

# CHAPTER 12

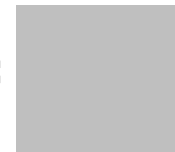
## Financing Real Estate



# Title vs Lien Theory States

**LIEN =**

**TITLE =**



# Title theory

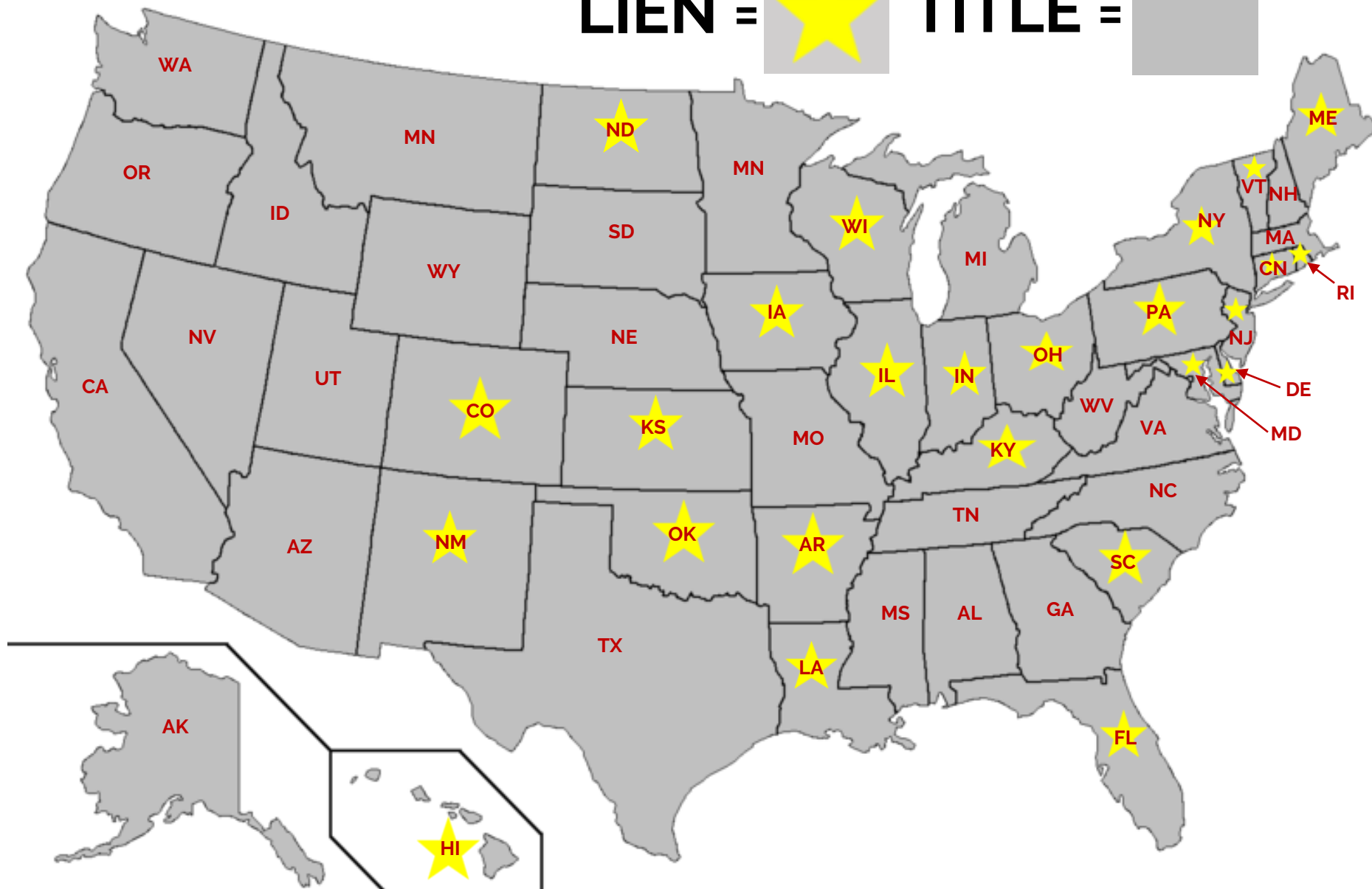
- Borrower takes possession, not title
- Deed of trust conveys title to 3rd party (trustee)
- Reconveyance Deed

# Lien theory



borrower takes possession and title

- Lender holds lien
- Satisfaction of Mortgage





## Promissory Note

A promise to pay (evidence of a debt)

- Must be signed by Mortgagor (Borrower)
- States Details of the Loan
- If co-signed, co-signor is responsible for note repayment in event of default



## Loan Instruments





# Loan Instruments

## Mortgage

Pledges property as security for a debt

- Hypothecate - pledging property as security without actually giving possession or title (voluntary lien)

## Mortgagor

- Gives the mortgage
- Receives the loan

## Mortgagee

- Receives the mortgage
- Gives the loan



## Acceleration Clause

- Allows lender to advance the due date (call the note) under certain circumstances

## Due on Sale Clause (alienation clause)

- Transfer of ownership
- Principal balance due
- Requires lender approval



# Essential Elements of a Mortgage





# Essential Elements of a Mortgage

## Defeasance Clause

- Only required clause in mortgage
- Requires lenders to acknowledge borrowers performance
- Only legally required clause in mortgage



## Escalator Clause

- Change of use in property
- Allows lender to increase rate

## Exculpatory Clause

- Foreclosure – lender looks to foreclosed property only
- No deficiency judgment
- Called nonrecourse loan

# Essential Elements of a Mortgage







# Essential Elements of a Mortgage

## Open-end Clause

- Borrower (mortgagor) can borrow against existing mortgage up to the amount of the original loan.
- Interest is less than refinancing

## Prepayment Clause

- States conditions and terms under which a mortgage may be paid early
- Allows lender to charge a fee for paying loan early



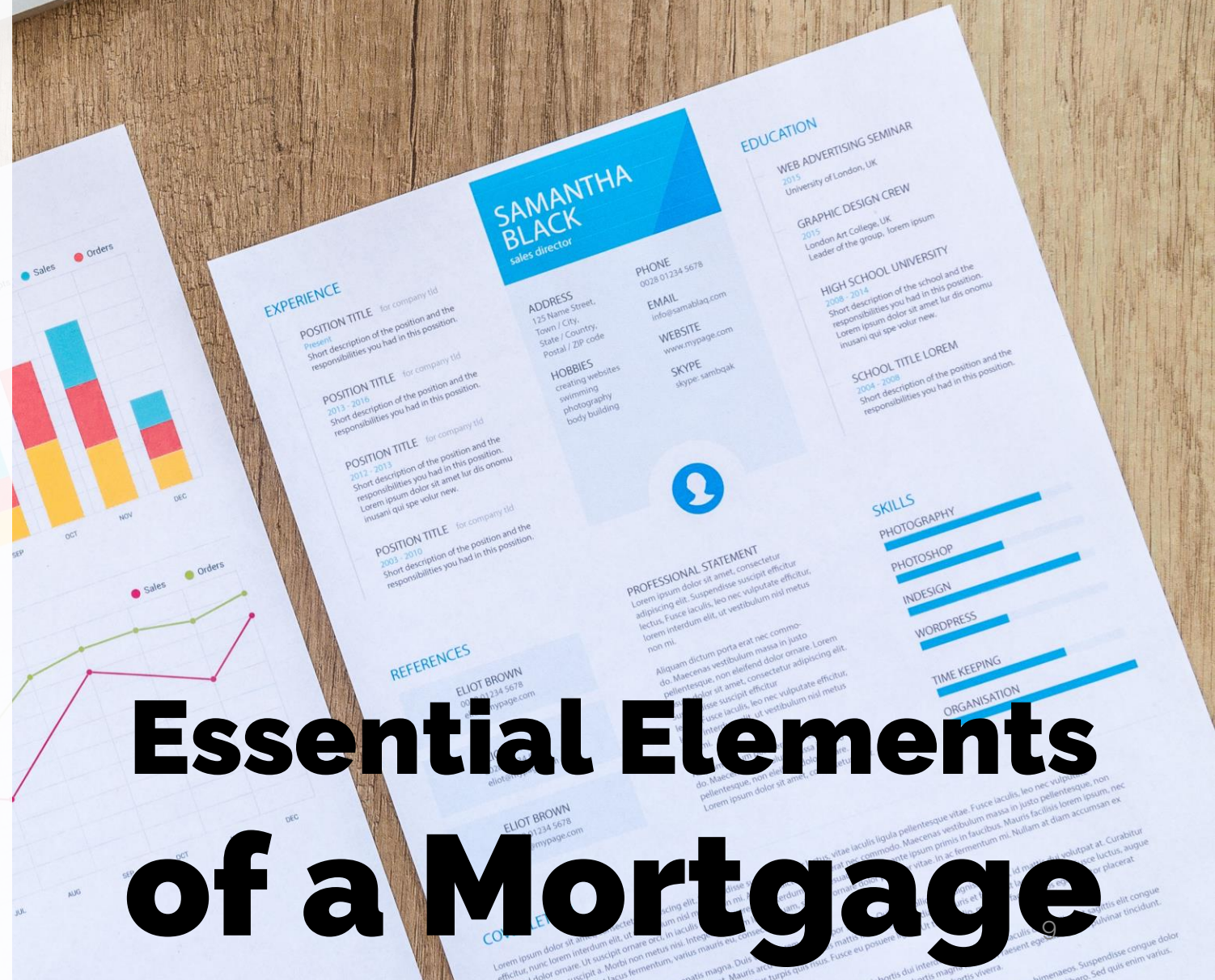
## Receivership Clause

- Income producing property
- Borrower defaults
- Lender can direct rents paid directly to them
- Prevents borrower from collecting rents during foreclosure

## Release Clause

- Allows mortgagor to sell individual lots free and clear of an underlying mortgage (first mortgage)
- Usually associated with a blanket mortgage

# Essential Elements of a Mortgage







# Essential Elements of a Mortgage

## Subordination Clause

- A recorded lien takes a secondary position to a lien recorded at a later date



A close-up photograph of a person's hand typing on a silver laptop keyboard. The hand is wearing a black and gold watch. In the background, there are architectural blueprints spread out on a desk. The laptop screen shows a macOS-style desktop with various application icons in the dock.

# Essential Elements of a Mortgage

## **Miscellaneous Provisions**

### **Real Estate Taxes**

- Borrower is required to pay real estate taxes

### **Insurance Clause**

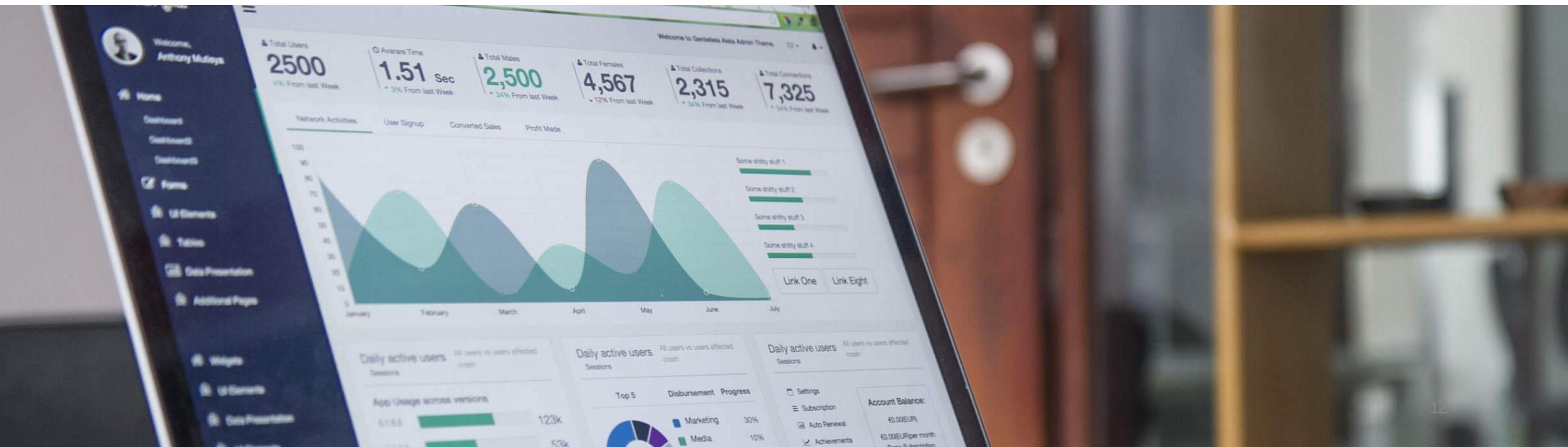
- Lender requires borrower to carry adequate fire and hazard insurance (taxes and insurance are included in mortgage payments)

### **Maintenance Clause**

- Borrower must maintain & protect property's value

# Satisfaction of a Mortgage

- Mortgage is paid in full
- Mortgagee prepares Letter of Satisfaction
- Mortgagor receives Letter of Satisfaction within 60 days
- Records in public records
- Offsets the mortgage lien





**Loan-to-Value (LTV)** (maximum loan amount)

- Percentage lender is willing to risk
- Loan of more than 80%
  - Borrower pays mortgage insurance
  - Protects lender from a loss in case of default

**Down Payment**

- Difference between loan value and sales price

**Interest rate**

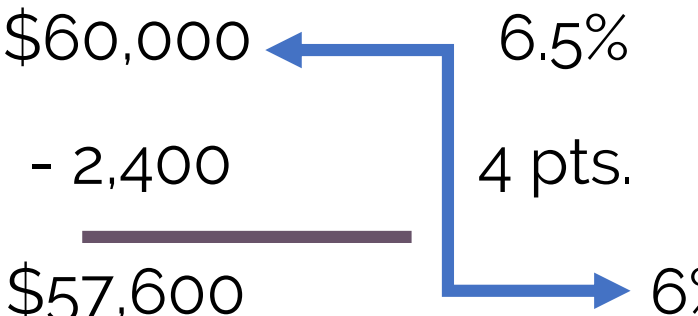
- Based on the individual borrower
- Market



# Mortgage Features

## Discount Points

Note amount	\$60,000	6.5%	APR (effective rate)
Prepaid Interest	- 2,400	4 pts.	(1 pt. = 1% of loan amount)
Actually received	\$57,600	6%	(each pt. paid = -.125%) (or -1/8 of 1%)



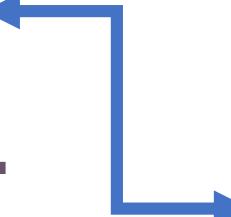
- Borrower pays 6% on the entire loan commitment (\$60,000)
- Lender's effective rate or true yield is 6.5% (6% + 4 x .125%)
- Lender must disclose interest rate as 6.5% APR
- \$2,400 is **prepaid** interest



# Mortgage Features

## Discount Points

Note Amount	\$60,000	6.5%	APR (effective yield)
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Actually Received	<u>\$57,600</u>	6%	(each pt. paid = -.125%) (or -1/8 of 1%)



### Question:

- 1) After paying 4 points, a borrower received an interest rate of 6%.  
What was the lender's effective yield?
- 2) A lender's stated interest rate is 6.5%.  
If the borrower pays 4 points, what interest rate would they pay?



A man in a dark suit and purple tie is shaking hands with another person whose hand is visible. They are over a desk with a spiral-bound notebook and some papers. The background is blurred, showing an office setting.

# Methods of Purchasing Mortgaged Property

## **Assumption of a mortgage**

- Buyer agrees to assume personal responsibility for the loan
- Seller remains personally responsible

## **Assumption with novation**

- Buyer is solely responsible for the loan
- Seller is relieved from further financial obligations

## **Subject to the mortgage**

- Mortgage and note remains in seller's name
- Seller remains solely responsible
- Not permissible with an alienation clause



## **Contract for Deed (Installment Contract)**

- Seller retains legal title
- Buyer receives equitable title and possession
- Entire loan paid – seller conveys title to buyer
- Should be recorded in county office records
- Secures buyers lien position

## **Assignment of Mortgage Contract**

- Lender (assignor) sells the mortgage to another lender (assignee)
- Estoppel certificate verifies loan balance

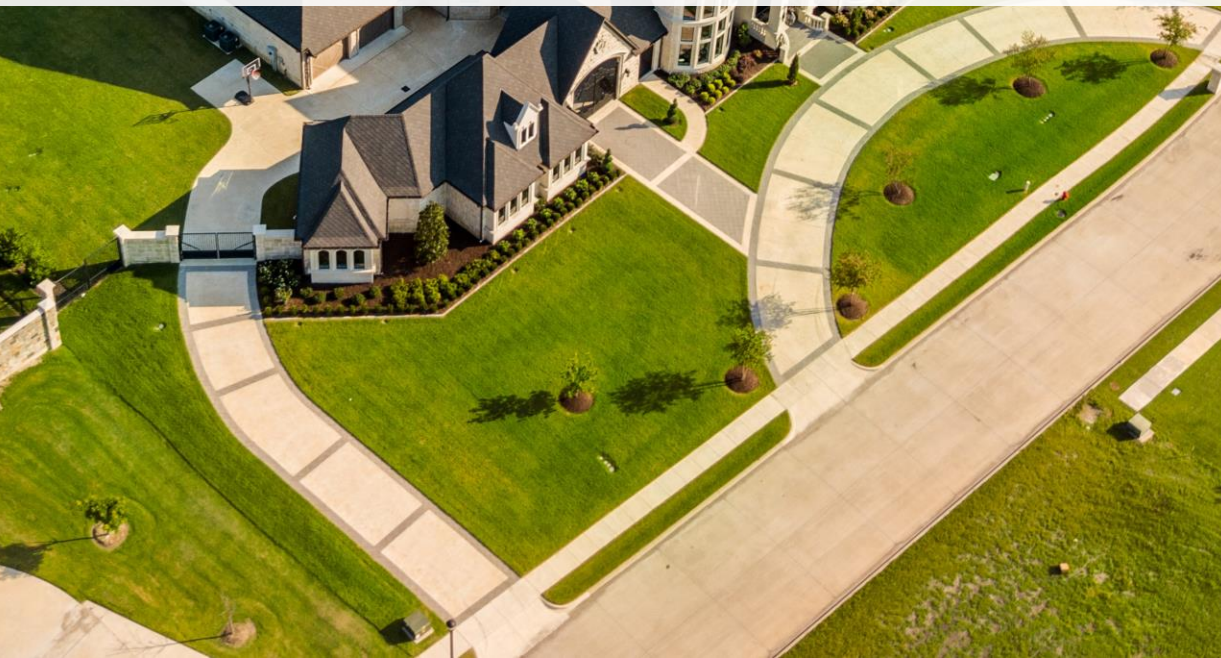


# **Methods of Purchasing Mortgaged Property**





# The Foreclosure Process



## Equity of Redemption

- Allows a defaulting mortgagor to redeem their position
- Pay all amounts incurred by the lender during foreclosure before the public sale
- Can be reinstated and resume making monthly payments (right to reinstate)

## Statutory Right of Redemption

(not available in Florida)

- Allows defaulting mortgagor to redeem property after public sale for a period of time



## Exculpatory Clause

- A foreclosure that receives less than the outstanding loan amount
- Lender cannot file a deficiency judgment action
- Lender can only look to the mortgaged property for satisfaction
- Clause is used in business loans

## Notice of Lis Pendens

- Legal notice that a lawsuit has been filed against real estate
- Notice informs the public that there may be pending legal action



# The Foreclosure Process<sup>19</sup>



# The Foreclosure Process



## Deficiency Judgment

- Property sells for less than owed, lender files a deficiency judgement against borrower's other assets
- Property sells for more than owed, excess funds go to borrower

## Surplus Money Action

- Surplus monies after foreclosing bank receives amount owed
- Junior lien holders file a surplus money action with the courts

## Deed in lieu of Foreclosure

- Defaulting borrower voluntarily deeds property to lender
- Borrower negotiates cancellation of debt



- Borrower makes interest only payments
- Principal is not reduced
- Balloon payment at end of loan term
- Usually for 3-5 years

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- Balloon payment at end of loan term
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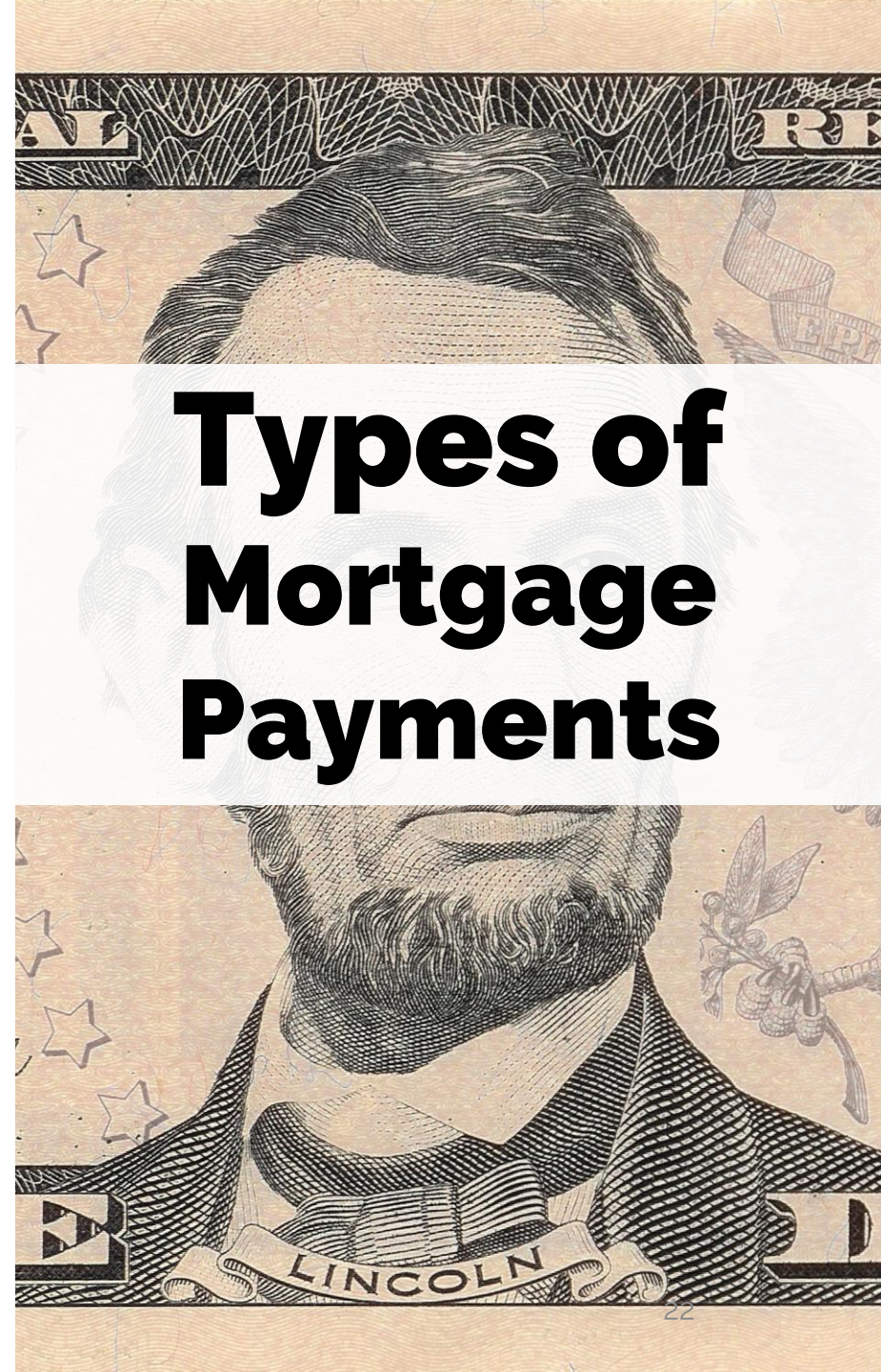
## Amortized Loan

- Level payments over the loan term
- End of term – principal balance is zero, interest is paid

## Partially Amortized Loan

- Level payments over the loan term
- Loan term is not long enough to pay the loan off
- Balloon payment due at end of term
- Final payment repays loan in full

# Types of Mortgage Payments







# Types of Mortgage Payments

- **Adjustable Rate Mortgage (ARM)**
- **Index**
  - Public index that can fluctuate and change the interest rate
- **Margin**
  - Added to the index which represents the lenders yield
  - Margin doesn't change – index does



# Fixed vs Adjustable Rate Mortgage

\$250,000 Mortgage Loan, 30-Year Term, 6% Fixed-Rate

**vs.**

3.5% Adjustable-Rate Mortgage (Annual Cap 2%, Lifetime Cap 6%)

Fixed Rate			Adjustable Rate		ARM Savings (Loss)	
Year	Paym ent	Rate	Paym ent	Rate	Month ly	Accru ed
1	\$1,499	6%	\$1,123	3.5%	\$376	\$4,512
2	1,499	6	1,411	5.5	88	5,568
3	1,499	6	1,723	7.5	(224)	2,880
4	1,499	6	2,052	9.5	(553)	(3,756)

- Borrower makes  $\frac{1}{2}$  the mortgage payment every 2 weeks
- Borrower actually pays 13 months payments each year
- Shortens the loan term
- Saves interest



## **Biweekly Mortgage Payment**



# Biweekly Mortgage Payment

**\$200,000 loan - 30 years @ 5%**

	<b>30 yr</b>	<b>Biweekly</b>
P&I Payment	\$1,073.64	\$536.82
Payments	X360	X656*
Total paid	386,510.40	352,153.92
Less loan amount	-200,000.00	-200,000.00
Total interest	186,510.40	152,153.92
<b>Interest Savings</b>	<b>-</b>	<b>\$34,356.48</b>

\*: A biweekly mortgage will be paid off in 25.23 years



# Conforming vs. Nonconforming Loans

## Conforming loans

- Loans that are written to comply with the secondary market
- Bundled and sold to Freddie Mac, Ginnie Mae & Fannie Mae
- Prevents primary lender from running out of funds

## NonConforming loans

- Loans that do not meet the secondary market requirements
- Not acceptable to Freddie Mac, Ginnie Mae & Fannie Mae
- Carry higher interest rates
- Lender retains loan in their portfolio and collects payments





- Early payments are not enough to pay all the interest
- Shortfall amount is added to the principal
  - Negative amortization
- Payments are increased each year by a set percentage
  - (not tied to an index)



## Conventional

- Private lender (not FHA or VA)
- Private mortgage insurance – borrower secures loan with less than 20% downpayment
- Lender is insured for losses up to 25% of loan amount in case of default
- PMI is automatically cancelled upon buyer achieving 22% equity from the original purchase price



# Major Loan Program Types



## Agency of U.S. Department of Agriculture

- Provides low-income loans to Americans in rural communities
- Administers:
  - Direct loans
  - Loan guarantees
  - Grants

## Rural Qualifications

- Areas with populations of 35,000 or less
- Homeownership to individuals
- Rental assistance
- Farm labor housing



## Rural Housing Services Administration Loan





# Major Loan Program Types

## FHA

- Insures loans against default
- Mortgage Insurance Premium (MIP)
  - 2.25% up-front MIP
  - Additional MIP paid monthly
  - Cannot cancel MIP for life of loan
- Minimum downpayment – 3.5%
- Maximum LTV – 96.5%
- Seller can contribute up to 6% of buyers closing costs
- Direct endorsement for lenders



## VA


- Down payment not required
- Lender is guaranteed 25% of loan amount in case of default
- Maximum guaranteed loan in 2020: \$510,400
- 25% = \$127,600 maximum guaranteed amount to lender
- Must be owner occupied residence
- No MIP – guarantee is paid for by funding fee added to loan amount
- Veteran must receive “Certificate of Eligibility”

## Major Loan Program Types



2,588,790	12,357	20,775	24,766	45,556
916,810	534	3,341	764	1,876
271,000	543	543	246	190
421,035	271	11,827	10,283	134
179,904	271	11,827	10,283	134
500,154	271	11,827	10,283	134
278,901	271	11,827	10,283	134
241,353	271	11,827	10,283	134
75,390	271	11,827	10,283	134
846,578	271	11,827	10,283	134
227,608	271	11,827	10,283	134
503,800	271	11,827	10,283	134
43,000	271	11,827	10,283	134
401,773	271	11,827	10,283	134
182,790	271	11,827	10,283	134
278,901	271	11,827	10,283	134
4,587,284	271	11,827	10,283	134
45,556	271	11,827	10,283	134
1,876	271	11,827	10,283	134
190	271	11,827	10,283	134
134	271	11,827	10,283	134
25,599	271	11,827	10,283	134
47,756	271	11,827	10,283	134





# Miscellaneous Types of Mortgages

## **Budget mortgage**

- Principal + interest + 1/12 of real estate taxes and insurance
- PITI – taxes and insurance are held in escrow

## **Construction loan**

- Owner, developer or builder
- Used for building or improvements
- Paid in draws or periodic installment payments based on construction progress

## **Purchase money mortgage**

- Any loan for purchase of real estate



# Miscellaneous Types of Mortgages

## **Package mortgage**

- Loan for real estate and personal property
- Example: stove, refrigerator, washer, dryer, etc.

## **Blanket mortgage**

- Loan covering two or more parcels of real estate
- Individual lots can be sold and released from the underlying mortgage

## **Reverse mortgage**

- Made to homeowners 62 years of age or older
- Receive payments from lender based on property equity
- Loan is due upon sale of property or death of home-owner



# Miscellaneous Types of Mortgages

## **Reduction Option mortgage**

- Fixed rate mortgage that allows borrower to refinance one time if prevailing interest rates are lower

## **3% Down mortgage**

- Conventional loan where borrowers put 3% downpayment as long as they have not owned a home for three years

## **Buydown mortgage**

- initial interest rates that increase at set periods (usually 1-year) until a fixed interest rate is reached

## **Participation mortgage**

- Lender offers a lower interest rate and in return shares in the income and/or resales proceeds of the property





# Miscellaneous Types of Mortgages

## Home equity loan

- Borrow equity on original loan
  - Equity comes from mortgage pay down and appreciation
  - Due to the 2018 Tax Cuts and Jobs Act interest is no longer tax deductible



## Credit evaluation standards

- Based on the Equal Credit Opportunities Act (ECOA)
- Protected classes from discrimination: race, color, religion, national origin, sex, marital status, age or receipt of income from public assistance programs

## Credit report

- Applicants credit history evaluated



# Loan Application Process





# Income Ratios

## TWO QUALIFYING RATIOS

### Housing Expense

$$\frac{\text{PITI}}{\text{GMI}}$$

28%

31%

-

Conventional

FHA

VA

### Total Obligations

$$\frac{\text{PITI} + \text{All Debts}}{\text{GMI}}$$

36%

43%

41%

**PITI** - principal, interest, taxes, insurance  
**GMI** - gross monthly income





# Loan Application Process

- Employment stability
- Income stability
- Gift letter



# Mortgage Underwriting (Analyzing Risk)

- Qualifying process
  - Applicant
  - Property







# **Qualifying the Applicant**

- Analyze desire and ability to pay
- Credit History
- Fair Isaac & Company (FICO)
  - 35% - payment history
  - 30% - outstanding debt
  - 15% - credit history
  - 10% - credit report
  - 10% - type of credit



- Income
- Dependable and stable
- Employment – 2 years
- Wages, bonuses, commissions alimony, child support
- Not:
  - Temporary employment
  - Unemployment
  - Contributions from family members

# Qualifying the Applicant

## Business Company

123 consensetur ipsum vel  
Fringilla est. Fucile 00029  
Tel: 123-456-789-0  
Fax: 123-456-789-1

Date: XX/XX/XX  
Invoice No: 0000001  
Customer ID: 223

Bill to: Curabitur suscipit, LTD  
456 Pellentesque, Aliquet  
2W st., S.U.O. 9999  
987-654-321

No.	Description	Quantity	Amount
1234	Id rutrum	2	246.53
2567	Sed interdum odio	5	855.75
0034	Pellentesque	8	594.67
0460	Maecenas molestie	3	492.74
4729	Integer varius nisi	4	356.40
4930	Quisque luctus turpis	7	400.00
4893		3	456.00

Comment	Subtotal	Amount
Sed interdum odio vel molestie suscipit.	Tax Rate	4500.45
Aliquet placerat nulla nec luctus varius.	Tax	8.78%
Donec auctor libero ac mollis efficitur.	Other	740.67
	TOTAL Due	\$241.12



# Qualifying the Applicant



- Other assets
- Reviewed by underwriter
  - Other real estate
  - Automobiles
  - Stocks, bonds, etc.
  - Assets attached in foreclosure



# Qualifying the Property

- Property is collateral for loan
- Appraiser analyzes market value
- Underwriter wants market value
- Redlining





# **Lending Laws**

## **Real Estate Settlement Procedures Act (RESPA)**

- Give consumers accurate assessments of settlement services
- Eliminate kickbacks and referral fees that increase settlement costs

## **Truth-in-lending Act (TIL)**

- Inform consumer of the true costs of credit
- Requires lenders to disclose lending costs as the APR
- Allow borrowers to compare true loan costs from lender to lender

## **Equal Credit Opportunity Act (ECOA)**

- Prohibits discrimination in arranging credit based on:
- Race, color, religion, national origin sex, age, marital status or receipt of income from public assistance programs



Time, rate, interest and  
principal

Formula:

\$\$ loan % years

$$I = P \times R \times T$$

# Real Estate Finance





# Coffee Break

15 Minutes