Loan Vocabulary Sheet:
Key Terms to Know Before Borrowing

When considering a loan, it's important to understand common words, phrases, and acronyms so you can read documents quickly and accurately and have conversations with your credit union representatives. By not fully understanding the terms, you put yourself at risk for error.

This quick vocab cheat sheet is for any first-time borrower or anyone who wants to brush up on their loan terminology before taking action. You'll gain more confidence, clarity, and be set up for success.

The ABCs of Loans

A. General Loan Basics	
Principal	The original amount of money you borrow from a lender, not including interest or fees.
Interest Rate	The percentage of the loan amount charged by the lender for borrowing money. • **Fixed interest rate:** Stays the same over the life of the loan. • **Variable interest rate:** Can change over time, often tied to market rates.
Loan Term	The length of time you have to repay the loan (e.g., 5 years, 30 years).
APR (Annual Percentage Rate)	The total yearly cost of borrowing, including the interest rate and any lender fees. It's a more complete measure of the loan's cost than the interest rate alone.
B. Costs and Fees	
Origination Fee	A fee charged by the lender to process a new loan, usually a percentage of the loan amount.
Closing Costs	Fees paid at the final stage of the loan process (especially for mortgages), covering services like title insurance, appraisals, and legal work.
Prepayment Penalty	A fee charged if you pay off a loan early, before the term is complete.
Late Payment Fee	A charge applied when you miss a loan payment deadline.

C. Credit and Risk-Related Terms	
Credit Score	A number that represents your creditworthiness, based on your credit history. Lenders use it to assess your risk as a borrower.
Debt-to-Income Ratio (DTI)	A percentage that compares your monthly debt payments to your monthly income. Lenders use it to evaluate your ability to take on more debt.
Collateral	An asset (like a car or home) you pledge to secure a loan. If you don't repay, the lender can take the asset.
Secured Loan	A loan backed by collateral (e.g., auto loan, mortgage).
Unsecured Loan	A loan that does not require collateral (e.g., personal loan, credit card).
D. Loan Types and Structures	
Installment Loan	A loan repaid in regular, fixed payments over time (e.g., auto loan, personal loan).
Line of Credit	A flexible loan that lets you borrow up to a set limit, pay it back, and borrow again (e.g., credit card, HELOC).
Balloon Payment	A large, lump-sum payment due at the end of some loans after smaller regular payments have been made.
Refinancing	Taking out a new loan to replace an existing one, usually to get better terms, like a lower interest rate.
E. Legal and Contractual Language	
Promissory Note	A legal document where you formally agree to repay the loan under certain terms.
Default	Failing to repay a loan as agreed. This can lead to penalties, damaged credit, or even legal action.
Cosigner	A person who agrees to repay the loan if the main borrower doesn't. This helps you qualify for the loan if your credit is low.
Underwriting	The lender's process of evaluating your creditworthiness and financial situation before approving a loan.

Ready to test yourself?

Take our short quiz to see which sections you may want to revisit. The answers can be found at the end of the quiz - but no peeking!

It is always encouraged to confer with a financial advisor or a representative from our team at Addition Financial if you are having trouble understanding any of the concepts we've defined. Keep this document as a reference when reading through the terms of your loan, and never hesitate to reach out to our team with any questions!

Loan Vocabulary Quiz: Test Your Borrowing Knowledge

1. What does the "principal" of a loan refer to?

A. The total amount including interest
B. The original amount borrowed, excluding interest
C. The fee charged by the lender
D. Your monthly payment

2. If a loan has a variable interest rate, that means:

A. Your interest rate stays the same over time
B. You pay less interest every month
C. Your interest rate can change based on the market
D. The rate only changes if you miss a payment

3. What is a "prepayment penalty"?

A. A fee for paying your loan late
B. A penalty for borrowing too much
C. A fee for paying your loan off early
D. An extra interest charge on large loans

4. What is collateral?

A. A bonus the lender gives you
B. An asset pledged to secure a loan
C. A fee paid to get a loan
D. A type of loan for students

5. What is APR (Annual Percentage Rate)?

A. The monthly interest rate on your loan
B. The total amount of your loan
C. The yearly cost of borrowing, including fees
D. The late payment fee

6. What happens if you "default" on a loan?

A. Your credit score goes up
B. The lender increases your rate
C. You fail to repay and may face legal action
D. You qualify for better loan terms

7. Which of the following best defines "debt-to-income ratio"?

A. The total amount of debt you owe
B. Your income before taxes
C. A comparison of your monthly debt payments to your monthly income
D. How much you've borrowed from friends

8. A "cosigner" is:

A. Someone who witnesses your loan agreement
B. Another borrower equally responsible for repaying the loan
C. A person who guarantees you won't default
D. A notary who reviews the loan terms

See the answers
on the next page.

Answer Key & Explanations

1. B – The principal is the original amount you borrow.

2. C – Variable interest rates fluctuate based on the market.

3. C – A prepayment penalty is charged when you pay off your loan early.

4. B – Collateral is something valuable you pledge to secure a loan (e.g., a car or home).

5. C – APR reflects the full yearly cost of borrowing, including interest and fees.

6. C – To default means failing to repay, which can hurt your credit and result in legal consequences.

7. C – Debt-to-income ratio helps lenders assess your ability to manage monthly payments.

8. B – A cosigner agrees to repay the loan if you can't.

Addition™ FINANCIAL

Contact Us

Main Number: 407-896-9411
Toll-Free Number: 800-771-9411

Connect

Email: info@AdditionFi.com
Website: AdditionFi.com

facebook.com/theAdditionFi
x.com/theAdditionFi
instagram.com/theAdditionFi