
San Juan Seoul Singapore Sydney Toronto

Copyright © 2004 by Jack Guttentag. All rights reserved. Printed in the United States of America. Except as permitted under the United States Copyright Act of 1976, no part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written permission of the publisher.

9 0 DOC/DOC 0 9 8 7

ISBN 0-07-142165-3

Editorial and production services provided by CWL Publishing Enterprises, Inc., Madison, Wisconsin, www.cwlpublish.com.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that neither the author nor the publisher is engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

—From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers

McGraw-Hill books are available at special quantity discounts to use as premiums and sales promotions, or for use in corporate training programs. For more information, please write to the Director of Special Sales, McGraw-Hill, 2 Penn Plaza, New York, NY 10121-2298. Or contact your local bookstore.

Introduction

For all practical purposes, I began writing this book in 1998 when I started writing a weekly newspaper column on mortgages that was syndicated by Inman. In 1999, I started www.mtgprofessor.com, which pulled the columns together, and added calculators, spreadsheets, and other materials including a way for readers to send me questions. I spent a lot of time organizing these materials into a coherent structure, and my thinking about a book version posited a similar organization.

For that reason, when Richard Narramore of McGraw-Hill approached me about preparing a book organized in an encyclopedia format, I resisted. But Richard was persistent, and I began to reconsider. Although I liked the organization on my Web site, I was forced to admit that my readers had a lot of trouble with it. About a third of my replies to those who wrote me consisted of referrals to the Web pages where the answer to their questions would be found.

Many of the questions I receive from consumers reflect what they have been told by loan officers and mortgage brokers, who don't think about mortgages the way I do. As one example, a mortgage contract may have a provision that allows the borrower to pay only the interest for some period—"interest-only." Any mortgage, whether it is fixed rate or adjustable rate, can have such a provision. It is an option. But that is not the way it is marketed. Loan officers and mortgage brokers sell it as a special kind of mortgage, as if there were fixed-rate, adjustable rate, and interest-only mortgages. Then their

customers may write me to ask about the advantages and disadvantages of interest-only mortgages compared to those other types. While this question makes no sense, those who ask it need to learn, with the least expenditure of time and effort, why it makes no sense.

The encyclopedia A to Z format turns out to be an efficient way to convey this information, avoiding conflict between the way I perceive a problem and the way many readers perceive it. I see interest-only as an option, many readers see it as a type of mortgage, but we can both agree that in an encyclopedia it appears under "I."

I'm known as "The Mortgage Professor." Often in this book I refer to my Web site, **www.mtgprofessor.com**, where you'll find backup information, mortgage calculators, and more to help you make the best decisions about financing or refinancing your real estate.

Acknowledgments

Much of what I know about the home mortgage market I learned from the 25,000 or so borrowers who have e-mailed questions and comments to me over the last six years. A number of loan officers and mortgage brokers have also contributed to my education, often by being combative, occasionally for good reason. Catherine Coy, who brokers in Los Angeles, has been particularly helpful in improving my understanding of what goes on in the mortgage trenches. My wife Doris has been quietly supportive, as she has been throughout the best years of my life.

—Jack Guttentag

The Mortgage Encyclopedia

Topics

A

| | |
|--------------------------------|----|
| A-Credit | 1 |
| Acceleration Clause | 1 |
| Accrued Interest | 1 |
| Adjustable Rate Mortgage (ARM) | 1 |
| Adjustment Interval | 12 |
| Affordability | 13 |
| Agreement of Sale | 15 |
| Alternative Documentation | 15 |
| Amortization | 16 |
| Annual Percentage Rate (APR) | 19 |
| Application | 22 |
| Application Fee | 22 |
| Appraisal | 22 |
| Appraisal Fee | 22 |
| Appraiser | 22 |
| Approval | 23 |
| APR | 23 |
| ARM | 23 |
| Assignment | 23 |
| Assumable Mortgage | 23 |
| Assumption | 27 |
| Auction Sites | 27 |
| Authorized User | 27 |
| Automated Underwriting | 27 |
| Automated Underwriting System | 27 |

B

| | |
|-------------------------------|----|
| Balance | 27 |
| Balloon | 28 |
| Balloon Mortgage | 28 |
| Bimonthly Mortgage | 29 |
| Biweekly Mortgage | 29 |
| Bridge Loan | 30 |
| Builder-Financed Construction | 31 |

C

| | |
|------------------------------|----|
| Cap | 31 |
| Cash-Out Refi | 31 |
| Closing | 32 |
| Closing Costs | 32 |
| Closing Date | 32 |
| Co-Borrowers | 33 |
| COFI | 36 |
| Conforming Mortgage | 36 |
| Construction Financing | 36 |
| Contract Chicanery | 39 |
| Conversion Option | 39 |
| Correspondent Lender | 39 |
| Co-Signing | 39 |
| Cost-of-Savings Index (COSI) | 40 |
| Credit Report | 40 |
| Credit Score | 41 |
| Cumulative Interest | 45 |
| Current Index Value | 46 |

D

| | |
|-----------------------------|----|
| Deadbeat | 46 |
| Debt Consolidation | 46 |
| Deed in Lieu of Foreclosure | 48 |
| Default | 48 |
| Deferred Interest | 48 |

Topics

| | |
|---------------------------------|----|
| Delinquency | 48 |
| Demand Clause | 48 |
| Direct Lender | 49 |
| Discount Points | 49 |
| Discretionary ARM | 49 |
| Documentation Requirements | 49 |
| Down Payment | 51 |
| “Dual-Apper” | 58 |
| Dual Index Mortgage | 58 |
| Due-on-Sale Clause | 58 |
| E | |
| Effective Rate | 59 |
| 80/10/10 and 80/15/5 Loan Plans | 59 |
| Equity | 59 |
| Escrow Account | 59 |
| F | |
| Fallout | 61 |
| Fannie Mae | 61 |
| FHA Mortgage | 61 |
| FICO Score | 64 |
| Financing Points | 64 |
| First Mortgage | 64 |
| Fixed-Rate Mortgage (FRM) | 64 |
| Float | 65 |
| Float-Down | 65 |
| Forbearance Agreement | 65 |
| Foreclosure | 65 |
| Freddie Mac | 65 |
| Fully Amortizing Payment | 65 |
| Fully Indexed Rate | 65 |
| G | |
| Generic Prices | 66 |
| Gift of Equity | 66 |

Topics

| | |
|--|----|
| Good Faith Estimate (GFE) | 66 |
| Government National Mortgage Association (GNMA) | 66 |
| Grace Period | 66 |
| Graduated Payment Mortgage (GPM) | 66 |
| H | |
| Hazard Insurance | 67 |
| Historical Scenario | 67 |
| Homebuyer Protection Plan | 67 |
| Home Equity Conversion Mortgage (HECM) | 67 |
| Home Equity Line | 67 |
| Home Equity Line of Credit (HELOC) | 67 |
| Home Equity Loan | 71 |
| Home Keeper | 71 |
| Homeowner's Equity | 71 |
| Housing Bank | 71 |
| Housing Expense | 73 |
| Housing Expense Ratio | 73 |
| Housing Investment | 73 |
| I | |
| Indexed ARMs | 76 |
| Initial Interest Rate | 76 |
| Initial Rate Period | 77 |
| Interest Accrual Period | 77 |
| Interest Cost (IC) | 77 |
| Interest Due | 78 |
| Interest-Only Mortgage (Option) | 78 |
| Interest Payment | 81 |
| Interest Rate | 82 |
| Interest Rate Adjustment Period | 83 |
| Interest Rate Ceiling | 83 |
| Interest Rate Decrease Cap | 83 |
| Interest Rate Floor | 84 |

| | |
|-----------------------------|----|
| Interest Rate Increase Cap | 84 |
| Interest Rate Index | 84 |
| Internet Mortgages | 84 |
| J | |
| Jumbo Mortgage | 84 |
| Junk Fees | 84 |
| L | |
| Late Fees | 85 |
| Late Payment | 85 |
| Lead-Generation Sites | 85 |
| Lender | 87 |
| Loan Amount | 87 |
| Loan “Flipping” | 87 |
| Loan Officer | 88 |
| Loan Provider | 88 |
| Loan-to-Value Ratio (LTV) | 88 |
| Lock Commitment Letter | 88 |
| Locking the Loan | 88 |
| Lock-Jumper | 94 |
| Lock Period | 94 |
| M | |
| Mandatory Disclosure | 94 |
| Manufactured Home | 95 |
| Margin | 98 |
| Market Niche | 98 |
| Maturity | 98 |
| Maximum Loan Amount | 98 |
| Maximum Loan-to-Value Ratio | 98 |
| Maximum Lock | 99 |
| Minimum Down Payment | 99 |
| Monthly Debt Service | 99 |
| Monthly Housing Expense | 99 |
| Monthly Total Expense | 99 |

Topics

| | |
|------------------------------|-----|
| Mortgage | 99 |
| Mortgage Auction Site | 100 |
| Mortgage Bank | 100 |
| Mortgage Broker | 100 |
| Mortgage Company | 103 |
| Mortgage Equations | 103 |
| Mortgage Insurance | 105 |
| Mortgage Insurance Premium | 105 |
| Mortgage Lender | 105 |
| Mortgage Payment | 106 |
| Mortgage Price | 106 |
| Mortgage Price Quotes | 107 |
| Mortgage Program | 110 |
| Mortgage Referrals | 110 |
| Mortgage Scams and Tricks | 112 |
| Mortgage Shopping | 123 |
| N | |
| Negative Amortization | 133 |
| Negative Amortization Cap | 133 |
| Negative Points | 133 |
| Net Branch | 133 |
| Net Jumping | 133 |
| Nichification | 133 |
| No-Asset Loan | 137 |
| No-Change Scenario | 137 |
| No-Cost Mortgage | 137 |
| No-Income Loan | 138 |
| Non-Conforming Mortgage | 138 |
| Non-Permanent Resident Alien | 138 |
| No-Ratio Loan | 139 |
| Note | 139 |

Topics

O

| | |
|-----------------|-----|
| 100% Loan | 139 |
| 125% Loan | 139 |
| Origination Fee | 139 |
| Overage | 139 |

P

| | |
|---|-----|
| Partial Prepayments (or Paying Off Early) | 141 |
| Pay-Down Magic | 146 |
| Payment Adjustment Cap | 147 |
| Payment Adjustment Interval | 147 |
| Payment Period | 148 |
| Payment Problems | 148 |
| Payment Rate | 151 |
| Payment Shock | 152 |
| Payoff Month | 152 |
| Per Diem Interest | 152 |
| Permanent Buydown | 152 |
| Pipeline Risk | 152 |
| PITI | 153 |
| PMI | 153 |
| Points | 153 |
| Portable Mortgage | 156 |
| Portfolio Lender | 158 |
| Pre-Approval | 158 |
| Predatory Lending | 158 |
| Prepayment | 162 |
| Prepayment Penalty | 163 |
| Pre-Qualification | 165 |
| Price Gouging | 165 |
| Primary Residence | 165 |
| Principal | 165 |

Topics

| | |
|------------------------------------|-----|
| Principal Limit | 166 |
| Private Mortgage Insurance (PMI) | 166 |
| Processing | 172 |
| Q | |
| Qualification | 173 |
| Qualification Rate | 179 |
| Qualification Ratios | 179 |
| Qualification Requirements | 179 |
| R | |
| Rate | 179 |
| Rate/Point Break-Even | 179 |
| Rate/Point Options | 180 |
| Rate Protection | 180 |
| Rebate | 180 |
| Recast Clause | 180 |
| Referral Site | 180 |
| Refinance | 181 |
| Required Cash | 190 |
| RESPA | 190 |
| Retail Lender | 194 |
| Reverse Mortgage | 194 |
| S | |
| Scheduled Mortgage Payment | 208 |
| Second Mortgage | 208 |
| Secondary Mortgage Markets | 213 |
| Self-Employed Borrower | 217 |
| Seller Contribution | 217 |
| Servicing | 217 |
| Servicing Agent | 222 |
| Settlement Costs | 222 |
| Shared Appreciation Mortgage (SAM) | 226 |
| Shopping Site | 227 |
| Short Sale | 227 |

Topics

| | |
|--|-----|
| Silent Second | 227 |
| Simple Interest | 227 |
| Simple Interest Biweekly Mortgage | 228 |
| Simple Interest Mortgage | 228 |
| Single-Lender Web Site | 228 |
| Stated Assets | 228 |
| Stated Income | 228 |
| Streamlined Refinancing | 229 |
| Subordinate Financing | 229 |
| Subordination Policy | 229 |
| Sub-Prime Borrower | 229 |
| Sub-Prime Lender | 229 |
| Swing Loan | 230 |
| T | |
| Tax Deductibility (of Interest and Points) | 230 |
| Teaser Rate | 231 |
| Temporary Buydown | 231 |
| Temporary Lender | 233 |
| Term | 233 |
| 3/2 Down Payment | 237 |
| Title Insurance | 237 |
| Total Annual Loan Costs (TALC) | 240 |
| Total Expense Ratio | 240 |
| Total Housing Expense | 241 |
| Total Interest Payments | 241 |
| Truth in Lending (TIL) | 241 |
| 12 MTA | 243 |
| U | |
| Underage | 243 |
| Underwriting | 244 |
| Underwriting Requirements | 244 |
| Upfront Mortgage Broker (UMB) | 244 |
| Upfront Mortgage Lender | 245 |

Topics

V

| | |
|-------------|-----|
| VA Mortgage | 247 |
|-------------|-----|

W

| | |
|----------------------|-----|
| Waiver of Escrows | 248 |
| Warrantable Condo | 248 |
| Wholesale Lender | 248 |
| Workout Assumption | 248 |
| Worst-Case Scenario | 248 |
| Wrap-Around Mortgage | 249 |

Y

| | |
|----------------------|-----|
| Yield-Spread Premium | 250 |
|----------------------|-----|

Z

| | |
|--------------|-----|
| Zero Balance | 250 |
|--------------|-----|

| | |
|------------------------------------|------------|
| Refinance Break-Even Tables | 251 |
|------------------------------------|------------|

A-Credit *A borrower with the best credit rating, deserving of the lowest prices that lenders offer.*

Most lenders require a FICO score above 720. See **Credit Score/Use of FICO Scores by Lenders**. There is seldom any payoff for being above the A-credit threshold, but you pay a penalty for being below it.

Acceleration Clause *A contractual provision that gives the lender the right to demand repayment of the entire loan balance in the event that the borrower violates one or more clauses in the note.*

Such clauses may include sale of the property, failure to make timely payments, or provision of false information.

I have never seen a note that did not have such a clause. Borrowers need not concern themselves with it except where the lender has discretion to exercise it without conditions. This would be referred to as a “demand feature,” and it would be flagged on the Truth in Lending Disclosure Statement. If that statement shows “This loan has a Demand Feature...,” the note should be read with care. See **Demand Clause**.

Accrued Interest *Interest that is earned but not paid, adding to the amount owed.*

For example, if the monthly interest due on a loan is \$600 and the borrower pays only \$500, \$100 is added to the amount owed by the borrower. The \$100 is the accrued interest. On a mortgage, accrued interest is usually referred to as **Negative Amortization**.

Adjustable Rate Mortgage (ARM) *A mortgage on which the interest rate can be changed by the lender.*

While ARM contracts in many countries abroad allow rate changes at the lender’s discretion (**Discretionary ARMs**), in the U.S. rate changes on ARMs are mechanical. They are based on changes in