What's Your Financial Vocabulary IQ?

In the current economic climate, we hear terms such as subprime, Fannie Mae, Freddie Mac, ARM, recession and depression. Do you know what these terms mean to your current financial situation? This month's column is designed to help you understand some of the financial terms you may need to know as you navigate the financial waters.

Adjustable Rate Mortgage (ARM)
Unlike a conventional mortgage with a fixed interest rate that remains the same throughout the life of the loan, an adjustable-rate mortgage changes periodically and payments may go up or down accordingly. The borrower may start out with a low interest rate, but as the interest rate rises, so does your payment.

Annual Percentage Rate (APR)
The yearly cost of a mortgage, including interest, mortgage insurance, and the origination fee (points), expressed as a percentage.

Annual Percentage Yield (APY)
The rate of return on an investment for a one-year period.

Average Daily Balance
A method for calculating interest in which the balance owed each day by a customer is divided by the number of days.

Bear
An investor who believes the stock market will decline.

Bond
Bonds are debt and are issued for a period of more than one year. The U.S. government, local governments, water districts, companies and many other types of institutions sell bonds. When an investor buys bonds, he or she is lending money. The seller of the bond agrees to repay the principal amount of the loan at a specified time, although some bond types may pay off prior to maturity.

Bull
An investor who believes the stock market will rise.

Consumer Price Index (CPI)
Measures the prices of consumer goods and services and is a measure of the pace of U.S. inflation. The U.S. Department of Labor publishes the CPI every month.

Conventional Fixed Mortgage
This type of government-sponsored mortgage meets the funding criteria of Fannie Mae and Freddie Mac.

Credit Scoring
A statistical technique that combines several financial characteristics to form a single numerical score to represent a customer's creditworthiness.

Depression
A period during which business activity drops significantly marked by high unemployment rates and deflation.

Fannie Mae (Federal National Mortgage Association)
Unlike Freddie Mac, Fannie Mae is a publicly traded company, created in 1938, to expand the flow of mortgage money by creating a secondary mortgage market to provide affordable home ownership to low, moderate, and middle-income Americans.

Freddie Mac (Federal Home Loan Mortgage Corp)
A stockholder-owned government-sponsored enterprise chartered by Congress in 1970 to keep money flowing to mortgage lenders in support of homeownership and rental housing for middle income Americans.

FHA Loan
A mortgage issued by federally qualified lenders and insured by the Federal Housing Administration (FHA) that is popular with first-time home buyers. It allows low to moderate income borrowers to borrow up to 97% of the value of the home.

Five Cs of Credit
Five characteristics that are used to form a judgment about a customer's creditworthiness: character, capacity, capital, collateral and conditions.

Prepayment penalty
The fee a borrower pays a lender when the borrower repays a loan before its scheduled time of maturity. Most loans do not include such provisions.

Recession
An extended decline in general business activity, a decline in the gross national product for two consecutive quarters.

Subprime Lending
Practice of making loans to borrowers who do not qualify for the best market interest rates because of their deficient credit history.

While we may be navigating some rough financial waters now, the sky is not falling. However, this would be a good time to talk to your community banker to make sure your financial lifeboat is sound.

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