

Financing and Mortgages

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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
- ▶ 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

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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

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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

- Down payment
- Payment amount
- Finance charge
- Number of payments
- Period of repayment

Column B

- Amount or percentage of down payment
- 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 of loan application.
- ▶ 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