

Financing and Mortgages

Chapter 17

Institutional Lenders:

- ◆ Commercial Banks
- ◆ Savings Banks
- ◆ Mutual Savings Banks
- ◆ Life Insurance Companies

Commercial Banks

- ◆ Demand Deposits (Checking Accounts)
- ◆ Savings Deposits
- ◆ Chartered by the State of Hawaii and controlled by state statutes; or
- ◆ National Banks which are required to be members of the Federal Reserve System which regulates according to federal law.

Savings Banks

- ◆ Formerly called Savings and Loans
- ◆ Individuals deposit money in savings accounts.
- ◆ Bank lends primarily in residential mortgages.
- ◆ Chartered by both federal and state governments.

Savings Banks

- ◆ Federal savings banks must be a member of Savings Association Insurance Fund (SAIF) and each account is insured for \$100,000.
- ◆ Federal Home Loan Bank (FHLB) was the regulator now it is Federal Deposit Insurance Corporation (FDIC)
- ◆ Major source of residential mortgage loans.
- ◆ Typical LTV of 80% unless PMI coverage.

Mutual Savings Banks

- ◆ Concentrated in Northeastern part of US.
- ◆ Use their depositors money to purchase mortgages from other lenders.
- ◆ Mutual savings banks are represented by:
 - Mortgage banker
 - ◆ Has its own funds to lend;
 - Mortgage broker
 - ◆ Brings together borrowers and lenders for a fee;

Life Insurance Companies

- ◆ Invest money from policy holders.
- ◆ Supply most of the loans on commercial properties, shopping centers, industrial properties and hotels.
- ◆ Ranked first among all lenders for total mortgage investments.

Non-Institutional Financing

- ◆ Mortgage Companies
- ◆ Purchase Money Mortgages
- ◆ Agreement of Sale (Land Contract)
- ◆ Sale and Leaseback
- ◆ Credit Unions
- ◆ Farmers Home Administration

Mortgage Companies

- ◆ Permits institutional lenders from one state to purchase mortgage loans in another, thereby creating a need for a financial servicing agent.
- ◆ They usually receive a percentage of the loan amount as their fee for taking care of loan application, closing of loan and collecting payments from the borrower.

Agreements of Sale

- ◆ Land Contract or Contract for Deed
- ◆ Buyer (Vendee) makes a down payment and makes payments to the Seller (Vendor).
- ◆ Vendee takes possession and assumes responsibilities and has equitable title.
- ◆ Seller retains legal title.
- ◆ Term is typically 3 to 5 years at which time Vendee receives deed from Vendor.

Advantages to Vendee

- ◆ Provides a means of financing when mortgage money may be hard to obtain.
- ◆ Allows vendee any appreciation in value.
- ◆ Flexibility in down payment requirements.
- ◆ Flexibility in loan to income ratio.
- ◆ Faster closing.

Advantages to Vendor

- ◆ Wider selection of buyers.
- ◆ Deferral of capital gains.
- ◆ Maintains reasonable control of the use of the property.
- ◆ Will often realize a higher sales price.
- ◆ Usually no appraisal required.
- ◆ Faster closing.

Disadvantages of Agreement of Sale

- ◆ Disadvantage to the seller would occur if the buyer defaults and the seller must incur costs to clear the title.
- ◆ Disadvantage to buyer is that seller does not have to deliver clear title until satisfaction of A/S; the seller's title may be not be marketable.

Sale and Leasebacks

- ◆ Popular with industrial & commercial.
- ◆ Seller-lessee deducts rent payments.
- ◆ Seller-lessee obtains maximum cash out.
- ◆ Frees up credit for seller-lessee.
- ◆ Buyer-lessor gets better net return.
- ◆ Buyer-lessor gets depreciation allowance.
- ◆ Buyer-lessor has advantage of appreciation.

“Fannie Mae”

- ◆ Federal National Mortgage Association
- ◆ Oldest secondary mortgage institution
- ◆ Former government corporation, now is a private organization.
- ◆ Money from sales of debentures, mortgage backed bonds, and discount notes.
- ◆ Purchases ARM, FHA, VA and FRM loans.

“Freddie Mac”

- ◆ Federal Home Loan Mortgage Corporation
 - “Freddie Mac” a government corporation.
- ◆ Controlled by Federal Home Loan Bank
- ◆ Buys FHA, VA and conventional loans from originating lenders.
- ◆ Freddie Mac sells its own securities to raise funds to purchase loans.
- ◆ Garn bill allows enforcement of due on sale.

“Ginnie Mae”

- ◆ Government National Mortgage Association
- ◆ An agency of HUD.
- ◆ Implements housing subsidy programs.
- ◆ Purchases special assistance mortgages authorized by congress, as well as low yield mortgages made to low to moderate income borrowers.

Mortgages

- ◆ Parties to the mortgage:
 - Mortgagor is the Borrower
 - Mortgagee is the Lender
- ◆ The Promissory Note makes the borrower personally liable for the debt.
- ◆ A mortgage loan is commonly repaid in installments amortized over a period of years.

Lien Theory (Hawaii)

- ◆ Lender makes a loan to borrower.
- ◆ Borrower retains legal title and gives a promissory note and mortgage.
- ◆ Lender has a lien on the property.
- ◆ When loan is paid, lender will record a release or satisfaction of mortgage.
- ◆ If the buyer defaults, the lender will have to foreclose to sell the property.

Title Theory

- ◆ Title is conveyed to a trustee to be held in trust until the note is paid in full.
- ◆ The instrument used is called a trust deed.
- ◆ Parties to a trust deed:
 - Borrower is the Trustor
 - Lender is the Beneficiary
 - Neutral 3rd Party is the Trustee

Title Theory

- ◆ Trustor retains equitable title including the right to possess, use and sell.
- ◆ Trustee holds “naked title”; as long as the borrower is not in default, the trustee's title lies dormant.
- ◆ When borrower pays in full, trustee cancels the note and issues a reconveyance or release deed.

Mortgage Instruments

- ◆ Written instrument
- ◆ Competent parties
- ◆ Description of the property
- ◆ Statement and term of the debt
- ◆ Mortgageable estate
- ◆ Foreclosure provisions
- ◆ Mortgagor's signature
- ◆ Voluntary delivery and acceptance
- ◆ Acknowledgement and recording

Mortgage Instruments

- ◆ No lien unless mortgage is recorded.
- ◆ Contract between the parties unless recorded.
- ◆ Unrecorded mortgage is void as to subsequent purchasers.
- ◆ Lien priority is determined by time of recordation.
- ◆ Mortgages inferior to real estate taxes and special assessments.

Factors Affecting Mortgages

- ◆ Acceleration Clause
- ◆ Alienation or Due on Sale Clause
- ◆ Escalation Clause
- ◆ Defeasance Clause
- ◆ Subordination Clause
- ◆ Covenant to Pay Taxes, Insurance, Repair

Assignment of Mortgage

- ◆ The sale of rights and interest in the mortgage to a third party is called an assignment of mortgage.
- ◆ The assignee may request:
 - Estoppel Certificate or
 - Certificate of No Defense.

Assumption of Mortgage

- ◆ Buyer assumes both payment and responsibility for the existing mortgage.
- ◆ Costs are less in mortgage assumption.
- ◆ Buyer should request a reduction certificate from the lender.
- ◆ Seller remains secondarily liable.
- ◆ Assume "subject to" mortgage.

Prepayment

- ◆ Many lenders have a prepayment penalty.
- ◆ No automatic right to prepay the loan.
- ◆ Mortgage should include an “or more” clause giving the mortgagor the right to pay the loan off early without penalty.

Release of Mortgage

- ◆ Upon full payment of a mortgage debt, a release or satisfaction of mortgage, is given to the mortgagor.
- ◆ Mortgagor should make sure the release is recorded.
- ◆ Death or bankruptcy of the mortgagor does not discharge a mortgage.

Private Mortgage Insurance (PMI)

- ◆ Allows lender to increase LTV.
- ◆ Lowers down payment for borrowers.
- ◆ Insures 20% of the loan balance.
- ◆ Borrower pays premium:
 - $\frac{1}{2}$ of one percent the first year.
 - $\frac{1}{4}$ of one percent each year thereafter.
- ◆ Lender must remove once LTV under 80%.

Usury

- ◆ Hawaii state law; 1% month or 12% year.
- ◆ Charging more is usury and carries criminal penalties.
- ◆ If usury, borrower only has to pay principal.
- ◆ Most lenders now exempted.
- ◆ Only applies to 2nd mortgages carried by private individuals other than a seller.

Points

- ◆ Service charge points. Processing fee paid by borrower in conventional loan.
 - One point is equal to 1% of loan amount.
- ◆ Discount points are charges by a lender in FHA and VA loans when the interest rate is lower than a conventional rate.
 - One point is equal to 1% of loan amount.
 - One point affects the yield by $1/8$ of a percent.

Mortgages Classified by Purpose

- ◆ Second Mortgages
- ◆ Purchase Money Mortgages
- ◆ Construction Loan Mortgages
- ◆ Blanket Mortgages
- ◆ Package Mortgages
- ◆ Wraparound Mortgages

Mortgages & Manner Repayment

- ◆ Amortized
 - (self-liquidating)
- ◆ Budget
- ◆ Balloon
- ◆ Open End
- ◆ ARM
 - Margin
 - Index
 - Caps
- ◆ GPM:
 - Graduated Payment i.e.. FHA 245
- ◆ RAM:
 - Reverse Annuity
- ◆ GEM:
 - Growing Equity
- ◆ Swing or Bridge
- ◆ SAM:
 - Shared Appreciation

FHA Insured Loans

- ◆ FHA established in 1934 and designed to:
 - Encourage improvement in housing standards.
 - Provide an adequate home financing system.
 - Exert a stabilizing influence on mortgage market and residential real estate.
- ◆ FHA was in response to lack of housing, excessive foreclosures and a collapsed building industry during the depression.

FHA Operates under HUD

- ◆ FHA does not:
 - Build homes.
 - Lend money itself.
- ◆ A loan is made by an approved FHA lender to a qualified buyer and repayment is merely **insured** by FHA.
- ◆ FHA repays 100% of loss suffered by lender in foreclosure.

Distinguishing Features of FHA:

- ◆ Low down payment; High LTV
- ◆ Available for building, buying, improving or refinancing owner occupied homes.
- ◆ Assumable only to qualified buyer with a release of liability to seller.
- ◆ Secondary financing for down payment is permitted within guidelines.
- ◆ HUD no longer fixes the rate or points.

More Features of FHA Loans:

- ◆ No prepayment penalty.
- ◆ Interest rate is usually fixed rate.
- ◆ Usual term is thirty years.
- ◆ Borrower pays mutual mortgage insurance:
 - Home: paid up front or financed in loan.
 - Condo: paid in monthly installments.

Veterans Administration Guaranteed

- ◆ VA or GI loans are made for similar purposes as FHA loans and are backed the U.S. government.
- ◆ Loan is made by a lender and the VA guarantees 25% of the balance.

Features of a VA Loan

- ◆ Most veterans with 90 days active duty.
- ◆ Unmarried widows of those who died from service connected causes.
- ◆ Interest rates no longer set by law.
- ◆ 100% loan up to VA maximum.
- ◆ 2nd mortgage for purchase is OK.
- ◆ Appraisal is called CRV

More Features of VA Loan

- ◆ What happens when CRV comes in low?
- ◆ Veteran certifies owner occupancy twice.
- ◆ No prepayment penalty.
- ◆ VA loan assumption and **novation**.
- ◆ VA has limited direct loans available.
- ◆ VA buyer or the seller can pay VA points.
- ◆ 1% origination fee & 3.5% VA Funding Fee

Hula Mae Loans

- ◆ Funds raised from tax-exempt bonds.
- ◆ Below market rates for 1st time buyers.
- ◆ Loans made by Hula Mae approved lenders.
- ◆ Hawaii and US Citizen at least 18 years old.
- ◆ No previous Hula Mae loan.
- ◆ Hasn't owned residence within 3 years.
- ◆ Adjusted household income limits

More About Hula Mae Loans

- ◆ 30 Year maximum term; 1 point to buyer.
- ◆ No maximum down payment.
- ◆ Owner occupant home or condo.
- ◆ If leasehold must have 35 years remaining.
- ◆ Not available for:
 - Refinance
 - Converting agreement of sale
 - Purchasing fee title to leasehold property.

Employee's Retirement System

- ◆ ERS loans are for state & county employees and retirees.
- ◆ ERS loans can be used for the:
 - purchase,
 - construction,
 - improvement,
 - refinancing,
 - purchase of leasehold property in fee.

Conditions for ERS Loan:

- ◆ Owner occupant home, condo, townhouse.
- ◆ Conventional loan max points 1% to buyer.
- ◆ Income after debts must be 3½ times the monthly mortgage payment.
- ◆ Sign affidavit of owner occupancy.
- ◆ Term of lease must exceed term of the loan by 10 years.

More on ERS Loans

- ◆ Refinancing an ERS loan only if making home improvements or buying the fee.
- ◆ Prepayment penalty the first year.
- ◆ Construction started within 4 or 6 months.
- ◆ ERS loans assumable by qualified persons.
- ◆ Agreement of Sale to anyone, but rate and terms may change.

Review

- ◆ FHA and VA Comparison Page
- ◆ Agreement of Sale Addendum
- ◆ Purchase Money Mortgage Addendum



Liens and Foreclosure

Chapter 18

Liens

- ◆ Encumbrances that affect the title.
- ◆ A right given to the creditor, lienor to have the debt satisfied out of the sale proceeds of the debtor, lienee.
- ◆ Lis Pendens is a public notice to a prospective purchaser or lender.

Specific Liens

- ◆ Mortgages
- ◆ Real Property Taxes and Assessments
 - One year right of redemption in Hawaii for tax sale only.
- ◆ Mechanics & Materialman's Liens
- ◆ Attachment (know the sequence)

Mechanics Liens

- ◆ Two stipulations for filing the lien:
 - Person must have furnished labor or materials.
 - Labor or material was used on property where lien is placed.
- ◆ Notice must be filed within 45 days of completion
- ◆ Lien expires 3 months after entry of court order unless lienor files suit.
- ◆ Liens relate back to date of commencement of work.

General Liens

- ◆ Judgment liens can continue for 10 years or until paid.
- ◆ Federal and State Estate Tax Liens
- ◆ Federal and State Tax Liens
- ◆ Decedent's Debts

Foreclosure

- ◆ Why foreclose on mortgagor?
- ◆ Judicial (Foreclosure by Suit)
 - Slow
 - Expensive
- ◆ Non-Judicial (Power of Sale Clause)
 - Based on advertisement and sale

More Foreclosure Rules:

- ◆ Deficiency Judgments possible
- ◆ Excess proceeds are paid to mortgagor
- ◆ What is non-recourse financing?
- ◆ Equity of Redemption Rules
 - Lender cannot determine the length of the redemption period.
 - Lender cannot ask mortgagor to waive this right in the mortgage document.



Truth-in-Lending

Chapter 19

Truth-in-Lending

- ◆ What is the purpose for Regulation Z ?
- ◆ Creditors: one who regularly extends consumer credit 25 times in a calendar year. Included is a seller who does owner financing more than 5 times a year.
- ◆ Arrangers: one who is paid to arrange a consumer loan.

Disclosure Statement

- ◆ Two most important items:
 - The finance charge
 - The annual percentage rate
 - The total of payments

Complete Disclosure Statement

- ◆ Total dollar amount of finance charge.
- ◆ Annual percentage rate.
- ◆ Number, amounts, timing of payments.
- ◆ Total of payments.
- ◆ Late payment fees
- ◆ Security interest
- ◆ Prepayment penalty.
- ◆ Method of computing rebates.
- ◆ Amount financed.
- ◆ Points or tax reserves.
- ◆ Agreement of sale disclosures.

Right of Rescission

- ◆ What is the intention of this law?
- ◆ If creditor extends credit and receives a security interest in the property, borrower has a 3 day right of rescission.
- ◆ If disclosures are not given, borrower has 3 years to rescind.
- ◆ Does not apply to residential mortgages.
- ◆ Does apply to refinance or 2nd mortgage.

Advertising

Column A

- ◆ Downpayment
- ◆ Payment amount
- ◆ Finance charge
- ◆ Number of payments
- ◆ Period of repayment

Column B

- ◆ Amount or percentage of downpayment
- ◆ Term of repayment
- ◆ Annual percentage rate and if increase is possible

Regulation Z Compliance

- ◆ Penalty is twice the amount of the finance charge with a maximum of \$1,000.
- ◆ Willful violation is misdemeanor punishable by a fine up to \$5,000, or 1 year in jail, or both.
- ◆ Enforced by Federal Trade Commission

RESPA Requirements

- ◆ Good Faith Estimate from the lender within 3 days.
- ◆ Use of HUD Form #1.
- ◆ Homebuyer's Guide to Settlement Costs

Further RESPA Requirements

- ◆ No kickbacks or payments of unearned fees.
- ◆ Lender must disclose business relationships with attorney, escrow, title etc. and give an estimate of their charges.
- ◆ Impound account cannot exceed current month plus 1/6 annual for taxes & insurance
- ◆ Lender can't charge for preparation of RESPA forms.
- ◆ Violators subject to criminal penalties & triple damages.

Equal Credit Opportunity Act

- ◆ Prohibits discrimination in lending on the basis of sex, marital status, **old age**, race, color, religion, national origin, or receipt of welfare.
- ◆ Can't question applicants about their plans to have children.
- ◆ Can't require additional co-signors for single female applicants.

Review

- ◆ Truth-In-Lending Disclosure Statement
- ◆ Good Faith Estimate