CHAPTER TWO

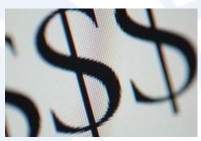
FINANCING

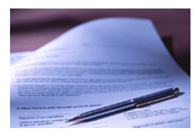
TABLE OF CONTENTS

1. NOTE - MORTGAGE / TRUST DEED

How does one go about getting a real estate loan?????

1. PROMISSORY NOTE or BOND Creates debt





But what does one use as security???

2. MORTGAGE Security For Debt

Lien Theory

Homeowner has title; lender has mortgage lien against property

TRUST DEED

Security For Debt

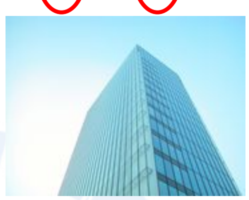
Title Theory

Lender has title until debt is paid off

MORTGAGE

LENDER

BORROWER



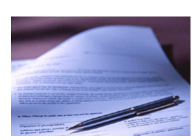
MORTGAGEE

Interest on loan
Right of foreclosure

MORTGAGOR

Retains full use
Maintains property
Pays insurance
Pays taxes

Note & Mortgage



If payments are not made, how is it foreclosed?????

The mortgagee / lender would have to go to court to foreclose

JUDICIAL FORECLOSURE

TRUST DEED

NEUTRAL
3RD PARTY

TRUSTEE

TRUST
DEED

LENDER

NOTE

BORROWER

BENEFICIARY

Legal holder of the note

TRUSTOR

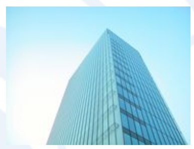
Retains full use
Maintains property
Pays insurance
Pays taxes

NON-JUDICIAL FORECLOSURE

TRUSTEE

Trustee sells property and pays off the beneficiary (lender)

LENDER



BENEFICIARY

If the mortgage is foreclosed on, how can the owner get the property back?????

3. REDEMPTION

Redeem = Buy Back

Defaulting borrower has certain time period to buy property back at foreclosure sale price plus any other costs owed

1. EQUITABLE - Before Foreclosure

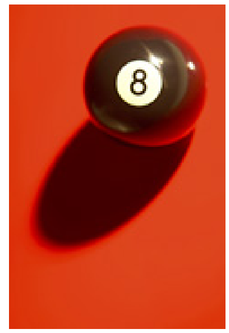
   Reclaim property before foreclosure

2. STATUTORY - After Foreclosure

   Reclaim property after foreclosure

What if the property does not sell for the amount owed on it?????

4. DEFICIENCY JUDGMENT



Personal judgment against defaulting borrower for any other debts owed and not satisfied by foreclosure sale

If the defaulting borrower owes more than one debt… who gets paid first?????

Property Taxes

Any other liens in order of priority

Defaulting borrower gets what's left

Taxes	$2,500
1st Mortgage	75,000
2nd Mortgage	10,000
Mechanic's Lien	3,000
Total	$90,500

Sold	$85,000
Taxes	<2,500>
Sub-total	82,500
1st Mortgage	<75,000>
Sub-total	7,500
2nd Mortgage	<7,500>
Balance	0

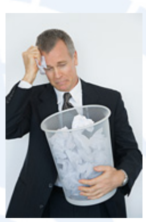
Defaulting borrower still owes $2,500 on 2nd Mortgage and $3,000 on mechanic's lien. These creditors could possibly convert these debts to a judgment lien and go after other assets of the defaulting borrower. Purchaser at the foreclosure sale buys property free of all debts.

If property had sold for $95,000, the defaulting borrower would be able to pay entire $90,500 owed and keep the remaining $4,500 which is in essence their equity.

Could the defaulting borrower just let the lender have the property and not have to go to court?????

5. DEED IN LIEU OF FORECLOSURE

Involuntary Alienation



Deed

Defaulting Borrower

Lender

2. ANALYSIS OF A NOTE

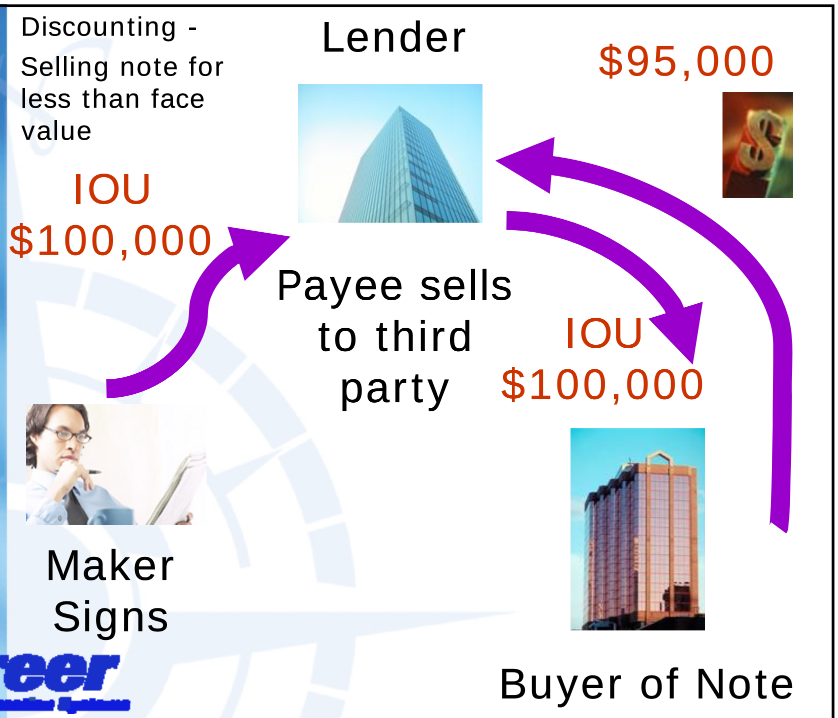
WHAT ARE SOME CHARACTERISTICS OF A NOTE?

1. NEGOTIABLE

Can be bought and sold

Discounting -

Selling note for less than face value



2. PAYMENTS

Real Estate note payments paid in ARREARS

At the end; e.g., May 1st house payment applies to April's interest

3. DEBT SERVICE

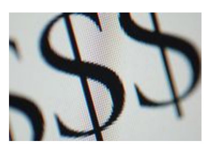
Principal & Interest

Principal and interest payments required to retire debt

Career Education Systems

4. REDUCTION CERTIFICATE

Issued by lender stating current loan balance



Career Education Systems

3. INTEREST / PAYMENT PLANS

NOW THAT I'VE BORROWED ALL THIS MONEY, HOW DO I PAY IT BACK?

INTEREST

% of loan balance

LEVERAGE Borrow $ to make $

A. PAYMENT PLANS

1. STRAIGHT NOTE (TERM LOAN)

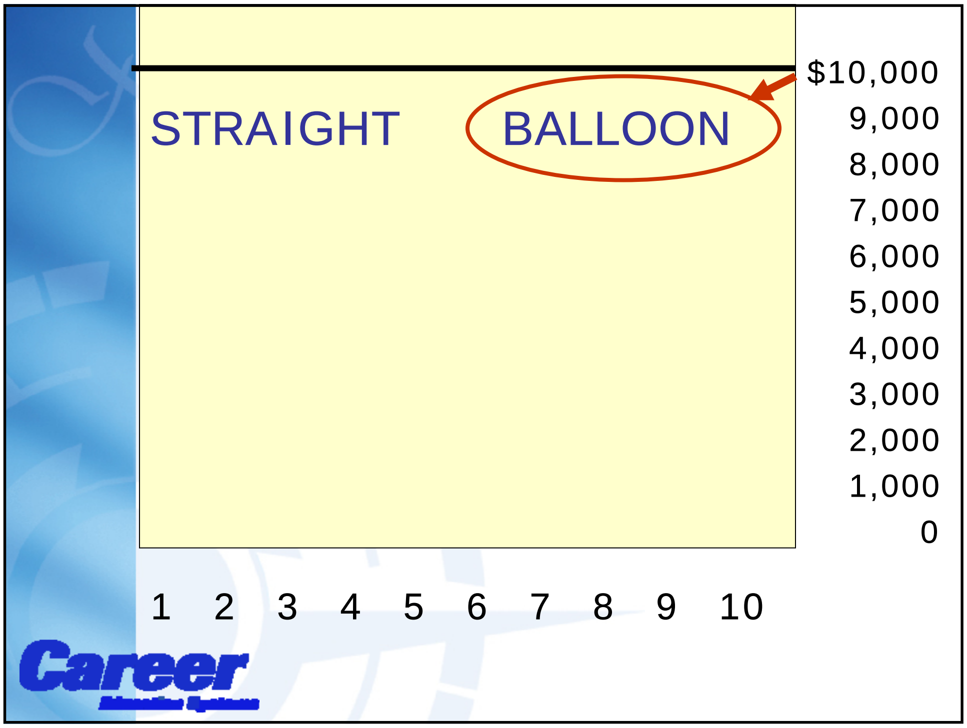
Interest only

Short term

Construction loan

Balloon payment

Final payment paying off loan balance in full



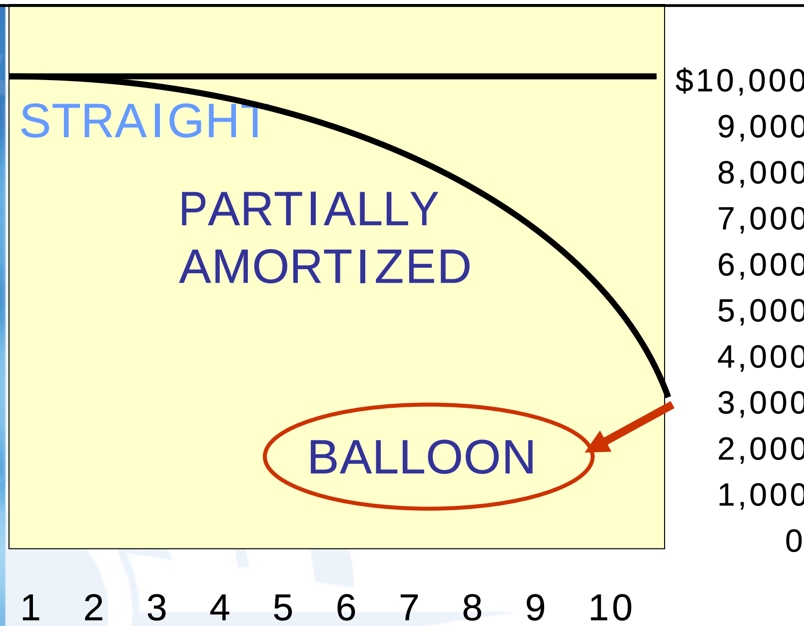
PAYMENT PLANS

2. PARTIALLY AMORTIZED NOTE

Principal and interest

Partially pay down loan balance

Balloon payment

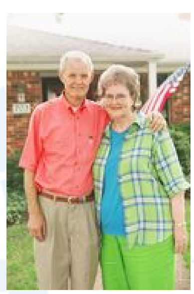


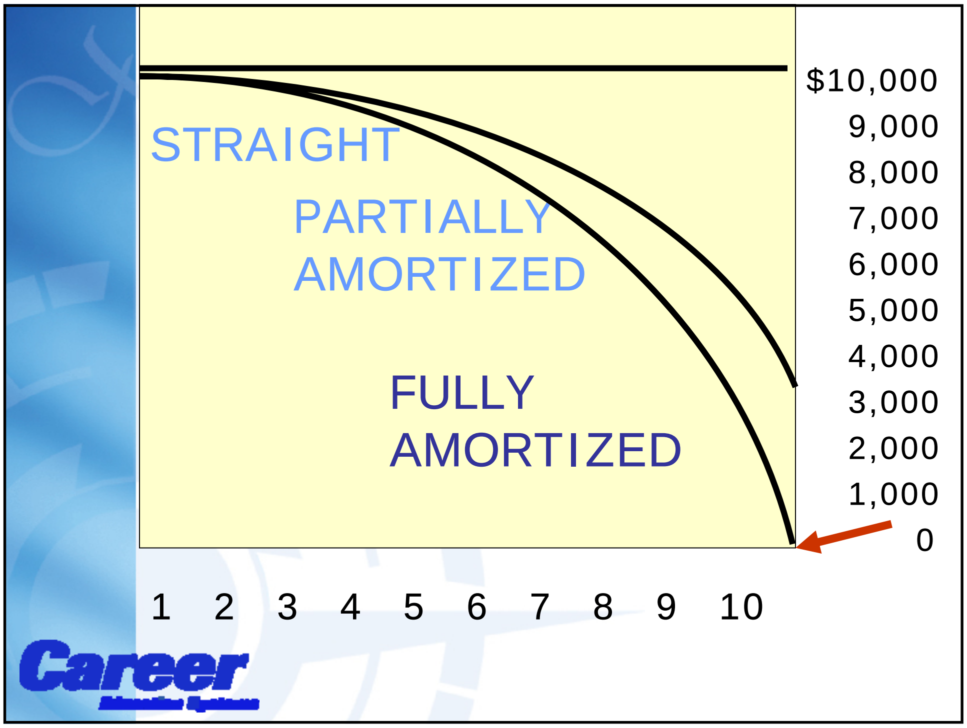
PAYMENT PLANS

3. FULLY AMORTIZED NOTE

Principal and interest

Totally pay off loan balance





FULLY AMORTIZED NOTE

Constant mortgage payment plan

PRIN	**100**	**110**	**120**	**130**	**140**
INT	**400**	**390**	**380**	**370**	**360**
TOTAL	**500**	**500**	**500**	**500**	**500**

EXAMPLE OF A PRINCIPAL AND INTEREST AMORTIZED NOTE

PRINCIPAL		INTEREST		TOTAL PMT
4	+	2	=	6
TOTAL PMT		INTEREST		PRINCIPAL
6	-	2	=	4
TOTAL PMT		PRINCIPAL		INTEREST
6	-	4	=	2

LOAN - $60,000 @ 10% interest for 30 years

PAYMENT - $526.54 per month (Principal and Interest)

What is the principal loan balance after the second month's payment?

STEP ONE

MONTH ONE

$526.54 (PRINCIPAL & INTEREST)

- ________ (INTEREST)

= ________ (PRINCIPAL)

STEP TWO

	$60,000.00	(LOAN BALANCE)
x	10%	(INTEREST RATE)
=	6,000.00	(INTEREST/YEAR)
÷	12	
=	500.00	(INTEREST/MONTH)

BACK TO STEP ONE

$526.54 (PRINCIPAL & INTEREST)

- 500.00 (INTEREST)

= 26.54 (PRINCIPAL)

STEP THREE

$60,000.00 (LOAN BALANCE)

- 26.54 (PAID ON PRINCIPAL)

=59,973.46 (REMAINING LOAN BALANCE)

STEP ONE

MONTH TWO

$526.54 (PRINCIPAL & INTEREST)

- ________ (INTEREST)

= ________ (PRINCIPAL)

STEP TWO

$59,973.46 (LOAN BALANCE)

x 10% (INTEREST RATE)

= 5,997.35 (INTEREST/YEAR)

÷ 12

= 499.78 (INTEREST/MONTH)

BACK TO STEP ONE

$526.54 (PRINCIPAL & INTEREST)

- 499.78 (INTEREST)

= 26.76 (PRINCIPAL)

STEP THREE

$59,973.46 (LOAN BALANCE)

- 26.76 (PAID ON PRINCIPAL)

=59,946.70 (REMAINING LOAN BALANCE)

FIGURE TOTAL INTEREST PAID

$	526.54	(P & I PER MONTH)
x	12	
=	6,318.48	(P & I PER YEAR)
x	30	
=	189,554.40	(P & I FOR 30 YEARS)

FIGURE TOTAL INTEREST PAID

$	189,554.40	(P & I FOR 30 YEARS)
-	60,000.00	(ORIGINAL LOAN)
=	129,554.40	(TOTAL INTEREST FOR 30 YEARS)

B. ALTERNATIVE PAYBACK METHODS

1. GRADUATED PAYMENT NOTE

Payments start out low, then go up yearly, eventually leveling off

02 $725

01 $700

00 $675

99 $650

98 $625

2. ADJUSTABLE RATE MORTGAGE (ARM)

Interest rate based on index

Interest changes periodically, thereby possibly changing all terms of the loans

Interest rate - up or down - CAP

Interest is at 2% above the rates paid on Treasury Bills with a maximum change of 2% in any year and a maximum change of 6% over the term of the loan

YEAR	INDEX	MARGIN	INT. RATE
1998	6%	2%	8%
1999	7%	2%	9%
2000	9%	2%	11%
2001	11.5%	2%	13%
2002	13%	2%	14%

4. PROVISIONS OF A MORTGAGE / TRUST DEED

WHAT ARE SOME COMMON PROVISIONS CONTAINED IN A MORTGAGE?

A. CLAUSES

1. PRE-PAYMENT PENALTY CLAUSE

Lender charges penalty for early pay-off

2. ACCELERATION CLAUSE (Due On Default Clause)

Lender calls loan balance due and payable upon happening of certain event, e.g., non-payment of mortgage

PAID	PAID	UNPAID	UNPAID	UNPAID
$700	$700	$700	$700	$700

REMAINING LOAN BALANCE BECOMES DUE IMMEDIATELY

3. ALIENATION CLAUSE (Due On SALE Clause)

Lender calls loan balance due and payable upon selling property; makes loan non-assumable

PAID	PAID	PAID	PAID	PAID
$700	$700	$700	$700	$700

REMAINING LOAN BALANCE BECOMES DUE IMMEDIATELY

4. SUBORDINATION CLAUSE (Changes Priority)

DATE	AMOUNT	RATE	PRIORITY
~~Jan., 98~~	~~$100,000~~	~~10%~~	~~1st MORTGAGE~~
Feb., 98	$15,000	11%	2nd MORTGAGE
Aug., 98	$100,000	8%	**1st MORTGAGE**

Changes priority that is different than recording date; lender waives their right in favor of another

5. DEFEASANCE CLAUSE (Null and Void Clause)

Voids security upon loan being paid off

PAID	PAID	PAID	PAID	AID
$700	$700	$700	$700	700

MORTGAGE OR
TRUST DEED
IS CANCELLED

Career

What is recorded to show that the note has been paid?????

MORTGAGE RELEASE → MORTGAGE

DEED OF RECONVEYANCE → TRUST DEED

Career

6. ESCALATOR CLAUSE

Lender can raise or lower interest rate (ARM)

7. ALTERATIONS CLAUSE

Obtain lender’s permission for major changes

B. ADDITIONAL TERMS

1. HYPOTHECATE

Borrower retains item used as security for loan; e.g., house or car loan

Borrower retains possession

2. PLEDGING

Lender retains item used as security for loan; e.g., stocks, bonds, etc.

Lender retains possession

3. ESCROW ACCOUNT

P rincipal

I nterest

T axes

I nsurance

Lender keeps pre-paid taxes and insurance

ESCROW

C. Two ways buyer can take over seller's loan

1. SUBJECT TO

Takes over payments

SOLELY liable to lender

BUYER

LIABLE TO LENDER

SELLER

2. ASSUMPTION

Takes over payments and PRIMARY liability

SECONDARILY liable to lender

BUYER

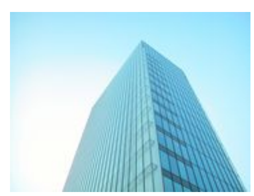
BOTH PARTIES LIABLE TO LENDER

SELLER

RELEASE OF LIABILITY

Given by lender

Granted by lender releasing seller from all liability, thereby making buyer solely liable



NOVATION

New takes place of old

New contract takes place of old contract; e.g., assumption with a release of liability

5. TYPES OF MORTGAGES / TRUST DEEDS

WHAT ARE THE DIFFERENT TYPES OF MORTGAGES AVAILABLE?

1. FIRST MORTGAGE

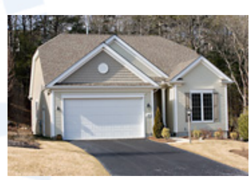
First to record is first in rights

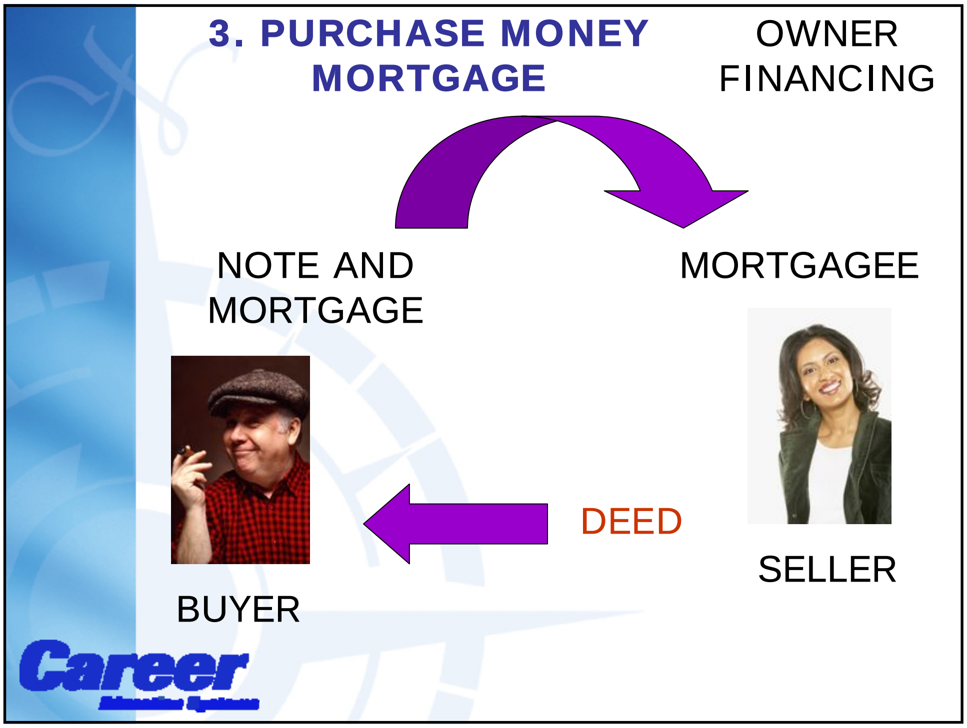
First to record

2. SECOND MORTGAGE

JUNIOR MORTGAGE

Any mortgage other than a first





SALE PRICE	$100,000
ASSUMED LOAN	- 80,000
DOWN PAYMENT	= 20,000
BUYER NEEDS	$ 20,000
BUYER HAS	- 15,000
SELLER LOANS	= 5,000

PURCHASE MONEY MORTGAGE

Career


4. BLANKET MORTGAGE
Covers more than one property;
used by developers, etc.
BLANKET
Career


PARTIAL RELEASE CLAUSE
Release property from blanket
as sold - $ to lender
BLANKET
SOLD
Career

5. PACKAGE MORTGAGE

Uses both real and personal property as security

Real & Personal

6. OPEN END MORTGAGE

Can borrow again on same loan; e.g., home equity loan – works like a credit card

Line of credit

7. GROWING EQUITY MORTGAGE

Pay extra on principal - build equity faster

EXTRA $ TO PRINCIPAL LOAN BALANCE

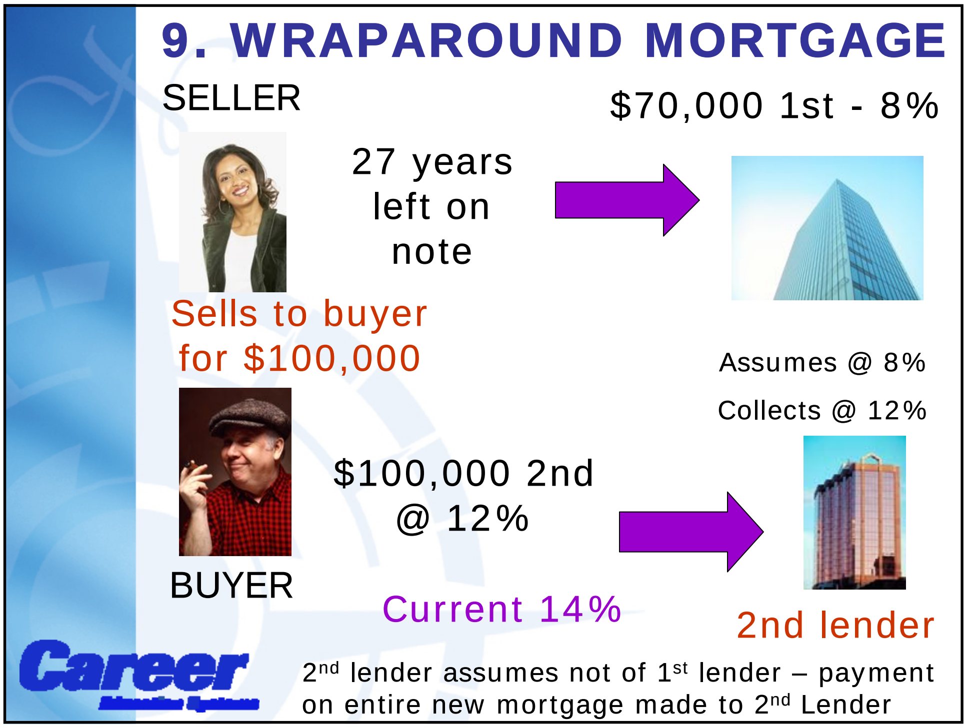
Gradually increasing payments applied to principal; increases normally predetermined or tied to an index

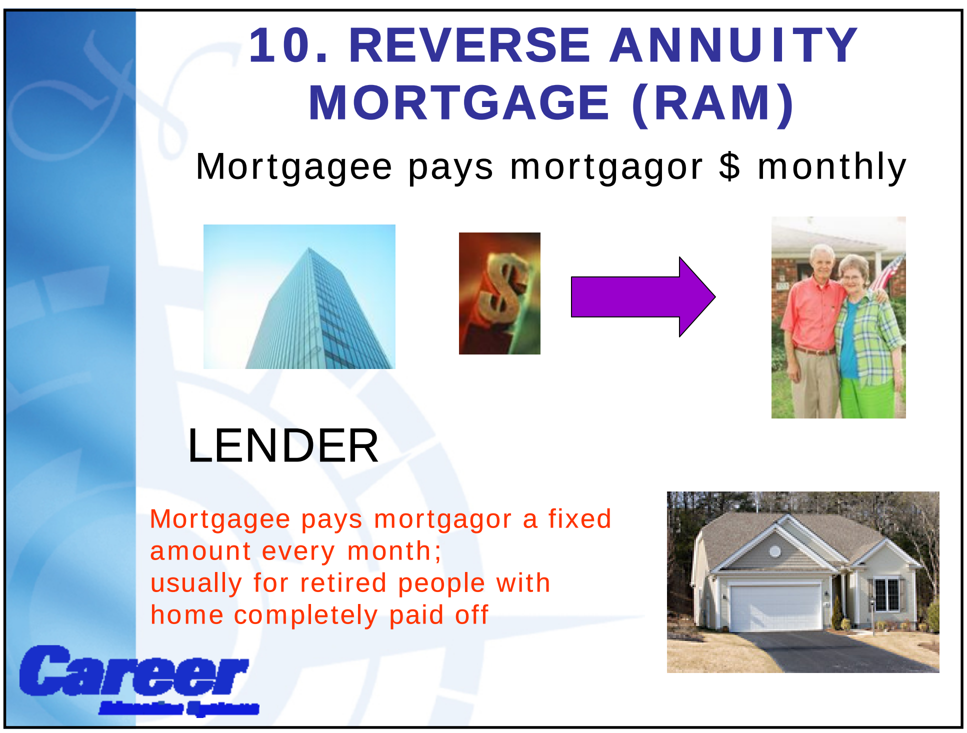
Career

8. CONSTRUCTION LOAN MORTGAGE

$ released as needed

Career


9. WRAPAROUND MORTGAGE
SELLER
$70,000 1st - 8%
27 years left on note
Sells to buyer for $100,000
Assumes @ 8%
Collects @ 12%
$100,000 2nd @ 12%
BUYER
Current 14%
2nd lender
Career
2nd lender assumes not of 1st lender – payment on entire new mortgage made to 2nd Lender


10. REVERSE ANNUITY MORTGAGE (RAM)
Mortgagee pays mortgagor $ monthly
LENDER
Mortgagee pays mortgagor a fixed amount every month;
usually for retired people with home completely paid off
Career

11. SHARED APPRECIATION MORTGAGE (SAM)

2006	2011
$80,000	$120,000

SAM - 9%
Current - 12%

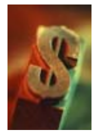
$20,000 to lender
$20,000 to borrower

Lender shares in appreciation plus interest

6. TYPES OF LOANS

WHAT ARE THE MAIN TYPES OF LOANS BUYERS CAN RECEIVE?

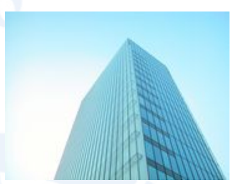
1. CONVENTIONAL

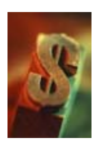


80% Loan to Value Ratio

Borrower - 20% Down

2. FEDERAL HOUSING ADMINISTRATION (FHA)

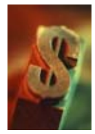




95 - 97% Loan to Value Ratio

Borrower - 3 - 5% Down

3. DEPARTMENT OF VETERAN'S AFFAIRS (DVA OR GI)



100% Loan to Value Ratio

Borrower - 0% Down

	CONV.	FHA	DVA
WHO	Any person	Any person	VETERANS – CERTIFICATE OF ELIGIBILITY
GOVT. SUPPORT	None	FHA under HUD – INSURES loans	VA GUARANTEES

	CONV.	FHA	DVA
TYPE OF PROPERTY	Any type	1-4 plex OWNER OCCUPIED	1-4 plex OWNER OCCUPIED
DOLLAR AMOUNT	No limits	FHA insures up to certain amounts – Make up difference in cash	Veterans can use eligibility again but only after previous VA loan has been paid off

Career

	CONV.	FHA	DVA
INTEREST RATES	Negotiable	Negotiable	Negotiable
PAYMENTS	Negotiable	Negotiable	Negotiable

Career

	CONV.	FHA	DVA
DOWN PAYMENT	Usually 20% - if less than 20%, must pay private mortgage insurance (PMI)	Usually 3 – 5% - Loan based on lower of sale price or appraisal	Nothing required – Loan based on lower of sale price or appraisal
DISCOUNT POINTS	Negotiable	Negotiable	Negotiable

	CONV.	FHA	DVA
PRE-PAYMENT PENALTY	Is allowed	Not allowed	Not allowed
ALIENATION CLAUSE	Is allowed	Not allowed – Buyer must qualify financially	Not allowed – Buyer must qualify financially – Anyone can assume

7. POINTS

WHAT EXACTLY IS A DISCOUNT POINT?

1. DISCOUNT POINTS

Point = Percent

RATE	POINTS
7%	0
6.5%	1
6%	2

Why does a lender charge discount points?????

INCREASE EFFECTIVE YIELD

Discount points are always based on the LOAN, not the sales price!!!!!

SALE PRICE	$	80,000
DOWN PAYMENT	-	10,000
LOAN AMOUNT	=	70,000

LOAN AMOUNT	$	70,000
DISC. POINTS	X	2%
POINTS PAID	=	1,400

2. BUYDOWN

Lowers interest rate during initial years of loan for buyer – helps buyer qualify for loan; similar to points in that one pays extra money up front to lower rate

Helps buyer qualify - Buy rate down

Note rate is 8% - Buyer buys down rate for first 2 years

YEAR	RATE
Year 1	6%
Year 2	7%
Year 3 & Beyond	8%

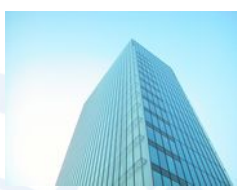
3. LOAN ORIGINATION FEE

Fee charged for originating and processing loan

Costs for initiating loan

4. LOCK-IN COMMITMENT

Lender guarantees borrower a fixed interest rate and a fixed amount of discount points for a certain time period



Lender locks buyer in on INTEREST RATE and DISCOUNT POINTS

8. ALTERNATIVE FINANCING

WHAT IF I WANT TO BUY A HOUSE BUT HAVE NO MONEY AND NO JOB?

1. CONTRACT FOR DEED / INSTALLMENT CONTRACT / LAND CONTRACT

Financing without a lender

VENDOR 2008 VENDEE

PROMISE $75,000

DEED

Seller retains Deed (LEGAL TITLE)

Buyer signs Contract (obtains EQUITABLE TITLE)

VENDOR 2018 VENDEE

DELIVERED
$75,000

DEED

VENDOR - SELLER - retains LEGAL TITLE

VENDEE - BUYER - obtains EQUITABLE TITLE when contract signed - receives LEGAL TITLE after final payment

Advantages: No qualifying, fewer closing costs, no or low down payment
Disadvantages: Riskiest for buyer - can lose equity, seller may still borrow against property, seller might be foreclosed on, seller not being able to provide marketable title

2. SALE / LEASEBACK

SELLER BUYER

DEED

ORIGINAL SELLER (LESSEE)

ORIGINAL BUYER (LESSOR)

LEASE

ADVANTAGES

1) Receive money
2) Business rent is tax deductible

ADVANTAGES

1) Depreciate improvements
2) Mortgage interest may be deductible
3) Gain appreciation on property

9. FEDERAL RESERVE

WHAT ARE WAYS TO CONTROL THE MONEY SUPPLY?

1. RESERVE CONTROLS

Percent of funds banks must keep on hand

RESERVE REQUIREMENT	CAN LOAN OUT	EFFECT ON ECONOMY
10%	90%	Lower interest rates – stimulates economy
20%	80%	Higher interest rates – slows economy

2. DISCOUNT RATE

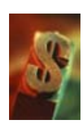
Interest rate banks pay to borrow money

7%

DISTRICT BANK

LOCAL BANK

10%



BORROWER

3. OPEN MARKET OPERATIONS

Buying and selling securities

Sell - decrease money supply

Buy - increase money supply

10. PRIMARY MORTGAGE MARKET

WHERE DOES A BUYER GO TO RECEIVE A LOAN?

1. SAVINGS & LOANS

Primarily residential loans

Largest investment in residential home loans

2. COMMERCIAL BANKS

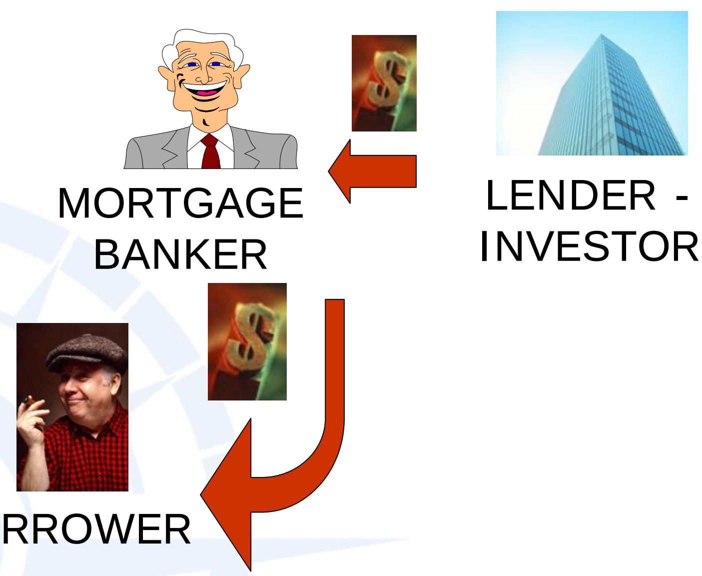
Primarily business loans

3. INSURANCE COMPANIES

Primarily high dollar loans

Career

4. MORTGAGE BANKERS



Career

PARTICIPATION LOANS

Lender participates in ownership and/or profits and/or equity growth

Ownership

Profits

Equity growth

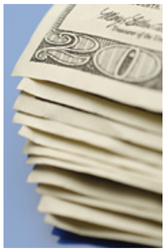
WAREHOUSING

Assemble loans into package for resale

11. SECONDARY MORTGAGE MARKET

DOES A LOCAL LENDER EVER SELL THEIR EXISTING NOTES TO OTHERS?

Purpose: Liquidity



Estoppel Certificate - States current loan balance

1. FEDERAL NATIONAL MORTGAGE ASSOCIATION - FNMA - FANNIE MAE

Private company

Buys notes from lenders, thus providing liquidity for lenders; raises money by selling Government guaranteed bonds; buys all types of loans

SELL NOTES

BUY NOTES

2. GOVERNMENT NATIONAL MORTGAGE ASSOCIATION - GNMA - GINNIE MAE

Government corporation under HUD; buys notes in depressed areas of country; primarily buys FHA & VA loans

HUD - Government corporation

3. FEDERAL HOME LOAN MORTGAGE CORPORATION - FHLMC - FREDDIE MAC

Primarily buy conventional notes from Savings & Loans

12. FINANCING LEGISLATION

ARE THERE ANY LAWS CONCERNING INTEREST RATE CHARGES, CLOSING COSTS, ETC.?

1. USURY LAWS

Set maximum interest rate

55% interest - How sweet it is!

2. TRUTH-IN-LENDING (REGULATION Z)

APPLIES TO	DOES NOT APPLY TO
Residential – 4 units or less	Business
	Commercial
Consumer credit	Agricultural
	Residential – over 4 units

Disclosure of LOAN costs

Lender gives borrower all LOAN costs - including Annual Percentage Rate (APR)

Takes all costs of borrowing and expresses as percentage

INTEREST RATE

$10,000 interest

$100,000 loan	**10% rate**

Career

ANNUAL PERCENTAGE RATE

$10,000 interest

$1,000 origination fee

$2,000 discount points

$13,000 total loan costs

$100,000 loan	**13% APR rate**

Career

RIGHT OF RESCISSION

3 day right to back out - does not apply to 1st mortgages

Career

ADVERTISING - to tell any credit terms, must tell all credit terms (FSBO's exempt)

COLUMN A TRIGGER TERMS	COLUMN B REQUIRED DISCLOSURES
Down payment	Cash price
Amount of any installment	Down payment
Finance charge in $	Terms of repayment
# of installments	APR
Period of repayment	# of installments

Career

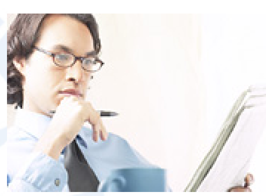
To tell interest rate, one must also tell the annual percentage rate

LEGAL WAYS TO ADVERTISE CREDIT - When advertised alone	ILLEGAL WAYS TO ADVERTISE CREDIT - When advertised alone
Low down payment	Only $2,000 down
FHA financing	Five thousand down
Compare our rates	12% FHA loans
Generous terms	2% lower then prime
Quick financing	15 year loans

3. REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

PURPOSE: to inform borrowers of TOTAL CLOSING COSTS

To inform borrowers ahead of time what rates and costs are so borrowers can shop around to get the best deal



Loans covered

New first mortgages on a 1-4 plex

ITEMS REQUIRED BY RESPA

1. Buyer's Guide to Settlement Costs (HUD booklet) - within 3 days of loan ap

Explains costs to close, given to buyer within 3 days of loan application

ITEMS REQUIRED BY RESPA

2. Good Faith Estimate of Settlement Costs - within 3 days of loan ap

ITEMS REQUIRED BY RESPA

3. Uniform Settlement Statement

(HUD - 1 Form)

Lists actual closing costs for seller and buyer

At time of closing

ITEMS REQUIRED BY RESPA

4. Limits on Pre-paids (taxes and insurance)

RESPA limits amount of pre-paid taxes and insurance that can be collected up front at closing

ITEMS REQUIRED BY RESPA

5. Prohibition of kickbacks

Refer business for $

LENDER BROKER

4. EQUAL CREDIT OPPORTUNITY ACT

Bans credit discrimination based on:

- Race
- Color
- Religion
- National Origin
- Sex
- Age
- Marital Status

