Glossary of Terms

A

Abstract of title: A summary of the public records relating to the title (or ownership) of a particular piece of land or property. An abstract of title should be a chronological history of recorded instruments that affect the title of the subject property. In some states, an attorney does a title search using an abstract. An attorney or title insurance company reviews an abstract of title to determine whether there are any title defects which must be cleared before a buyer can purchase clear, marketable, and insurable title.

Acceleration clause: A clause in a note, *bond,* mortgage or deed of trust giving the lender the right to demand the remaining balance due and payable before its original date due to an event of a *default*.

Accessory building: A building or structure detached from but on the same property as a main building. Examples of accessory buildings are garages, storage buildings and guest houses.

Accrued interest: Interest accumulated on a loan but not paid since the last due date.

Act of God: An event that causes damage by nature such as a flood, earthquake or tornado. Often referred to in insurance documents.

Action to quiet title: A court action to establish ownership of real property. This court action usually removes any interest or claim to title of real estate, also referred to as a "cloud" on the title. Normally a lender will not commit to a mortgage for a property with title issues. If the complainant is successful in the court action, the title is made quiet, or "clean".

Adaptive reuse: Providing a new use for an older, but sound, structure. Examples might be an abandoned warehouse that is converted into housing or a business such as a charter school.

Add-on interest: Interest added to the amount of the loan on the front end, or beginning of the loan repayment period. The balance (of principal and interest) is then paid by installments. This form of interest is much more expensive than simple interest paid on the entire amount for the entire term of the loan.

Adjustable-Rate Mortgage (ARM): Normally used to describe residential mortgages where the *interest rate* changes during the life of the loan in line with movements in an *index* rate. The rate is usually based on indices tied to the nation's economy. Commercial mortgages with these rates are referred to as "floaters," or having *floating rates*.

Adjusted basis: The original cost of the property plus improvements (including what it cost to sell the property), less depreciation. The gain on the sale is calculated by subtracting the adjusted basis from the sale price.

Agreement of sale: A contract in which a seller agrees to sell and a buyer agrees to buy, under certain specific terms and conditions spelled out in writing and signed by both parties. May be known by various names, such as *contract of purchase*, purchase agreement, binder or *sales agreement* according to location or jurisdiction. See *earnest money*.

American Institute of Architects (AIA): A professional organization of architects. All members of the AIA are registered architects who adhere to AIA' s standards of ethical practice, however, registered or licensed architects are not required to be members of the AIA.

American Land Title Association (ALTA): An organization comprising title insurance companies, abstractors and attorneys specializing in real property law. ALTA has adopted many title insurance policy forms that standardize coverage nationally for property owners and lenders. Many states require ALTA standardized title insurance policies.

Amortization schedule: A list showing the payment number, interest payment, principal payment, total payment and unpaid principal balance.

Amortization: The process of paying off a debt or mortgage, usually by monthly payments. There will be a portion of *interest* and principal in every loan payment. In most standard mortgages, the monthly payment is even with an increasing amount of that payment going toward principal reduction over time.

Amount financed: The base loan amount without regard to *closing costs,* discount points or mortgage insurance premiums.

Application fee: Some lenders may require a small fee as part of the application process. It may be nonrefundable.

Appraisal Institute: A professional organization of real estate appraisers. The Appraisal Institute is the result of a merger between the former American Institute of Real Estate Appraisers (AIREA) and the Society of Real Estate Appraisers. The surviving designations are the MAI (Member of the Appraisal Institute) and SRA (Senior Residential Appraiser).

Appraisal report: A written opinion of the fair *market value* of real estate. The report contains the estimate of value; date of valuation; certification and signature of the appraiser; the purpose, qualifying conditions and description of the subject property and its ownership; a neighborhood description; the approaches to value; and the final determination of value. An appraiser usually reports the present market value for an existing property and proposed improvements. For example, the appraiser may report a value as of the conclusion of construction and as of a projected date. Normally required for all mortgages to be completed by a licensed professional.

There are three different types of valuation approach depending upon the property type and current or anticipated usage. The Market Approach bases value on the sales of other comparable properties. The *Cost Approach* bases value on what it will cost to replace the property. The Income Approach bases value on the income produced by owning the property. In most appraisals all three approaches will be used, with the appraiser stating what approach was most influential in making the final determination of value. In some markets, charter schools can pose a difficultly for appraisers as they attempt to locate comparable school properties and to calculate the possible income generated by the property.

Appraiser: One who estimates value on a professional level. Qualified appraisers have designations of MAI (Member of the Appraisal Institute) or SRA (Senior Residential Appraiser).

Appreciation: An increase in the value of a property due to changes in market conditions or other causes.

Arm's-length transaction: A transaction between individuals who do not have a conflict of interest or reason for collusion. The value of property should be questioned for fairness or accuracy if there is not an arm's-length transaction between buyer and seller. In general, appraisers typically use comparable sales that arm's-length transactions in the market approach to value.

Arrears: Refers to the end of a period with respect to interest payments. For example, interest on a mortgage is paid in arrears, as contrasted with rent, which is paid in advance. For example, a mortgage payment due May 1 is for the interest and principal for April; rent due May 1 is for the month of May. The term can also pertain to delinquent mortgage payments. A mortgage loan that is three months delinquent can be said to be three months in arrears.

Assessed valuation: The dollar amount or value on what real estate tax is levied. If a property worth $100,000 is assessed for tax purposes at 50% of value, the assessed valuation is $50,000. County or township tax assessors normally make appraisals for tax reasons. Many state laws require properties to be reappraised periodically. If the taxpayer disagrees with the appraisal, he or she can appeal to a board of appeal or board of equalization.

Assessment: (1) The fair market value of property for tax purposes. (2) An expense appropriated to a unit of a whole such as a condominium assessment for common grounds, maintenance or an additional charge for improvement. (3) A levy for adding a product or service to a neighborhood, such as curbs or sewers. (4) A value given to a property owner for the taking of the property by the process of *condemnation*.

Asset: Something of value that is owned. An asset could be a parcel of land, a building, stocks or *bonds*, and other "fixed assets" such as heavy equipment, computers and furniture.

Assign: The act of transferring rights or property to another.

Assignee: One who receives rights or property. An assignee stands in the place of the *assignor* for rights, liabilities and interest in the property.

Assignor: One who assigns rights or property.

Assumption of mortgage: An obligation undertaken by the purchaser of property to be liable for payment of an existing mortgage. In a full assumption, the purchaser is substituted for the original mortgagor in the mortgage instrument and the original mortgagor is to be released from further liability. In the assumption, the lender's consent is usually required. The original mortgagor should always obtain a written release from further liability to be fully released under the assumption. Failure to obtain such a release may keep the original mortgagor liable for payments on the mortgage if the assumptor of the mortgage fails to make the monthly payments.

Attestation: The act of witnessing a signature on an legal document.

B

Backup contract: A term often used with contracts to buy real estate. A backup contract is a contract that replaces a prior contract in the event of failure to perform or close by the parties of the prior contract. The seller should get a release from the buyer on the first contract before canceling the contract and proceeding with the second (or backup) contract.

Balloon mortgage: A mortgage loan with periodic payments of principal and interest that do not completely amortize the loan. The balance of this type of mortgage loan is due and payable in a lump sum at a specified time in the future. The borrower pays interest regularly, but may or may not make small principal repayments during the loan period. The unpaid balance is due at a specific time in the future as stated in the mortgage or deed of trust. At the *maturity* date, the borrower must pay the full amount by refinancing the debt or selling the property to pay the full amount. This final payment can be called a bullet or simply the balloon payment. Some lenders guarantee refinancing when the balloon payment is due as long as certain conditions or covenants are met, although they do not commit to a specified interest rate. The rate at refinancing could be much higher than the borrower's current rate. This can be referred to as a "rate reset" or an "extendible rider". Other lenders do not offer automatic refinancing. Without such a guarantee, the borrower could be forced to start the whole business of shopping for mortgage funds again, besides paying *closing costs* and front-end charges a second time. A balloon mortgage can be a senior or junior mortgage; i.e., a first or second mortgage.

Bankruptcy: When a person or business is declared by a court to be unable to pay outstanding debts, that person or business is said to be in bankruptcy. Any assets must be then turned to a trustee for management, an individual appointed by the bankruptcy court.

Base line: A surveyor's term used to show an east-west line.

Basis points: A term used in relationship to interest rates. One basis point is equal to 1/100 of 1 percent, so that 100 basis points equal 1 percent. May be used to describe the amount over an index rate that is charged to a borrower or to describe the amount of fees for a loan.

Binder: A preliminary agreement, secured by the payment of earnest money, under which a buyer offers to purchase real estate. See *Agreement of sale*.

Blanket mortgage: (1) A single mortgage used to secure a debt for money loaned on several properties such as the lots a builder owns in a subdivision. It is important for the borrower (mortgagor) to ask for a partial release clause in a blanket mortgage. A partial release clause will release each lot that is sold for a stated amount that is a portion of the entire debt. Without a partial release clause, the entire debt must be paid before the mortgage is released (2) Mortgage lien secured by two or more property parcels. (3) A mortgage on a residential cooperative building.

Blended rate: Interest paid on a full loan amount, with two mortgages at different interest rates (and possibly different terms and amortizations).

Block grant: Federal funds allocated to a state for a group of related services, such as affordable housing, maternal and child health services, or drug abuse programs.

Boilerplates or Boilerplating: Standard language found in contracts, deeds or deeds of trust, and in covenants, conditions and restrictions.

Bond: A formal certificate that evidences a debt and outlines the terms. It is a formal promise to pay the lender (or bond issuer) a specified sum of money at a future date — with or without *collateral*. The promise must be in writing and signed and sealed by the maker (borrower). The balance owed is paid on a future date with a series of interest payments in the interval.

Book value: An accounting term used to show the value of a business as a whole or particular asset, such as real estate. The value is shown by accounting records that give the cost of the assets plus any improvement minus depreciation. Depending on the reason for valuation, book value may be marked down for a distress sale, but is not typically marked up to reflect an increase in value.

Boring test: Using soil samples obtained by boring deep holes in the ground to determine the strength of the subsoil for construction purposes.

Breach of contract: Failure to perform according to the terms of a contract. The party who has not breached the contract can rescind the agreement and sue for damages or for performance.

Breach of trust: Abuse of the responsibilities or authority as set forth in a trust agreement or contract.

Bridge financing or bridge loan: Short-term mortgage financing between the end of one loan or financing instrument and the beginning of another, normally for less than one year.

Broker: Someone who, for a fee, places loans with lending institutions but does not directly lend money or service loans. Also, a term used for real estate agents who bring sellers and prospective buyers together, or landlords and prospective tenants.

Builder's risk insurance: Insurance used to protect builders against fire and special risks while they have a building under construction. Normally required by construction lenders.

Building code: Local and state laws that set minimum construction standards.

Building line or setback: Distances from the ends and/or sides of a lot beyond which construction may not extend. The building line may be established by a filed plat of subdivision, by restrictive covenants in deeds or *leases*, by building *codes*, or by *zoning* ordinances.

Building permit: A written permit that must be obtained from a local jurisdiction by anyone performing new construction on a property.

Buyer's agent: A real estate agent who works for the buyer of a house, not the seller.

C

Cap: An upper limit on how much an interest rate or the monthly payment of an adjustable or floating rate mortgage can change at each adjustment or during the life of a mortgage. This limit may adjust annually. A lender would normally charge a fee to a borrower for a cap. See also collar and floor.

Capital improvement: A permanent improvement that increases the value of real property and extends the useful life of the property and is an expenditure that differs from a necessary repair expense. For example, painting a house is a maintenance repair expense, whereas the installation of vinyl or aluminum siding is a capital improvement.

Carryback financing: When the seller finances the sale of property to a buyer. See *seller financing*.

Cash flow: Cash receipts minus cash disbursements from a given operation or asset (such as a building) for a particular period of time. Similar to EBITDA (Earnings Before Interest expenses, Taxes, Depreciation and Amortization costs).

Cash reserve: A requirement by some lenders that buyers have sufficient cash remaining after closing to make future mortgage payments or property repairs. Lenders may require reserves to be funded into a separate account as a part of the closing process.

Certificate of Occupancy (CO): An official document by a governing authority stating that a structure complies with local *zoning* and building codes is ready for use and may be occupied legally. In some jurisdictions known as a Use and Occupancy Permit (U&O).

Certificate of Title: A certificate issued by a title company or a written opinion rendered by an attorney that the seller has *clear title* to the property that is being offered for sale. A certificate of title offers no protection against any hidden defects in the title that an examination of the records could not reveal. The issuer of a certificate of title is liable only for damages due to negligence. The protection offered a property owner under a certificate of title is not as secure as that offered in a title insurance policy.

Change order: A form used by a general contractor or other builder to specify changes from the approved construction documents used to construct a building. Should be approved by architect and project manager. Most lenders will want to approve change orders of a minimum size as part of their loan disbursement process.

Clear title: A title that is free of liens and legal questions as to ownership of the property.

Closing costs: Those expenses which buyers, sellers and lenders normally incur to complete a transaction in the transfer of ownership of real estate. These costs are in addition to price of the property and are items prepaid at or before the *closing day.* They include the appraisal, *credit report,* processing or application fee*, origination fee,* and transfer taxes. In commercial transactions, most closing costs incurred by the lender are paid for by the borrower.

Closing day: The day on which the formalities of a real estate sale are concluded and at which time title passes from seller to buyer. It is normally a meeting during which all the papers are signed (the loan is "closed") and loan funds are often transferred. May also be referred to as settlement.

Cloud (on Title): An outstanding claim or encumbrance which adversely affects the marketability of title.

Codes: Standards for constructing buildings that are established by city, state or municipal governments. In most areas these codes are modeled after national codes and establish minimum requirements for construction buildings. Points covered by codes include design, quality of construction, use and occupancy of the building on the *site*, safety and health. Some jurisdictions may require additional codes for school buildings.

Collar: The use of a *cap* and a *floor* in a floating rate loan. A collar prevents the interest rate from rising above the cap or below the floor. Usually paid for annually by the borrower.

Collateral or security: Assets that are pledged to secure a debt. If the borrower does not repay the loan as agreed, the lender can *foreclose* and take possession of the collateral. Typically, the property financed with a mortgage serves as the bank's collateral.

Commission: Money paid to a real estate agent or *broker* by the seller (or the buyer) as compensation for finding a buyer (or seller) and completing the sale. Usually the commission is set as a percentage of the sales price, and depending upon local real estate practice, may be negotiable.

Commitment letter: A formal, legally binding written offer by a lending institution stating the terms under which it agrees to loan money to a borrower.

Common Area Maintenance: (CAM) Charges paid by the tenant to landlord for the upkeep of areas designated for the use and benefit of all tenants. Common Areas in commercial buildings often include stairways, hallways, restrooms, courtyards, etc.

Comparables: Properties that are similar or comparable to the subject project. See *Direct Sales Comparison*.

Completion bonds: Bonds provided by contractors to lenders to guarantee completion of construction in accordance plans and *specifications*.

Condemnation: A determination by a governmental agency that a particular building is unsafe or unfit for use.

Contiguous: Properties that touch each other.

Contingency: An item in any contract stating that the contract is good only in certain cases. For example, a real estate sales contract may be binding only if the buyer obtains financing at a certain rate or if the seller replaces the shingles on the roof. Contingencies must be written in the contract to be enforceable. Also, a line item in a budget to cover unforeseen expenses.

Contract of purchase or contract of sale: See *Agreement of Sale.*

Contractor: In the construction industry, a contractor is one who contracts to erect buildings or portions of them. There are also (sub)contractors for each phase of construction: heating, electrical, plumbing, air conditioning, mechanical, and others.

Conversion clause or convertible loan: A provision in some floating or adjustable rate loans that allows you to change the adjustable rate to a fixed-rate loan at some point during the term. Usually conversion is allowed at the end of the first adjustment period. At the time of the conversion, the new fixed rate is generally set at one of the rates then prevailing for fixed rate mortgages. The conversion feature may be available at extra cost.

Co-signer: A person or corporation who signs loan documents, such as a mortgage note with another person. The co-signer is responsible for making payments, if the borrower does not.

Cost approach: A way to determine the market value of a property by evaluating the costs of creating a property exactly like the subject.

Co-tenancy: A form of co-ownership of property. Examples include: tenancy in common, tenancy-by-the-entirety, *joint tenancy.*

Counter-offer: Rejection of an offer by a seller or buyer with a simultaneous substitute offer.

Covenant: A clause in a mortgage that obligates or restricts the borrower and which, if violated, can result in a default leading to foreclosure. Covenants typically fall into two categories: reporting (such as submission dates for audited financial statements) and financial (maintaining a certain level of cash or *debt service coverage)*. Charter schools may also have covenants for enrollment levels or student achievement.

Credit report: A report of an individual's (or business's) credit history prepared by a credit bureau and used by a lender in determining an applicant's creditworthiness.

Cross-default clause: A provision in one mortgage making the mortgagor in default on all mortgages included in the group if a default occurs on just one mortgage. The cross-default clause allows a lender to foreclose if the borrower is in default on just one mortgage.

D

Daily interest: The amount of interest the borrower pays the lender calculated on a daily basis. It equals the annual interest rate divided by 360 or 365 and multiplied by the amount of the loan. Also called per diem interest.

Debt service coverage (or debt coverage ratio): Relationship between Net Operating Income (NOI) and annual debt service payments. NOI is the income from a property or of a business after *operating expenses* have been deducted but before deducting taxes and financing expenses (principal and interest). Annual debt service is the amount to be paid each year in principal and interest. Lenders usually require that this ratio be at or above a certain level for the life of a loan. The ratio can be described as calculating the amount available in operating income for each dollar of debt.

Debt service: Loan payment.

Declaration of trust: A document that acknowledges property is being held by a trustee for another individual or organization.

Decree: An order or judgment of a court.

Deed: A formal written legal instrument by which title to real property is transferred from one owner to another. The deed must contain an accurate description of the property being conveyed, be signed and witnessed according to the laws of the State where the property is located, and be delivered to the purchaser at *closing day*. There are two parties to a deed: the grantor and the grantee. Compare to a *Deed of Trust.*

Deed of Trust: Like a Promissory Note, a document in which real property is given as security for a debt. However, in a *deed of trust* there are three parties to the instrument: the borrower (or trustor), the trustee, and the lender (or beneficiary). In such a transaction, the borrower transfers the legal title for the property to the trustee who holds the property in trust as security for the payment of the debt to the lender or beneficiary. Many lenders will name officers of the financial institution as the trustee. If the borrower pays the debt as agreed, the deed of trust becomes void. If, however, the borrower defaults in the payment of the debt, the trustee may sell the property at a public sale, under the terms of the deed of trust. In most jurisdictions where the deed of trust is in force, the property may be sold without benefit of legal proceedings. Not the same as a *Deed.*

Default: Failure to make mortgage payments as agreed in the mortgage or deed of trust. It is the mortgagor's responsibility to remember the due date and send the loan payment prior to the due date, not after. Generally, thirty days after the due date if payment is not received, the mortgage is in default. In the event of default, the mortgage may give the lender the right to accelerate payments, take possession and receive rents, and start foreclosure. Defaults may also come about by the failure to observe other conditions *(covenants)* in the mortgage or deed of trust.

Defective title: Title that is not clear.

Deferred interest: Interest due but unpaid. Mortgages that permit negative amortization (such as a *graduated-payment mortgage* or a *floating rate* loan without a rate cap) will allow deferred interest.

Deferred maintenance: In an appraisal, a type of depreciation (decrease in value) caused by failure to properly maintain a property; sometimes called curable physical depreciation.

Deficiency: In the event of a foreclosure, there is a deficiency when the highest bid in a foreclosure sale is less than the outstanding balance plus foreclosure-related costs.

Delinquency: A loan in which a payment is overdue but not yet in default.

Demand note: A debt instrument that allows the lender to call the balance due at any time without prior notice.

Deposit: Cash paid to the seller when a formal sales contract is signed. See *earnest money*.

Depreciation: Decline in value of a property due to normal wear and tear, adverse changes in the neighborhood, or any other reason. In accounting, the coast of an asset is depreciated (allocated) over its useful life.

Direct sales comparison: Property value estimation in an appraisal using the sales prices of similar properties *(comparables)* and making value adjustments according to such things as square footage, room count, lot size, condition and amenities in order to obtain a realistic fair market value of the property being appraised. Same as *Market Approach*.

Discounting: The process of reducing the value of money to be received in the future to reflect the opportunity cost of waiting to receive the money.

Down payment: The amount of cash normally required by a lender to be paid by the borrower at closing. Down payment plus mortgage amount should equal the total project cost (sales price or construction costs). Typically 5% to 25% of the amount of the total cost. Sometimes call *equity*.

Due diligence: See *underwriting.*

Due-on-sale clause: A provision in a mortgage allowing the lender to demand repayment in full if the borrower sells the property which secures the mortgage.

E

Earnest money (good faith deposit): The *deposit* money given to the seller or seller's agent by the potential buyer upon the signing of the agreement of sale. This money indicates a seriousness on the part of the buyer. If the sale goes through, the earnest money is applied against the down payment. If the sale does not go through, the earnest money may be forfeited or lost unless the offer to purchase expressly provides that it is refundable. Most purchase contracts require that certain contingencies (such as the availability of financing and acceptance of property condition) be removed prior to the deposit being forfeited. Additional earnest money may be required for an extension of the sale agreement.

Easement or Easement rights: (1) A legal interest that one person/corporation has in land belonging to or in possession of another person/corporation entitling the owner of the easement to use the other's land. (2) A right of way giving persons other than the owner limited access to or over a property. An electric company obtaining a *right-of-way* across private property is a common example.

Economic life: The period of time over which real property is estimated to be profitably utilized.

Economic obsolescence: Loss in property value caused by conditions external to the property. A common example would be the typewriter, made obsolete by the personal computer.

Effective age: The apparent age of a property based on its appearance and wear; may be more than, the same as, or less than the actual or chronological age.

Egress: A means of exit from a parcel of land or from a building, usually used in reference to fire safety.

Eminent domain: Right of a government agency to take private property for a public purpose against the will of the owner. Fair compensation must be paid to the owner whose property is taken.

Encroachment: An obstruction, building, or part of a building that intrudes beyond a legal boundary onto neighboring private or public land, or a building extending beyond the building line.

Encumbrance: (1) A legal right or interest in land that affects a good or clear title, and diminishes the land's value. It can take numerous forms, such as *zoning* ordinances, easement rights, claims, mortgages, liens, charges, a pending legal action, unpaid taxes, or restrictive covenants. An encumbrance does not legally prevent transfer of the property to another. A title search is usually done to reveal the existence of such encumbrances. (2) Anything that imposes a legal burden on title to land such as liens for security purposes, easements, and restrictive covenants.

Equity financing: Use of buyer's funds to finance property.

Equity: The value of an owner's unencumbered interest in real estate. Equity is computed by subtracting borrowed funds and other liens from the property's fair market value. Equity increases in a property as a mortgage is paid off, and as the property appreciates in value. When the mortgage and all other debts against the property are paid in full, the owner has 100% equity in the property.

Erosion: The loss of land by wearing action of water or wind.

Escrow agent: A person or corporation employed by parties to a real estate transaction to receive documents and money and deliver them in accordance with their instructions. Often a title company.

Escrow agreement (escrow instructions): A contract between the parties to a real estate transaction to effect a settlement of the transaction in escrow.

Escrow: Usually documents and money deposited with a neutral third party (the *escrow agent*) to hold until the occurrence of a specified event such as the signing of loan documents. In real estate sales transactions, the escrow agent is given the Deed by the seller, *down payment* or *equity* by the buyer and mortgage funds by the buyer. The escrow agent releases loan funds and *down payment* to the seller at closing and delivers the title to the buyer.

Estoppel certificate: Document in which the borrower verifies the remaining balance and interest rate of a loan.

Estoppel: A doctrine of law that prevents a person from asserting facts or rights inconsistent with prior words or conduct.

F

Feasibility analysis: Study of the cash flow, marketability, profitability potential and overall desirability of a project.

Fee simple: Absolute ownership of and rights to use and control real property.

Finance: To supply money for a purchase. A lender can finance a building with a mortgage loan.

First mortgage: The mortgage that has first claim to the borrower's assets in the event of a default.

Fixed expenses: Expenses or payments that do not vary from month to month depending on production of a business, such as rent, or insurance. Compare to *variable expenses.*

Fixed lease: A lease in which the lessee pays a fixed amount for the duration of the lease. May also be referred to as a Gross Lease.

Fixed payment mortgage: Periodic payments of principal and interest on a mortgage which remain constant over the loan term.

Fixed-rate mortgage: A mortgage in which the interest rate does not change during the entire term of the loan.

Fixture: Anything attached to real property in such a manner that to remove it would damage the property. Must meet legal tests.

Floating rate: An interest rate on a loan which changes during the life of the loan, often monthly but can change quarterly or annually. These variable rates are based on an index rate and can be used for mortgages and other loans such as lines of credit. A floating rate is usually lower than a *fixed rate* of interest, but there is risk of very high rates in the future as index rates change.

Flood insurance: Insurance required for properties in federally designated flood areas.

Floor: The interest rate below which a floating rate cannot fall. Agreed upon by borrower and lender; normally requires annual fee.

Forbearance: The lender's postponement of foreclosure to give the borrower time to catch up on overdue payments.

Foreclose: The legal process of the lender taking a property when the borrower has defaulted on the loan. The lender typically then sells the property to recoup its loss on the unpaid loan, though some lenders may pursue alternative routes such as placing a new borrower in the property.

Front foot: A measure of property by which the distance is measured along the street, highway, stream, or other body of water.

Fully amortizing mortgage: A method of loan amortization in which equal periodic payments completely repay the loan during the loan term.

Functional obsolescence: Outdated design, fixtures, and other factors within the structure itself that detract from a building's value.

G

General partnership: Form of co-ownership wherein all partners have a voice in the management of a business and unlimited liability for its debts.

General warranty deed: A deed which conveys not only all the grantor's interests in and title to the property to the grantee, but also warrants that if the title is defective or has a *"cloud"* on it (such as mortgage claims, tax liens, title claims, judgments, or mechanic's liens against it) the grantee may hold the grantor liable.

Good faith deposit: See *earnest money.*

Graduated-payment mortgage (GPM): A type of stepped-payment loan in which the borrower's payments are initially lower than those on a comparable level-rate mortgage. The payments gradually increase over a predetermined period, and then are fixed at a level-pay schedule, which will be higher than the level-pay *amortization* of a level-pay mortgage originated at the same time. The difference between what the borrower actually pays and the amount required to fully *amortize* the mortgage is added to the unpaid *principal* balance. Normally for borrowers with future debt service capacity higher than current capacity.

Ground lease: A lease of the land only. Usually the land is leased for a relatively long period of time to a tenant that constructs a building on the property.

Gross area: The entire floor area of a building including hallways, closets and other non-usable space.

Grade: The level of the ground at the structure foundation.

Gross lease: A lease agreement in which the lessee pays a fixed rental amount for the duration of the lease and the lessor (property owner) pays the expenses associated with owning the property such as taxes, repairs, insurance and other costs. Compare to *Triple-Net-Lease*.

H

Hazard insurance: Insurance that compensates for a loss on a specific property due to damages caused by fire, vandalism, theft, storm damage and certain other natural disasters.

Highest and best use: The use of a property that will yield the greatest return on the property.

HVAC: Heating, Ventilation, and Air Conditioning.

I

Impound account: See *escrow.*

Improvement: (1) A structure situated on real property. (2) An activity that increases a property's value such as upgrading an HVAC system or modernizing the facility.

Index: A statistic that indicates some current economic or financial condition. Indexes are often used to set and adjust the interest rates on loans. Common indexes are Prime Rate, LIBOR and Treasury Bonds.

Industrial revenue bond: Bonds issued to raise funds for developing commercial buildings.

Ingress: A means of entry to a property.

Inspection: Physical examination of a property or building to confirm it meets the standards of a contract. When a property is constructed, it is normally inspected by an individual from a unit of local government to be sure all work is done properly. Construction lenders may also require inspections prior to disbursing loan funds. Inspections normally include a determination of the soundness of the building and the condition of mechanical systems, such as plumbing and heating.

Installment debt: Debts or accounts that are paid off in monthly payments, or installments, such as credit-card accounts. Often refers to unsecured debt.

Interest: A charge that a borrower pays to a lender to borrow money.

Interest-only loan: A method of loan amortization in which interest is paid periodically over the term of the loan and the entire loan amount (principal) is paid at maturity.

Involuntary lien: A lien such as taxes or *mechanic's lien* imposed without consent of the property owner.

J

Joint tenancy: Form of co-ownership giving each tenant equal interest rights in the property, including the right of survivorship

Junior mortgage: Any mortgage on a property that is subordinate to a senior mortgage in priority. Also called subordinated mortgage.

L

Land contract (installment sale contract, installment contract, and contract for deed): A contract in which a seller of real estate promises to deliver a deed to the buyer at some time in the future after the buyer has, in an agreed upon number of payments of principal and interest, paid the purchase price in full. During the payment period, the buyer may use and occupy the land and real estate but no deed or title exchanges hands.

Late charge: The penalty a borrower must pay when a payment is made after the agreed upon due date.

Latent defect: A concealed defect not easily determined from an inspection of the property.

Lease: A contract between the property owner and another person to use or occupy the land for a set period of time.

Leasehold: Legal interest in real property acquired by a tenant (lessee) when he/she enters into a rental agreement with the owner of the property (landlord or *lessor*). Normally for a fixed period of time at a specified price, without transfer of ownership. A leasehold is a fixed asset and can be used to obtain financing.

Lessor: A person who rents or leases a property to another. Also referred to as a Landlord.

Letter of credit: Arrangement with a lending institution that agrees to substitute its credit for the borrower's credit. Used by borrower to secure debt and guarantees payment on that debt up to a specified amount. Borrower pays fees to the bank providing a letter of credit (LC).

Leverage: The amount of long-term debt that a company has in relation to its equity. Can be expressed as a ratio or a decimal. Greater leverage (higher debt to net worth or net assets) is indicated by a higher leverage number.

Liability insurance: Protection for a property owner, contractor, individual or corporation to protect against claims of negligence or inappropriate action resulting in bodily injury or property damage.

Lien: A claim on property as security for money owed. Such claims may include obligations not met such as debt, judgments, unpaid taxes, materials, or labor. May be against all property or specific property.

Liquidated damages: A specified sum of money agreed upon in a contract that one party will pay the other in the event of a breach of the contract.

Liquidity: A measure of how easily (and without cost) assets can be converted to cash. Lenders may measure the strength of a borrower's liquidity using something called the current ratio: current assets divided by current liabilities. The higher the number, the better the liquidity.

Loan agreement: Document which specifies amount, repayment structure and covenants. Compare to *Promissory Note* and *Deed of Trust*.

Loan balance: The amount of money remaining to be paid on an amortizing loan at a given time.

Loan commitment: See *commitment letter*.

Loan origination: The process whereby a lender initiates a loan with a borrower.

Loan Servicing: See *servicing*.

Loan To Value Ratio (LTV): A percentage that expresses the *loan balance* on a property compared to its appraised value (loan amount divided by the property value). In making a mortgage loan, a lender uses the LTV to ensure that a property is worth more than the loan amount. Most lenders will limit the loan amount based on this ratio.

M

Margin (also known as Spread): The amount a lender adds to the *index rate* to calculate the interest rate of a loan. May be described in percentages or *basis points*.

Market approach: The process during an appraisal of comparing the subject property to equivalent properties sold recently to arrive at an estimate of value for the property.

Market interest rate: Interest rate currently utilized by lenders and investors, often for similar transactions.

Market value: Price that a property should be purchased by a buyer in a competitive and open market under "fair sale" conditions (e.g., there is sufficient marketing time, no coercion, typical financing availability, arms-length negotiation and knowledgeable buyers and sellers). Sometimes called fair market value.

Marketable title: A title that is free and clear of objectionable liens, *clouds*, or other title defects. A title which enables an owner to sell a property freely to others and which others will accept without objection.

Maturity: The date a loan or mortgage must be paid in full.

Mechanic's lien: A lien that can be filed by laborers or material suppliers; it is against real property created for the purpose of securing payments for services performed or materials furnished in the construction or repair of buildings or making other improvements to land.

Metes and bounds: A method of land description using measurements, boundaries, and directions.

Mortgage commitment: See *commitment letter.*

N

Negative amortization: Occurs when monthly payments on a loan do not cover all of the interest cost accumulated. The interest cost not paid is added to the principal balance. This can result in a higher loan balance after time and higher monthly payments than the original loan amount. Most often happens with adjustable or floating interest rates with fixed monthly payments.

Nonconforming use: A use of land that violates *zoning* regulations or *codes* but can lawfully continue because the use began before the new *zoning* ordinance was enacted.

Note (also called Promissory Note): A legal document obligating a borrower to repay a loan at a stated interest rate and during a specified period of time. Compare to *mortgage.*

Notice of default: A formal written notice to a borrower that a *default* has occurred and that legal action may be taken. See *default*.

O

Offer: A purchase proposal to the seller of a property, detailing the amount the interested buyer would pay and other conditions that would have to be met before the proposed sale.

Open-end mortgage: A mortgage agreement that allows the mortgagor to borrow additional funds from the mortgage lender in the future, normally with a borrowing limit. This limit may be based on loan-to-value or may simply be the original loan amount (re-borrowing against principal previously paid).

Operating expenses: Costs necessary to run a business, such as salaries and utilizes.

Option: A contract given by the owner of a property, giving the right to buy or lease the property at a certain price within a specified period of time.

Origination fee: A fee paid to a lender for processing a loan application; it is often stated as a percentage of the mortgage amount, or *basis points,* and paid at *closing*.

P

Participation: A loan in which two or more lenders participate. The borrower may or may not be aware of this arrangement. Some participations are done after loan closing; others are active partnerships during the *underwriting* process.

Party wall: A wall erected on the line between two adjacent properties for the use of both parties.

Physical depreciation: Physical deterioration and concurrent loss in property value caused by wear, tear, and decay.

Plat: A map or chart of a lot, subdivision or community drawn by a surveyor showing boundary lines, buildings, improvements on the land, and easements.

Plot plan: A drawing showing the placement of a building on a site with precise locations, dimensions, and elevations.

Plottage: The increase in value of land by assembling smaller properties into one larger site.

Point or points (also basis points): A term used in relationship to interest rates. One point is equal to 1/100 of 1 percent, so that 100 points equal 1 percent. May be used to describe the amount over an index rate that is charged to a borrower or to describe the amount of fees for a loan.

Prepayment: Payment of a mortgage loan, or part of it, before the due date. Mortgage agreements often restrict the right of prepayment either by limiting the amount that can be prepaid in any one year or charging a penalty for prepayment. The practice of charging money for an early payoff of the existing mortgage loan varies by state, type of lender, and type of loan.

Prepayment penalty: A fee charged to a borrower who pays off a loan before *maturity*. Must be included in loan documents.

Prime rate: The interest rate charged by lenders to their best customers. Often also refers to the prime rate as published in the Wall Street Journal (WSJ). The WSJ Prime Rate is determined via a poll of 30 US banks.

Principal: In finance, the basic element of the loan as distinguished from interest and any other charges. It is the amount upon which interest is calculated and paid.

Pro-forma statements: Financial analysis showing what is expected to occur; projections. Can describe balance sheets or income statements.

Promissory note (Note): A document on which a borrower promises to repay a loan. A legal document obligating a borrower to repay a loan at a stated interest rate and during a specified period of time. The agreement serves as proof of indebtedness and states the manner in which it shall be paid. The note states the actual amount of the debt that the mortgage secures. Compare to *Deed of Trust* and *loan agreement.*

Proposal letter (Term sheet): An indication of preliminary interest from a lending institution. Normally outlines general terms for *interest rate*, *amortization* and conditions precedent to closing.

Prorate: Allocation of costs and income between the buyer and seller of real estate at the time of the transaction closing, based upon the time of ownership of each.

Purchase Agreement: See *Agreement of Sale.*

R

Rate lock: A specified interest rate, available normally for a short period of time, committed to by a lender.

Raw land: Land with no improvements.

Recording: Filing a document with the appropriate public official in order to provide notice and affect the property title.

Refinancing: The process of paying off one loan with the proceeds from a new loan secured by the same property.

Rentable area: The actual square foot area for which the tenant will pay rent. Compare with *gross area* and *usable area*.

Reserve or reserve account: Funds set aside, usually paid by the borrower at closing or out of borrower's cash, in a segregated bank account. Funds may be used to make normal monthly loan payments or in case of a late payment.

Restrictive covenants: Private restrictions limiting the use of real property. Restrictive covenants are created by deed and may bind all subsequent purchasers of the land, or may bind only one seller and buyer. Restrictive covenants may limit the density of buildings per acre, regulate size, style, or price range of buildings to be erected, or prevent particular businesses from operating.

Right-of-way: The right to cross over or under another person's property for ingress, egress, utility lines, or sewers.

Riparian rights: Rights of an owner of property adjacent to a body of water allowing owner to use the water.

S

Sales agreement: See *agreement of sale.*

Sales comparison approach: See *Market approach.*

Second mortgage: A mortgage that has rights that are subordinate to the rights of the *first mortgage* holder.

Security: See *collateral.*

Security interest: The right of a creditor (a lender, for example) to take control of property offered as security.

Servicing: The act of billing, collecting payments, keeping records about covenant requirements, following up on deliquencies, and taking foreclosure actions. May also include loan analysis after closing.

Setback: A distance from the curb to the building. Often a minimum setback is specified by ordinance or code.

Site: Parcel of land developed to the point that it is ready for construction of a building or other improvements.

Specifications: A detailed description of the size, shape, materials, and other details of a construction project.

Spot zoning: Zoning that sets aside certain areas for purposes different from the general area requirements.

Spread (also known as Margin): The number of percentage points the lender adds to the *index rate* to calculate the interest rate of a loan. May be described in percentages or *basis points*.

Step up lease: A lease in which the rental amount paid by the lessee increases by a preset rate at predetermined intervals.

Subcontractor: Someone who performs services under contract with a general contractor. One example would be a plumber.

Sublease: A lease between from a tenant to another lessee. The new lessee is a sublessee or a subtenant.

Subordinate mortgage: Any mortgage on a property that is subordinate to a senior mortgage in priority. Also called *junior mortgage.*

Survey: A map or plat showing a property's boundaries, any places the property may have been improved or changed, rights of way, and other physical features. A survey is often required by the lender to provide assurance that a building is actually sited on the land according to its legal description.

T

Takeout: Financing from a lender for a permanent loan to pay off a construction loan. Generally includes specific conditions and is normally required to be in place by construction lenders before closing the loan or construction can begin.

Tax credit: Allowable reduction in the amount of income tax owed.

Term loan: The period of time during which payments (of *principal* and/or *interest)* must be made. Compare to *amortization.*

Terms: All conditions placed on a contract or loan, including the interest rate, any finance charges, and the length of the loan.

Title company: A company that examines real estate titles and issues title insurance.

Title insurance: Insurance that protects buyers and lenders against loss in the event of title disputes.

Title search or examination: A check of the public title records to make sure the buyer is purchasing real estate from the legal owner and there are no liens, overdue special assessments, or other claims or outstanding restrictive covenants filed in the record, which would adversely affect the marketability or value of title.

Title: Document establishing legal ownership of real estate. A clean title is one that shows no liens against it.

Tract: An area of land.

Triple-net lease: A lease in which the tenant pays, in addition to rent, taxes, insurance and maintenance. Compare to *gross lease*.

U

Underwriting: The work and research done by a lender to evaluate borrower creditworthiness and to ascertain risks involved prior to deciding whether or not to make a loan.

Unsecured credit: Any credit that is not secured by property (such as a house). A credit card is unsecured credit; a mortgage loan is secured.

Usable area: Rentable area minus certain common areas that are shared by all tenants (corridors, storage, bathrooms, etc.).

Usury: Interest on a loan at a rate higher than allowed by law.

V

Variable expenses: Costs, such as utilities, which vary with a building's occupancy rate or the production levels of a company.

Variance: In zoning, the right to deviate from the use of land prescribed by an existing zoning ordinance.

Z

Zoning: A county or city law stating the types of use to which properties can be put in specific areas.