Financing

Instructor

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Financing

Sources Of Financing

1. Institutional (banks, mortgage brokers, mortgage companies, insurance companies)
2. Seller financing (land contract, and purchase money mortgage)
3. Assumption of existing financing
4. Other sources of financing

INSTITUTIONAL

Primary mortgage market and the *secondary mortgage market* are sources of funds for financing.

Primary Mortgage Market

Institutions known as fiduciary lenders because of their fiduciary obligations to their depositors are in the Primary Mortgage Market. They originate or make loans directly to borrowers.

Savings & Loans

* Specialize in long-term, single-family home loans.
* May offer conventional, FHA or VA mortgages.

Mutual Savings Banks

* Are located primarily in the northeastern United States.
* State chartered, owned by depositors and originate FHA or VA loans.

Commercial Banks

* Have historically specialized in short-term loans (such as home improvement loans, mobile home loans and commercial loans).
* Have become more active in the negotiation of long-term residential loans.

Insurance Companies

* Specialize in large scale, long term loans that finance commercial and industrial property. May require an equity kicker or participation financing in the loans the negotiate.

Mortgage Bankers

* Originate loans from insurance companies, pension funds or individuals.
* They package and sell mortgages and service them.

Mortgage Brokers

* Do not originate loans
* Bring borrowers and lenders together and are paid a percentage of the money borrowed.

Credit Unions

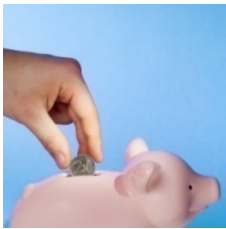
A source of funding for its members

Pension Funds

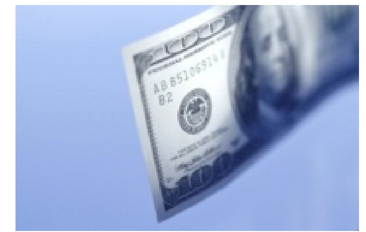
Work through mortgage bankers and mortgage brokers in real estate financing.

Rural Economic & Community Development Agency

* Is a federal agency under the Department of Agricultures that negotiates loans to people in rural areas.
* negotiates loans for the purchase of property, to operate farms or to purchase farm equipment. The interest paid on the loan is determined by the income of the borrower.
* originates loans either through a private lender or directly by the agency.



The Federal Reserve System also known as “the FED”



Was established to stabilize the economy by controlling the money supply and credit available in the country. It does this by controlling the flow of money and interest rates in the marketplace through its member banks by controlling their reserve requirements and the interest the banks have to pay to borrow money from the FED (Prime Rate) and by selling Treasury Bills (creating money)

* An oversupply of money creates inflation; an undersupply can cause a recession

* Increase reserve requirements – the money supply shrinks, thus increasing interest rates

* Decrease reserve requirements – the money supply grows, thus decreasing interest rates.

* The discount rate of interest is the rate the FED charges for loans to its member banks, and it can move money into or out of commercial banks by buying or selling government bonds.

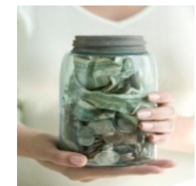
SELLER FINANCING

Seller Financing such as land contract, and purchase money mortgages are a form of financing where the seller becomes the lender

Land Contract - Installment Land Contract - Contract For Deed

is a contract for the sale of real estate where payments are made periodically. The payments are given to the seller (vendor) , who keeps legal title until the loan is repaid in full. The buyer has possession and an equity interest. No Mortgage involved Should the buyer default , the seller can evict the buyer and retain all money paid.

Purchase Money Mortgage (PMM)



is a creative financing technique that developed when interest rates were high. Usually the seller agrees to finance a portion or all of the purchase price. This is also known as a take back mortgage. The note and mortgage is *created at the time of the purchase*. Its purpose is to make the sale possible. Seller becomes a lender with a note that can be a 1st, 2nd etc.

Assumption of Financing

Assumption of Mortgage - A Buyer acquiring title to property where there is an existing mortgage and agreeing to be personally liable for the terms and conditions of the mortgage including payments (assumption). This can only be done with the approval of the original lender if there is a due on sale clause.

"Subject To" The Mortgage - A Buyer acquiring title to property where there is an existing mortgage but the seller (original borrower) remains liable for the debt, even if the buyer defaults. The new buyer is secondarily liable.

Types Of Loans

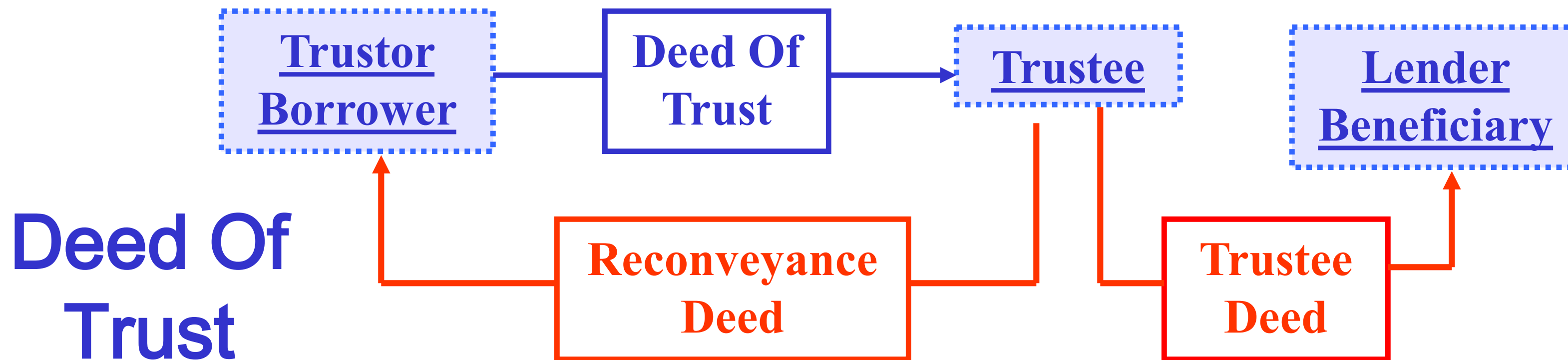
1. Security for loans (trust deeds, land contracts, mortgages)
2. Repayment methods (adjustable rate mortgage, fully/partially/non-amortized loans)
3. Forms of financing (FHA, VA, Rural Housing Service loans of the USDA, conventional loan)
4. Secondary mortgage markets (FNMA, FHLMC, GNMA)
5. Other types of mortgage loans (wraparound, blanket, package)

Security For Loans – Security Instruments

(1) Mortgages – used primarily in lien-theory states
(2) Trust Deeds- used primarily in title-theory states
(3) Land Contracts – used when the seller is financing the purchase of the property.

Lien Theory States — Mortgage & Note are recorded – Borrower keeps title but agrees that the lender has a right to foreclose

Title Theory States — Lender has legal title to the property and the borrower has equitable title. Lender has the right to take possession upon default



Deed Of Trust

Legal title is given by the borrower (Trustor) to a third party (Trustee), for the benefit of the Lender (Beneficiary). A defeasance clause states that when the final payment is made the interest is defeated and a deed of reconveyance is given by the Trustee to the Trustor. If borrower defaults the Trustee starts foreclosure. A nonjudicial foreclosure or foreclosure by advertisement.

REPAYMENT METHODS

Equity — Difference between the market value & any liens on the property

Loan to Value Ratio — The relationship between the amount of mortgage loan and the value of the real estate being used as collateral

Value of Property - Loan Amount = Equity

Low LTV = High down payment – Low Risk For Lender – Owner has High Equity

High LTV = Low Down Payment – High Risk To Lender – Owner has Low Equity

Determining LTV - If property has appraised value of $100,000, secured by a $90,000 loan the LTV is 90 percent

90,000 / 100,000 = 90%

Mortgage

A pledge of property to a lender - collateral

Promissory Note

Evidence of the debt & states the terms of repayment

BORROWER

Mortgagor – Obligor - Promissor

LENDER

Mortgagee – Obligee - Promisee

TYPES OF LOANS

Conventional (Conforming) Loans	A loan that does not require mortgage insurance. Normally those loans that have an 80% loan to value. These loans are eligible to be sold in the secondary market. Not insured or guaranteed by the government.
Conventional Uninsured Mortgage	Typically, the borrower has a 20% or greater down payment
Conventional Insured Mortgage	Typically, the borrower has less than 20% down payment
Unconventional Mortgage (VA & FHA)	FHA is insured by the government VA is guaranteed by the government
Private Mortgage Insurance (PMI)	Insurance provided by private insurers that protect the lender against a loss due to foreclosure and a deficiency. Usually required if the loan is greater than 80% of the value of the property.
Discount Points	If the interest rate a lender gets for a loan is lower than the rate (yield) the investor demands, the lender charges the borrower discount points. A % of the loan – 3 points = 3% of the amount being borrowed.

Borrowers:

INTEREST

1 Discount Point = 1% of loan amount

Is charged as prepaid interest at the closing

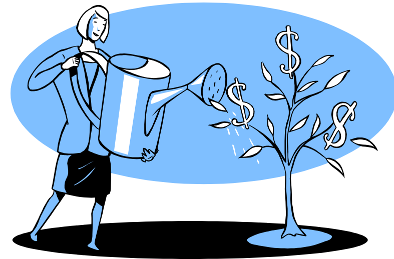
3 Discount Points Charged on a $100,000 loan

($100,000 x 3%, or .03) = $3,000

If a house sells for $100,000 and the borrower seeks an $80,000 loan

Each point would be $800, NOT $1,000

In some cases, the points in a new acquisition may be paid in cash at closing by the buyer rather than being financed as part of the total loan amount



Discount Points and Investor Yield

Calculate the net amount of a $75,000 loan after a three-point Discount is taken:

Multiply loan amount by 100 percent minus the discount

$75,000 x (100% - 3%)

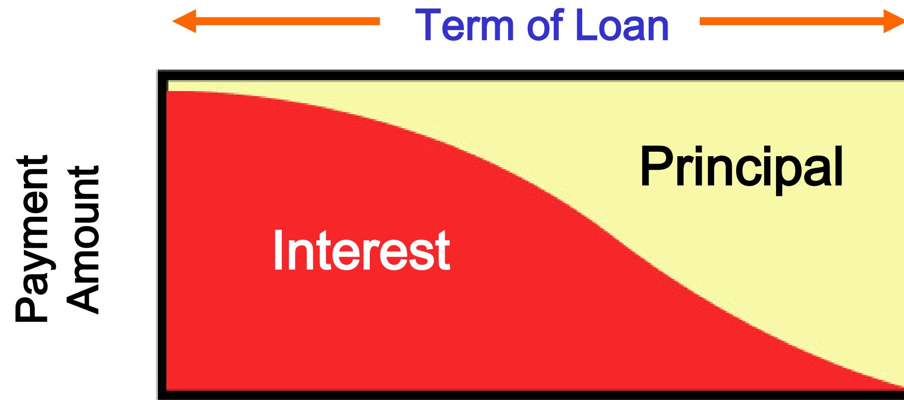
$75,000 x 97%

$75,000 x .97 = $72,750

Or deduct the dollar amount of the discount from the loan:

Amortized Loan

In which the principal as well as interest is payable in periodic payments (monthly) over the term of the loan. At the end of the loan the principal balance is zero – Known as Budget Loan – taxes & insurance reserve – PITI. A fully amortized loan or direct reduction loan, at the end of the loan period the principal balance is zero.



Refinance your loan

Original 30 year loan – 7 years have been paid – 6 Percent Interest – Original loan $200,000 - $1199.10 monthly.

Redo Loan – Balance $179,279 – 7 yr total Pd Interest - $80,003 - 7 yr total Pd Principal $20,721

Lender 7 year return $80,003/$200,000 = 40% over 7 years

Balloon Mortgage

The principal and interest payments do not pay of the entire loan.

Term Mortgage

A construction loan is an example where the borrower receives the money in stages or draws and makes periodic payments of interest.

A nonamortized loan, periodic interest payments, but nothing is applied to the principal balance. Interest only is paid. Also called straight mortgages.

Adjustable-Rate Mortgages (ARMS)

Contains an escalation clause allows the interest to adjust over the loan term. Principal and Interest on 30 year Mortgage originated at one rate of interest that then fluctuates up or down during the loan term based on some objective economic indicator – Index – Margin - Rate Caps - Payment Cap. The premium charged by the lender and added to an index is to determine the interest is called the margin.

Bridge Loan – a sum of money lent by a bank to cover an intereval between wo transactions., the buying of one house and the sellin of another

Blanket Mortgage – covers *more than one parcel or lot.* It is a mortgage covering more than one parcel of real estate, providing for each parcel's partial release from the mortgage lien upon repayment of a definite portion of the debt. Used by builders and developers.

Buy-down Mortgage

– a way to temporarily (or permanently) lower the interest rate on a mortgage or deed of trust loan. Used to reduce the monthly payments for the first few years of the loan, funds in the form of discount points given the lender by the buyer or seller to buy down or lower the interest rate, thus reducing payments.

Budget Mortgage Includes principal, interest, taxes and insurance payments (P.I.T.I.)

Principle – A sum loaned or employed as a fund or an investment, As distinguished from it's income or profits

Interest – A charge made by or paid to a lender for the use of money

Taxes - money raised by government or municipal quasi-public to fund its operation, based on property value.

Insurance- the transfer of risks from individual to a company, premium collected from the many to pay the losses of the few.

Tax and Insurance Reserves

Impound - reserve fund required by lenders to meet future real estate taxes and property insurance premiums.

Escrow account - the trust account established by a broker under the provisions of the license law for the purpose of holding funds on behalf of the broker principle or some other person until the consummation or termination of a transaction.

Flood Insurance Reserves

National Flood Insurance Reform Act of 1994

Imposes certain mandatory obligations on lenders and loan servicers to set aside (escrow) funds for flood insurance on new loans for property in flood prone areas.

(GPM) Graduated Payment Mortgage

Also known as a flexible payment plan. The borrower makes lower monthly payments for the first few years and larger payment for the remainder of the loan term. If the lower monthly payments do not cover all of the interest charges, the lender adds the unpaid interest to the principal balance. This creates negative amortization, because the loan balance increases instead of decreases.

Growing-Equity Mortgage (GEM) a.k.a. Rapid-Payoff Mortgage

A loan in which the monthly payments increase annually, with the increased amount being used to reduce directly the principal balance outstanding and thus shortening the overall term of the loan.

Package Loans

– include not only the real estate but also all personal property (appliances) installed on the premises.

Nehemiah Grant Program

Provides home buyers with gift money toward the down payment and closing costs. The gift can be from a non-profit organization or the seller.

(SAM) Shared Appreciation Mortgage

The lender agrees to originate the loan at below market interest rates in return for a guaranteed share of the appreciation the borrower will realize when the property is sold. Used in commercial projects.

Reverse – Annuity Mortgage (RAM)

Allows elderly homeowners to borrow against the equity in their homes and receive monthly payments from the lender. The loans come due on a specific date or on the occurrence of a specific event, such as the sale of the property or the death of the borrower.

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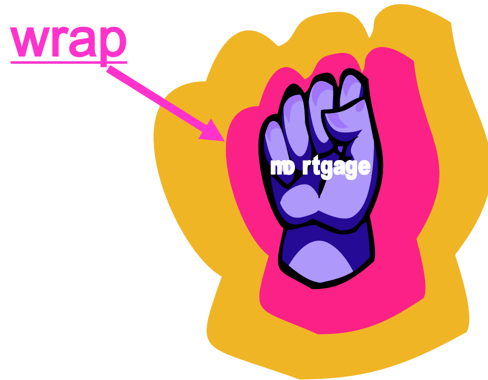

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Wraparound loans

– enables a borrower with an existing mortgage or deed of trust loan to obtain additional financing from a second lender without paying off the first loan

Agent's Responsibility In Seller Financing

Seller's Agent

should encourage:

(1) Due on Sale Clause – if property is resold the note is due

(2) Deficiency Judgment (Recourse) – if the property goes through foreclosure and the sale of the property does not bring enough money to pay the note the borrower still owes the difference.

(3) Secured notes – any note should have a property that is pledged as collateral.

If buyer is corporate - recommend personal Guaranties from corporate owners.

Buyer's Agent

Should recommend terms that are in the buyer's best interest i.e., low down payment, deferred interest, long maturity date, no due-on-sale, long grace period, and non-recourse clause

Unconventional Loans

FHA- Insured Loans

Federal Housing Administration (FHA) – operates under HUD – It does not build homes or lend money. The agency insures loans to lenders for buyers who qualify for FHA loans.

Pre-Payment privileges

A borrower may repay an FHA – insured loan on a one-family to four-family residence without a penalty.

Assumption rules

FHA Loans before Dec 1986 have no restrictions on assumptions
Loans between December 1, 1986 & December 15, 1989 new buyer must undergo a credit worthiness review
For FHA Loans after December 15, 1989 assumption is not permitted without complete buyer qualifications.

VA-Guaranteed Loans

Department Of Veterans Affairs (VA) – guarantees loans to purchase or construct residential homes for eligible veterans and their spouses (including unremarried spouses of veterans whose deaths were service-related). It guarantees loans to purchase mobile homes and land to place them on. The borrower pays a loan origination fee to the lender, as well as a funding fee, depending on the down payment amount to the VA. 100% loans.

(CRV) Certificate Of Reasonable Value

The VA issues a certificate of reasonable value (CRV) for the property being purchased. It is a VA approved appraisal.

Agricultural Loan Programs

Farm Service Agency (FSA) — Originally the Farmers Home Administration is a federal agency of the Dept Of Agriculture. It offers programs to help families purchase or operate family owned farms.

The Farm Credit System (System) — Provides loans to borrowers including farmers, ranchers, rural homeowners, agricultural cooperatives, rural utility systems, and agribusinesses.

Farmer Mac — Formerly the Federal Agricultural Mortgage Company, (FAMC). It is similar to Fannie Mae or Freddie Mac in that it provides a secondary market for agricultural loans.

How the Secondary Mortgage Market Works
LENDER
Freddie Mac
WALL STREET

The Secondary Mortgage Market

Here loans made by the primary mortgage market, are bought and sold only after they have been funded. This helps lenders raise capital to continue making mortgage loans.

Fannie Mae

Formerly the Federal National Mortgage Association or FNMA - Quasi-governmental agency - Fannie Mae deals in conventional and FHA and VA loans. It is a privately owned corporation that issues its own common stock.

Ginnie Mae

Formerly the Governmental National Mortgage Association or GNMA - governmental agency - Division of HUD – a corporation without capital stock. It's pass-through certificate is a security interest in a pool of mortgages that pass through the principal and interest payments to the certificate holder.

Tandem Plan

Fannie Mae & Ginnie Mae join forces. It provides that Fannie Mae can purchase high-risk, low-yield (usually FHA) loans at full market rates – Then Ginnie Mae guarantees payments absorbing the difference between the low yield and current market prices

Freddie Mac

Formerly the federal home loan mortgage corporation or FHLMC – provides a secondary market for mortgage loans, primarily conventional loans. It has the authority to purchase mortgages, pool them, and sell bonds in the open market with the mortgages as security.

Freddie Mac, one of America's biggest buyers of home mortgages, is a stockholder-owned corporation chartered by Congress in 1970 to keep money flowing to mortgage lenders in support of homeownership and rental housing.

Homebuyers apply for mortgages from primary market mortgage lenders such as banks, thrifts (which include savings and loan associations and savings banks), mortgage companies, credit unions, and online lenders. The primary market mortgage lender evaluates the homebuyer's ability to repay the mortgage, and if the lender's criteria are met, arrangements are made to make the loan. The transaction between the lender and the borrower culminates in what is called "the closing." By signing the closing documents, the lender agrees to fund the purchase of the home and the homebuyer agrees to pay the mortgage as negotiated. Once the loan is closed, the funds are transferred from the primary lender to the property seller.

Entering the Secondary Market

After the closing, the primary lender may either hold the mortgage in its portfolio (along with other loans it has made) or sell it in the secondary mortgage market.

When primary mortgage lenders sell loans in the secondary market, they generally sell them as loans to an institution like Freddie Mac. They then use the proceeds of the sale to make new loans to other homebuyers in their community.

Freddie Mac is one of the largest investors in mortgages. As a major player in the secondary mortgage market, they
- **buy mortgages that meet their underwriting and product standards,**
- **package those loans into securities, and**
- **sell the securities to investors on Wall Street.**

Investing in Making Homes Possible

The mortgages purchased are bundled or pooled together as mortgage-backed securities (MBS). There is a guarantee of timely payment of principal and interest to MBS investors and these purchases are financed by issuing debt and mortgage securities. Investors value Freddie Mac's guarantee and the homogeneous quality and liquidity of MBS over individual mortgages. Because of these attributes, investors in MBS are willing to accept a slightly lower yield as the funds pass through to them from us.

Mortgage-backed securities: Securities that represent an interest in a pool of loans, such as residential mortgages.

Debt securities: Securities are issued by Freddie Mac to raise funds. The issuer promises to pay interest and to repay the debt on a specified date. These debt securities are issued in the U.S., Europe, and Asia.

Freddie Mac uses the funds from sales of these securities sales to purchase more loans from primary lenders. In this way, they are constantly replenishing the pool of funds available for new loans, which allows primary lenders to use the cash they get to originate new mortgages. This makes the mortgage process fast, convenient, and affordable. The process is shown below:

About half of all new single-family mortgages originated today are funded in the secondary mortgage market.

Tangible Benefits

The supply of cash the secondary mortgage market makes available to lenders through this process drives down mortgage rates by as much as one-half percent - saving the homeowner with a $150,000 mortgage around $18,000 in interest over the life of a 30-year loan. That savings helps make homeownership affordable for more families and individuals than would be possible without the secondary mortgage market. As a result, homeownership is a reality for many American families, and not just a dream.

Institution	Secondary Market Function	Entity
Fannie Mae	Conventional, VA, FHA Loans	Privately Owned Corporation
Ginnie Mae	Special Assistance Loans	Government Agency in HUD
Freddie Mac	Mostly conventional loans	Privately Owned Corporation

Terms And Conditions

1. Loan application requirements
2. Loan origination costs (appraisal fee, credit reports, points)
3. Lender requirements (property insurance, escrows, deposits, underwriting criteria)
4. Conditional approval
5. Provisions of federal regulations (Truth-in-Lending Act, Equal Credit Opportunity Act)

LOAN APPLICATION REQUIREMENTS

The loan process consists of filling out the application, analyzing the borrower and the property, processing the loan application and closing the loan.

LOAN ORIGINATION COSTS

Pays the lender for the cost of processing a lo
application (based on a % of loan)

CONDITIONAL APPROVAL

Approval of every loan is conditional on some terms being met by the borrower such as: * satisfactory title report * mortgagees' title insurance * homeowner's insurance policy * Survey * verification of job status * affidavit of marital status * copy of the settlement sheet of the house just sold * verification of bank accounts * payoff of a particular bill * inspection reports required by the lender * any repairs required by the appraiser.

A lock in clause in the loan application guarantees that the interest rate quoted the buyer on loan application is *locked* In for a specific time.

PROVISIONS OF FEDERAL REGULATIONS

Lending laws provide protection to the consumer as well as to the lender.
Lenders must follow federal lending laws.

Usury Charging Interest above the maximum allowed is usury.

Truth in Lending Act and Regulation Z

Created by the Federal Trade Commission (FTC), requires that credit institutions inform borrowers of the true cost of obtaining credit. Generally applies when a credit transaction is secured by a residence. "Full Disclosure"

Creditor According to Regulation Z is any person who extends consumer credit more than 25 times each year or more than 5 times each year if the transactions involve dwellings as security.

3 Day Right of Rescission The borrower has 3 days to rescind the transaction by merely notifying the lender. This right of rescission does not apply to owner-occupied residential purchase-money or first mortgage or deed of trust loans.

Advertising Regulation Z provides strict regulation of real estate advertisements of all types. If one part of mortgage terms are used all must be stated.

- Cash Price
- Required Down Payment
- Number, amounts, and due dates of all payments.
- Annual % Rate
- Total # of Payments

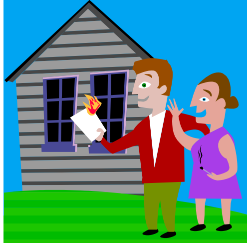
Penalties

$10,000 for each day a violation continues. A fine of up to $10,000 may be imposed for unfair practices.

Equal Credit Opportunity Act (ECOA)

Prohibits lenders and others who grant or arrange credit to consumers from discriminating against credit applicants based on the following.

Race – Color – Religion - National Origin – Sex - Marital status - Age (provided the applicant is of legal age) - Dependence on public assistance



Community Reinvestment Act of 1977 (CRA)

Refers to the responsibility of financial institutions to helpmeet their communities needs for low-income and moderate-income housing.

Real Estate Settlement Procedures Acts (RESPA)

Applies to any residential real estate transaction involving a new first mortgage

- D. Common Clauses and Terms in Mortgage Instruments

1. Prepayment
2. Interest rates (fixed rates, adjustable rates)
3. Release
4. Due-on-sale
5. Subordination
6. Escalation
7. Acceleration
8. Default
9. Foreclosure and redemption rights
10. Non-recourse provision
11. Recession

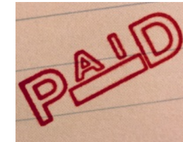
PREPAYMENT

An open mortgage ;usually allows a borrower to pay off the loan at anytime over the life of the loan without a penalty. This is allowed by a prepayment privilege clause in the mortgage. When this occurs the lender receives less interest and may charge a prepayment penalty which is a % of the remaining mortgage balance.

INTEREST RATES

The interest paid by the borrower is a charge for the use of money. A fixed interest rate is constant over the life of the loan. An adjustable interest rate can change over the life of the loan.

INTEREST



RELEASE

When the mortgage is paid in full the lender must release its interest in the property .

Lien Theory States A mortgage release or satisfaction piece is recorded.

Title Theory States A defeasance clause provides that the lender release its interest in the title. If the mortgage document was a trust deed, the reconveyance deed must be recorded to release the lender's title interest.

Due – on- Sale - a provision in the mortgage that states that the entire balance of the note is immediately due and payable if the mortgagor transfers (sells) the property.

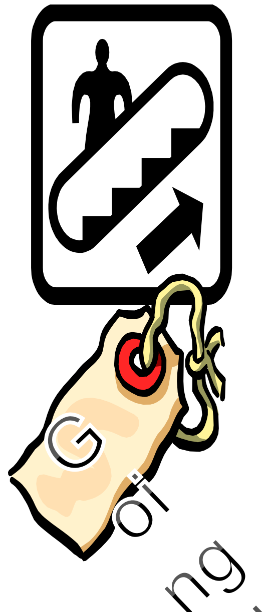
Alienation Clause a mortgages may also contain an alienation clause providing that if the property is conveyed to any party without the lender's consent, the lender can collect full payment.

Subordination – relegation to a lesser position, usually in respect to a right or security

ESCALATION – An escalation clause is found in a n adjustable rate mortgage and in certain leases. In a mortgage it allows the interest rate to adjust over the life of the loan.

ACCELERATION An acceleration clause allows the lender to call the note due and payable in advance of the loan term. The entire balance is due.

DEFAULT The default clause protects the lender if there is a nonperformance of a duty or obligation on the part of the borrower.



Foreclosure

Legal procedure in which property pledged
As security is sold to satisfy the debt

Foreclosure Sale — A legal procedure whereby [property used as security for a debt is sold to satisfy the debt in the event of default in payment of the mortgage note or default of other terms in the mortgage document

Judicial Foreclosure — Allows the property to be sold by court order after the mortgagee has given sufficient public notice.

Nonjudicial Foreclosure (Allowed only in some states) – allows for the property to be sold, without court action, when the security instrument contains a power of sale clause. In states where deed of trust loans are recognized, the Trustee is generally given the power of sale. Some states allow a similar power of sale to be used with a mortgage loan.

Deed in Lieu of Foreclosure Or "friendly foreclosure" — Alternative to foreclosure accepted by lender from borrower in a mutual Agreement

Equitable Right Of Redemption

Before The Foreclosure Sale

If after default **but before the foreclosure sale,** the borrower (Or any other person with an interest in the real estate such as another creditor) pays the lender the amount in default plus costs

After the foreclosure sale — **Statutory Right of Redemption**

Defaulting borrowers given a chance to redeem their property

Equitable Redemption (before the sale)

Statutory Redemption (after the sale)

Date of Default

Date of Sale

End of Redemption Rights

Deed to Purchaser at Sale

If redemption is not made or if state law does not provide for a redemption period the successful bidder at the sale receives a deed to the real estate

Convey whatever title the borrow had

Deficiency Judgment

Foreclosure may not produce enough cash to pay the loan balance in full after deducting expenses and accrued unpaid interest. Mortgagee may be entitled to a personal judgment against the borrower for the unpaid balance

Non Judicial Foreclosure — Is used in states where the mortgage contains a power-of- sale clause.

Strict Foreclosure — Allows the lender to foreclose on the property after appropriate notice has been given to the delinquent borrower and the proper papers have been filed in court.

NONRECOURSE PROVISION — The borrower is not held personally liable for the note.

RECISSION — Means that the contract has been canceled, terminated or annulled and the parties have been returned to the legal positions they were in before they entered the contract.