# 10 Terms First-Time Homebuyers Should Know

## Applying for a mortgage is easier when you learn how to talk to lenders.

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In about a month or so, it won't just be spring. It'll be home selling and buying season, and you'll start seeing the “For Sale” signs posted in yards as well as online advertisements beckoning prospective homebuyers.

But before you allow yourself to be beckoned, it would behoove you to familiarize yourself with the following 10 terms – especially if this is your first time making one of the biggest purchases of your life.

**1. Fixed-rate mortgage.** This means the interest rate you pay on your home loan won't change. Over the years, your mortgage payment will likely change some – property taxes will likely rise, your homeowners insurance might climb or fall, or you might shed your PMI (a term we’ll come back to). But generally, if you have a fixed-rate mortgage, your monthly mortgage payment won't change much over the years.

**2. Adjustable-rate mortgage.** Also known as an ARM, this is essentially the opposite of a fixed-rate mortgage. You'll have a fixed rate for several years, maybe five or 10, and then the interest rate adjusts according to the fully indexed interest rate, often the prime rate, which is what banks charge their most creditworthy customers. So while your interest rate and payments will likely be lower in the beginning than those of the homeowner with the fixed-rate mortgage, hope that interest rates remain low throughout the life of your loan. As interest rates climb, so too will your own interest rate and monthly payments.

**3. Prequalified.** This can be a confusing term, mostly because homebuyers tend to mix it up with preapproved, says Rick Hogle, chief strategic officer at Supreme Lending, a mortgage company in Dallas.

If your lender tells you that you're prequalified for a house, that's a good start – but you're still a long way from being a homeowner. "Prequalification requires less documentation," Hogle says. "It provides a general idea of the loan amount in which a homebuyer might qualify." This way, you can start looking a home and have a sense of what type of house you can afford.

Preapprovals are a much bigger deal, Hogle says. These require the submission of many more documents, such as pay stubs, bank statements and tax returns.

Preapprovals are really for homeowners who are ready to commit to buying a house. If you're preapproved, you've basically been told that the bank will lend you money for a house, provided you don't blow things in the meantime, while you're house hunting, like missing a bunch of payments or racking up credit card debt before you're actually approved.

**4. Conventional loans.** These are the typical loans that many people, but not all, apply for when they want a mortgage.

"Those with low credit scores usually won't qualify for conventional loans," says Passard Dean, associate professor of accounting at Saint Leo University in Saint Leo, Florida. "In the past, you were also required to put a down payment of at least 5 percent. However, with the new guidelines from Fannie Mae and Freddie Mac, you can now put a down payment as low as 3 percent.  These loans generally require a credit score of above 650.

**5. Federal Housing Administration loan.** Have poor credit? You'll probably get one of these, also known as FHA loans.

“These are excellent for first-time homebuyers with subprime credit scores," Dean says. "In addition to more relaxed credit scores and lower upfront costs, the down payment can be as low as 3 percent."

**6. Appraisal.** This is an estimate that determines what your property is worth. Banks need homes to be appraised, in part, so they don't lend you, say, $300,000 for a house that's only worth $175,000. After all, if you can't pay the loan, the bank will send you packing and will sell the home. But most people won't buy a $175,000 home for $300,000, and knowing that, the bank doesn't want to lend you more than your house is worth.

**7. Private mortgage insurance.** This is a monthly insurance payment you'll have to pay if the down payment on your house is less than 20 percent of the appraised value or sale price. If you don't want to pay the PMI fee – which often ranges from .03 to 1.15 percent of the original loan, divided into 12 monthly payments – you'll have to fork over a bigger down payment or buy a cheaper house. Usually, PMI insurance isn't something you pay forever (it just seems like it, if you have a small down payment.) Typically, after your payments reach 20 percent of the value of your home, you stop paying PMI.

**8. Closing costs.** These are fees related to buying a house that your lender charges you, or you rack up from various third parties, such as a home inspector. According to the online real estate database Zillow.com, expect your closing costs to be 2 to 5 percent of the purchase price of your home. That may sound like a lot, but there are many costs involved in closing the deal, from buying title insurance to paying for points and attorney and surveyor fees.

**9. Points**. One point is a charge equal to 1 percent of the loan amount. So if you're buying a $200,000 house, and a lender is charging you 2 points, that's $4,000. Three points, $6,000. And why do you care? Because points are prepaid interest. The more points you pay, the lower your interest rate will be. If you're planning to live in your house a few years, you could make a good argument for not paying points, but if you believe you'll go the distance with a 30-year mortgage, it generally makes financial sense to pay as many points as you can afford to snag that lower interest rate, which, in the long run, should save you money. Ask your lender to do the math.

**10. Escrow.** When you hear your real estate agent throw this word around, you'll know you're probably near the end of the homebuying process. The word can be used in a few different ways, but when you think escrow, think of a third, neutral party. For instance, you may have looked at a house, loved it, made an offer and offered a deposit – which would then be put in escrow.

That is, it'll be put in a third-party account, probably set up by your real estate agent. This way you aren't giving the homeowner your deposit, also sometimes called earnest money. Usually you can’t recoup these deposits if you back out of the contract, but if the seller decides to sell the home to somebody else, you most certainly would get your deposit back. The escrow account keeps your deposit safe so the homeowners don't inadvertently spend your money and put you through the hassle of having to get them to repay you.

You might also hear your lender talking about an escrow account where your property taxes and homeowners insurance go until they're paid.

Of course, you *can* buy a house without truly understanding real estate and lender speak. Those professionals will walk you through everything, and you can likely nod your way through it all. But that doesn't mean you should. After all, some would argue that's how many homeowners got themselves in trouble before the 2007 recession, making decisions they shouldn't have, and buying homes they didn't realize they really couldn't afford.