Amortization The name given to periodic reductions in the principal amount due on a mortgage or other loan. When the full amount is repaid, the loan is fully amortized.

Balloon A mortgage in which the debt service (interest and principal) that is paid regularly will not result in the complete payment of the loan at the end of the mortgage term. The payment that represents the amount of principal still due at the end of the term is called the balloon payment. "To balloon" a mortgage is to schedule the amortization payments over a longer period that the term of the mortgage. Balloon Payment is the last payment on a loan when that payment is substantially larger than other earlier payments. Often used with mortgage loans, e.g., when a mortgage loan is amortized for a period of time with level payments and then becomes due before it is fully amortized.

Closing Costs The costs incurred as the result of a purchase or sale of a business and paid by the parties at closing. These costs may include an origination fee, title insurance, attorney fees, broker fees, survey, appraisal, transfer taxes, government guarantee fee, and such prepaid items as taxes and insurance escrow payments. Closing, also called settlement, is the completion of a business transaction that transfers certain rights of ownership in exchange for monetary and other agreed-to considerations. Closing includes the delivery of business ownership, financial adjustments, and signing of notes (if financed), and the disbursement of funds necessary to the business purchase transaction.

Collateral Specific property, securities, or other assets pledged by a borrower to a lender as a backup source of loan repayment. If the borrower does not pay as agreed, the financial institution has the right to repossess the asset and sell it to satisfy any outstanding loan amount.

Commercial Appraisal The valuation of commercial property by an appraiser. An appraiser is a person trained and qualified to estimate the value of a business or real property. Appraisers are usually professionally trained and experienced. Many belong to the Society of Real Estate Appraisers (SREA) or are Members of the Appraisal Institute (MAI).

Debt Service Coverage Usually expressed as a coverage ratio, often used in underwriting income property loans, that shows what proportion of the company's net profit and noncash expenses will be needed to pay the principal due on long-term debt in the coming year. The calculation is net profit after tax plus depreciation plus noncash expenses less dividends divided by current maturities on long-term debt. Also called "traditional cash flow"

Environmental Report This is an engineering study conducted on real property to determine any environmental hazards or risks. Most commercial loan approvals require an environmental assessment report. A Phase One environment assessment report is a research report on the environmental history of real property, usually done through document research. If the Phase One report uncovers a potential environmental risk, the financial institution may (and usually does) require a Phase Two report. A Phase Two report entails collecting ground samples at the site. If a Phase Two environmental assessment report discovers contamination at a site, the owner must take action to remediate the contamination. This can be costly, but some states provide assistance. Once the site is "clean" (i.e., no contamination found), a state's regulatory agency issues a No Further Action letter. Most financial institutions will not lend to borrowers requesting mortgages on contaminated properties.

Equity Injection The amount of cash or other valuable consideration required from a borrower in order to induce the financial institution to approve a loan request. Also called down payment.

FICO Score A popular credit scoring system used by many financial institutions to determine the personal creditworthiness of a borrower. The Fair Isaac (FICO) score can range from 400 to 800 (the higher, the better).

First Mortgage / Deed of Trust A mortgage having priority over other mortgage liens against certain property. In the event of default, a first mortgage takes precedence over a second mortgage, which takes precedence over a third mortgage, and so on, though certain liens, such as tax liens and mechanic's liens, may take priority over the first mortgage. A <u>Deed of Trust</u> is a sealed instrument in writing executed and delivered that conveys or transfers property to a trustee. A deed of trust usually but not necessarily covers real property. A deed of trust is used in some states (e.g., North Carolina) instead of a mortgage. Property is transferred to a trustee by the borrower, in favor of the lender, and reconveyed to the borrower on payment in full.

Fund Control / Construction Fee A fee charged by a financial institution for overseeing the disbursement of funds on a construction project. Construction oversight includes (i) verifying completion of tasks by subcontractors, (ii) ensuring that subcontractors are paid timely, (iii) managing general contractor draws, and (iv) other duties concerning disbursement of funds during construction. This fee ranges from 1% to 2% of the construction costs.

Guarantee Fee A fee, similar to an insurance premium, charged by the government for insuring am eligible commercial loan. The fee amount depends on the size of the loan. The Small Business Administration (SBA) charges a fee between 2.0% and 3.5% for the portion of the loan SBA guarantees (e.g., SBA 7(a) loans). The United State Department of Agriculture (USDA) charges a fee of 2% for its Business & Industry rural loans.

Interest Rates The rate assessed for use of borrowed funds. The rate generally is computed on a percentage-per year basis. A <u>Variable Rate</u> loan is a loan with an interest rate that may fluctuate. The rate is tied usually to an index (such as The Wall Street Journal Prime rate or 1-Month LIBOR) reflecting changes in market rates of interest. A fluctuation in the interest rate causes changes in either the payments or loan term. Limits often are placed on the degree to which the interest rate or the payments can vary. A <u>Fixed Rate</u> loan is a loan in which the interest rate remains the same over the life of the loan or for a period of time. Many fixed rate loan products sold today are fixed for a period of time (e.g., 3, 5, 10 years), then either reset to a new fixed rate or convert to a variable rate loan. Many financial institutions use the SWAP rate as an index for pricing fixed rate loans.

Loan-to-Value The computation is the loan request divided by the market value of the subject property. Financial institutions use this benchmark as a measure of how much leverage is acceptable for a particular property type. Property types that could easily be converted for other uses (multi-use properties) enjoy higher loan-to-value (LTV) rates than properties with unique structures (special-use properties). Most assisted living facilities, nursing homes, and adult care centers are multi-use properties. Examples of special use properties are hotels, gas stations, car washes, and schools.

Origination Fee / Points A fee charged to the borrower as a way to cover the expenses of processing the loan application. This is usually calculated as a percentage of the loan amount. The origination fee on commercial loans usually ranges from 1% to 2%.

Prepayment Penalty A charge for the privilege of repaying an obligation before the agreed maturity date. Prepayment penalties often are charged on loans extended at an interest rate considered favorable to the lender in the long, rather than the short, run. Most long-term government-insured loans have prepayment penalty provisions.