

This Glossary contains Real Estate terms regarding buying, selling, renting, home finance, home construction/improvement, legal terms, and will constantly be under construction as we find new items to add.

A-frame Design

An interior style that features a steeply peaked roofline and a ceiling that is open to the top rafters.

Absolute Net

Lease that requires the tenant to pay all costs (including rent) associated with the operation, repair and maintenance of the building. This includes real estate taxes, utilities, repair and maintenance. Also referred to as net-net-net (NNN) or "triple net."

Abstract of Judgment, Law

The summary of a court judgment that creates a lien against a property when filed with the county recorder.

Abstract of Title

A compilation of the recorded documents relating to a parcel of land, from which an attorney may give an opinion as to the condition of title. Also known in some states as a "preliminary title report."

Abutting

Bordering upon or next to; the joining or touching of adjoining land; sharing a common boundary.

Accelerated Cost Recovery System

A tax calculation that provides greater depreciation in the early years of ownership of real estate or personal property.

Acceleration Clause

A clause in your mortgage which allows the lender to demand payment of the outstanding loan balance for various reasons (ie: you missed a payment). The most common reasons for accelerating a loan are if the borrower defaults on the loan or transfers title to another individual without informing the lender.

Accelerated Depreciation

A bookkeeping method that depreciates property faster in the early years of ownership.

Acknowledgment

A declaration made by a person signing a document before a notary public or other officer.

Accretion

An addition to or expansion of land through natural causes. An increase of land along the shore of a body of water through water-borne sediment.

Acre

A measurement of land equal to 4,840 square yards or 43,560 square feet.

Ad Valorem

In proportion to the value, according to value.

Additional Principal Payment

Monies paid by the borrower in addition to the principal amount due, usually monthly. If you have extra money occasional months, it's a good idea to make additional principal payments in order to more quickly reduce your remaining balance.

Adjustable-Rate Mortgage (ARM)

A mortgage in which the interest changes periodically, according to corresponding fluctuations in an index. All ARMs are tied to indexes.

Adjusted Basis

Original cost of the property plus capital expenditures for improvements minus depreciation.

Adjustment Date

The date the interest rate changes on an adjustable-rate mortgage

Adjustments

Any money that the buyer and seller "credit" each other at closing, such as taxes, down payments, etc.

Adverse Possession

Most states have laws which permit someone to claim ownership of property which is occupied by him for a number of years. This is common where a fence is erected over a boundary line (called an "encroachment") without the objection of the rightful owner. After a number of years, the person who erected the fence may be able to commence a court proceeding to declare that the property belongs to him.

Affordability Analysis

A detailed analysis of the borrower's ability to buy a home, made up of factors such as: income, holdings, debts, the type of mortgage that will be used, the location of the home, and closing costs.

All-Inclusive Deed of Trust

See "wraparound mortgage"

ALTA

American Land Title Association.

Aamenity

A feature of a home (like a pool or a garage) which isn't crucial to the home's existence. Things like a roof and doors are not amenities.

Amortization

The loan payment consists of a portion which will be applied to pay the accruing interest on a loan, with the remainder being applied to the principal. Over time, the interest portion decreases as the loan balance decreases, and the amount applied to principal increases so that the loan is paid off (amortized) in the specified time.

Amortization Schedule

A table which shows how much of each payment will be applied toward principal and how much toward interest over the life of the loan. It also shows the gradual decrease of the loan balance until it reaches zero.

Annual Percentage Rate (APR)

This is not the note rate on your loan. It is a value created according to a government formula intended to reflect the true annual cost of borrowing, expressed as a percentage. It works sort of like this, but not

exactly, so only use this as a guideline: deduct the closing costs from your loan amount, then using your actual loan payment, calculate what the interest rate would be on this amount instead of your actual loan amount. You will come up with a number close to the APR. Because you are using the same payment on a smaller amount, the APR is always higher than the actual not rate on your loan.

Annuity

An annuity is an investment which requires an initial "value outflow(s)" (usually cash, but not always) from the investor, and later gives the investor periodic "value inflow(s)", and possibly future periodic "value outflow(s)" as well. The IRR, PV, and NPV of the "value inflow(s)" and value "outflow(s)" can be calculated using time value of money principles.

In this software, the initial value outflow (at the beginning of the 1st year) is the Investment the buyer makes to acquire the property. This is the Downpayment + Closing Costs + Loan Points + Exceptional Closing Costs. Repairs made at or near closing are called "Exceptional Closing Costs" and are entered in the "Exceptional Closing Costs" grey data input cell on the "Form" sheet. Examples of two common Exceptional Closing Costs are replacing the roof and/or carpet before, at, or soon after closing. Exceptional Closing Costs are by definition paid by the Buyer. If the Seller pays for a repair it is not an Exceptional Closing Cost because it does not count as part of the Buyer's Investment (i.e.- value outflow) to acquire the property.

In this software, the value inflows are the "Annual Benefits Totals" for years 1 - 9 which are comprised of Cash Flow, Appreciation, Loan Reduction, and Tax Benefits (see the "Total Benefits" sheet) and are treated as occurring at the end of each year even though some of these benefits occur monthly. The "Annual Benefits Totals" column shows each year's financial benefits of ownership. The 10th year's "Annual Benefits Total" is a value outflow due to Capital Gains Tax at the time of sale (projections assume a sale at the end of the 10th year). The IRR and NPV of the value inflows and outflows are then calculated and stated as the IRR and the NPV FBO (financial benefits ownership) of the income property if purchased by the specific investor being analyzed.

The "Annuity Approach" used by this software to analyze income property is not common to the real estate industry and is not based on Standard Real Estate Practices. It is an accounting based approach. This software does all the usual Standard Real Estate Practices (SREP) analyses and then expands them using Generally Accepted Accounting Principles (GAAP) to analyze the investment property as if it were an annuity. This only works with income properties and cannot be used with non-income producing properties. Any physical property type of real estate can be analyzed as an income property if the owner or prospective owner receives, is projected to receive, or could receive an income as a result of owning the property. The income is usually the result of renting or leasing the property, but other income producing possibilities may exist.

Annuity Value

"Annuity Value" is the value of the investor's projected Financial Benefits of Ownership (i.e.- value outflows and inflows over time). "Annuity Value", "Personal Value", and "the value of the investor's projected financial benefits of ownership" are all synonymous. The "Annuity Value" must be determined by the investor's CPA. It can be the PV FBO (Present Value of the Financial Benefits of Ownership), NPV FBO (Net Present Value of the Financial Benefits of Ownership), or it whatever the investor's CPA decides.

See the "Annuity" section above and the "Personal Value" and "Value" sections below for more information. "Annuity Value" is NOT the same thing as Property Value.

APOD (Annual Property Operating Data)

This is an operating statement for an income producing property. The APOD follows standard real estate practice, NOT standard accounting practice when calculating Net Operating Income. That means that Depreciation Expense should NOT be deducted from Adjusted Gross Income when calculating Net

Operating Income. Therefore, DO NOT enter Depreciation Expense in the Operating Expenses. Cap Rate calculations depend on this.

Application

The form used to apply for a mortgage loan, containing information about a borrower's income, savings, assets, debts, and more.

Appraisal

A written justification of the price paid for a property, primarily based on an analysis of comparable sales of similar homes nearby.

Appraised Value

The value of a property at a given time, based on facts regarding the location, improvements, etc., of the property and surroundings.

Appraiser

An individual qualified by education, training, and experience to estimate the value of real property and personal property. Although some appraisers work directly for mortgage lenders, most are independent.

Appreciation

The increase in the value of a property due to changes in market conditions, inflation, or other causes. The general concept of property appreciation is so simple and basic that everyone reading this probably understands it well enough that there is no need to cover the basics. So I will cover a more advanced area of appreciation.

How do you decide what projected future annual Appreciation % to enter in the Form (data input) sheet? Entering a reasonable % is not as simple as you may think. You may know how to do the research, but do you know how to do the calculations CORRECTLY? Please finish reading this before you decide if you know how to do these things correctly.

If you think that deciding on a reasonable, projected, future Annual Appreciation % is as simple as guessing, or as simple as looking at the past history of the subject property and comparable properties and using arithmetic to find the Annual Appreciation % based on past sales, then you do not understand what is involved, so you need to read the rest of this topic.

Your goal should be to enter (in the Form sheet) a reasonable, projected, future average Annual Appreciation for the subject property based on the past average annual appreciation of several comparable properties, and the subject property itself, if it has been bought and sold before.

You can enter your best guess to get a book of projections, but if you want to create professional, accurate projections, then you must do some background research and calculations. The research involves going to the title company or assessor's office (don't rely only on a multiple listing service because at least half of income properties are sold by their owner or by a commercial real estate agent who does not enter income properties in the MLS) with a list of comparable properties and determining the prices each property sold for the last 2 times. Also do this with the subject property if it has been sold at least twice before. If the subject property has not been sold twice before, which is the case with newer properties, then research comparable properties.

The difference between the prices each time a property sold obviously is your total dollars of appreciation.

You also have the time elapsed between the sales.

It may seem like common sense that you could use arithmetic to find the average % annual appreciation (compounded yearly). That would be WRONG and would mistakenly inflate the average annual appreciation. Annual Appreciation compounds each year, which means the property value grows

exponentially. That means algebra, logs or roots, not simple arithmetic, must be used. Sure you can use simple arithmetic to go forward in time to determine dollars of appreciation when you are given the percentage, but you CANNOT use arithmetic to find the percentage; you need algebra, or a financial calculator or software that does the algebra for you (i.e.- you can go forward in time with simple arithmetic, but cannot go backward in time, except with algebra, specialty calculator, or software).

Once you correctly solve the historical (past) average annual appreciation percentage for one comparable property, you should do a few more comparables. Once you have 5 or so comparable properties, you should take the median value. That means take the most common value. For example, if you solved for the (historical, past) appreciation percentage of 5 comparable properties, and you got these percentages: 3%, 5%, 5%, 6%, 10%, you would use 5% as your median historical appreciation for that type of property in that area because we have an odd number of values to choose from, so we just pick the middle value of 5%. If you had an even number of comparables, you would take the two middle values, add them together, and divide by 2.

In this example, when filling out the Form sheet line 10 in this Benefits IPO workbook, you would enter 5% for the (projected future) Appreciation for the subject property (based on your research).

For those wanting to use a financial calculator to find the average annual appreciation percentage compounded yearly, plug the earlier sales price into present value, the later sales price into future value, plug the number of years into the number of periods (3 years is 3 periods, 5 years & 6 months is 5.5 periods, etc). You do not enter anything for payment. Solve for interest (paid at end of each period). If you entered the data correctly, you get the correct answer.

Arrears

Payment made after its due is in arrears. Interest is said to be paid in arrears since it is paid to the date of payment rather than in advance.

Assessed value

The valuation placed on property by a public tax assessor for purposes of taxation.

Assessment

The placing of a value on property for the purpose of taxation.

Assessor

A public official who establishes the value of a property for taxation purposes.

Asset

Items of value owned by an individual. Assets that can be quickly converted into cash are considered "liquid assets." These include bank accounts, stocks, bonds, mutual funds, and so on. Other assets include real estate, personal property, and debts owed to an individual by others.

Assignment of Contract

A process by which a person sells, transfers and/or assigns his rights under an agreement. Often used in the context of the assignment of a purchase contract by a buyer or the assignment of a lease by a tenant.

Assumable Loan

A loan secured by a mortgage or deed of trust containing no "due-on-sale" provision. Most pre-1989 FHA loans and pre-1988 VA loans are assumable without qualification. Some newer loans may be assumed with the express permission of the note holder.

Assumption of Mortgage

Agreement by a buyer to assume the liability under an existing note secured by a mortgage or deed of trust.

Back-end Ratio, or Debt Ratio

The amount you pay in monthly debt (car payments, credit cards, student loans, etc.) divided by your gross monthly income.

Balloon Mortgage

A note calling for periodic payments which are insufficient to fully amortize the face amount of the note prior to maturity, so that a principal sum known as a "Balloon" is due at maturity.

Balloon Payment

The final lump sum payment that is due at the termination of a balloon mortgage.

Bankruptcy

By filing in federal bankruptcy court, an individual or individuals can restructure or relieve themselves of debts and liabilities. Bankruptcies are of various types, but the most common for an individual seem to be a "Chapter 7 No Asset" bankruptcy which relieves the borrower of most types of debts. A borrower cannot usually qualify for an "A" paper loan for a period of two years after the bankruptcy has been discharged and requires the re-establishment of an ability to repay **debt**.

Basis

The financial interest one has in a property for tax purposes. Basis is adjusted down by depreciation and up by capital improvements.

Betterment

An improvement (such as renovations and additions) that increases a property's value, different from routine home maintenance and repairs.

Bill of Sale

A written document that transfers title to personal property. For example, when selling an automobile to acquire funds which will be used as a source of down payment or for closing costs, the lender will usually require the bill of sale (in addition to other items) to help document this source of funds.

Binder

A report issued by a title insurance company setting forth the condition of title and setting forth conditions, which, if satisfied, will cause a policy of title insurance to be issued. Also known as a "title commitment."

Biweekly Mortgage

A mortgage in which you make payments every two weeks instead of once a month. The basic result is that instead of making twelve monthly payments during the year, you make thirteen. The extra payment reduces the principal, substantially reducing the time it takes to pay off a thirty year mortgage. **Note:** there are independent companies that encourage you to set up bi-weekly payment schedules with them on your thirty year mortgage. They charge a set-up fee and a transfer fee for every payment. Your funds are deposited into a trust account from which your monthly payment is then made, and the excess funds then remain in the trust account until enough has accrued to make the additional payment which will then be paid to reduce your principle. You could save money by doing the same thing yourself, plus you have to have faith that once you transfer money to them that they will actually transfer your funds to your lender.

Blanket Mortgage

A mortgage covering two or more pieces of real estate.

Blended Payments

A repayment method by which the same amount is paid each month, but the composition of the interest and principal changes with each payment. With each payment, the amount allocated to the principal increases as the amount allocated to interest decreases. Most mortgages use blended payments because it provides a consistent monthly payment amount for the borrower.

Bona Fide

Authentic; made or carried out in good faith; real; sincere; genuine.

Bond Market

Usually refers to the daily buying and selling of thirty year treasury bonds. Lenders follow this market intensely because as the yields of bonds go up and down, fixed rate mortgages do approximately the same thing. The same factors that affect the Treasury Bond market also affect mortgage rates at the same time. That is why rates change daily, and in a volatile market can and do change during the day as well.

Borrower (mortgager)

One that mortgages property; a person who applies for and receives a mortgage loan.

Breach

To break or violate an agreement.

Bridge Loan

Not used much anymore, bridge loans are obtained by those who have not yet sold their previous property, but must close on a purchase property. The bridge loan becomes the source of their funds for the down payment. One reason for their fall from favor is that there are more and more second mortgage lenders now that will lend at a high loan to value. In addition, sellers often prefer to accept offers from buyers who have already sold their property.

Broker

Broker has several meanings in different situations. Most Realtors are "agents" who work under a "broker." Some agents are brokers as well, either working for themselves or under another broker. In the mortgage industry, broker usually refers to a company or individual that does not lend the money for the loans themselves, but broker loans to larger lenders or investors. (See the Home Loan Library that discusses the different types of lenders). As a normal definition, a broker is anyone who acts as an agent, bringing two parties together for any type of transaction and earns a fee for doing so.

Building Codes

Local regulations regarding the design and construction buildings.

Buydown

Usually refers to a fixed rate mortgage where the interest rate is "bought down" for a temporary period, usually one to three years. After that time and for the remainder of the term, the borrower's payment is calculated at the note rate. In order to buy down the initial rate for the temporary payment, a lump sum is paid and held in an account used to supplement the borrower's monthly payment. These funds usually come from the seller (or some other source) as a financial incentive to induce someone to buy their property. A "lender funded buydown" is when the lender pays the initial lump sum. They can accomplish this because the note rate on the loan (after the buydown adjustments) will be higher than the current market rate. One reason for doing this is because the borrower may get to "qualify" at the start rate and can qualify for a higher loan amount. Another reason is that a borrower may expect his earnings to go up substantially in the near future, but wants a lower payment right now.

Buyer's Agent

A real estate broker or agent who represents the buyer's interests, although typically his fee is a split of the listing broker's commission. Also known as the "selling agent."

Call Option

Similar to the acceleration clause.

Cap

Adjustable Rate Mortgages have fluctuating interest rates, but those fluctuations are usually limited to a certain amount. Those limitations may apply to how much the loan may adjust over a six month period, an annual period, and over the life of the loan, and are referred to as "caps." Some ARMs, although they may have a life cap, allow the interest rate to fluctuate freely, but require a certain minimum payment which can change once a year. There is a limit on how much that payment can change each year, and that limit is also referred to as a cap.

Capital Expenditure

The cost of an improvement made either to extend the life of a property or to increase its value.

Capital Gain

Profit from the sale of a "capital" asset, such as real property. A long-term capital gain is a gain derived from property held more than 12 months. Long-term gains can be taxed at lower rates than short-term gains.

Capital Improvement

Any item, structure or addition which is a permanent improvement to the property.

Cap Rate aka Overall Rate of Return (OAR) is based on the 1st year only (actually the first month X 12).

A higher Cap Rate (OAR) suggests a better Property Price to Net Income relationship. Therefore, a higher Cap Rate is better than a lower Cap Rate if the properties are in like (equal) physical condition. They are rarely in equal condition, which is why Property Price adjustments should usually be made before calculating Cap Rate (OAR). Many other factors besides Cap Rate (OAR) should be taken into consideration when evaluating an income property.

There are different ways to calculate Cap Rate according to what part of the USA you are in. The software uses the method that is the most common.

Standard Real Estate Practices (SREP) (used by lenders, agents, appraisers, developers, etc.) differ from Generally Accepted Accounting Principles (GAAP) with regard to "Net Operating Income" and "Net Income" calculations. SREP uses these terms interchangeably and calculates them WITHOUT deducting Depreciation or Interest expense from the Adjusted (Effective) Gross Income. This software adheres to both SREP and GAAP, except with regard to "Net Operating Income" and "Net Income" calculations, which are calculated according to the context of the topic. To reduce confusion, neither dollars of "Net Operating Income" or "Net Income" are shown anywhere in this software; however, the SREP calculated NOI and NI are used to calculate Debt Coverage Ratios (DCR) and Cap Rate (OAR).

Cap Rate is Year 1 Net Income divided by Purchase Price.

Net Income here means as calculated by real estate practices. Depreciation and Interest are not deducted from the Adjusted (Effective) Gross Income when calculating the Net Income.

Net Income is arrived at by deducting the Vacancy Factor, Expenses, and Management Fee from the Scheduled Gross Income. Net Income is always a projection, even on buildings with an operating history, because the Net Income and Expenses used are the projected 1st year (into the future) Net Income based on taking the monthly figures at the time of the property purchase (or hypothetical purchase) and

multiplying by 12 to get an annual number. Cap Rate does not take into account anything beyond the 1st year, and in the 1st year does not consider Depreciation (related Tax Benefits), Appreciation, or Interest write-offs. Cap Rate is a convenient, but very superficial way to evaluate an income property.

Cap Rate is commonly used by investors and agents because it is simple and convenient to calculate, and because it is stated in most income property listings which allows convenient comparisons of comparable properties. IRR is a much better indicator, but is more difficult to calculate (without software), and requires more input data, and therefore more research. Also, Cap Rate is in regard to the property, regardless of who the investor will be. IRR is based on a combination of the property data and the investor's personal data (financing terms, Tax Bracket, etc.). Therefore, Cap Rate is a good way to make a superficial analysis of large numbers of comparable properties, especially if you do not know who the investor will be, but IRR is a good way to make an in-depth analysis when the choices have been narrowed down to only a few properties, and it is known who the prospective investor (buyer) is, and what their personal data is (financing terms they can get, Tax Bracket, etc.).

Cap Rate is a projected number used to compare income properties for sale when it is not known who the investor (i.e.- buyer) will be. To be a valid comparison the properties have to be like properties in like condition, and the Cap Rates have to be correctly calculated using the same calculation method. Even if all these things happen, the Cap Rate is static because it doesn't consider Appreciation, Depreciation, time value of money, or other time issues. Cap Rates also don't consider the effect that financing has on properties. Cap Rate is lacking in information compared to IRR, but Cap Rate has the following advantages: it is simple to calculate, only requires property data (not investor data which may not be available), and is stated in almost all income property listings nationwide (IRR is rarely stated, but if stated is usually an incorrect figure anyway).

Caps (interest)

Limits on the amount that the interest rate on an ARM can change per year and/or during the life of the loan. Payment caps limit the amount that monthly payments for an ARM may change.

Cash Flow

The amount of cash gained over a period of time from an income-producing property. It should be enough to pay the expenses for that property (mortgage payment , maintenance, utilities, etc.)

Cash-Out Refinance

When a borrower refinances his mortgage at a higher amount than the current loan balance with the intention of pulling out money for personal use, it is referred to as a "cash out refinance." [\(top\)](#)

Certificate of Deposit

A time deposit held in a bank which pays a certain amount of interest to the depositor. [\(top\)](#)

Certificate of Deposit Index

One of the indexes used for determining interest rate changes on some adjustable rate mortgages. It is an average of what banks are paying on certificates of deposit. [\(top\)](#)

Certificate of Eligibility

A document issued by the Veterans Administration that certifies a veteran's eligibility for a VA [loan.](#)

Certificate of Reasonable Value (CRV)

Once the appraisal has been performed on a property being bought with a VA loan, the Veterans Administration issues a CRV.

Chain of Title

The chronological order of conveyance of a parcel of land, from the original owner to the present owner.

Change Frequency

The frequency of payment and/or interest rate changes in an ARM, usually expressed in months.

Chattel

Personal property.

Clear Title

A title that is free of liens or legal questions as to ownership of the property.

Closing

The passing of a deed or mortgage, signifying the end of a sale or mortgage of real property. Also known in some areas as "passing papers" or "closing of escrow" or "settlement."

Closing Costs

Expenses incurred in the closing of a real estate or mortgage transaction. Most fees are associated with the buyer or borrower's loan.

Closing Statement

A detailed written summary of the financial settlement of a real estate transaction, showing all charges and credits made, all cash received and paid.

Cloud on Title

An uncertainty, doubt or claim against the rights of the owner of a property, such as a recorded purchase contract or option.

Co-Borrower

An additional individual who is both obligated on the loan and is on title to the property.

Collateral

Something of value (such as a car or a home) deposited with a lender to guarantee the repayment of a loan. In a home loan, the property is the collateral. The borrower risks losing the property if the loan is not repaid according to the terms of the mortgage or deed of trust.

Collection

When a borrower falls behind, the lender contacts them in an effort to bring the loan current. The loan goes to "collection." As part of the collection effort, the lender must mail and record certain documents in case they are eventually required to foreclose on the property.

Commission

Most salespeople earn commissions for the work that they do and there are many sales professionals involved in each transaction, including Realtors, loan officers, title representatives, attorneys, escrow representative, and representatives for pest companies, home warranty companies, home inspection companies, insurance agents, and more. The commissions are paid out of the charges paid by the seller or buyer in the purchase transaction. Realtors generally earn the largest commissions, followed by lenders, then the others

Commitment

A written promise to make or insure a loan for a specified amount and on specified items. Also used in the context of title insurance ("title commitment").

Common Area Assessments

In some areas they are called Homeowners Association Fees. They are charges paid to the Homeowners

Association by the owners of the individual units in a condominium or planned unit development (PUD) and are generally used to maintain the property and common areas.

Common Areas

Those portions of a building, land, and amenities owned (or managed) by a planned unit development (PUD) or condominium project's homeowners' association (or a cooperative project's cooperative corporation) that are used by all of the unit owners, who share in the common expenses of their operation and maintenance. Common areas include swimming pools, tennis courts, and other recreational facilities, as well as common corridors of buildings, parking areas, means of ingress and egress, etc.

Common Law

An unwritten body of law based on general custom in England and used to an extent in some states.

Community Property

In community property states (CA, LA, TX, WI, ID, AZ, NV, NM, WA), all property of husband and wife acquired after the marriage is presumed to belong to both, regardless of how it is titled.

Comparables or "Comps"

Comparables are similar properties in a similar location which are for sale, or have recently been sold, or have a sale pending on them.

Also, in the case of income properties, a comparable is any similar property which may be used for comparing income, expenses, vacancy factor, and other operational details, regardless of whether the property is for sale or has ever been sold.

Often you will want to compare properties as potential investments. When comparing properties, you can only compare properties of like type and condition, and then only if the numbers are correctly calculated using the same methods. If you do all the calculations yourself by using this software, you can assure yourself that the numbers were calculated using the same methods on all properties which means you are comparing apples to apples, so long as the properties are of like type & condition and the input numbers are accurate.

If you cannot find a property that is exactly alike, you will have to find as similar a property as possible and then make adjustments to the lesser property to bring it up to (hypothetical) equality with the better property. Then you can make comparisons. The more alike the properties are to begin with, the less you will have to adjust, and the more accurate the comparison.

Compound Interest

Interest computed on the principal and the unpaid accumulated interest of a loan.

Condominium

A structure of two or more units, the interior space of which are individually owned. The common areas are owned as tenants in common by the condominium owners, and ownership is restricted by an association.

Condominium Conversion

Changing the ownership of an existing building (usually a rental project) to the condominium form of ownership.

Condominium Hotel

A condominium project that has rental or registration desks, short-term occupancy, food and telephone services, and daily cleaning services and that is operated as a commercial hotel even though the units are individually owned. These are often found in resort areas like Hawaii.

Construction Loan or Interim Loan

A short-term loan for financing the cost of construction. The lender makes payments to the builder at periodic intervals as the work progresses.

Contingency

The dependence upon a stated event which must occur before a contract is binding. Used both in the context of a loan and a contract of sale.

Contract

An oral or written agreement to do or not to do a certain thing. Some states (ie: Arizona) still honor the handshake, but it's best to get it in writing.

Contract for Deed (conditional sales contract, installment contract)

A contract for the sale of real estate where the deed (title) of the property is transferred only after all payments have been made. This is a risky contract, because buyers can lose their entire investment if the owner declares bankruptcy before the deed has been transferred.

Contract of Sale

A bilateral (two way) agreement wherein the seller agrees to sell and buyer agrees to buy a certain parcel of land, usually with improvements. Also used to reference to an installment land contract (see below).

Conventional Mortgage

A loan neither insured by the FHA nor guaranteed by the VA.

Convertibility Clause

A clause in some ARMs which allows the buyer (borrower) to change to a fixed-rate mortgage at a specified time.

Convertible ARM

An adjustable-rate mortgage that allows the borrower to change the ARM to a fixed-rate mortgage within a specific time.

Conveyance

A written document (such as a deed or lease) that transfers ownership interest in a property from one person to another.

Cooperative (co-op)

A type of multiple ownership in which the residents of a multiunit housing complex own shares in the cooperative corporation that owns the property, giving each resident the right to occupy a specific apartment or unit.

Cooperative Apartment

A cooperative is a corporation which holds title to the land and building. Each coop owner has shares of stock in the corporation which corresponds to an equivalent proprietary lease of his apartment space. Coops were very popular in New York City at one time, but are less common because of their lack of marketability due to high association fees.

Cost of Funds Index (COFI)

One of the indexes that is used to determine interest rate changes for certain adjustable-rate mortgages. It represents the weighted-average cost of savings, borrowings, and advances of the financial institutions such as banks and savings & loans, in the 11th District of the Federal Home Loan Bank.

Credit

An agreement in which a borrower receives something of value in exchange for a promise to repay the lender at a later date.

Credit History

A record of an individual's repayment of debt. Credit histories are reviewed by mortgage lenders as one of the underwriting criteria in determining credit risk.

Credit Report

A report of an individual's credit history prepared by a credit bureau and used by a lender in determining a loan applicant's creditworthiness.

Credit Repository

An organization that gathers, records, updates, and stores financial and public records information about the payment records of individuals who are being considered for credit.

Creditor

A person or entity (a bank or other lender) who funded the loan and to whom a debt is owed.

Cul-de-sac

A dead-end street with a turn-around space at the end. These are attractive to some homeowners because the ending street cuts down on "thru" traffic, speeding, etc.

Debt

An amount owed to another.

Debt Coverage Ratio (DCR) aka Debt Service Ratio, aka Debt Service Coverage Ratio.

Software can calculate Debt Coverage Ratio (DCR) based only on income, expenses, and payments associated with the investor's interest in the subject property.

DCR can also be calculated based on the investor's total personal income and financial obligations, including those associated with the subject property. However that is beyond the scope of this software.

There is a different Debt Coverage Ratio for each year of ownership based on that year. The lender is primarily concerned with the Debt Coverage Ratio for year one.

Also, if there is more than one loan, there is a DCR for each loan according to its position, and there is a DCR for the total of all loans.

Standard Real Estate Practices (SREP) (used by lenders, agents, appraisers, developers, etc.) differ from Generally Accepted Accounting Principles (GAAP) with regard to "Net Operating Income" and "Net Income" calculations. SREP uses these terms interchangeably and calculates them WITHOUT deducting Depreciation or Interest expense from the Adjusted (Effective) Gross Income. This software adheres to both SREP and GAAP, except with regard to "Net Operating Income" and "Net Income" calculations, which are calculated according to the context of the topic. To reduce confusion, neither "Net Operating Income" or "Net Income" are shown anywhere in this software; however, they are used to calculate Debt Coverage Ratios (DCR) and Cap Rate (OAR).

The Debt Coverage Ratio formula is as follows:

Annual Net Operating Income divided by Annual Loan(s) Payment(s) = DCR

Net Operating Income in this context means as calculated by real estate practices. Depreciation and Interest are not deducted from the Adjusted (Effective) Gross Income when calculating the Net Operating Income. In real estate practices, the terms Net Operating Income and Net Income are synonymous, and are different than in accounting practices.

This software uses annual figures, not monthly, so that balloon payments (if any) are figured in.

DCR is used by lenders to determine how likely it is that a property will generate enough net income to make the loan payments (i.e. - Lenders use this ratio as one means to determine if a property is a good risk to loan money on). The minimum ratio the lender requires to make a loan will depend on the lender, the borrower's credit, the type of property, the property's Cash Flow, and the loan terms.

DCR is how many times larger the estimated Net Operating Income is than what the loan payments would be for the same time period.

If you are a lender you know all this. If you are not a lender you should consult a lender regarding the minimum debt ratio they will accept if they are making a loan on a specific property, to a specific borrower, at a specific time.

If there is a 2nd position loan, the 2nd position loan's DCR is best described by the following formula:
$$\frac{\text{Net Operating Income} - \text{1st Position Loan's Payment}}{\text{2nd Position Loan's Payment}} = \text{2nd Position Loan's DCR}$$

For a 3rd position loan the DCR would be as follows:
$$\frac{\text{Net Operating Income} - \text{1st Position Loan's Payment} - \text{2nd Position Loan's Payment}}{\text{3rd Position Loan's Payment}} = \text{3rd Position Loan's DCR}$$

Debt-to-income Ratio

The ratio (expressed as a percentage) which describes a borrower's monthly payments on long-term debts divided by their "net effective income" (for FHA and VA loans) or gross monthly income (for conventional loans).

Deed

The legal document conveying title to a property.

Deed-in-lieu

Short for "deed in lieu of foreclosure," this conveys title to the lender when the borrower is in default and wants to avoid foreclosure. The lender may or may not cease foreclosure activities if a borrower asks to provide a deed-in-lieu. Regardless of whether the lender accepts the deed-in-lieu, the avoidance and non-repayment of debt will most likely show on a credit history. What a deed-in-lieu may prevent is having the documents preparatory to a foreclosure being recorded and become a matter of public record.

Deed of Trust

Some states, like California, do not record mortgages. Instead, they record a deed of trust which is essentially the same thing.

Default

Failure to make the mortgage payment within a specified period of time. For first mortgages or first trust deeds, if a payment has still not been made within 30 days of the due date, the loan is considered to be in default.

Deferred Interest

Unpaid interest added to the loan balance.

Deficiency

The difference between the amount owed to a note holder and the proceeds received from a foreclosure sale. The lender may, in some states, obtain a "deficiency judgment" against the borrower for the difference.

Delinquency

Failure to make mortgage payments when mortgage payments are due. For most mortgages, payments are due on the first day of the month. Even though they may not charge a "late fee" for a number of days, the payment is still considered to be late and the loan delinquent. When a loan payment is more than 30 days late, most lenders report the late payment to one or more credit bureaus.

Department of Veterans Affairs (VA)

An independent governmental agency which guarantees long-term, low- or no-money-down mortgages to eligible veterans.

Deposit

A sum of money given in advance of a larger amount being expected in the future. Often called in real estate as an "earnest money deposit."

Depreciation

A decline in the value of property; the opposite of appreciation. Depreciation is also an accounting term which shows the declining monetary value of an asset and is used as an expense to reduce taxable income. Since this is not a true expense where money is actually paid, lenders will add back depreciation expense for self-employed borrowers and count it as income.

Discount Points

In the mortgage industry, this term is usually used in only in reference to government loans, meaning FHA and VA loans. Discount points refer to any "points" paid in addition to the one percent loan origination fee. A "point" is one percent of the loan amount.

Discrimination in Advertising

HUD does not allow the use of words of a discriminatory nature in any printed or published material. For example, adult building, Jewish home, restricted, private, integrated and traditional.

Documentary Tax Stamps

Stamps, affixed to a deed, showing the amount of transfer tax. Some states simply charge the transfer tax without affixing stamps. Also known as "doc stamps."

Double Closing

A closing wherein a property is bought and then sold simultaneously. Also called "double escrow" and "flipping."

Down Payment

The part of the purchase price of a property that the buyer pays in cash and does not finance with a mortgage.

Due-on-interest

A mortgage clause that allows a lender to call a loan due and payable upon the transfer of the property. Known as "paragraph 17" in FNMA/FHLMC mortgages.

Due-on-Sale Clause

A provision in a mortgage or deed of trust that gives the lender the option to require payment in full of the indebtedness upon transfer of title to the property (or any interest therein).

Earnest Money Deposit

A deposit made by the potential home buyer to show that he or she is serious about buying the house.

Easement

An interest which one has in the land of another. May be created by grant, reservation, agreement, prescription, or necessary implication.

Effective Age

An appraiser's estimate of the physical condition of a building. The actual age of a building may be shorter or longer than its effective age.

Eminent Domain

A Constitutional right for a Governmental authority to acquire private property for public use by condemnation, and the payment of just compensation.

Encroachment

Construction or imposition of a structure onto the property of another.

Encumbrance

A claim, lien or charge against real property.

Entitlement

VA home loan benefit are known as entitlement and/or eligibility.

Equal Credit Opportunity Act (ECOA)

A federal law that requires lenders and other creditors to make credit equally available without discrimination based on race, color, religion, national origin, age, sex, marital status, or receipt of income from public assistance programs.

Equitable Title

The interest of the purchase under an installment land contract (see below).

Equity

The difference between the market value of the property and the homeowners mortgage debt.

Escrow

Delivery of a deed by a grantor to a third party for delivery to the grantee upon the happening of a contingent event.

Escrow Account

Once you close your purchase transaction, you may have an escrow account or impound account with your lender. This means the amount you pay each month includes an amount above what would be required if you were only paying your principal and interest. The extra money is held in your impound account (escrow account) for the payment of items like property taxes and homeowner's insurance when they come due. The lender pays them with your money instead of you paying them yourself.

Escrow Analysis

Once each year your lender will perform an "escrow analysis" to make sure they are collecting the correct amount of money for the anticipated expenditures.

Escrow Disbursements

The use of escrow funds to pay real estate taxes, hazard insurance, mortgage insurance, and other property expenses as they become due.

Escrow Payment

That portion of a borrower's monthly payment held in trust by the lender to pay for taxes mortgage

insurance, hazard insurance, lease payments, and other items as they become due. Also known as "impounds."

Estate

From the English feudal system, this defines the extent of one's ownership in a property.

Estate for Years

An estate limited to a term of years. An estate for years is commonly called a "lease." Upon the expiration of the estate for years, the property reverts back to the former owner.

Eviction

The lawful expulsion of an occupant from real property.

Examination of Title

The report on the title of a property from the public records or an abstract of the title.

Exclusive listing

A written contract that gives a licensed real estate agent the exclusive right to sell a property for a specified time.

Executor

A person named in a will to administer an estate. The court will appoint an administrator if no executor is named. "Executrix" is the feminine form.

Fair Credit Reporting Act (FCRA)

A consumer protection law that regulates the disclosure of consumer credit reports by consumer/credit reporting agencies and establishes procedures for correcting mistakes on one's credit record.

Fair Market Value

The highest price that a buyer, willing but not compelled to buy, would pay, and the lowest a seller, willing but not compelled to sell, would accept.

Fannie Mae, Federal National Mortgage Association (FNMA)

The Federal National Mortgage Association, which is a congressionally chartered, shareholder-owned company that is the nation's largest supplier of home mortgage funds. For a discussion of the roles of Fannie Mae, Freddie Mac (FHLMC), and Ginnie Mae (GNMA), see the Library.

Fannie Mae's Community Home Buyer's Program

An income-based community lending model, under which mortgage insurers and Fannie Mae offer flexible underwriting guidelines to increase a low- or moderate-income family's buying power and to decrease the total amount of cash needed to purchase a home. Borrowers who participate in this model are required to attend pre-purchase home-buyer education sessions.

Farmers Home Administration (FmHA)

An organization that finances loans for farmers and other qualified borrowers who are unable to obtain loans elsewhere.

Federal Housing Administration (FHA)

An agency of the U.S. Department of Housing and Urban Development (HUD). Its main activity is the insuring of residential mortgage loans made by private lenders. The FHA sets standards for construction and underwriting but does not lend money or plan or construct housing.

Fee Simple

The highest form of ownership. An estate under which the owner is entitled to unrestricted powers to dispose of the property, and which can be left by will or inherited. Also known as "Fee" or "Fee Simple Absolute."

Fee Simple Estate

An unconditional, unlimited estate of inheritance that represents the greatest estate and most extensive interest in land that can be enjoyed. It is of perpetual duration. When the real estate is in a condominium project, the unit owner is the exclusive owner only of the air space within his or her portion of the building (the unit) and is an owner in common with respect to the land and other common portions of the property.

FHA Mortgage

A mortgage that is insured by the Federal Housing Administration (FHA). Along with VA loans, an FHA loan will often be referred to as a government loan.

FICO

A FICO score is a credit score developed by Fair Isaac & Co. Credit scoring is a method of determining the likelihood that credit users will pay their bills. Fair, Isaac began its pioneering work with credit scoring in the late 1950s and, since then, scoring has become widely accepted by lenders as a reliable means of credit evaluation. A credit score attempts to condense a borrower's credit history into a single number. Fair, Isaac & Co. and the credit bureaus did not reveal how these scores were computed. The Federal Trade Commission has ruled this to be acceptable.

Credit scores are calculated by using scoring models and mathematical tables that assign points for different pieces of information which best predict future credit performance. Developing these models involves studying how thousands, even millions, of people have used credit. Score-model developers find predictive factors in the data that have proven to indicate future credit performance. Models can be developed from different sources of data. Credit-bureau models are developed from information in consumer credit-bureau reports. Credit scores analyze a borrower's credit history considering numerous factors such as:

- Late payments
- The amount of time credit has been established
- The amount of credit used versus the amount of credit available
- Length of time at present residence
- Employment history
- Negative credit information such as bankruptcies, charge-offs, collections, etc.

There are really three FICO scores computed by data provided by each of three bureaus – Experian, Trans Union and Equifax. Some lenders use one of these three scores, while other lenders may use the middle score.

How can I increase my score?

While it is difficult to increase your score over the short run, here are some tips to increase your score over a period of time:

- Pay all your bills on time. Late payments and collections have a serious impact on your score. Do not apply for credit frequently. Having a large number of inquiries on your credit report can worsen your score.
- Reduce your credit card balances. If you use 50% or more of each credit card, it can negatively affect your credit score.
- Don't pay off all your credit cards each month. Banks like to make money and want that interest. If you are constantly paying off your cards early, they may feel that your 30 year home loan may be paid off early too.

Reduce the number of credit items to Five. If you have two loans (ie: house and car), then reduce the number of credit cards to Three. If you have more than 5 credit items, it will affect your credit score negatively.

If you have limited credit, obtain additional credit. Not having sufficient credit can also negatively impact your score.

Check your credit history once a year. Make sure there are no errors. If there are, contact the credit-bureau, and the credit agency, and have the errors corrected.

[Get a FREE copy of your credit report](#)

Firm Commitment

A lender's agreement to make a loan to a specific borrower on a specific property.

First Mortgage

The mortgage that is in first place among any loans recorded against a property. Usually refers to the date in which loans are recorded, but there are exceptions.

Fixed-rate Mortgage

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

Fixture

Personal property that becomes real property when attached in a permanent manner to real estate.

Flood Insurance

Insurance that compensates for physical property damage resulting from flooding. It is required for properties located in federally designated flood areas.

Foreclosure

A proceeding to extinguish all rights, title, and interest, of the owner(s) of property in order to sell the property to satisfy a lien against it. About half of the states use a "mortgage foreclosure," which is a lawsuit in court. About half use a "power of sale" proceeding which is dictated by a deed of trust and is usually less time-consuming.

401(k)/403(b)

An employer-sponsored investment plan that allows individuals to set aside tax-deferred income for retirement or emergency purposes. 401(k) plans are provided by employers that are private corporations. 403(b) plans are provided by employers that are not for profit organizations.

401(k)/403(b) Loan

Some administrators of 401(k)/403(b) plans allow for loans against the monies you have accumulated in these plans. Loans against 401K plans are an acceptable source of down payment for most types of loans.

Freddie Mac, Federal Home Loan Mortgage Corporation (FHLMC)

A federal Agency purchasing first mortgages, both conventional and federally insured, from members of the Federal Reserve System, and the Federal Home Loan Bank System.

Front-end Ratio

Your prospective monthly mortgage payments divided by your gross monthly income. This comes out to a percentage, and a lender uses this percentage to get an idea of how much of your income will be going to pay your loan. If they like the number (say, below 29%) then they will be more inclined to sell you the loan.

Gain

Gain is the investor's profit from selling the property at the time of sale, which in this software is at the end of the 10th year. Gain is the Appreciation over the term of ownership less closing costs when the property was purchased plus dollars of Depreciation related Tax Deductions taken over the term of ownership.

Gain due to Appreciation

The increase in property value due to inflation and/or an increased demand for land and/or improved properties less closing costs when the property was purchased.

Gain due to Depreciation

That portion of the investor's overall realized gain (at the time the property is sold) that is due to having taken tax deductions for the Depreciation of the improvements over the time of ownership.

Ginnie Mae, Government National Mortgage Association (GNMA)

A federal association working with FHA which offers special assistance in obtaining mortgages, and purchases mortgages in a secondary capacity.

Good Faith Estimate

A lender's estimate of closing costs and monthly payment required by R.E.S.P.A.

Government Loan (mortgage)

A mortgage that is insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA) or the Rural Housing Service (RHS). Mortgages that are not government loans are classified as conventional loans.

Government National Mortgage Association (Ginnie Mae)

A government-owned corporation within the U.S. Department of Housing and Urban Development (HUD). Created by Congress on September 1, 1968, GNMA performs the same role as Fannie Mae and Freddie Mac in providing funds to lenders for making home loans. The difference is that Ginnie Mae provides funds for government loans (FHA and VA)

Graduated Payment Mortgage (GPM)

A type of flexible-payment mortgage where the payments increase for a period of time and then level off.

Grant Deed

A deed commonly used in California to convey title. By law, a grant deed gives certain warranties of title.

Grantor/Grantee Index

The most common document recording indexing system is by grantor (the person conveying an interest, usually the seller or mortgagor) and grantee (the person receiving an interest, usually the buyer or mortgagee). All documents conveying property or an interest therein (deed, mortgage, lease, easement, etc.) are recorded by the grantor's last name in the grantor index. The same transaction is cross-indexed by the grantee's last name in the grantee index.

Gross Rent Multiplier (GRM)

A lower GRM suggests a better Property Price to Income relationship. Therefore, a lower GRM is better than a higher GRM if the properties are in like (equal) physical condition. They are rarely in equal condition, which is why Property Price adjustments should usually be made before calculating GRM. Many other factors besides GRM should be taken into consideration when evaluating an income property.

GRM is commonly used because it is convenient to calculate with a hand calculator, NOT because it is a good or reliable financial indicator. GRM is not very informative, but you need to understand GRM anyway because it is commonly used and stated in listings. Understanding GRM is not as simple as you might think (see below).

There are 4 different methods for calculating GRM. Also, GRM is sometimes called "Gross Income Multiplier" (GIM). The calculation method and name depend on where in the USA you are located. In this software, the name "Gross Rent Multiplier" (GRM) is consistently used.

As for calculating the GRM, in some parts of the country the "Adjusted Gross Income" (AGI) aka "Effective Gross Income" (EGI) is used for the calculation; while in other areas the "Scheduled Gross Income" (SGI) aka "Potential Gross Income" (PGI) is used.

This software always uses "Scheduled Gross Income" (SGI) in calculations because that is most common.

Property Purchase Price divided by SGI = GRM (a lower GRM is better than a higher one)

In some parts of the country Monthly SGI is used, while in other areas Annual SGI is used. This software calculates it both ways, so that you get a "Monthly GRM" and an "Annual GRM".

In some regional areas the monthly figure is called GIM and annual figure is called GRM, and in other regions the reverse is true. To resolve this regional terminology conflict, this software ONLY uses the term GRM and does NOT use the term GIM. In this software there is a "Monthly GRM" and an "Annual GRM".

To manually calculate the Annual GRM, take the Purchase Price and divide the Annual Scheduled Gross Income into it. First calculate the Gross Rent by taking the monthly Gross Rent at the time of purchase and multiply by 12 (hence Annual GRM is indirectly based on the first month). Since there is no appreciation figured into this, and there will likely be appreciation, that means the GRM number is conservative, but that is how it's done. This is for quick comparisons to the GRMs of other properties. An Annual GRM of 8 means the price is 8 times larger than the Annual Gross Income. If one property is an 8 and another a 9, then the 9 costs more in relation to the Scheduled Gross Income.

GRM does not tell anything about property condition, expenses, appreciation, depreciation, or a lot of other things, but is fast and convenient to figure out, however it only is useful for like properties in "like condition". GRMs do not consider the effects of time, expenses, or financing, so GRMs are not very informative, but they are at least more likely to be truthful than Cap Rates because a seller cannot misrepresent his monthly Scheduled Gross Income without a high likelihood of being caught.

With Cap Rates a seller could misrepresent expenses and vacancy factor, and thereby alter the Cap Rate to look falsely good. This is not as easy to verify as is Gross Rent and Sales Price which are all that is needed to verify a GRM.

Both Cap Rates and GRM are supposed to be quick, easy comparisons of investment properties, however the Cap Rate is too subject to misrepresentation to be taken seriously, unless you carefully investigate the expenses and vacancy factor which is not something you have time for if you are making quick and easy comparisons of many properties. Therefore GRM is usually better for quick and dirty comparisons. For an in-depth comparison, look at cash flow, return, and especially at Internal Rate of Return (IRR). Of course you will want to verify the income, expenses, vacancy factor for the local area, prior history of appreciation in that locale, etc. The point is that it's worth investigating the input numbers for the information you get from the returns, internal rate of return, and cash flow. It is not worth the effort in my opinion to go to that investigative trouble to check out a Cap Rate when the Cap Rate doesn't tell you much anyway. GRM doesn't tell much either, but at least it's generally accurate because it cannot easily be misrepresented, and it's fast to calculate as well.

Guaranteed Mortgage (guaranteed loan)

A mortgage guaranteed by a third party.

Guaranty

An agreement by which one person assumes responsibility of assuring payment or fulfillment of another's debts or obligations, or something given as security for the execution, completion, or existence (or payment) of something else.

Hazard Insurance

Insurance coverage that in the event of physical damage to a property from fire, wind, vandalism, or other hazards.

Heirs and Assigns

Words usually found in a contract or deed which indicate that the obligations assumed or interest granted or binding upon or insured to benefit of the heirs or assigns of the party.

Historically Based Input Amounts

Input amounts based on the historical (i.e. - past and/or current) performance of the subject property, such as Contract Rents, Historical Expenses, Historical Vacancy Factor, etc.

Home Equity Conversion Mortgage (HECM)

Usually referred to as a reverse annuity mortgage, what makes this type of mortgage unique is that instead of making payments to a lender, the lender makes payments to you. It enables older home owners to convert the equity they have in their homes into cash, usually in the form of monthly payments. Unlike traditional home equity loans, a borrower does not qualify on the basis of income but on the value of his or her home. In addition, the loan does not have to be repaid until the borrower no longer occupies the property.

Home Equity Line of Credit (HELOC)

A mortgage loan, usually in second position, that allows the borrower to obtain cash drawn against the equity of his home, up to a predetermined amount.

Home Inspection

A thorough inspection by a professional that evaluates the structural and mechanical condition of a property. A satisfactory home inspection is often included as a contingency by the purchaser.

Homeowner's Association

An association of people who own homes in a given area for the purpose of improving or maintaining the quality of the area. Also used in the context of a condominium association.

Home Inspection

A complete and thorough inspection of the physical condition of a property, including all major systems and structural elements, conducted by someone who knows what to look for and who will disclose the findings to you.

Homeowner's Insurance

An insurance policy that combines personal liability insurance and hazard insurance coverage for a dwelling and its contents.

Homeowner's Warranty

A type of insurance often purchased by homebuyers that will cover repairs to certain items, such as heating or air conditioning, should they break down within the coverage period. The buyer often requests the seller to pay for this coverage as a condition of the sale, but either party can pay.

Hot Market

A market in which houses are selling fast. Also known as a **seller's market**, because the seller will

benefit by selling their house at or above their asking price because, theoretically, high demand drives the price up.

Housing Expenses-to-income Ratio

A borrower's housing expenses divided by his/her net effective income (for FHA/VA loans) or gross monthly income (for conventional loans). Expressed as a percentage.

HUD Median Income

Median family income for a particular county or metropolitan statistical area (MSA), as estimated by the Department of Housing and Urban Development (HUD).

HUD-1 Settlement Statement/Sheet, Closing Statement

A document that provides an itemized listing of the funds that were paid at closing. Items that appear on the statement include real estate commissions, loan fees, points, and initial escrow (impound) amounts. Each type of expense goes on a specific numbered line on the sheet. The totals at the bottom of the HUD-1 statement define the seller's net proceeds and the buyer's net payment at closing. It is called a HUD1 because the form is printed by the Department of Housing and Urban Development (HUD). The HUD1 statement is also known as the "closing statement" or "settlement sheet."

Impound Account

Account held by a lender for payment of taxes, insurance, or other payments. Also known as an "escrow" account.

Index

A published interest rate against which lenders measure the difference between the current interest rate on an ARM and that earned by other investments (such as one-, three-, and five-year U.S. Treasury security yields, the monthly average interest rate on loans closed by savings and loan institutions, and the monthly average costs-of-funds incurred by savings and loans).

Initial Interest Rate, Start Rate, Teaser

The interest rate of the mortgage at the time of closing.

Installment Land Contract

The ILC is an agreement wherein the buyer makes payments in a manner similar to a mortgage. The buyer has "equitable title." However, the seller holds legal title to the property until the contract is paid off. The buyer has equitable title, and, for all intents and purposes, is the owner of the property. Also known as a "contract for deed" or "contract of sale."

Installment Sale

A sale which involves the seller receiving payments over time. The Internal Revenue Code contains specific definitions and promulgates specific rules concerning installment sales and tax treatment of them. Also known as an "owner carry" sale.

Insured Mortgage

A mortgage insured against loss to the mortgagee in the event of default and failure of the mortgaged property to satisfy the balance owing plus costs of foreclosure.

Interest

The amount of money charged for the use of the money borrowed.

Interest Adjustment

If the closing (the date on which the buyer takes possession of the property) occurs at a time of the month

other than the date on which the mortgage payment is due, the borrower will pay an amount to cover interest from the interest adjustment date.

Interest Rate

The percentage of an amount of money which is paid for its use for a specified time.

Interest Rate Ceiling

The maximum interest rate for an ARM loan.

Interest Rate Floor

The minimum interest rate for an ARM loan.

Interim Financing

A construction loan made during completion of a building or a project which is replaced by a permanent loan once the building is completed.

Investment

It is very important that you read this. Normally, the definition of the word "Investment" varies according to context. However, in this software it is always defined the same way and all calculations are based on that definition. The definition is extremely important mathematically with regard to the calculation of Returns, IRR, and NPV FBO. Some background information and a detailed explanation follow.

In the context of real estate in general, the term "Investment" can mean the property itself, or the money (value outflow) needed to purchase the property. In the context of this software, the term "Investment" always means the value outflow (usually money) needed to purchase the property, but this needs further definition.

In Standard Real Estate Practice (SREP), when using the term Investment to mean the value outflow (usually money) needed to purchase the property, this means the Downpayment. Therefore, in SREP the Downpayment is considered to be the Investment (i.e.- value outflow to purchase the property) and is used in the Returns and IRR calculations. This is NOT an accurate way to calculate Returns or IRR because the true Investment is the Downpayment + Closing Costs + Exceptional Closing Costs + Loan Points. In other words, the true Investment is the total value outflow (usually money) paid by the Buyer to purchase the property. The Downpayment is only a portion of the true Investment.

According to Generally Accepted Accounting Principles (GAAP): When analyzing an Annuity, the total value outflow needed to purchase the Annuity is used as the initial value outflow at the beginning of the first period in the Return, IRR, and NPV calculations. In this software the 1st year is the first period.

This software analyzes income property like an Annuity. The Investment (i.e.- value outflow) needed to purchase the property (i.e.- annuity) is the total value outflow (usually money) needed to purchase the property. Therefore, the Investment = Downpayment + Closing Costs + Exceptional Closing Costs + Loan Points.

In other words, the Investment is the total value outflow (usually money) paid by the Buyer to purchase the property.

Therefore, in the context of this software the term Investment is mathematically defined as follows:

$$\text{Investment} = \text{Downpayment} + \text{Closing Costs} + \text{Exceptional Closing Costs} + \text{Loan Points}.$$

In this software, the term Investment means the total value outflow (usually money) paid by the Buyer to purchase the property. This allows this software to make the most accurate calculations possible for Returns, IRR, PV FBO, and NPV FBO. These calculations are made according to Generally Accepted Accounting Principles.

Note: Exceptional Closing Costs are anything other than the Downpayment, Closing Costs, or Loan Points that the Buyer (i.e.- investor) must pay for before closing, at closing, or within one year of closing.

Typically, an Exceptional Closing Cost is a much needed repair, such as a new roof or carpet, but can be anything.

Investor

A source of money for a lender to loan.

Joint and Several Liability

A liability which allows a creditor to collect against any one of the debtors for the entire amount of the debt, regardless of fault or culpability. Most mortgage notes that are signed by husband and wife create joint and several liability.

Joint Tenancy

An undivided interest in property, taken by two or more joint tenants. The interests must equal, accruing under the same conveyance, and beginning at the same time. Upon death of a joint tenant the interest passes to the surviving joint tenants, rather than to the heirs of the deceased.

Judgment

The decision of a court of law. Money judgments, when recorded, become a lien on real property of the defendant.

Judicial Foreclosure

A type of foreclosure proceeding used in some states that is handled as a civil lawsuit and conducted entirely under the auspices of a court. Other states use non-judicial foreclosure.

Jumbo Loan

A loan that exceeds Fannie Mae's and Freddie Mac's loan limits, currently at \$227,150. Also called a nonconforming loan. Freddie Mac and Fannie Mae loans are referred to as conforming loans.

Key Lot

The one property in a development that is key to the entire development's success.

Kicker, Equity Kicker, Lender Participation

A lender or investor's right to share any income from a property, in addition to loan payments.

Land Lease

Owners of property will sometimes give long-term leases of land up to 99 years. A lease of more than 99 years is considered a transfer of fee simple. Land leases are commonly used to build banks, car lots and shopping malls upon.

Land Trust

A revocable, living trust primarily used to hold title to real estate for privacy and anonymity. Also known as an "Illinois Land Trust" or "Nominee Trust." The land trustee is a nominal title holder, with the beneficiaries having the exclusive right to direct and control the actions of the trustee.

Late Charge

The penalty a borrower must pay when a payment is made a stated number of days. On a first trust deed or mortgage, this is usually fifteen days.

Lease

A written agreement between the property owner and a tenant that stipulates the payment and conditions under which the tenant may possess the real estate for a specified period of time. [\[Top\]](#)

Leasehold Estate

A way of holding title to a property wherein the mortgagor does not actually own the property but rather has a recorded long-term lease on it.

Lease/Option

An agreement by which the lessee (tenant) has the unilateral option to purchase the leased premises from the lessor (landlord). Some lease/option agreements provide for a portion of the rent to be applied towards the purchase price. The price may be fixed at the beginning of the agreement or be determined by another formula, such as an appraisal at a later time. Also referred to as a "lease/purchase."

Lease/Purchase

Often used interchangeably with the expression "lease/option," but technically means a lease in conjunction with a bilateral purchase agreement. Often used by real estate agents to mean a purchase agreement whereby the tenant takes possession prior to close of escrow.

Legal Description

A property description, recognized by law, that is sufficient to locate and identify the property without oral testimony.

Lender

A term which can refer to the institution making the loan or to the individual representing the firm. For example, loan officers are often referred to as "lenders."

Liabilities

A person's financial obligations. Liabilities include long-term and short-term debt, as well as any other amounts that are owed to others.

Liability Insurance

Insurance coverage that offers protection against claims alleging that a property owner's negligence or inappropriate action resulted in bodily injury or property damage to another party. It is usually part of a homeowner's insurance policy.

License

An authority to do a particular act or series of acts upon the land of another without possessing any estate or interest therein. (eg: a ski lift ticket). A license is similar to an easement in that it gives someone permission to go across your property for a specific purpose. An easement is a property interest, whereas a license is a contractual right.

Lien

An encumbrance against property for money, either voluntary (eg: mortgage) involuntary (eg: judgment) or by operation of law (eg: property tax lien).

Life Cap

For an adjustable-rate mortgage (ARM), a limit on the amount that the interest rate can increase or decrease over the life of the mortgage.

Life Estate

An estate in real property for the life of a living person. The estate then reverts back to the grantor or to a third party.

Line of Credit

An agreement by a commercial bank or other financial institution to extend credit up to a certain amount for a certain time to a specified borrower.

Liquid Asset

A cash asset or an asset that is easily converted into cash.

Liquidated Damages

A contract clause which limits a party to a sum certain in lieu of actual damages. In the case of a real estate purchase and sale contract, the seller's legal remedy is limited to the buyer's earnest money deposit.

Lis Pendens (LIS)

A legal notice recorded to show pending litigation relating to real property and giving notice that anyone acquiring an interest in said property subsequent to the date of the notice may be bound by the outcome of the litigation. Often filed prior to a mortgage foreclosure proceeding.

Listing Price

The price at which a house is listed for sale; the asking price.

Loan

A sum of borrowed money (principal) that is generally repaid with interest.

Loan Officer

Also referred to by a variety of other terms, such as lender, loan representative, loan "rep," account executive, and others. The loan officer serves several functions and has various responsibilities: they solicit loans, they are the representative of the lending institution, and they represent the borrower to the lending institution.

Loan Origination

How a lender refers to the process of obtaining new loans.

Loan Reduction

What is the "Loan Reduction" category in the "Total Benefits sheet"?

In the "Cash Flow" sheet the entire Loan Payment was subtracted from the Scheduled (Effective) Gross Income when calculating Cash Flow . The Principal portion of the Loan Payment is not lost value, so it must be added back to the value stream when calculating the benefits of ownership, simple return, and IRR in the "Total Benefits" sheet.

Therefore, the Principal portion of the Loan Payment is added back to the value stream in the Loan Reduction (aka Principal Paid) column of the "Total Benefits" sheet so that the Annual Benefits Total for each year can be calculated. The Annual Benefits Totals are then used to calculate simple returns and IRR.

Loan Reduction is what RealBenefits calls the Principal portion of the Loan Payment where it is added back into the value stream in the "Total Benefits" sheet.

Here is another way of looking at Loan Reduction. Look at the "Annual Cash Flow" sheet. The Payment on Loan(s) is deducted from the Adjusted (Effective) Gross Income; the Operating Expenses and Management Fee are also deducted. This results in the Annual Cash Flow (pocketable cash).

Now look at the "Total Benefits" sheet.

The Annual Cash Flow from the "Annual Cash Flow" sheet is entered into the Cash Flow column on the "Total Benefits" sheet. REMEMBER that the Annual Cash Flow figure is cash in the investor's pocket AFTER paying all Loan Payments, Operating Expenses, and Management Fees.

The Principal Paid is not cash the investor can put in his or her pocket, but is not an expense either. It is savings in the form of Equity Increase and must therefore be added back to the value stream when

calculating the financial benefits of ownership. The Loan Reduction (aka Principal Paid) column in the "Total Benefits" sheet is where that value is added back to the value stream.

Loan Servicing

After you obtain a loan, the company you make the payments to is "servicing" your loan. They process payments, send statements, manage the escrow/impound account, provide collection efforts on delinquent loans, ensure that insurance and property taxes are made on the property, handle pay-offs and assumptions, and provide a variety of other services.

Loan-to-value (LTV) Ratio

The percentage relationship between the amount of the loan and the appraised value or sales price (whichever is lower).

Lock-in

An agreement in which the lender guarantees a specified interest rate for a certain amount of time at a certain cost.

Lock-in Period

The time period during which the lender has guaranteed an interest rate to a borrower.

Margin

The number of percentage points the lender adds to the index rate to calculate the ARM interest rate at each adjustment

Market Analysis/Value

A report estimating the resale value of a property. Usually prepared by a real estate agent showing comparable sales of properties in the vicinity based on tax records and information from the Multiple Listing Service.

Marketable Title

Title which can be readily marketed to a reasonably prudent purchaser aware of the facts and their legal meaning concerning liens and encumbrances.

Market Based Input Amounts

Input amounts based on the performance of comparable properties, such as the Market Rent, Market Expenses, Market Appreciation, Market Vacancy Factor, etc.

Maturity

The date on which the principal balance of a loan, bond, or other financial instrument becomes due and payable.

Mechanics Lien

A lien created by state law for the purpose of securing priority of payment for the price of value of work performed and materials furnished in construction or repair of improvements to land, and which attached to the land as well as the improvements.

Merged Credit Report

A credit report which reports the raw data pulled from two or more of the major credit repositories. Contrast with a Residential Mortgage Credit Report (RMCR) or a standard factual credit report.

Modification

Occasionally, a lender will agree to modify the terms of your mortgage without requiring you to refinance. If any changes are made, it is called a modification.

Mortgage

A security instrument given by a borrower to secure performance of payment under a note. The document is recorded in county land records, creating a lien (encumbrance) on the property. Also known as a "deed of trust" in some state. The borrower is also called a "mortgagor."

Mortgage Banker

For a more complete discussion of mortgage banker, see "Types of Lenders." A mortgage banker is generally assumed to originate and fund their own loans, which are then sold on the secondary market, usually to Fannie Mae, Freddie Mac, or Ginnie Mae. However, firms rather loosely apply this term to themselves, whether they are true mortgage bankers or simply mortgage brokers or correspondents.

Mortgage Broker

One who for a fee, brings together a borrower and lender, and handles the necessary applications for the borrower to obtain a loan against real property by giving a mortgage or deed of trust as security.

Mortgage Guaranty Insurance Corporation (MGIC)

A private corporation which, for a fee, insures mortgage loans similar to FHA and VA insurance, although not insuring as great a percentage of the loan.

Mortgage Insurance

Insurance required for loans with a loan-to-value ratio above 80%. Also called "PMI," "MIP."

Mortgage Insurance Premium (MIP)

The amount paid by a mortgagor for mortgage insurance, either to a government agency such as the Federal Housing Administration (FHA) or to a private mortgage insurance (MI) company.

Mortgage Life and Disability Insurance

A type of term life insurance often bought by borrowers. The amount of coverage decreases as the principal balance declines. Some policies also cover the borrower in the event of disability. In the event that the borrower dies while the policy is in force, the debt is automatically satisfied by insurance proceeds. In the case of disability insurance, the insurance will make the mortgage payment for a specified amount of time during the disability. Be careful to read the terms of coverage, however, because often the coverage does not start immediately upon the disability, but after a specified period, sometime forty-five days.

Mortgage Warehousing

A system whereby a mortgage company will hold loans which would ordinarily be sold, in order to sell later at a better price. These are used as collateral security with a bank to borrow new money to loan.

Mortgagee

The party lending the money and receiving the mortgage.

Mortgagor

The party who borrows the money and gives the mortgage.

Multidwelling Units

Properties that provide separate housing units for more than one family, although they secure only a single mortgage.

Negative Amortization

A condition created when a loan payment is less than interest alone. Even though payments are made on time, the amount owing increases.

Negotiable Rate Mortgage

A loan in which the interest rate is adjusted periodically.

Net Effective Income

Gross income minus federal income taxes.

Net Income (as calculated by real estate vs. accounting practices)

Real estate practice is to use the terms Net Income and Net Operating Income interchangeably because in real estate practice they are synonymous. In real estate practice the Operating Expenses are deducted from the Adjusted (Effective) Gross Income to arrive at the "Net Income" aka "Net Op Income". Depreciation and Interest Expense ARE NOT deducted from the Adjusted (Effective) Gross Income.

In accounting practices, the terms Net Operating Income and Net Income are two different things. Net Operating Income is calculated by deducting Operating Expenses, including Depreciation, from the Adjusted (Effective) Gross Income (Interest is not deducted). Net Income is calculated by deducting all expenses, including Depreciation and Interest.

This software intentionally avoids stating the dollars of Net Operating Income or Net Income anywhere. This is to avoid confusion because these terms mean different things in real estate vs. accounting practices. However, the terms "Net Income" and "Net Operating Income" are used to explain several concepts. Therefore, always read the notes to see which "Net Income" or "Net Op. Income" is being referred to (i.e.- real estate or accounting).

No Cash-Out Refinance

A refinance transaction which is not intended to put cash in the hand of the borrower. Instead, the new balance is calculated to cover the balance due on the current loan and any costs associated with obtaining the new mortgage. Often referred to as a "rate and term refinance."

No Cost Loan

All non-recurring closing costs except transfer tax are paid by the lender. Not available in purchases in counties where buyer customarily pays all of the title and escrow. Almost all lenders offer loans at "no points." You will find the interest rate on a "no points" loan is approximately a quarter percent higher than on a loan where you pay one point.

No-doc Loan

A loan requiring very little loan documentation. These loans usually require large (25%) down payments.

Non-assumption Clause

A statement in a mortgage contract forbidding the assumption of the mortgage without the lender's approval.

Nonconforming Use

A property which does not conform to the zoning of the area.

Note

A written promise to repay a certain sum of money on specified terms. Also known as a "promissory note."

Note Rate

The interest rate stated on a mortgage note.

Notice of Default (NOD)

A formal written notice to a borrower that a default has occurred and that legal action may be taken.

Open End Mortgage

A mortgage permitting the mortgagor to borrow additional money under the same mortgage, with certain conditions, usually as to the assets of the mortgage.

Option

The unilateral right to do something. For example, the right to renew a lease or purchase a property. The *optionee* is the holder of the option. The *optionor* is the grantor of the option. The optionor is bound by the option, but the optionee is not.

Original Principal Balance

The total amount of principal owed on a mortgage before any payments are made.

Origination Fee

A fee or charge for work involved in the evaluation, preparation and submission of a proposed mortgage loan. Usually about 1% of the loan amount. On a government loan, the loan origination fee is also one percent of the loan amount, but additional points may be charged which are called "discount points." One point equals one percent of the loan amount. On a conventional loan, the loan origination fee refers to the total number of points a borrower pays.

Owner Financing

A property purchase transaction in which the property seller provides all or part of the financing.

Package Mortgage

Mortgage covering both real and personal property.

Paper

A mortgage, deed of trust, or land contract, which is given instead of cash.

Partial Payment

A payment that is not sufficient to cover the scheduled monthly payment on a mortgage loan. Normally, a lender will not accept a partial payment, but in times of hardship you can make this request of the loan servicing collection department.

Partial Release

A release of a portion of property covered by a mortgage.

Payment Change Date

The date when a new monthly payment amount takes effect on an adjustable-rate mortgage (ARM) or a graduated-payment mortgage (GPM). Generally, the payment change date occurs in the month immediately after the interest rate adjustment date.

Performance Mortgage

A mortgage or deed of trust given to secure performance of an obligation other than a promissory note.

Periodic Payment Cap

For an adjustable-rate mortgage where the interest rate and the minimum payment amount fluctuate

independently of one another, this is a limit on the amount that payments can increase or decrease during any one adjustment period.

Periodic Rate Cap

For an adjustable-rate mortgage, a limit on the amount that the interest rate can increase or decrease during any one adjustment period, regardless of how high or low the index might be.

Periodic Tenancy

An estate from week-to-week, month-to-month, etc. In the absence of a written agreement (or upon the expiration of a lease once payments are accepted), a periodic tenancy is created. Either party can terminate this type of arrangement by giving notice, usually equal to the amount of the period or as prescribed by state law.

Perk Test (Percolation)

The test to determine the capability of the soil to absorb liquid, both for construction and septic systems.

Permanent Mortgage/Loan

A mortgage on completed construction for a long period of time.

Personal Property

Any property that is not real property.

Piggy-back Loan

If you need to finance more than 80% of your home's price, a "piggyback loan" is a way to avoid PMI (private mortgage insurance). A "piggyback loan" is a second mortgage to back up the first mortgage. The first and main mortgage is for 80 percent of the home's price. The piggyback loan is for the remainder amount of financing you need.

PITI

This stands for principal, interest, taxes and insurance. If you have an "impounded" loan, then your monthly payment to the lender includes all of these and probably includes mortgage insurance as well. If you do not have an impounded account, then the lender still calculates this amount and uses it as part of determining your debt-to-income ratio.

PITI Reserves

A cash amount that a borrower must have on hand after making a down payment and paying all closing costs for the purchase of a home. The principal, interest, taxes, and insurance (PITI) reserves must equal the amount that the borrower would have to pay for PITI for a predefined number of months.

Planned Unit Development (PUD)

A type of ownership where individuals actually own the building or unit they live in, but common areas are owned jointly with the other members of the development or association. Contrast with condominium, where an individual actually owns the airspace of his unit, but the buildings and common areas are owned jointly with the others in the development or association.

Pledged Account Mortgage (PAM)

When the borrower places money in a pledged savings account, and these funds, plus interest earned, are gradually used to reduce mortgage payments.

Points

Fee paid by a borrower to obtain a loan. A point is one percent of the principal amount of the loan. The borrower may usually pay more points to reduce the interest rate of the loan.

Power of Attorney

A legal document that authorizes another person to act on one's behalf. A power of attorney can grant complete authority or can be limited to certain acts and/or certain periods of time.

Pre-approval

A loosely used term which is generally taken to mean that a borrower has completed a loan application and provided debt, income, and savings documentation which an underwriter has reviewed and approved. A pre-approval is usually done at a certain loan amount and making assumptions about what the interest rate will actually be at the time the loan is actually made, as well as estimates for the amount that will be paid for property taxes, insurance and others. A pre-approval applies only to the borrower. Once a property is chosen, it must also meet the underwriting guidelines of the lender. Contrast with pre-qualification

Prepaid Expenses

Money necessary to create an escrow account or to adjust the seller's existing escrow account. Can include taxes, hazard insurance, private mortgage insurance and special assessments.

Prepayment

Any amount paid to reduce the principal balance of a loan before the due date. Payment in full on a mortgage that may result from a sale of the property, the owner's decision to pay off the loan in full, or a foreclosure. In each case, prepayment means payment occurs before the loan has been fully amortized.

Prepayment Penalty

Fees for early repayment of debt, allowed in 36 states and the District of Columbia.

Pre-qualification

This usually refers to the loan officer's written opinion of the ability of a borrower to qualify for a home loan, after the loan officer has made inquiries about debt, income, and savings. The information provided to the loan officer may have been presented verbally or in the form of documentation, and the loan officer may or may not have reviewed a credit report on the borrower.

Primary Mortgage Market

Lenders making mortgage loans directly to borrowers such as savings and loan associations, commercial banks, and mortgage companies. These lenders sometimes sell their mortgages into the secondary mortgage markets such as FNMA or GNMA, etc.

Prime Rate

The interest rate that banks charge to their preferred customers. Changes in the prime rate are widely publicized in the news media and are used as the indexes in some adjustable rate mortgages, especially home equity lines of credit. Changes in the prime rate do not directly affect other types of mortgages, but the same factors that influence the prime rate also affect the interest rates of mortgage loans.

Principal

The amount borrowed or remaining unpaid. The part of the monthly payment that reduces the remaining balance of a mortgage.

Principal Balance

The outstanding balance of principal on a mortgage. The principal balance does not include interest or any other charges. See remaining balance.

Principal, Interest, Taxes, and Insurance (PITI)

The four components of a monthly mortgage payment on impounded loans. Principal refers to the part of the monthly payment that reduces the remaining balance of the mortgage. Interest is the fee charged for

borrowing money. Taxes and insurance refer to the amounts that are paid into an escrow account each month for property taxes and mortgage and hazard insurance.

Private Mortgage Insurance (PMI)

Mortgage insurance that is provided by a private mortgage insurance company to protect lenders against loss if a borrower defaults. Most lenders generally require PMI for a loan with a loan-to-value (LTV) percentage in excess of 80 percent. Similar to FHA or VA insurance, insuring part of the first mortgage or deed of trust, enabling the lender to make a conventional loan of a higher percentage of the property value.

Promissory Note

A written promise to repay a specified amount over a specified period of time.

Property Tax

Generally, tax levied on both real and personal property with the amount of the tax dependent on the value of the property.

Property Value

The term "Property Value" is self-explanatory. Property Value is NOT the same thing as "Annuity Value", "Personal Value", or the "value of the investor's projected financial benefits of ownership". See the "Value" section below for more information.

Note: The NPV FBO is not the Net Present Value of the income property. The NPV FBO is the Net Present Value of the specific investor's projected future Financial Benefits of Ownership. NPV FBO is the PV FBO less the Investment of Downpayment + Closing Costs + Exceptional Closing Costs + Loan Points.

Prorate

To divide in proportionate shares. Used in the context of a closing, at which such as property taxes, interest, rents and other items are adjusted in favor of the seller, buyer or lender.

Public Auction

A meeting in an announced public location to sell property to repay a mortgage that is in default.

Planned Unit Development (PUD)

A project or subdivision that includes common property that is owned and maintained by a homeowners' association for the benefit and use of the individual PUD unit owners.

Purchase Agreement

A written contract signed by the buyer and seller stating the terms and conditions under which a property will be sold.

Purchase Money Mortgage

A mortgage given by the buyer to the seller as part of the purchase consideration, as opposed to a hard money mortgage.

Purchase Money Transaction

The acquisition of property through the payment of money or its equivalent.

Qualification Requirements

guidelines used by lenders to decide whether to loan money to an applicant.

Qualified Acceptance, Conditional Acceptance

acceptance for a loan (or other contract) provided that certain conditions are met.

Qualified Buyer

A person who has been pre-approved for a mortgage loan.

Qualifying Ratios

Calculations that are used in determining whether a borrower can qualify for a mortgage. There are two ratios. The "top" or "front" ratio is a calculation of the borrower's monthly housing costs (principle, taxes, insurance, mortgage insurance, homeowner's association fees) as a percentage of monthly income. The "back" or "bottom" ratio includes housing costs as well as all other monthly debt.

Quantum

A quantity or amount, a specified portion.

Quiet Title Proceeding

A court action to establish or clear up uncertainty as to ownership to real property. Often required if a lien or cloud appears on title that cannot be resolved.

Quit Claim Deed

A document that transfers a title, right or claim to another person, giving up all claims to a possession. Often used to clear up a cloud on title.

Radon

A radioactive gas which seeps up from the ground and can cause health problems. A radon test is often part of the home inspection.

Rate Lock

A commitment issued by a lender to a borrower or other mortgage originator guaranteeing a specified interest rate for a specified period of time at a specific cost.

Real Estate

Land and anything permanently affixed to the land, and those things attached to the buildings.

Real Estate Agent

A person licensed to negotiate and transact the sale of real estate.

Real Estate Investment Trust (REIT)

A method in investing in real estate in a group, with certain tax advantages.

Real Estate Owned (REO)

The Bank has foreclosed on the property, and now the bank owns it.

Real Estate Settlement Procedures Act (RESPA)

A federal law requiring disclosure of certain costs in the sale of residential property which is to be financed by a federally insured lender. Also requires that the lender provide a "good faith estimate" of closing costs prior to closing of the loan.

Real Property

Land and appurtenances, including anything of a permanent nature such as structures, trees, minerals, and the interest, benefits, and inherent rights thereof.

Realtor®

A real estate agent, broker or an associate who holds active membership in a local real estate board that is affiliated with the National Association of Realtors.

Rescission of Contract

Annulling a contract and placing the parties to it in a position as if there had not been a contract.

Recital

Setting forth a deed or other writing some explanation for the transaction.

Recorder

The public official who keeps records of transactions that affect real property in the area. Sometimes known as a "Registrar of Deeds" or "County Clerk."

Recording

The act of publicly filing a documents, such as a deed or mortgage.

Recording Fees

Money paid to the lender for recording a home sale with local authorities, making it public record.

Recourse Note

A note under which the holder can look personally to the borrower for payment.

Redemption

The right, in some states, for an owner of lien holder to satisfy the indebtedness due on a mortgage in foreclosure after sale.

Refinance Transaction

The process of paying off one loan with the proceeds from a new loan using the same property as security.

Refinancing

The repayment of a loan from the proceeds of a new loan using the same property as collateral.

Re-issue Rate

A discounted charge for a title insurance policy if a previous policy on the same property was issued within a specified period (usually three to five years).

Release

An instrument releasing a lien or encumbrance (eg: mortgage) from a property.

Remaining Balance

The amount of principal that has not yet been repaid. See principal balance.

Remaining Term

The original amortization term minus the number of payments that have been applied.

Rent Loss Insurance

Insurance that protects a landlord against loss of rent or rental value due to fire or other casualty that renders the leased premises unavailable for use and as a result of which the tenant is excused from paying rent.

Repayment Plan

An arrangement made to repay delinquent installments or advances.

Replacement Reserve Fund

A fund set aside for replacement of common property in a condominium, PUD, or cooperative project -- particularly that which has a short life expectancy, such as carpeting, furniture, etc.

Reverse Annuity Mortgage (RAM)

A mortgage in which the lender makes periodic payments to the borrower using the borrower's equity in the home as collateral (the loan grows larger as time passes).

Revolving Debt

A credit arrangement, such as a credit card, that allows a customer to borrow against a pre-approved line of credit when purchasing goods and services. The borrower is billed for the amount that is actually borrowed plus any interest due.

Right of First Refusal

A provision in an agreement that requires the owner of a property to give another party the first opportunity to purchase or lease the property before he or she offers it for sale or lease to others.

Right of Ingress or Egress

The right to enter or leave designated premises.

Right of Survivorship

In joint tenancy, the right of survivors to acquire the interest of a deceased joint tenant.

Sale-leaseback

A technique in which a seller deeds property to a buyer for a consideration, and the buyer simultaneously leases the property back to the seller.

Sale Price

The price at which the house actually sold. The difference between a home's sale price and the listing price is useful for buyers in making offers on comparable homes.

Satisfaction of Mortgage, Release of Mortgage

The document issued by the mortgagee when the mortgage loan is paid in full.

Second Mortgage

A loan secured by a mortgage or trust deed, which lien is junior to a first mortgage or deed of trust.

Secondary Financing

A loan secured by a mortgage or trust deed, which lien is junior to another mortgage or trust deed.

Secondary Mortgage Market

The buying and selling of first mortgages and deeds of trust deeds by banks, insurance companies, government agencies, and other mortgagees.

Secured Loan

A loan that is backed by collateral.

Security

The property that will be pledged as collateral for a loan.

Security Instrument

A document under which collateral is pledged (eg: mortgage)

Security Interest

Interest that a lender takes in the borrower's property to assure repayment of a debt.

Seller Carry-back

An agreement in which the owner of a property provides financing, often in combination with an assumable mortgage.

Septic System

A sewage system, whereby waste is drained through pipes and a tile field into a septic tank.

Servicer

An organization that collects principal and interest payments from borrowers and manages borrowers' escrow accounts. The servicer often services mortgages that have been purchased by an investor in the secondary mortgage market.

Servicing

The collection of mortgage payments from borrowers and related responsibilities of a loan servicer.

Set Back Ordinance

Regulates the distance from the lot line to the point where improvements may be constructed.

Settlement Statement

A statement prepared by a closing agent (usually a title or escrow company) giving a complete breakdown of costs and charges involved in a real estate transaction. Required by RESPA on a form HUD-1.

Shared Appreciation Mortgage (SAM)

A mortgage in which a borrower receives a below-market interest rate and, in return, the lender (or other investor) receives a portion of the future appreciation in the value of the property.

Sheriff's Deed

Deed given at sheriff's sale in foreclosure of mortgage.

Signed, Sealed and Delivered

A phrase indicating that everything necessary to convey has been done by the grantor.

Simple Interest

Interest which is computed only on the principal balance.

Soft Market

A market where houses aren't selling much or quickly, so the sales price is likely to be significantly lower than the asking (listing) price. It's a good time for buyers to buy, but not the best time for prospective sellers to sell.

Specific Performance

An action to compel the performance of a contract, when money damages or breach would not be satisfactory.

Starker Exchange (1031)

Tax-deferred exchanges permit owners to sell investment property and defer tax payments by reinvesting

the proceeds into another investment property (or investment properties). In order to completely defer the payment of tax, among other things, the replacement property must be of equal or greater value and all the equity from the sold property must be reinvested in the new property. The marriage of 1031 exchange and TIC/CORE allows investors not only to defer their capital gains taxes but also to upgrade their investment real estate.

Statutory Lien

An involuntary lien, including tax liens, mechanics liens, etc.

Subject-To

When transferring title to a property encumbered by a mortgage lien without paying off the debt or assuming the note, the buyer is taking title "subject to."

Sublet

To rent part of one's estate in a lease. A subtenant is not in privity of contract with the landlord and neither can look to each other for performance of a lease agreement.

Subdivision

A housing development that is created by dividing a tract of land into individual lots for sale or lease.

Subordinate financing

Any mortgage or other lien that has a priority that is lower than that of the first mortgage.

Subordination

The process by which a lien holder agrees to permit his lien to become junior or "subordinate" to another lien.

Substitute of Trustee

A document which is recorded to change the trustee under the deed of trust.

Subprime Loan

These loans are priced higher than prime loans, often much higher. Loans to borrowers whose credit is less than perfect will almost always be subprime loans. There are also other circumstances that lead to subprime loans, including high outstanding debt, unproven income, etc. Even borrowers with good credit may receive subprime loans for a variety of reasons, including fraud, discrimination, failure to shop around, etc.

Survey

A drawing or map showing the precise legal boundaries of a property, the location of improvements, easements, rights of way, encroachments, and other physical features.

Sweat Equity

Contribution to the construction or rehabilitation of a property in the form of labor or services rather than cash.

Tax Lien

Lien for nonpayment of taxes.

Tax Sale

Public sale of property at auction by government authority, after a period of nonpayment of property taxes.

Tax-Deferred Exchange/Starker Exchange (1031)

Tax-deferred exchanges permit owners to sell investment property and defer tax payments by reinvesting the proceeds into another investment property (or investment properties). In order to completely defer the payment of tax, among other things, the replacement property must be of equal or greater value and all the equity from the sold property must be reinvested in the new property. The marriage of 1031 exchange and TIC/CORE allows investors not only to defer their capital gains taxes but also to upgrade their investment real estate.

Ten Thirty One (1031) Exchange/Starker Exchange

Tax-deferred exchanges permit owners to sell investment property and defer tax payments by reinvesting the proceeds into another investment property (or investment properties). In order to completely defer the payment of tax, among other things, the replacement property must be of equal or greater value and all the equity from the sold property must be reinvested in the new property. The marriage of 1031 exchange and TIC/CORE allows investors not only to defer their capital gains taxes but also to upgrade their investment real estate.

Tenancy by the Entirety

A form of ownership recognized in some states by which husband and wife each owns the entire property. As with joint tenancy, in event of death of one, the survivor owns the property without probate. In some states, tenancy by entirety protects the property from obligations of one spouse.

Tenancy in Common

With tenancy in common, each owner (called a "tenant") has an undivided interest in the possession of the property. Each tenant's interest is salable and transferable. Each tenant can convey his interest by deed, mortgage or by a will. Joint ownership is presumed tenants in common if nothing further is stated on the deed.

Term

The lifespan of the contract to repay a loan.

Testator

One who dies leaving a testament or will.

Third-party Origination

A process by which a lender uses another party to completely or partially originate, process, underwrite, close, fund, or package the mortgage it plans to deliver to the secondary mortgage market.

Title

Title is the *evidence* of ownership. In essence, title is more important than ownership because having proper title is *proof* of ownership. If you have a problem with your title, you will have trouble proving your ownership and thus selling or mortgaging your property.

Title Company

A company that specializes in examining and insuring titles to real estate.

Title Insurance

An insurance policy which protects the insured (purchaser and/or lender) against loss arising from defects in title. A policy protecting the lender is called a "Loan Policy," whereas a policy protecting the purchaser is called a "Owner's Policy." Virtually all transactions involving a loan require title insurance.

Title Search

The examination of municipal records by a title company to determine the legal ownership of property.

Transfer of Ownership

Any means by which the ownership of a property changes hands. Lenders consider all of the following situations to be a transfer of ownership: the purchase of a property "subject to" the mortgage, the assumption of the mortgage debt by the property purchaser, and any exchange of possession of the property under a land sales contract or any other land trust device.

Transfer Tax

State or local tax payable when title passes from one owner to another.

Treasury index

An index that is used to determine interest rate changes for certain adjustable-rate mortgage (ARM) plans. It is based on the results of auctions that the U.S. Treasury holds for its Treasury bills and securities or is derived from the U.S. Treasury's daily yield curve, which is based on the closing market bid yields on actively traded Treasury securities in the over-the-counter market.

Trustee

A fiduciary who holds or controls property for the benefit of another.

Truth in Lending

Federal law requiring, among other things, a disclosure of interest rates charges and other information about a loan.

Two-step Mortgage, Premier Mortgage

A mortgage in which the borrower receives a below-market interest rate for a specified number of years (7 to 10) and then receives a new interest rate adjusted (within limits) to market conditions at that time.

Two- to Four-family Property

A property that consists of a structure that provides living space (dwelling units) for two to four families, although ownership of the structure is evidenced by a single deed.

Underwriting

The decision whether to make a loan to a potential homebuyer based on credit, employment, assets, and other factors, and the matching of this risk to an appropriate rate and term or loan amount.

Usury

Interest charged in excess of the legal rate established by law.

Value

There are two separate value issues: Property Value, and the value of the financial benefits of ownership. The value of the financial benefits of ownership is also called "Annuity Value" (see the "Annuity" topic above). The value of the financial benefits of ownership is also called "Personal Value" because it is the value of the specific investor's projected financial benefits of ownership based on the property data and that investor's personal data. Therefore, "Annuity Value", "Personal Value", and "the value of the investor's projected financial benefits of ownership" are all synonymous.

Regardless of the type of value you are attempting to address, you should make at least two analyses. One based on the current gross income, vacancy factor, and expenses, and another based on what they should be under new management. This is because the quality of the management has such a large impact on these factors, and the management usually changes when the property ownership changes.

In accordance with Standard Real Estate Practices, you can compare the Cap Rate and GRM (Gross Rent Multiplier) of the subject property to the Cap Rates and GRMs of comparable properties to arrive at an estimate of Property Value. However, Cap Rates are often inaccurate because landlords (i.e.– sellers) often misstate the expenses and/or vacancy factor (which is why GRM is sometimes used). Also, Cap

Rate and GRM do not take into account the available financing terms, which may be different for each property (such as contract terms). Financing terms can substantially affect the investment. The attributes of the Cap Rate and GRM are that they are easy and convenient to calculate and are stated in almost all income property listings' data.

By comparing the subject property's Cap Rate and GRM to those of comparable properties, the Property Value can be estimated. However, Cap Rate and GRM do not take into account the property condition and therefore, can only be used to compare properties of similar condition. Cap Rate and GRM are based on the 1st year only, and therefore, even with a property inspection they ignore repairs which would be needed after the 1st year. Cap Rate also ignores several important financial issues: Interest Deductions, Depreciation Deductions, Appreciation, and the time value of money. GRM ignores even more issues than Cap Rate does.

Cap Rate, GRM, and Property Value are topics that agents, appraisers, and professional investors already address. To address these topics, a physical property inspection and access to a current comparable property database are needed. Agents typically address these topics for free (CMAs), and appraisers address these topics if an appraisal is done. Therefore, the Cap Rate, GRM, and Property Value are issues that have probably been addressed before the investor goes to a CPA for advice. The investor can probably get Cap Rate, GRM, and Property Value issues addressed most economically by a real estate professional. Therefore, RealBenefits recommends leaving the Property Value topic to agents, appraisers, and professional investors, rather than a CPA, but a CPA is still needed for advice on other topics described below.

Ultimately, agents, appraisers, and investors must make an educated guess about Property Value. In a market economy, the true Property Value is whatever the highest bidder is willing to pay for the property, but this isn't known until after a sale closes. Therefore, Cap Rate is as close as the "Benefits IPO" software comes to addressing Market Value. It does not explicitly state the Market Value for the reasons described above.

What the investor (buyer) cannot get from the real estate community are the things they need most from a CPA. Standard Real Estate Practices, and therefore the real estate community, traditionally ignore several financial benefits of ownership when making analyses: Interest Write-offs, Depreciation Write-offs, Appreciation, how financing affects the investment, and the time value of money. Also, the real estate community traditionally ignores many issues related to things that occur after the first year. This "Benefits IPO" software uses accounting principles to address these issues by analyzing all the financial benefits of ownership for years 1–10 as if the income property were an annuity. The IRR and NPV of the Financial Benefits of Ownership (NPV FBO) are stated and can be thought of as the IRR and NPV of the "annuity". The investor cannot get assistance in these areas from the real estate community (unless they're using this software). Also, although many real estate investors understand the real estate principles involved, few understand the accounting principles involved. Therefore, the investor needs a CPA's assistance to address all of the issues mentioned in this paragraph.

The investor especially needs a CPA's help in determining the "value of the investor's projected financial benefits of ownership" (aka "Personal Value", aka "Annuity Value"). Although the "Benefits IPO" software states the IRR and NPV FBO, it does not explicitly state the value of the projected financial benefits of ownership. Stating the value of the projected financial benefits of ownership is beyond the scope of this software and is something that the investor needs their CPA's help with. The projections made by this software are tools to assist CPAs in making value decisions. PV FBO and NPV FBO are possible "Annuity Values", but "Annuity Value" is not explicitly stated because the investor's CPA must determine it.

VA Mortgage/Loan

A mortgage that is guaranteed by the Department of Veterans Affairs (VA).

VA Mortgage Funding Fee

A premium of up to 1-7/8 percent (depending on the size of the down payment) paid on a VA-backed loan.

Vested

Having the right to use a portion of a fund such as an individual retirement fund. For example, individuals who are 100 percent vested can withdraw all of the funds that are set aside for them in a retirement fund. However, taxes may be due on any funds that are actually withdrawn.

Veterans Administration (VA)

An agency of the federal government that guarantees residential mortgages made to eligible veterans of the military services. The guarantee protects the lender against loss and thus encourages lenders to make mortgages to veterans.

Waive

To give up a claim or right voluntarily, to relinquish. A **waiver** is a document that evidences that relinquishment.

Walk-through Inspection

A final walk-through immediately prior to closing to verify that no changes have taken place and no new damage has occurred.

Warranty Deed

A deed under which the seller makes a guarantee or warranty that title is marketable and will defend all claims against it.

Wear and Tear

Normal use and the resulting reduction in value of a property.

Wraparound Mortgage

A mortgage that is subordinate to and incorporates the terms of an underlying mortgage. The mortgagor (borrower) makes payments to the mortgagee (lender) who then makes payments on an underlying mortgage. Also referred to as an "all inclusive deed of trust" in some states.

Yield Spread Premium

A "kickback" from the lender to the mortgage broker for the additional profit made from marking up the interest rate on a loan.

Zero Cost Loan

A loan that pays for all nonrecurring closing costs, except for transfer tax. No applicable in a purchase transaction in a county where the buyer customarily pays title and escrow fees.

Zoning

City regulations determining the character or use of property. Zoning Laws divide cities into different areas according to use, from single-family residences to industrial plants. Zoning Ordinances control the size, location, and use of buildings within these different areas.