UT PL 32 The Basics of Finance 2 Study Guide

Term	
collateralized mortgage obligation	A secondary market product that is a fixed income security that uses mortgage-backed securities as collateral. It is subdivided into graduated risk classes so that investors can more easily determine how much risk they want to take on.
conforming loan	A mortgage loan that conforms to GSE (Fannie Mae and Freddie Mac) guidelines, such that it can be purchased on the secondary debt market.
default risk	The risk of not being paid. A rising market covers default risk, because a homeowner can sell the property in that market and make the lender whole.
delayed payment risk	The risk of payment being deferred, which is a risk because the delay of receiving money lowers the overall value of the investment.
Desktop Underwriter	Fannie Mae's automatic underwriting technology. It provides lenders a comprehensive credit risk assessment that determines whether a loan meets Fannie Mae's eligibility requirements.
direct lender	Someone who is making a loan directly to the consumer, with the intent to hold at least a portion of that loan in their investment.
discount rate	The interest rate charged to commercial banks and other depository institutions for loans received from the Federal Reserve's discount window.
discount window	An instrument of monetary policy that allows eligible institutions to borrow money from the central bank, usually on a short-term basis, to offset temporary shortages of liquidity.
federal funds rate	The federal funds target rate is set by the governors of the Federal Reserve, which they enforce by open market operations and adjustments in the interest rate on reserves. They intervene by influencing the rate at which banks are lending to one another. This impacts short-term interest rates, not long-term rates.
Federal Home Loan Mortgage Corporation	Known as FHMLC or Freddie Mac, an entity that buys mortgages on the secondary market, pools them, and sells them as a mortgage-backed security to investors. A government-sponsored enterprise (GSE).
Federal National Mortgage Corporation	Known as FNMA or Fannie Mae, an organization started to create a market to help loans move more smoothly. Its primary purpose is to provide liquidity for first government-backed loans (such as FHA and VA loans), and because of it, loans are more affordable. A government-sponsored enterprise (GSE).
Federal Reserve System	The central bank of the United States (not government-owned). It conducts monetary policy by influencing money and credit conditions. It also maintains the stability of the financial system.
Government National Mortgage Corporation	Known as GNMA or Ginnie Mae, established to ensure timely payments for FHA and VA loans so that they would be more attractive investments.
institutional lender	Buyers of loans on the secondary market. Lenders looking to provide capital to others who are working through the origination/underwriting process.
interest risk	The risk that interest rates will go up and devalue the current, lower-interest loan.
Loan Prospector	Freddie Mac's automatic underwriting technology.
mortgage backed bond	A secondary market product that uses mortgage loans to issue a bond. Used to raise capital to issue more loans.

mortgage pay through bond	A secondary market product issued like a mortgage backed bond but pays like a pass through security.
Nationwide Mortgage LicensingSystem and Registry	The system of record for non-depository financial services licensing or registration in participating state agencies.
pass through security	A secondary market product that passes principal and interest payments to the holder. An equity interest in the loan.
prepayment risk	The risk that a loan will be paid off early or otherwise refinanced at a lower interest rate, reducing the value that the investor would receive from interest.
prime loan	Loans to borrowers who meet specific lending criteria that qualify them as a higher credit quality for a lender. Typically associated with conventional or conforming loans.
reserve requirement	A central bank regulation that sets the minimum amount of reserves that must be held by a commercial bank.
subprime loan	Loans to borrowers who do not have a strong credit history and are not considered as low of a credit risk. This refers to the credit quality of the borrower, rather than being a specific, separate product.
The SAFE Act	Known as the Secure and Fair Enforcement for Mortgage Licensing Act, this legislature mandates a nationwide licensing and registration system for residential mortgage loan originators. The SAFE Act requires that federal registration and state licensing and registration be accomplished through the Nationwide Mortgage Licensing System and Registry.
underwriter	The role of the underwriter is to make sure that the loan is assembled in such a way and that the documentation and appropriate information is there so that when they put that loan into a pool of other mortgages it meets basic criteria. Underwriters must be sure that there is a complete file and that that file meets the criteria for investors in the secondary market who are purchasing those loans. They determine if the buyer has the capacity to repay the loan, that it is more than likely that they will be able to continue their payments in a timely manner. They are also examining the collateral to make sure that the property actually exists.

Concept

Discounting a Loan	Lenders sometimes sell a loan at a discount if circumstances have changed. For example, if the credit rating has decreased, it is no longer worth as much as it was. This applies to the secondary market, not to the original loan agreement.
Interest Rates and Real Estate	When interest rates rise, the number of people purchasing homes (or the size of the homes they buy) goes down.
Loan Risk	Loan owners must take into account specific types of risks, even though mortgages have collateral.
The Market for Debt	Demand is lenders who want to lend (who want to buy debt). Supply is borrowers who want to borrow (who want to sell debt). As price moves up, interest rates fall. However, if lots of people want to borrow money, supply goes up, price goes down, and interest rates go up.
The Secondary Market	The secondary loans market, in which existing loans are bought and sold. Many people buy and sell loans, typically in large packages. The goal is to ensure that lenders have enough capital to be able to continue providing loans.
Who Buys Debt?	There are large sources of capital looking for a wide variety of assets, such as pensions, other large institutional resources (university endowments), and private money. One of the easiest ways for them to get exposure to real estate as an asset class is to buy mortgages.

Why Does Your Lender Want to Sell Your Loan?	Most lenders either specialize in originating loans or holding loans long-term. It takes a tremendous amount of capital to hold loans.