10 Terms Every Homebuyer Should Know

Buying a home is a common undertaking for many Americans, but it's also one of the most complicated — not to mention costly — purchases adults will ever make. It's important to understand these 10 essential terms so you're ready to make smart decisions with your money.

Adjustable-rate mortgage (ARM): A mortgage with an interest rate that can change over time. It typically has a low, fixed initial interest rate and then may adjust regularly either up or down depending on market conditions. It can't exceed a set rate cap.

Closing costs: Fees from buying a house from both the lender and third parties like inspectors, attorneys, surveyors and title insurance companies. These typically add up to 3%-6% of the total home price, though some of these charges are negotiable.

Down payment: When you're buying a home and financing it with a mortgage, most lenders require you to put down a certain amount of cash upfront, usually 5% to 20% of the total price. Your mortgage covers the amount remaining after the down payment.

Escrow: A neutral, third-party account that protects the money of both buyers and sellers until real estate transactions are finalized. For example, if you choose to make a deposit with an offer on a home, it would go into an escrow account first rather than directly to the seller. Once you've bought a home, escrow accounts are also typically used to hold money for homeowners insurance and property taxes until payment is due.

FHA loan: A mortgage offered through the Federal Housing Administration that has less strict credit and down payment requirements compared with conventional loans. It's ideal for people with less-than-stellar credit who aren't able to qualify for conventional financing. The tradeoff: Along with paying monthly mortgage insurance fees, you'll also pay a hefty upfront premium.

Fixed-rate loan: A mortgage with an interest rate that won't change over the course of the loan. The rate may be higher than an ARM, but you'll never have to worry about it increasing.

Interest: Money your lender charges you for cash you borrow, indicated by an annual percentage rate, or APR (for example, 4%). Your interest rate will depend on your credit history and how much you can afford for a down payment.

Principal: The amount of money you borrow. Note that you end up paying significantly more than this amount because of interest.

Private mortgage insurance (PMI): If you don't put 20% of the home's price in a down payment, some lenders require this insurance to lessen their risk. It's typically paid with a monthly fee added to mortgage payments. You can often cancel it once you have a certain amount of equity in the home.

VA loan: Mortgages for qualified current or former members of the U.S. military. These typically offer more favorable interest rates and require low to no down payment. They're offered by financial institutions but backed by the Department of Veterans Affairs.

Home buying can be confusing, but knowing this important lingo will make it easier to navigate the process.