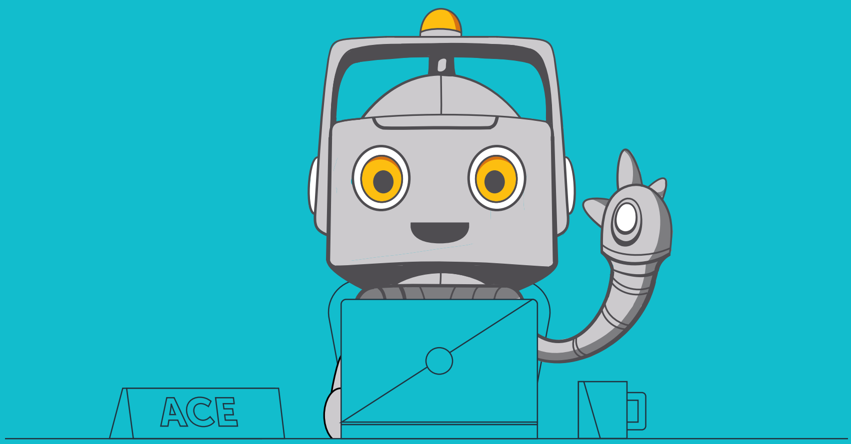
ACEABLE

TEXAS PRE-LICENSE REAL ESTATE FINANCE STUDY GUIDE



HELLO THERE!

Welcome to the Texas Pre-License Real Estate Finance Study Guide, your one-stop reference for everything you need to ace both your Aceable course exam and the state real estate exam. Inside this guide, you'll find:

- **A chapter-by-chapter review of important concepts from the course**
- **Key terms**
- **All the important math equations you need to memorize**
- **Study schedules to help keep you on track**
- **And more!**

As you make your way through the course, stop back here when you need more review on a concept or if you just want to brush up before a level assessment.

When you're ready to take the final, I'll be here to help you prepare. And don't forget, there are also practice tests you can take as many times as you like.

Whether you're just starting your pre-licensing journey or about to crush that exam, this guide is an important piece of your study puzzle. So get in there! I can't wait to show you all the fun study tools I've put together for you to use.

You've got this!

Your robot study buddy,

ACE READYWILLINGAND ABLE

01

The Nature and Cycle of Real Estate Finance

The Nature of Real Estate Finance

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The Nature of Real Estate Finance

Chapter Objectives Explain how real estate financing works **|** Describe real estate financing's role in the economy **|** Discuss how the economy and housing market interact **|** Describe what various professionals in the industry do

History of Real Estate Finance

Way back in the early 1900s, mortgage loans were interest-only and had terms as short as three to five years (compared to the standard 15- or 30-year mortgages we have today)! Homeowners would have multiple mortgages at the same time and refinanced frequently when they had trouble paying them off. The situation got worse when the Great Depression hit. Many people were unemployed or otherwise unable to make payments, and financial institutions were either going out of business or refusing to make home mortgage loans. This led to the creation of the Federal Housing Administration by Congress in 1934.

Financing Today

Consumers in this country and in this day and age are extremely familiar with the credit system. Most of us have credit cards that allow us to purchase items immediately and pay for them later or over an extended period of time. Real estate financing is the same concept on a larger scale.

Pre-Qualification and Pre-Approval

Pre-qualification and pre-approval for a loan are not the same thing.

Pre-qualification is the first step in determining “how much house” the buyer can afford and which type of loan might be best. The buyer supplies information about their financial situation to the lender, who then provides a general estimate.

Pre-approval is the more official process of being approved by the lender to borrow a specific amount at an interest rate within a small range. **A mortgage application, credit report, and supporting financial documentation are required.**

Pre-approval is always a wise first step for buyers, and it's practically a necessity in hot real estate markets. If a seller has multiple offers on their house, a buyer has an edge on the competition if they have material proof (in the form of a lender's pre-approval letter) of their ability to close the deal.

Final approval, the most official step, happens when the lender is evaluating the exact loan for a specific property. Approval results in loan commitment; disapproval results in application rejection.

THREE STEPS TO LOAN APPROVAL

	PRE-QUALIFICATION	PRE-APPROVAL	FINAL APPROVAL
Lender evaluates borrower based on borrower-supplied info	✓		
Lender evaluates borrower based on credit report & other info		✓	✓
Lender charges fee(s)		✓	✓
Lender evaluates a specific property			✓
Results in loan commitment or application rejection			✓

Mortgage Brokers

A mortgage broker is someone who brings together a borrower and a lender in order to create a mortgage. Mortgage brokers generally package and sell loans to larger investors.

Mortgage Bankers

A mortgage banker is an entity or person who provides mortgage financing by using their own funds. The loans come from the mortgage banker, rather than a commercial bank or savings association.

Correspondent Lenders

Similar to a mortgage banker, a correspondent lender offers loans using their own money at their own risk. The difference is that a correspondent lender generally works on a smaller scale than mortgage brokers and bankers.

The Life of a Mortgage

1. **Origination:** The creation of a new mortgage is called **origination**. Mortgages can be originated by mortgage brokers, mortgage bankers, or correspondent lenders.
2. **Loan processing:** The lender collects information from the buyer that will help determine the loan type and amount they will qualify for. The person who is seeking the loan will need to complete and submit an application to kick off the loan processing. **Lenders have to consider a borrower's income, credit, debt, source of funds, and net worth.** They do this by creating a file for each interested borrower containing pertinent information about them and the property. They also verify that the information provided by the borrower is actually true. A major component of loan processing is ordering and **checking the borrower's credit reports**. Not all creditors report to all **three of the big national credit reporting agencies (Equifax, Experian, and TransUnion)**, so a single individual could have a different score from each agency.
3. **Underwriting:** Underwriting is the process of deciding the level of risk a lender would take on by offering a loan to a certain borrower for a specific property. It's a complex process that has been automated to some degree, but still requires the work of a specially trained professional.
4. **Funding:** Funding happens when the lender provides the cash in the amount of the approved loan. It is the transferring of funds to a title company or escrow company so that they may be disbursed from there. Usually, the homebuyer doesn't get the keys until funding (not just closing) has occurred.
5. **Closing:** Closing is the consummation of a real estate transaction when all the necessary contracts are signed and the lender disburses the funds of the mortgage loan. The physical meeting at which the paperwork is signed for the property transfer is also called the closing.
6. **Loan servicing:** Loan servicing is a collection of monthly payments, usually including payments on the **principal, interest, taxes, and insurance, or PITI**, along with the maintenance of records. The loan servicer is also responsible for sending the collected funds to the note holder and contacting the borrower about any delinquencies. Additionally, the loan servicer will provide the borrower an annual statement that details the activity of the escrow account, showing the account balance and payments for property taxes, homeowners insurance, and other escrowed items.

Buying Subject to Existing Mortgages

When purchasing a home subject to the existing mortgage, the title changes hands, so the buyer owns the house legally, but the seller's old mortgage stays in place. The buyer pays the seller, and the seller turns around and pays the lender, usually keeping a cut for themselves.

Subject-to sales are controversial and are of questionable legality in some places. Always advise clients to consult an attorney in a subject-to transaction.

Key Terms

closing

the consummation of a real estate transaction when all necessary contracts are signed and the lender disburses the funds of the mortgage loan

correspondent lender

a lender who offers loans using their own money at their own risk, generally on a smaller scale than mortgage brokers and bankers

funding

the transferring of funds by the lender to a title company or escrow company so that they may be disbursed

loan processing

when the lender collects information and an application from the buyer that will help determine the loan type and amount they will qualify for

mortgage broker

someone who brings together a borrower and a lender in order to create a mortgage

mortgage bankers

companies or individuals that originate mortgages, using their own or borrowed funds (as opposed to depositor funds)

origination

the creation of a new mortgage

pre-qualification

the first step in determining "how much house" the buyer can afford and which type of loan might be best; the buyer supplies information about their financial situation to the lender, who then provides a general estimate

pre-approval

official process of being approved by a lender to borrow a specified amount at an interest rate within a small range; a mortgage application, credit report, and supporting financial documentation are required

servicing

the ongoing collection of monthly payments and maintenance of records by a loan servicer

underwriting

the process of determining the level of risk a lender is willing to take in extending a loan to a borrower

Mortgage Lending Activities

Chapter Objectives **Differentiate between primary and secondary markets** | **Describe escrow accounts** | **Explain the servicing and transfer of loans** | **Identify common loan programs**

Collateral

Collateral is something of value that is pledged to a lender as a promise to repay a loan. In real estate finance, the borrower is offering real property as the collateral for a loan on that same property. Real estate can be terribly expensive. The price range is extreme, but even the most modest starter home costs way more than any item you'd typically charge to your credit card.

With stakes so high, lenders want more than just the promise of interest payments each month. **They want the right to foreclose on the property and sell it to get some of their money back in the event that the borrower stops making payments.**

Hypothecation

In hypothecation, the borrower maintains their ownership of the asset and has free reign to use and enjoy it. The lender has an equitable title in the property, meaning they have no right to the property unless there is a default. Once the loan is fully paid off, that right disappears.

Leverage

In the context of mortgages, leverage is the use of a relatively small amount of money in order to get a much bigger loan for purchasing real estate. That relatively small amount is the down payment.

The Primary Market

The primary market is where mortgages are first created by connecting lenders to borrowers. Lenders in this market have a supply of savings deposited by their members. Rather than letting that money sit around indefinitely until the depositor withdraws it, the lender puts it to work by lending it to a borrower. The borrower gets the funds they need for that lovely home, and they pay interest to the lender (who makes some decent money off the situation). Some of that money is paid to the people who deposited their savings that made it all possible.

Primary Market Institutions:

- Credit unions
- Commercial banks
- Life insurance companies
- Savings banks

The Secondary Market

The majority of mortgages are not retained by the original lender who created them. Most are quickly packaged and offered up on the secondary market, which is **where loans and servicing rights are sold to investors**. The purpose of the primary market selling loans to the secondary market is that it frees up funds for the primary lenders to create more mortgages rather than stopping at the finite amount they could take on as portfolio loans.

The secondary market is made up of:

- Fannie Mae
- Freddie Mac
- Ginnie Mae
- Federal Home Loan Bank
- Private investors
- Life insurance companies

PRIMARY VS. SECONDARY MARKET

	PRIMARY MARKET	SECONDARY MARKET
WHAT HAPPENS HERE?	Mortgages originate	Mortgages are bought and sold
WHO OPERATES HERE?	Mortgage lenders and mortgage borrowers	Mortgage lenders and mortgage buyers
WHO ARE SOME ACTORS IN THIS MARKET?	Credit unions, homebuyers, and banks	Fannie Mae, Freddie Mac, Ginnie Mae, and Farmer Mac
WHY DOES THIS MARKET EXIST?	Borrowers get mortgages from banks so they can afford to buy homes	Banks sell loans so they can give more loans to borrowers
WHAT'S AN EXAMPLE OF THIS MARKET?	Melissa is approved for a mortgage by ABC Bank	Freddie Mac buys Melissa's mortgage from ABC Bank

Mortgage Servicing and Escrow

A home mortgage gets passed on to a servicer for ongoing management. What exactly does that servicer do?

- Collects the homeowner's payments every month
- Maintains the escrow account (if the borrower has to or chooses to have one) for annual expenses, like taxes and home insurance
- Contacts the borrower about late payments or defaults
- Answers questions the borrower may have about the loan

Escrow Accounts

The escrow account contains money that the borrower pays to the loan servicer, which the servicer reserves until it's needed to pay for the home insurance and property taxes.

Maintaining Home Insurance

If a homebuyer used a loan to buy a home, that means the lender has an interest in their property. For this reason, the lender can (and almost certainly will) require the homeowner to keep the place insured against damage. The servicer may also need to see proof of the insurance policy.

Property Valuation

Mortgage lending activities involve more than just making sure that loan applicants are qualified. Lenders must also get a detailed understanding of the property that is to be mortgaged. This involves a thorough and accurate property valuation, using the sales comparison or cost approach for residential property and a cap rate for income-producing property.

Sales Comparison Approach

The sales comparison approach **determines value by comparing the subject property to the sales prices of "comps" (short for comparables, aka similar properties) that have been sold recently.**

Comp Adjustments

To make adjustments, appraisers assign a dollar value to certain features and qualities of properties. If the comp has a desirable feature that the subject property does NOT have, the value of the feature is subtracted from the sales price of the comp. If the comp is lacking a desirable feature that the subject property has, the value is added to the comp price. The point of an adjustment is to see how much the properties would sell for if they were all exactly the same. Those prices should be telling the same story.

Cost Approach

The cost approach estimates the value of a property by determining how much it would cost to completely replace it and then subtracting from that value to account for depreciation. The cost approach works better when placing a value on new construction. It gets trickier when you apply it to older construction because building materials and methods change a lot over time. The cost approach is most appropriate for public or commercial properties that aren't commonly seen in the open real estate market. Examples include schools, churches, and roller skating rinks.

Income Approach

The income approach determines the value of a property by paying particular attention to the amount of income a property could produce for its owner. This could be actual income (such as rent that is actually being paid to the owner) or potential income (income that the owner could potentially collect if they rented out the space). Examples of properties that are a good fit for the income approach are apartment complexes.

Government vs. Conventional Loans

Loans are either government-guaranteed (insured), such as FHA or VA loans, or they are conventional loans. Conventional loans are not insured by the government. They either call for private mortgage insurance (PMI) or they can be free of insurance if the buyer pays a down payment of at least 20% of the sales price.

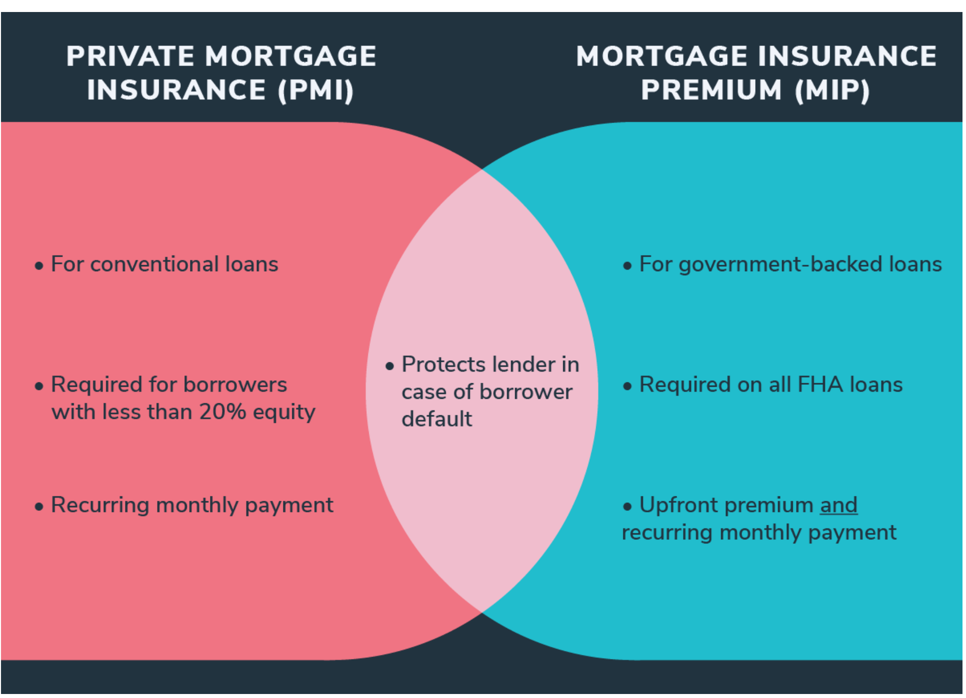
FHA Loans

Federal Housing Administration (FHA) loans are an option **for homebuyers who may not be qualified for a conventional loan**. It allows them to put down a smaller down payment (as low as 3.5%) and get into their own home sooner than they may have been able to afford it without this program. The small down payment is acceptable to lenders because they have some assurance that the FHA will pay them if the buyer defaults.

Mortgage Insurance Premium

A mortgage insurance premium, or MIP, is required insurance to protect the lender in the event of borrower default on an FHA loan. Notice that this is different from the insurance that is sometimes required for conventional loans.

- Conventional loan requires PMI (Private Mortgage Insurance)
- FHA loan requires MIP (Mortgage Insurance Premium)



VA Loans

VA (Veteran's Association) loans are similar to FHA loans. The VA guarantees loans instead of insuring them. The guarantee protects the lender if the borrower defaults on the loan. The borrower pays a fee upfront for the guarantee, but there are no ongoing monthly premiums.

This type of loan can be guaranteed for 100% of the loan amount, meaning it allows qualifying veterans to buy a home without paying a down payment at all.

Conventional Loans

Conventional loans **have no government guarantee or insurance**. At one time, all conventional loans required a 20% down payment. Later, an industry was developed for the provision of Private Mortgage Insurance (PMI) on conventional loans. Private mortgage insurance protects the lender in the event of borrower default on a conventional loan.

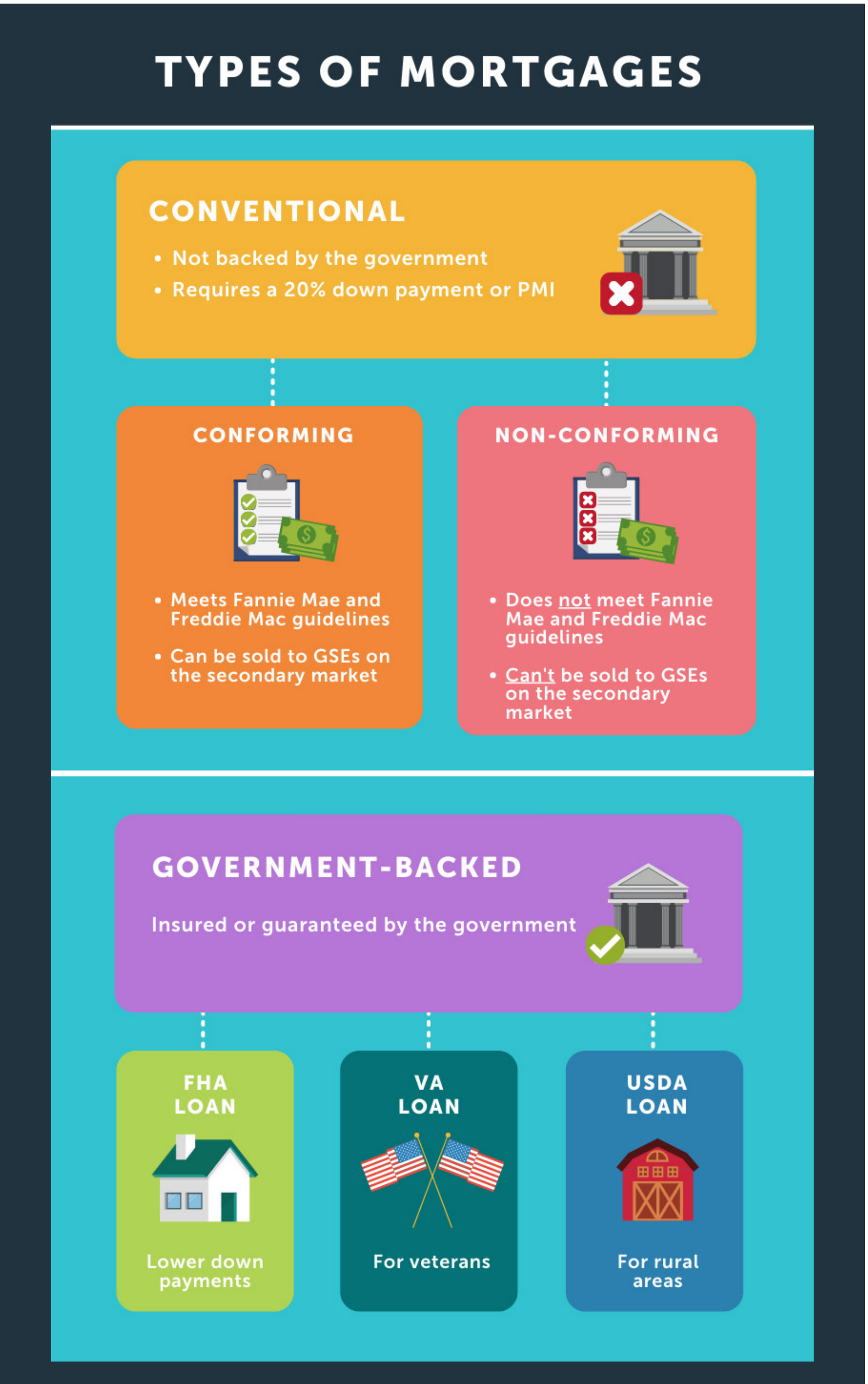
Once the homeowner reaches 20% equity, they can stop paying for PMI.

Conforming vs. Non-Conforming

Conventional loans can either be conforming or non-conforming.

Conforming conventional loan: Made according to the guidelines that will allow the loan to be sold on the secondary market. (FHA, VA, and conforming conventional loans are all eligible to be sold on the secondary market.)

Non-conforming conventional loan: Will probably become a loan held in the lender's portfolio because it does not meet the guidelines to be sold. (For example, a "jumbo loan" will be a nonconforming loan because it exceeds the maximum loan amount allowed to be sold on the secondary market.)



Seller Financing

In seller financing, the seller becomes the lender. The buyer makes mortgage payments directly to the seller.

Interest-Only Loans

With interest-only loans, monthly payments are applied to only the interest for a set period. During the life of the loan, the borrower is not paying down the principal amount at all. The advantage of this is that since they are not paying down principal, their payment will be significantly lower. **Interest-only loans can be okay for short-term situations, but refinancing is key.** Most homebuyers stay away from interest-only loans. They're more common in commercial real estate.

Finding the Cost of an Interest-Only Loan

Loan amount x Interest rate = Total annual interest

Step 1: Find the total annual interest

Multiply the loan amount by the interest rate (in the form of a decimal) using the formula above.

Step 2: Calculate the monthly payment

Divide the total annual interest by 12 months to get the monthly payment.

Loan Assumption

In an assumption transaction (or "loan assumption"), the buyer purchases the home and assumes the existing mortgage on the property. (FHA and VA loans are assumable as long as qualifications are met.) This can be very **valuable for the buyer if interest rates are rising and there is a low rate on the loan they are assuming**.

When a Loan is in Default

A loan is in default when the borrower fails to make one or more payments. Since it's the mortgage servicer's responsibility to look out for the property, they take a series of actions to address the default.

The SAFE Act

The Secure and Fair Enforcement for Mortgage Licensing Act of 2008, or SAFE Act is a national law required the states to pass legislation saying that all mortgage loan originators (MLOs for short) must be licensed in accordance with national standards.

The purpose of the SAFE Act is to protect consumers across the country from fraud by defining minimum licensing and registration standards for mortgage loan originators.

Key Terms

collateral

something of value that is pledged to a lender as a promise to repay a loan

conforming loan

a loan that has been made according to the guidelines that will allow the loan to be sold on the secondary market

cost approach

a method of estimating the value of a property by determining how much it would cost to replace the building or other improvements, minus the cost of depreciation, plus the value of the land itself

income approach

method of estimating the value of a property based on the amount of income it could produce for its owner

leverage

the use of a relatively small amount of money in order to get a much bigger loan for purchasing real estate

mortgage insurance premium (MIP)

required insurance to protect the lender in the event of borrower default on an FHA loan

non-conforming loan

a loan that does not follow Fannie Mae and Freddie Mac guidelines and thus will not be purchased by them on the secondary market

primary market

market in which mortgages are first created by connecting lenders to borrowers

private mortgage insurance (PMI)

insurance that protects the lender if a borrower defaults on a conventional loan; usually required when the borrower has less than 20% equity

sales comparison approach

property valuation method that determines value by comparing the subject property to the sales prices of similar properties that have sold recently

secondary market

market in which loans and servicing rights are sold to investors

Real Estate Cycles

Chapter Objectives **Explain the economic cycles | Understand how economic cycles affect the real estate industry | Give examples of recession throughout history | Discuss how to be successful throughout the cycle**

The Four Phases

The four major phases of the real estate market cycle are: recovery, expansion, hyper supply, and recession.

The real estate cycle will go through these phases, in this exact order, and then it will repeat all over again. What's not so predictable? The duration and timing of each phase. Real estate cycles don't exist in a vacuum. They can be affected by national and international events, interest rates, and other factors controlled by the people we put into power in the government. But just to give you an idea, one common theory is that **the complete cycle lasts seven to nine years on average**.

Recovery

Recovery is the phase that follows a recession. In a recovery, conditions stabilize and the outlook for the market is just starting to look brighter.

Distinguishing characteristics of a recovery phase include:

- High unemployment (but it's not getting any worse)
- Lots of home foreclosures
- People have seen the damage caused by recession and are afraid to buy homes (even though it's arguably a good time to "buy low")
- Government lowers interest rates to encourage investments

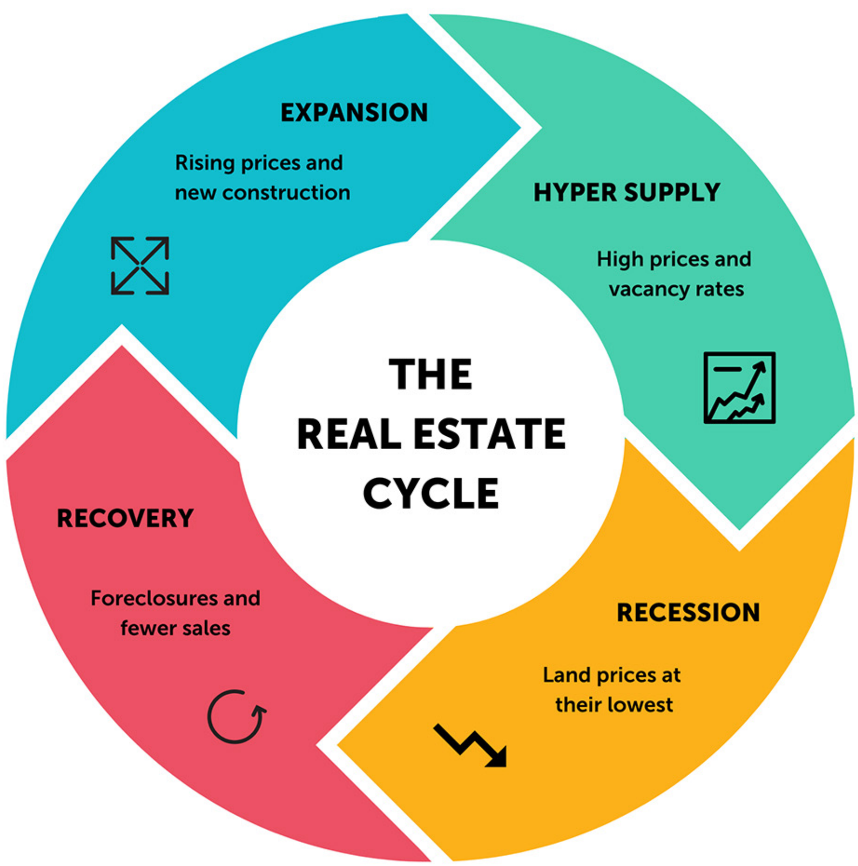
Expansion

During the next phase, called expansion, market activity really picks up. Businesses are hiring more, and people tend to view real estate as a good investment again. There is a general sense of being "out of the woods" and recovered from the last recession.

Signs of expansion include:

- Most available properties have been bought or rented, driving vacancy rates down
- Rent and home prices are rising
- Construction for new homes and commercial buildings starts

At the end of the expansion phase, people may pay more for real estate than it's worth, because they are anticipating future increases in value.



Hyper Supply

When the market enters the hyper supply phase, supply catches up with (and eventually surpasses) demand. The first warning sign is an increase in vacant or unsold property. And yet, investors can't just stop building after all the work they've put into their projects up until this point. They're on the hook to finish projects and pay back the loans they took out. And so we enter the hyper supply phase, also called the "boom."

Hyper supply is marked by:

- Crazy high prices
- Lots of building projects going on
- Vacancies start to rise

Recession

The final phase in the real estate cycle, recession, starts when occupancy falls below average (specifically, the long term average that evens out cycle changes). Homes sit on the market, unsold. Prices are driven down. Foreclosures abound, especially when the real estate recession is coupled with an economic recession that leaves homeowners unemployed and unable to pay their overly high mortgages.

Classic symptoms of a recession include:

- High unemployment
- Decreased spending by consumers and businesses
- Less investment in new buildings, factories, and equipment
- Land prices are at their lowest
- Decreased interest rates

The Cause of Recession

A recession is a **period in which economic activity and gross domestic product dramatically decline and stay that way for at least six months.** People spend less money on goods and services, and companies lay off employees.

Recession is often **caused by an economic shock**, like the bursting of an economic bubble. A bubble forms when the value of something (typically real estate or stocks) grows so much that its market value is higher than its actual value. When the "burst" happens, the price for the overvalued item drops.

Timing

Demand can swell quickly, prompting builders to build more homes. But it can take five to seven years to plan communities, acquire land and permits, and actually build properties from the ground up. The high demand/low supply situation can persist and strain the market for a very long time while builders work to address the problem.

There's often a psychological lag taking place in consumers' minds. Even as the economy recovers from a recession and presents opportunities for investment and growth, many people prefer to wait for a strong and obvious economic upturn before they feel comfortable making big purchases (like property).

Supply and Demand

Demand tells us how many consumers are able to afford a home, which in turn is affected by many factors, such as employment rates, wages, interest rates, and more. Characteristics of the population, the social attitudes prevalent at the time, and the legal and tax structure of the economy also shape the demand for real estate. **Supply is determined by looking at the number of properties that are vacant or are available for sale or rent.**

The Housing Affordability Index gauges the affordability (and therefore demand) of housing in the real estate market.

This index **compares median household income to the income needed to purchase a median-priced home**. One is published monthly by the National Association of REALTORS.

Inflation

Inflation is a general rise in prices. It **results in a decrease in the dollar's purchasing power**.

It is important to note that **inflation is influenced by governmental actions, such as increasing the money supply**.

The Exchange Rate

The exchange rate is the amount of foreign currency that a U.S. dollar can buy. For example, if $1 can buy 11 Mexican pesos, then the exchange rate is 11 pesos on the dollar. When one currency buys less foreign currency than before, it is said to be depreciating. **Depreciation of the dollar is a strong indicator of high inflation risk.**

Gross Domestic Product

Strong economic growth can also indicate future inflation. Growth, measured by the gross domestic product (GDP), is often accompanied by an increase in aggregate demand. Greater demand leads to rising prices, that is, to inflation.

Unemployment

Falling unemployment often accompanies economic growth. When more people have jobs, there is more disposable income in circulation, thus greater demand and higher prices. Economists use a function called the Phillips curve, which states that **high unemployment is correlated with deflationary pressures and low unemployment with inflationary pressures**.

Inflation and Interest

High inflation can be damaging to the real estate market. **When inflation is low, interest rates are usually low** as well. The opposite is also true: **high inflation and high interest rates go hand in hand**.

Types of Incentives

Tax incentives include tax exemptions, tax deductions, and tax credits. **A tax exemption is a dollar-by-dollar reduction in the appraisal value of a property (the value it will be taxed on).** The value a government places on land or buildings for real estate taxes is the **assessed value**.

There are several kinds of tax exemptions:

- **Homestead exemptions:** A property that is occupied by its owner as a permanent residence is considered a homestead. Second homes, vacation homes, and unoccupied investment properties aren't considered homesteads. Most states (including Texas) provide some sort of homestead exemption so that only a portion, rather than the full value, of the home is taxed.
- **Disability exemptions:** People with disabilities may receive a property tax exemption in certain states, including Texas.
- **Senior citizen exemptions**: Texas provides tax exemptions for senior citizens. Texas offers a $10,000 senior citizen exemption in addition to the homestead exemption for residents who are 65 or older. **School taxes are also frozen when the homeowner files for the over-65 exemption in Texas.** Therefore, school taxes will no longer increase unless there are property improvements that cause the tax appraisal to increase.
- **Capital gains tax exemption:** Married couples who sell their principal residence are exempt from the capital gains tax up to the amount of $500,000. Homeowners who are single are exempt up to $250,000. These are examples of a tax-free gain (profit) on the sale of a house.

Income Tax Incentives

Income tax incentives include deductions and credits.

Tax deductions: Reductions in a taxpayer's taxable income, which in turn lower the amount of that taxpayer's income tax liabilities (that is, their taxes owed).

Tax credits: Immediate, dollar-for-dollar reductions in a taxpayer's tax liabilities. For example, if a taxpayer owes $100 in taxes and claims a $25 tax credit for the same tax year, then they only owe $75 in taxes.

Here's a comparison of the two:

TAX CREDIT VS. TAX DEDUCTION

	TAX CREDIT	TAX DEDUCTION
Lowers taxable income	✗	✓
Takes money off tax bill	✓	✗
Lowers total taxes paid	✓	✓
Applied before you get the bill	✗	✓
Transferrable	✓	✗
Non-refundable	✓	✓

Determining Taxable Income

Step 1: Add sources of income together

Add the gross annual income and the capital gains income to get the homeowner's total income.

Gross income + Capital gains income = Total income

Step 2: Subtract tax exemptions

Take the total income from Step 1 and subtract both the capital gains exemption and the mortgage interest exemption.

Total income - Capital gains exemption - Mortgage interest exemption = Taxable income

Impact of the Economy

Chapter Objectives **Identify factors that affect the real estate market** | **Explain supply and demand** | **Describe incentives and infrastructure in Texas**

Demand

Demand can be defined as consumers' ability and willingness to buy a good or service at a certain price. The demand for real estate is affected by several factors.

Price

Price is the clearest example of a factor that affects demand. When real estate costs more, fewer people are willing to buy. The price of a particular piece of real estate is influenced by many factors. Prices can increase because of increases in construction costs, the cost of financing, and property values.

Income

The second factor affecting real estate demand is personal income. If the average salary goes down, or the unemployment rate goes up, the demand for certain types of housing is likely to decrease. If employment is on the upswing and/or wages increase, there will be more demand for real estate, including real estate at higher price points.

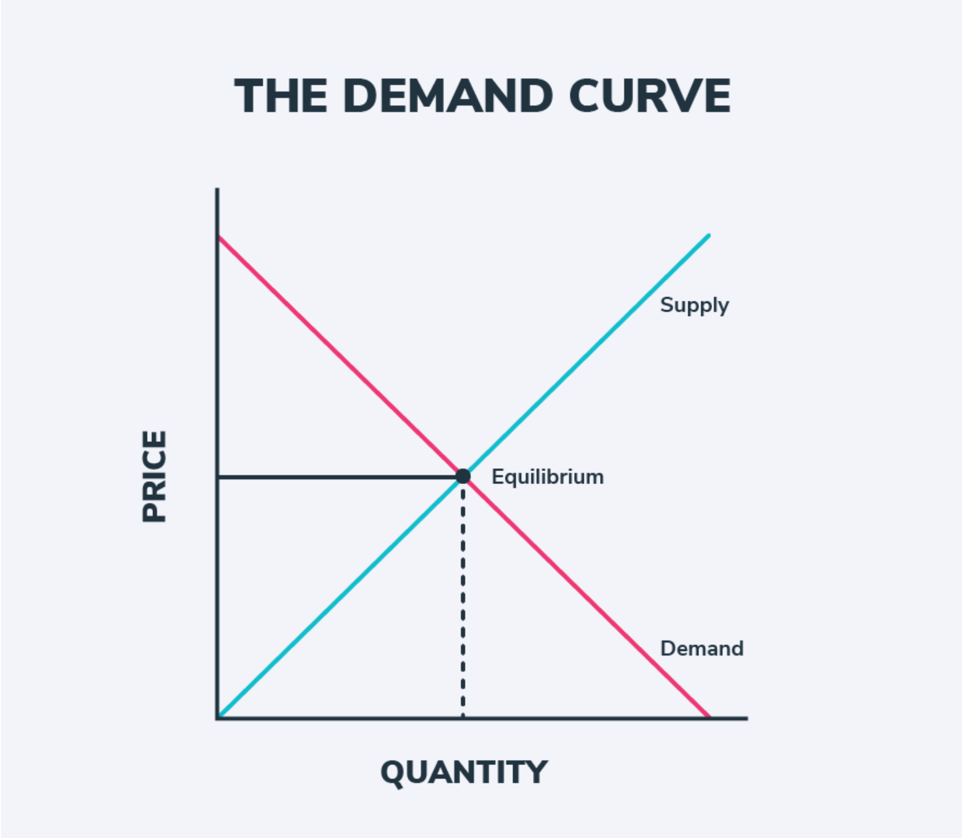
Expectations

A buyer's expectations of their future financial situation, and of the economy as a whole, will affect the demand for real estate. Consumers are less likely to buy a home if any of the following situations apply:

- Buyers expect that their income will decrease in the near future.
- They expect that the price of housing will decrease in the near future.
- They expect that the price of housing will decrease at the time they expect to sell their current house.

The Demand Curve

The demand for any commodity, such as real estate, can be illustrated using a demand curve.



The horizontal axis is "Quantity," representing the amount of a commodity sold. The vertical axis is "Price" representing the cost to purchase a given amount of a commodity. First, note that even though this is called a "demand curve" it has two curves (or lines in this example) - one for supply and one for demand. This is because in any market, there are people providing a commodity (suppliers) and people who want to buy that commodity (consumers). The two curves represent the perspectives of the two sides of the market.

Anyone producing or supplying a commodity wants to sell as many of them as they can, at the highest price they can. This line starts low, representing the fact that suppliers generally don't want to sell things for very low prices. However, the line continues up and to the right, illustrating that suppliers would love to sell a high volume of anything at a high price. The Demand curve moves down and to the right, representing the fact that consumers are usually interested in getting as much as they can for the lowest price that they can.

You can probably guess that neither the suppliers nor the consumers are going to get their "perfect world" scenario all the time, and that there is going to be some price they have to agree upon in order to make a deal. This is the **equilibrium point** - representing **the price at which a commodity is actually selling**.

Supply

Supply is an economic term for **the available amount of something**, and it's based on the willingness and ability of sellers in a given market to sell their property. Several factors affect supply.

Price

As the price of housing increases, owners become more willing to sell. Similarly, as the price of a loan increases — that is, as the interest rate goes up — lenders become more willing to lend (but buyers become less willing to take loans because of the higher interest rate).

Cost of Production

The supply of real estate is also affected by the cost of its production. If construction costs go down, it is cheaper to build houses, apartments, and office buildings, so more of them will appear on the market.

If, on the other hand, the cost of construction goes up, the greater expense to builders makes new housing scarcer. An increase or decrease in the price of raw land has a similar effect. However, because real estate is a long-lasting commodity, there is usually an existing supply of houses that have already been built on the market.

Expectations

Expectations affect supply as much as they affect demand. If sellers expect the price of real estate to go up in the near future, they will be less likely to sell right now. If sellers expect the price to go down soon, they will be more likely to sell right away.

Supply and Demand

The two forces of supply and demand together help to determine the actual price and quantity of real estate on the market. The law of supply and demand states that the forces of supply and demand push the market price of any commodity to one particular point, the market equilibrium. This equilibrium is the point at which the supply and demand curves cross.

In short, one very important factor affecting the supply and demand of housing is the supply of money. In general:

- The higher the supply of money available to finance real estate ventures, the higher the demand for housing.
- When the demand for housing becomes higher than the supply, property price increases.
- The lower the supply of money available to finance real estate ventures, the lower the demand for housing.
- When the supply becomes higher than the demand, property price decreases.

Key Terms

demand

consumers' ability and willingness to buy a good or service at a certain price

market

a theoretical construct that isolates the selling and purchasing of any one particular commodity from the economy as a whole

supply

an amount of a commodity that is available based on the willingness and ability of sellers in a given market to sell that commodity

Information Resources

Chapter Objectives **Know where to go for industry information and support for real estate professionals and the consumers they serve**

National Association of REALTORS

To stay current on industry news at the national level, check in regularly with the folks at the National Association of REALTORS.

On their website, you will find educational content on real estate, including research, statistics, and political and legislative information. You'll also find out about upcoming events for members, directories, and their Code of Ethics.

Federal Housing Finance Agency

At the Federal Housing Finance Agency's website, you can see the latest conforming loan requirements and mortgage rates, performance and accountability reports, interactive maps, and other data relevant to real estate finance. You can even comment on rules that are being considered by the FHFA.

Internal Revenue Service

The official online home of the Internal Revenue Service has you covered with helpful forms and articles.

U.S. Census Bureau

Browse around the digital troves of the U.S. Census Bureau. They've got statistics on many different aspects of housing.

United States Department of Agriculture

Another great resource is the USDA Home Loans and First Time Homebuyers website. USDA loans are a good option for first-time homebuyers. However, a person does not have to be a first-time homebuyer to get a USDA loan. One advantage is that the USDA Home Loan Program does not require a down payment.

Secondary Markets

Check out the websites of heavy hitters Fannie Mae, Freddie Mac, and Ginnie Mae. You'll find up-to-date news about the companies, as well as info on various loan products.

Texas REALTORS

The Texas REALTORS has a site focused on educating home buyers. The site includes information regarding various types of available affordable housing financing, how student loans affect financing a home, and how to avoid mistakes between loan approval and closing.

The Real Estate Center

One of the best resources to use to maintain your knowledge of the current economic cycle in Texas comes from the Real Estate Center at Texas A&M. They issue a monthly report that covers statistics on employment, unemployment, growth of different communities, building permits, housing activity, and more.

In addition, the Real Estate Center provides education in the form of various conferences, and they publish a monthly magazine for Texas real estate license holders called the Tierra Grande that provides statistical information about Texas real estate.

Texas Veterans Land Board

The Texas Veterans Land Board offers home loans, home improvement loans, and land loans for Texas Veterans and spouses of veterans currently residing in Texas. Search for their website to learn more.

02

Scenario-Based Learning Exercise: Oldtown

Scenario levels are not included in the study guide. Please refer back to the course for further review on this topic.

03

Money and the Monetary System

Money and the Federal Reserve System

Chapter Objectives **Summarize a brief history of money in the United States | Describe the role of the Federal Reserve in the American economy**

Legal Tender

All United States money (coins and currency) is a valid and legal offer of payment for debts and financial obligation.

There is, however, no federal statute mandating that a private business, a person, or an organization must accept currency or coins as payment for goods and/or services. Private businesses are free to develop their own policies on whether or not to accept cash (unless there is a state law to the contrary).

To fund the American Revolution, the Continental Congress issued the first paper money of the new republic. The bills were called *continentals*.

Almost a century later, the Union found itself in need of money to pay for the American Civil War. So, the federal government printed paper money again. This new money was a predecessor to our current bills — they were known as *United States Notes* (or, *Greenbacks*).

The problem was, along with these greenbacks, plenty of other currencies were floating all around the United States' economy.

With all these different currencies going around, it was hard for banks and people to know what kind of denominations to carry. Some were backed up by silver and gold; some weren't. Different currencies were worth different amounts, and some weren't even held by banks — oftentimes leaving the customer out to dry if they wanted to withdraw their funds.

The Federal Reserve Act

With the help of financial experts and after a period of debate, Wilson was presented with the Federal Reserve Act. A paragon of compromise, the proposed bank was cast as a decentralized central bank.

President Wilson signed the **Federal Reserve Act in 1913, creating the Federal Reserve**.

The purpose of the **Federal Reserve** is to:

1. Conduct the monetary policy of the United States
2. Supervise and regulate financial institutions for the protection of the consumer
3. Maintain the financial system's stability
4. Provide services to the government, to financial institutions, and to the public

Another function of the Federal Reserve Act is the authorization of new banknotes. You might recognize these notes as the bills sitting in your wallet right now. They are officially known as Federal Reserve Notes. They are put into circulation by the different regional Federal Reserve banks.

If you look at that bill in your wallet, you will find the words: "This note is legal tender for all debts, public and private." The unique power of that note is that the Federal Reserve backs up its value with its own assets.

The Federal Reserve System

So, in order to take power away from the federal bank and give some to the private sector, the Federal Reserve Act created the Federal Reserve System (sometimes just known as “the Fed”). This system is composed of 12 member banks across the United States, each serving a different geographical area.

Regional Banks

These regional Reserve Banks have boards of directors made up of local citizens. The great compromise is that these banks represent both the people and the private sector of banking, while the Board of Governors represents the federal government side.

The President of the United States nominates seven people to serve on the Board of Governors for 14-year terms, and the Senate confirms the president’s nominations. Additionally, the president appoints a chairman and vice-chairman of the board from the seven nominees.

The job of the Board of Governors is to set the discount rate and the reserve requirement for member banks. Additionally, the board forms a proper part of the 12-member Federal Open Market Committee (FOMC). The remaining five members of the FOMC are appointed from the 12 Federal Reserve banks. The FOMC is in charge of the Fed’s open-market operations, such as the purchase and sale of government securities.

Any bank may become a member of the Federal Reserve System, and **all federal banks are required to become members**. By becoming a member of the system, a bank has the benefit of borrowing money from the Fed. In exchange for this benefit, member banks must abide by the Fed’s regulations and requirements.

Congress established maximum employment and price stability as the macroeconomic objectives for the Federal Reserve; they are sometimes referred to as the Federal Reserve's dual mandate. Apart from these overarching objectives, Congress determined that operational conduct of monetary policy should be free from political influence. As a result, the Federal Reserve is an independent agency of the federal government.

Policy Tools

The Federal Reserve uses a variety of policy tools to foster its statutory objectives of maximum employment and price stability. **One of its main policy tools is the target for the federal funds rate (the rate that banks charge each other for short-term loans), a key short-term interest rate.**

The Federal Reserve's control over the federal funds rate gives it the ability to influence the general level of short-term market interest rates. By adjusting the level of short-term interest rates in response to changes in the economic outlook, the Federal Reserve can influence longer-term interest rates and key asset prices. These changes in financial conditions then affect the spending decisions of households and businesses.

Key Terms

Federal Reserve

centralized United States bank created to conduct monetary policy and stabilize the U.S. economy

Federal Reserve Act

the 1913 act that created the Federal Reserve

legal tender

United States coins and currency good for all debts, public charges, taxes, and dues

monetary policy

refers to the actions of central banks to achieve big, macroeconomic policy objectives

Instruments of Credit Policy

Chapter Objectives **Explain how the Federal Open Market Committee (FOMC) oversees the federal government's open market operations | Summarize how open market operations can raise or lower interest rates | Identify the Fed's three instruments for implementing monetary policy**

Federal Open Market Committee

The top monetary policy-making body for the Federal Reserve is the Federal Open Market Committee (FOMC). The Federal Reserve is able to manipulate the interest rate through the use of open market operations.

If the federal interest rate needs to be raised, then the Federal Reserve will decrease the money supply by taking away surplus liquidity from commercial banks. If the interest rate needs to be lowered, they will increase the money supply by giving commercial banks liquidity. Liquidity describes cash or assets that can be converted to cash quickly.

The Three Instruments of Monetary Policy

The Fed's three instruments for implementing its monetary policy by influencing the money supply are:

1. **The discount rate**: The discount rate is the interest rate at which the Fed lends money to its member banks. The Fed can influence the market by raising or lowering the discount rate. When the discount is raised, banks that borrow money end up paying more for it. This makes financial institutions less willing to lend, as it costs them more money to do so.
2. **The reserve requirement:** Changing the reserve requirement is another method the Fed uses to influence the market. The Fed has the authority to require all depository institutions (not just member banks) to keep a certain percentage of their funds in the regional Reserve bank. When the reserve requirement is high, banks literally have less money to lend. This shifts the demand curve for real estate, causing prices to drop and sales to fall off. Similarly, when the requirement is low, banks have more money to lend. This causes increases in the demand for real estate, the prices of homes, and the number of sales.
3. **Open-market operations:** The Federal Open Market Committee (FOMC) is in charge of the Fed's principal tool — open-market operations. These **operations consist of buying government securities**, either from the U.S. Treasury or from other federal agencies, and selling them. **A security is a debt instrument, such as a mortgage loan, that is held as evidence of a debt to be repaid with interest.** The U.S. Treasury sells securities when it needs to acquire funds to finance government activities or to repay other securities. Most of the Fed's securities holdings are issued by the U.S. Treasury: About half of them are Treasury bills (T-bills), and the other half are Treasury notes and bonds.

Securities

The Fed typically has one of two goals in mind when buying and selling securities:

1. Reach a targeted amount of reserve balances held at the Reserve
2. Reach a targeted federal funds rate

In connection with the reserve requirement, banks have accounts with the Fed in which they keep their required reserves.

Key Terms

discount rate

the interest rate at which the Fed lends money to its member banks

Federal Open Market Committee (FOMC)

the Federal Reserve's policy-making body charged with overseeing the federal government’s open market operations

open market operations

adjustments to the supply of money implemented by the Federal Reserve to influence the interest rate

reserve requirement

requirement that all depository institutions (not just member banks) keep a certain percentage of their funds in the regional Reserve bank

security

any financial asset that can be traded, including futures, stocks, mortgage loans, and options

The U.S. Treasury and the U.S. Mint

Chapter Objectives **Explain the role of the U.S. Treasury in the economy** | **Describe the different bureaus under the Treasury Department, including the U.S. Mint**

The United States Treasury

In 1789, Congress established the **United States Department of the Treasury** to manage the government's revenue. The first Secretary of the Treasury was none other than Alexander Hamilton.

The purpose of the U.S. Treasury is to maintain a strong economy and create economic opportunities and job opportunities. The Treasury does this by promoting conditions enabling economic growth and stability, both at home and abroad, while working to strengthen national security by combating any financial threats. And by protecting the integrity of the financial system, the Treasury manages the U.S. Government's finances and resources effectively.

Steward for the U.S. Economy

The Treasury serves as the steward of U.S. economic and financial systems and as an influential participant in the world economy. Along with promoting economic prosperity and ensuring the financial security of the United States, activities such as advising the President on financial situations and encouraging economic growth are also part of the responsibility of the Treasury Department.

Functions of the Treasury Department

The Treasury Department maintains systems that are critical to the nation's financial infrastructure, such as:

- Borrowing the necessary funds to run the federal government
- Collecting revenue
- Producing coins and currency

Money Laundering

A big responsibility of the Department is the investigation and prosecution of financial criminals.

Through the **Office of Terrorism and Financial Intelligence (TFI)**, the Treasury tracks crimes such as money laundering.

Money laundering generally refers to financial transactions in which criminals, including terrorist organizations, attempt to disguise the proceeds, sources, or nature of their illicit activities by funneling the money through otherwise legitimate business transactions. Money laundering facilitates a broad range of serious underlying criminal offenses and ultimately threatens the integrity of the financial system.

Shell Companies

One common way that money is laundered is through real estate transactions through the use of shell companies.

These are companies that aren't really companies, insofar as they don't have any real operations. They are in and of themselves perfectly legal and they can exist as vehicles for business transactions, like transferring assets from one company to another or maybe just holding assets.

They are often used to obscure the identity of or limit the liability of the true owner/owners of real property. Some shell companies are used to anonymously purchase high-end luxury real estate.

Troubled Asset Relief Program (TARP)

In 2008, the future of the American economy wasn't looking super bright. As a reaction to the economic downturn, the Troubled Asset Relief Program (TARP) was created.

Here's a little more on the two programs that came to the assistance of stressed homeowners through TARP.

- **Making Home Affordable® (MHA):** The Making Home Affordable Program® (MHA) **provided mortgage relief to homeowners to prevent avoidable foreclosures.** This included the Home Affordable Modification Program (HAMP), which permanently reduced mortgage payments to affordable levels for qualifying borrowers. MHA expanded to include a number of other specialized programs. MHA helped over 1.8 million families obtain mortgage relief and avoid foreclosure. MHA expired in December 2016.
- **Hardest Hit Fund® (HHF):** The Hardest Hit Fund® was **created to provide targeted aid to families in states hit hard by the economic and housing market downturn**. The participating states were chosen either because they are struggling with unemployment rates at or above the national average or steep home price declines greater than 20% since the housing market downturn.

The Internal Revenue Service

Another bureau of the Treasury Department is the Internal Revenue Service (IRS). The IRS is the largest of the Treasury bureaus. **The responsibility of the IRS is to collect taxes and administer the Internal Revenue Code (the United States tax law).** The IRS also oversees many government benefit programs.

The United States Mint

The primary mission of the U.S. Mint, a unit of the U.S. Treasury Department, is to serve the American people by **manufacturing, distributing, and circulating precious metal, collectible coins, and national medals, as well as providing asset security**.

Key Terms

money laundering

financial transactions in which criminals, including terrorist organizations, attempt to disguise the proceeds, sources, or nature of their illicit activities by funneling the money through otherwise legitimate business transactions

shell companies

companies that don't have any real operation, but exist as vehicles for business transactions

The Federal Deposit Insurance Corporation

Chapter Objectives **Recognize the historical economic situation that led to the creation of the Federal Deposit Insurance Corporation (FDIC) | Summarize the significance of the Glass-Steagall Act and the Dodd-Frank Reforms in banking**

Bank of Failures

In 1893 and 1907, the United States experienced a couple of scary financial panics. During these scares, the stock market fell by almost 50%, and people sprinted to their banks to withdraw their money (known as a bank run).

When a large number of people withdraw their money from a bank at the same time, it tends to create an even bigger panic, resulting in even more withdrawals. This chain of events could cause banks to become insolvent almost instantly. During this era, more than one-third of all U.S. banks failed.

1933 Banking Act

Immediately after his inauguration, President Franklin D. Roosevelt called a special session of congress and declared a four-day banking holiday. And during this “holiday,” **Roosevelt signed the 1933 Banking Act (sometimes known as the Emergency Banking Act of 1933). With this act, Roosevelt hoped that the banks would reopen with a renewed confidence.**

Federal Deposit Insurance Corporation (FDIC)

The most notable feature of the 1933 Banking Act was the creation of the Federal Deposit Insurance Corporation (FDIC).

The FDIC started insuring deposits in January 1934 for up to $2,500 (the insurance limit has historically been raised over time) and since then, **no depositor has ever lost insured funds as result of bank failure**.

The FDIC is responsible for promoting public confidence in the U.S. financial system. Insuring consumer deposits has helped tremendously in limiting the effect on the economy when a bank or other institution fails.

Insurer of Deposits

The Federal Deposit Insurance Corporation insures all types of deposits — certificate of deposit (CDs), checking, savings, money market, and NOW accounts (checking accounts where you can earn interest on deposited money) — held in all FDIC-insured depository institutions, including national banks and federal savings associations.

The present insured amount is $250,000, per depositor, per insured depository institution for each account ownership category.

FDIC Funding

The FDIC is funded by premiums that banks and thrift institutions pay for deposit insurance coverage and from earnings on investments in U.S. Treasury securities. **They receive no funding from Congress.** The FDIC insures approximately $9 trillion of deposits in U.S. banks and thrifts — deposits in virtually every bank and thrift in the country.

FDIC Responsibilities:

- Directly examines and supervises more than 4,500 banks and savings banks for operational safety and soundness.
- Examines banks for compliance with consumer protection laws, including, but not limited to: the Fair Credit Billing Act, the Fair Credit Reporting Act, the Truth-In-Lending Act, and the Fair Debt Collection Practices Act. The FDIC also examines banks for compliance with the Community Reinvestment Act (CRA), which requires banks to help meet the credit needs of the communities they were chartered to serve.
- Responds immediately when a bank or thrift institution fails.

FDIC Policy Standards

The FDIC created a number of policy standards outlined for lending companies, but not an entire policy that should be followed by all. Each lender should factor things such as company size, number of lenders, location, etc., into the creation of their policies in adherence to the FDIC.

The Glass-Steagall Act

The Glass-Steagall Act accomplished sought to **separate the activities and goals of investment banks from those of commercial Federal Reserve banks.** It prohibited the riskier, more speculative investment banks from opening consumer deposit accounts, and it prevented commercial Federal Reserve members banks (that did take deposits) from:

- Dealing in non-governmental securities for customers
- Investing in non-investment grade securities for themselves
- Underwriting or distributing non-governmental securities
- Affiliating (or sharing employees) with companies involved in such activities

The law proved to be fairly controversial over time. Government bodies increasingly began interpreting the law more and more liberally and commercial banks and investment banks began affiliating again in murky ways. **Eventually, in 1999, the law was repealed.**

Some argue that the repeal of the Glass-Steagall Act helped lead to the housing bubble and financial crisis. Others argue that the practices that led to the crisis were not prohibited by Glass-Steagall and that, in fact, the law had already been dying for decades.

Dodd-Frank Wall Street Reform and Consumer Protection Act

After the housing bubble and financial crisis, a series of financial reforms was passed known as the Dodd-Frank Act. While it did not reinstate the Glass-Steagall Act, it created the most significant financial reforms to the American banking system since the post-Great Depression legislation.

Among the many far-reaching regulations the Act implemented, it gave the FDIC the power to liquidate more than just commercial and investment financial institutions with its insurance fund. This meant that the FDIC was granted the power to liquidate insurance companies and other non-bank financial institutions and thus protect consumers from more risk.

Key Terms

1933 Banking Act

a depression-era federal act that created the Federal Deposit Insurance Corporation

Dodd-Frank Act

created a new consumer watchdog to prevent mortgage companies and payday lenders from exploiting consumers

Federal Deposit Insurance Corporation (FDIC)

independent agency that provides deposit insurance to depositors in U.S. banks

Glass-Steagall Act

a part of the 1933 Banking Act; prevents investment banks from taking deposits and preventing commercial Federal Reserve members banks from various risky behaviors

The Federal Home Loan Bank System

Chapter Objectives **Explain the purpose and structure of the Federal Home Loan Bank System | Describe the community investment programs employed by the FHLBanks**

The Federal Home Loan Bank System

The Federal Home Loan Bank System is a system of regional banks from which local lenders borrow funds to finance housing, economic development, and jobs.

Federal Home Loan Banks are member owned cooperatives. Banks, thrifts, credit unions, and insurance companies have the right to become members of the FHLBanks. Each member is a shareholder. Most lenders take advantage of being able to borrow money from their regional FHLB office at good terms.

The purpose of the Federal Home Loan Bank System is to **support residential mortgage lending and related community investment** through its member financial institutions. The System provides members with access to:

- Reliable, economical funding and technical assistance
- Special affordable housing programs

A History of The Federal Home Loan Bank System

The Federal Home Loan Bank Act of 1932 extended $125 million in credit to savings and loan institutions and created the Federal Home Loan Bank System with 11 regional banks.

In 1933, the Home Owners Loan Act gave savings and loans the ability to be chartered by the federal government, and the thrifts were given essential lending authority to offer emergency relief for homeowners who could refinance their home loan for 20 years. The terms of these new loans were revolutionary: **The first fixed-rated, amortized loan was created.** For the first time, borrowers received amortized loans with rates as low as 5% with an 80% loan-to-value ratio.

By 1936, one in every 10 homeowners received financing through this law. In the first two years of its enactment, one million loans totaling $3 billion were made. The amortized, fixed-rate loan is now the industry standard.

FHLB Affordable Housing Programs

The Federal Home Loan Bank System features two programs to support homeownership:

1. **Affordable Housing Program (AHP):** One of the most successful and valuable private sources of funding for the financing and building of affordable housing in the United States
2. **Community Investment Program (CIP):** A program operated by each FHLBank that offers below-market-rate loans to members for long-term financing for housing and economic development that benefits low- and moderate-income families and neighborhoods

Who Oversees and Funds The FHLB Programs?

Each FHLBank is independently owned and is governed by its own board of directors. The FHLBanks fund themselves principally by selling loans on the secondary market.

Key Terms

Community Investment Program (CIP)

a program operated by each FHLBank that offers below-market-rate loans to members for long-term financing for housing and economic development that benefits low- and moderate-income families and neighborhoods

Federal Home Loan Bank Act of 1932

an act that extended $125 million in credit to savings and loan institutions and created the Federal Home Loan Bank System, setting up the 12 regional banks

Information Resources

Chapter Objectives **Identify valuable resources for more information on government financial institutions**

The Federal Reserve

The Federal Reserve's website will give you recaps of their meetings with the Federal Open Market Committee as well as information regarding the people that make up the Board of Governors.

U.S. Treasury

The U.S. Treasury's website is an exhaustive resource center if you need help with policy information or small business programs.

Federal Reserve Regulations

Learn more about the Fair Credit Reporting Act at debt.org.

Learn more about the Home Mortgage Disclosure Act at the Federal Financial Institutions Examination Council's (FFIEC) website.

Federal Deposit Insurance Company (FDIC) information can be found at fdic.gov.

Federal Home Loan Bank (FHLB) information can be found at fhlb-of.com.

Other Resources

The Office of the Comptroller of Currency's website has a lot of information and resources for the financial sector.

04

Additional Government Influence

U.S. Department of Housing & Urban Development

Significant Federal Legislation

State and Local Programs

Agricultural Lending

Review of Loan Estimate

Review of Closing Disclosure

U.S. Department of Housing & Urban Development

Chapter Objectives **Explain the ways HUD and its major programs have shaped the industry and housing in general | Describe the details of the Fair Housing Act | Identify the primary way RESPA influences the home-buying process | Distinguish between public and subsidized housing programs**

HUD

HUD, or the Department of Housing and Urban Development was created in 1937 through the U.S. Housing Act and in 1965 was founded as a Cabinet department as part of the "Great Society" program of President Lyndon Johnson to help develop and carry out policies on housing and metropolises. **HUD's mission was "to increase homeownership, support community development, and increase access to affordable housing free from discrimination."**

HUD has many duties, one of which is the enforcement of the Fair Housing Act (Title VIII of the Civil Rights Act of 1968). HUD has a staff of administrative law judges to oversee cases it prosecutes involving violations of these acts. HUD has the authority to seek damages and levy fines, the limits of which are set by Congress.

Fair Housing Act (Title VIII of the Civil Rights Act of 1968)

The Fair Housing Act is a federal law that prohibits discrimination in housing based upon race, color, religion, or national origin, and was amended to include sex, disability, and familial status. It's intended to protect the buyer or renter from seller or landlord discrimination.

The Fair Housing Act also makes it illegal for anyone to:

- Threaten, coerce, intimidate, or interfere with anyone exercising a fair housing right or assisting others who exercise that right.
- Advertise or make any statement that indicates a limitation or preference based on a protected class. This prohibition against discriminatory advertising applies to single-family and owner-occupied housing that is otherwise exempt from the Fair Housing Act.

HUD Major Programs

HUD works to strengthen the housing market through a number of major programs:

- Federal Housing Administration (FHA)
- Community Development Block Grants
- HOME Investment Partnership Act
- Rental assistance
- Public or Subsidized Housing
- Fair Housing and Equal Opportunity
- Government National Mortgage Association, or Ginnie Mae

Real Estate Settlement Procedures Act (RESPA)

HUD was originally responsible for enforcing the Real Estate Settlement Procedures Act (RESPA). It is currently the responsibility of the Consumer Financial Protection Bureau (CFPB).

RESPA was passed by Congress in 1974 and was designed to protect potential homeowners and empower them to become more educated and aware consumers.

RESPA requires lenders to provide "good faith estimates" of closing and settlement costs to prospective borrowers. It also prohibits the practice of kickbacks.

Federal Housing Administration (FHA)

The Federal Housing Administration, or FHA, provides mortgage insurance on loans made by FHA-approved lenders throughout the United States. The administration insures mortgages on single family and multifamily homes (including manufactured homes and hospitals). It is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception.

In 1934, Congress created the Federal Housing Administration. It became a part of the HUD's Office of Housing in 1965.

FHA Mortgage Insurance

FHA loans are mortgages insured by the Federal Housing Administration. FHA mortgage insurance gives lenders protection against losses that can occur when homeowners default on their mortgage loans. This insurance encourages lenders to offer FHA loans at attractive interest rates and with less stringent and more flexible qualification requirements.

FHA is an insurer and not a lender.

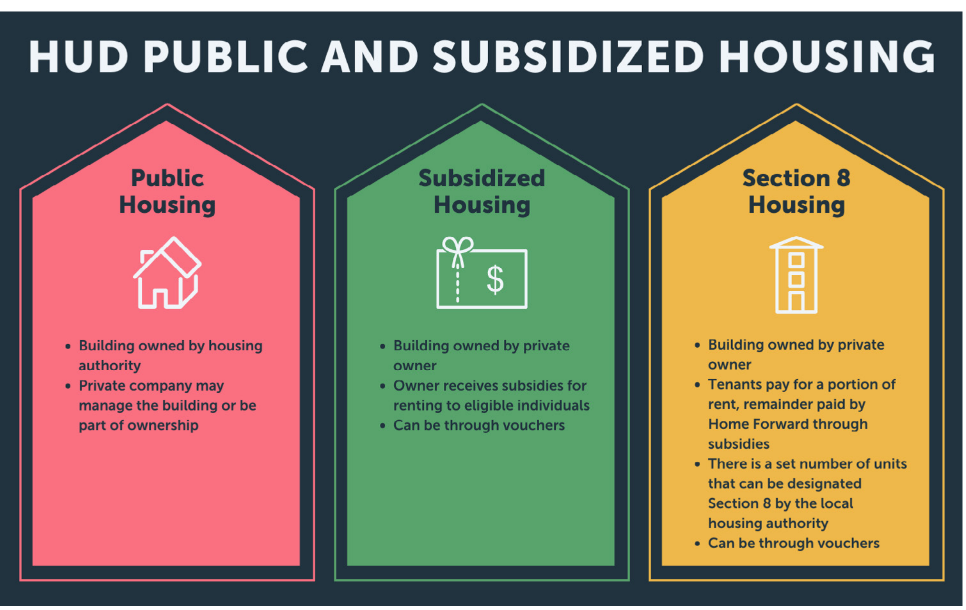
The Housing and Urban Development Act of 1970

The Housing and Urban Development Act of 1970 introduced the federal Experimental Housing Allowance Program (EHAP) and the Community Development Corporation, authorizing larger outlays for housing subsidy programs and rent supplements for moderate-income households.

In the 1970s, studies began to show that the biggest housing problem afflicting low-income families and individuals was no longer substandard housing, but instead the high percentage of income spent on housing. With this knowledge, Congress passed the **Housing and Community Development Act of 1974**, amending the Housing Act again to create the **Section 8 Program**.

Public Housing

In a public housing situation, the housing authority owns the resident's building and is the resident's landlord. A private company may manage the building for the housing authority or be part of the ownership, but the building is controlled by the housing authority.



Subsidized Housing

In subsidized housing, the housing authority is not the landlord. **The housing is owned and operated by private owners who get subsidies in exchange for renting to low- and moderate-income individuals and families.** Owners can be individual landlords or for-profit or nonprofit corporations.

Section 8 Housing

HUD manages Section 8 Housing, or a federally funded low-income housing program that **allows private landlords to rent apartments and homes at fair market rates to qualified low-income tenants, with a rental subsidy administered by Home Forward**.

Key Terms

Department of Housing and Urban Development (HUD)

a department in the federal government which is in charge of enforcing federal fair housing laws

Federal Housing Administration (FHA)

government agency charged with insuring mortgages

Ginnie Mae

a government-owned entity that supports the secondary mortgage market by guaranteeing mortgage-backed securities (MBSs) insured by the U.S. government

public housing

housing provided for people with low incomes, subsidized by public funds

Real Estate Settlement Procedures Act (RESPA)

legislation passed to eliminate kickbacks in lending and to disclose the costs of closing a loan

subsidized housing

government sponsored economic assistance programs aimed at alleviating housing costs and expenses for people with low to moderate incomes

Significant Federal Legislation

Chapter Objectives **Identify how the CRA addresses discrimination in lending | Understand how TILA promotes the informed use of consumer credit and identify the consequences for those who don't comply with its requirements | Describe what Regulations M and Z do to protect people who use consumer credit | Explain how the Dodd-Frank Act helped re-stabilize the financial status of the country | Identify what types of transactions the Foreign Investment Real Property Tax Act of 1980 (FIRTPA) affects**

The Community Reinvestment Act (CRA)

The **Community Reinvestment Act, or CRA** was enacted by Congress in 1977 with the intent to **address discrimination in loans made to individuals and businesses from low and moderate-income neighborhoods.**

The CRA makes all banking institutions that receive Federal Deposit Insurance Corporation insurance get proper evaluation from federal banking agencies in order to determine if the bank offers credit in all communities in which they are chartered to do business. The law emphasizes that an institution's CRA activities should be completed in a "safe and sound manner" and doesn't require institutions to make high-risk loans that may bring losses to the institution.

The CRA requires that each government-insured depository institution **act in good faith to meet the credit needs of its entire community**, and the good faith of the institutions covered under the CRA is evaluated periodically by federal agencies responsible for regulating financial institutions.

Some lending institutions limit the number of loans or the loan-to-value ratio in certain areas of a community or city. This is called **redlining**. If an institution practices redlining because of an individual or group's membership in a protected class, it violates both the federal Fair Housing Act and the Community Reinvestment Act.

Truth in Lending Act (TILA)

The **Truth in Lending Act of 1968**, also known as **TILA**, is a **federal law designed to promote the informed use of consumer credit**. TILA requires consumer credit disclosures about terms and cost in order to standardize the manner in which costs associated with borrowing are calculated and disclosed.

TILA does many things, including:

- Gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling
- Regulates certain credit card practices
- Provides fair and timely resolution of credit billing disputes

TILA introduced the **Annual Percentage Rate, or APR**, calculation mandated for all consumer lenders. (APR refers to the annual rate charged for borrowing or earned through an investment and is expressed as a percentage representing the actual yearly cost of funds over the term of a loan.) Doing so barred the old pattern of misleading interest rate calculations (used mainly on auto loans).

What TILA Covers

Each of the following loans is covered by TILA if the loan is to be repaid in more than four installments or if a finance charge is made:

- Real estate loans
- Loans for personal, family, or household purposes
- Consumer loans for $25,000 or less

TILA does NOT cover business loans.

In addition to setting up a more uniform system for disclosures, TILA makes sure to:

- Protect consumers against inaccurate and unfair credit billing and credit card practices
- Provide consumers with rescission rights
- Provide for rate caps on certain dwelling-secured loans
- Impose limitations on home equity lines of credit and certain closed-end home mortgages

TILA's Regulations

TILA is designed to help consumers compare the costs of credit from different lenders with one another and with the cost of buying with cash and to protect consumers from unfair and inaccurate credit practices. The act has **two principal regulations**, referred to as **Regulation M** and **Regulation Z**.

Regulation M

Regulation M applies to leased property. Regulation M implements the Consumer Leasing Act, which applies to everyone who regularly leases, offers to lease, or arranges for the lease of personal property under a consumer lease.

Regulation M is designed to provide consumers with meaningful disclosures that enable them to compare terms for a certain lease with those for other leases. It also, when appropriate, allows them to compare lease terms with those for credit transactions.

Regulation Z

Regulation Z protects people when they use consumer credit.

Regulation Z bans practices concerning payments made to compensate mortgage brokers and other loan originators. **The goal of Regulation Z is to protect consumers in the mortgage market from unfair practices and wrongdoings.**

Regulation Z applies to credit transactions where credit is:

- Extended to consumers
- Offered on a regular basis (For instance, Ms. A offering her friend Ms. B a loan doesn't fall under Regulation Z, but a car dealership that offered consumer financing on a regular basis would.)
- Either subject to a finance charge, such as an interest rate or financing fees, or is to be paid in four or more installments
- To be used for personal, family, or household purposes (that is, not for business, commercial, or agricultural purposes)
- A closed-end transaction (that is, any line of credit that is not open-ended or revolving)

Real Estate Settlement Procedures Act (RESPA)

The **Real Estate Settlement Procedures Act, or RESPA**, was enacted by HUD in 1974. RESPA is a statute focused on **consumer protection**.

RESPA aims to educate consumers about closing and settlement services and to provide information that helps consumers be informed judges of these services' proper cost. Its intent is to eliminate questionable fees that are unnecessarily tacked-on and can increase the cost of closing and settlement services.

Loans Covered by RESPA

RESPA applies to most loans that are secured by a mortgage lien placed **on a one- to four-family residential property**. So, people's family homes that they buy with a mortgage.

These loans include:

- Purchase loans
- Assumptions
- Property improvement loans
- Refinancing loans and equity lines of credit (generally)

Within three days of receiving a loan application, the lender must provide the applicant with the following material:

- **A booklet entitled "Settlement Costs and You,"** published by HUD, concerning settlement services
- **A truth-in-lending statement**, indicating the total credit costs and the annual percentage rate (APR) of the loan, which may differ from the initial rate a borrower will pay on the loan
- **A good-faith estimate of settlement costs**, detailing the expected costs of closing and indicating which settlement services are mandated by the lender

RESPA Prohibitions

These regulations apply to transactions involving the purchase of a one-to-four family home:

- No party (such as a seller, lender, or servicer) may give or accept a fee or anything else of value for the referral of a closing service.
- No party may charge a fee for a service that is not actually performed, nor may it split an earned fee with another party that has not performed or helped to perform the service for which the fee was charged.
- The seller may not require as a condition of sale that the borrower use a specific title insurance company.
- RESPA limits the amount of money a lender can keep in an escrow account for the payment of taxes and insurance.

RESPA explicitly "prohibits anyone from giving or accepting a fee, kickback, or anything of value in exchange for referrals of settlement service business involving a federally related mortgage loan."

This means, for example, that license holders cannot accept payment of any sort for referring clients to a bank. License holders who provide computerized loan origination services must also comply with RESPA regulations.

Violations of RESPA regulations can lead to serious penalties for both license holders and lending institutions' employees. Fines of up to $10,000 can be assessed, as can prison terms of up to a year.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

In July 2010, **The Dodd-Frank Wall Street Reform and Consumer Protection Act** was enacted, a sizable piece of financial reform legislation named after sponsors U.S. Senator Christopher J. Dodd and U.S. Representative Barney Frank. The act was a huge Wall Street reform, and **provided common-sense protections, creating a new consumer watchdog to prevent mortgage companies and pay-day lenders from exploiting consumers. The main goal of Dodd-Frank was to protect people from unfair and abusive financial practices, and to make sure things like the financial crisis didn't happen again.**

Consumer Financial Protection Bureau (CFPB)

The Consumer Financial Protection Bureau (CFPB) was established by Dodd-Frank in order to **develop and enforce clear and consistent rules for the financial marketplace and hold financial firms to higher standards**.

The CFPB is responsible for supervising banks, credit unions, and other financial companies to enforce federal consumer financial laws. Let's review the events that led up to the CFPB's creation:

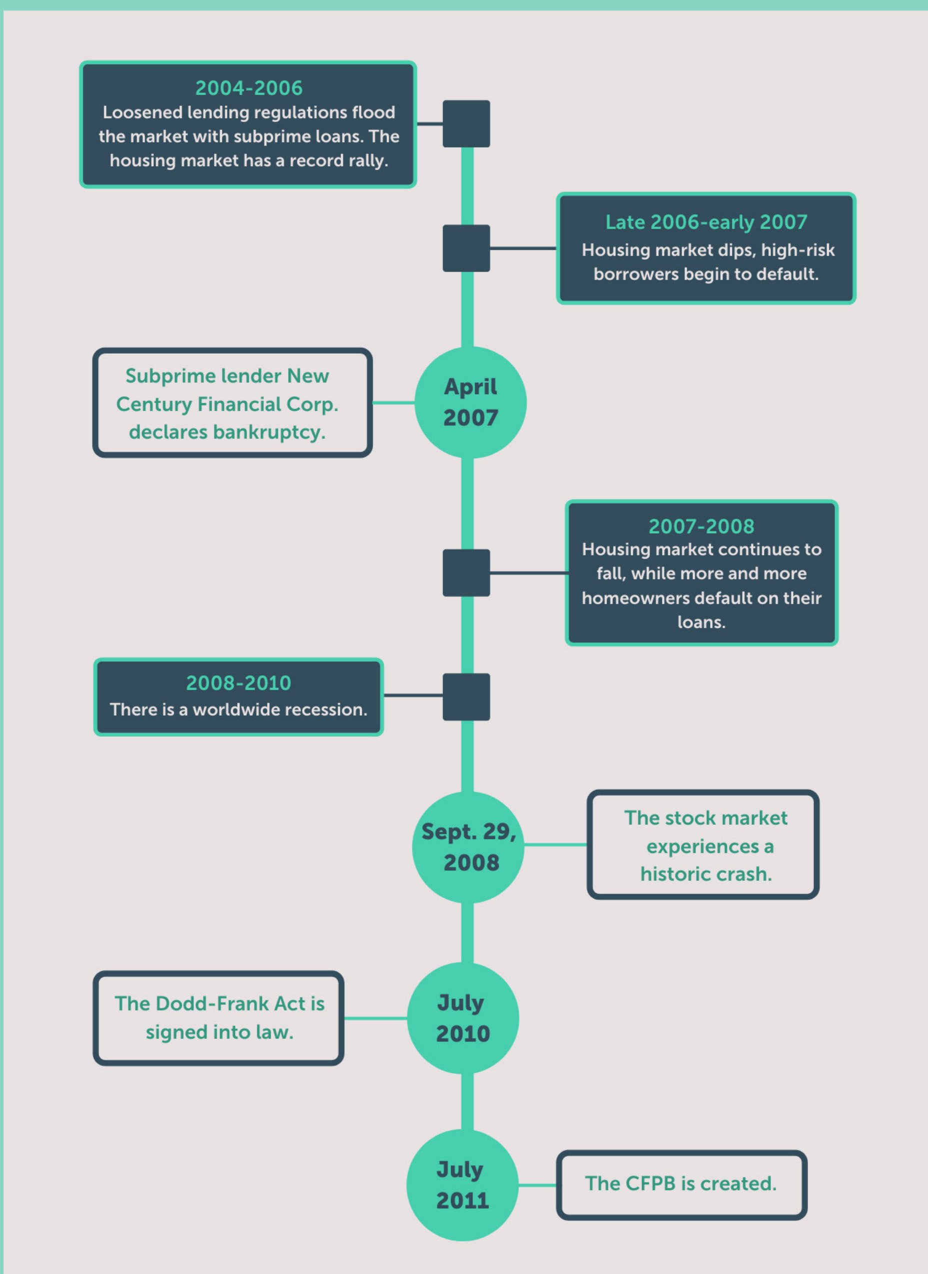
These are the **primary goals of the CFPB**:

- Create easier-to-use mortgage disclosure forms
- Improve consumer understanding
- Aid in comparison shopping for the borrower
- Prevent surprises at the closing table, aka "Know Before You Owe"

The Consumer Financial Protection Bureau exists to **protect borrowers from dishonest lending practices**.

This bureau can sometimes be confused with the Fair Housing Act, and although they are both public protectors, the CFPB does **not** field complaints from people about discrimination by lending companies.

SUBPRIME MORTGAGE CRISIS TIMELINE



Secure and Fair Enforcement for Mortgage Licensing Act

On July 30, 2008, the **Secure and Fair Enforcement for Mortgage Licensing Act of 2008, or SAFE Act**, was passed. **The primary purpose of the SAFE Act is to protect consumers and reduce fraud.** Mortgage loan originators who work for an insured depository or its owned or controlled subsidiary that is regulated by a federal banking agency, or for an institution regulated by the Farm Credit Administration are all registered. All other mortgage loan originators are licensed by the states.

Mortgage Assistance Relief Services (MARS)

Mortgage Assistance Relief Services, or MARS, is a Federal Trade Commission Rule that protects consumers from predators while they're in default on their mortgage.

Since homeowners facing foreclosure may find themselves desperate to hold on to their homes, some companies swoop in and claim they can help by negotiating new mortgage terms with lenders or servicers.

MARS makes it illegal to charge upfront fees and requires specific disclosures in ads and the same specificity when a lender's offer is forwarded to a homeowner.

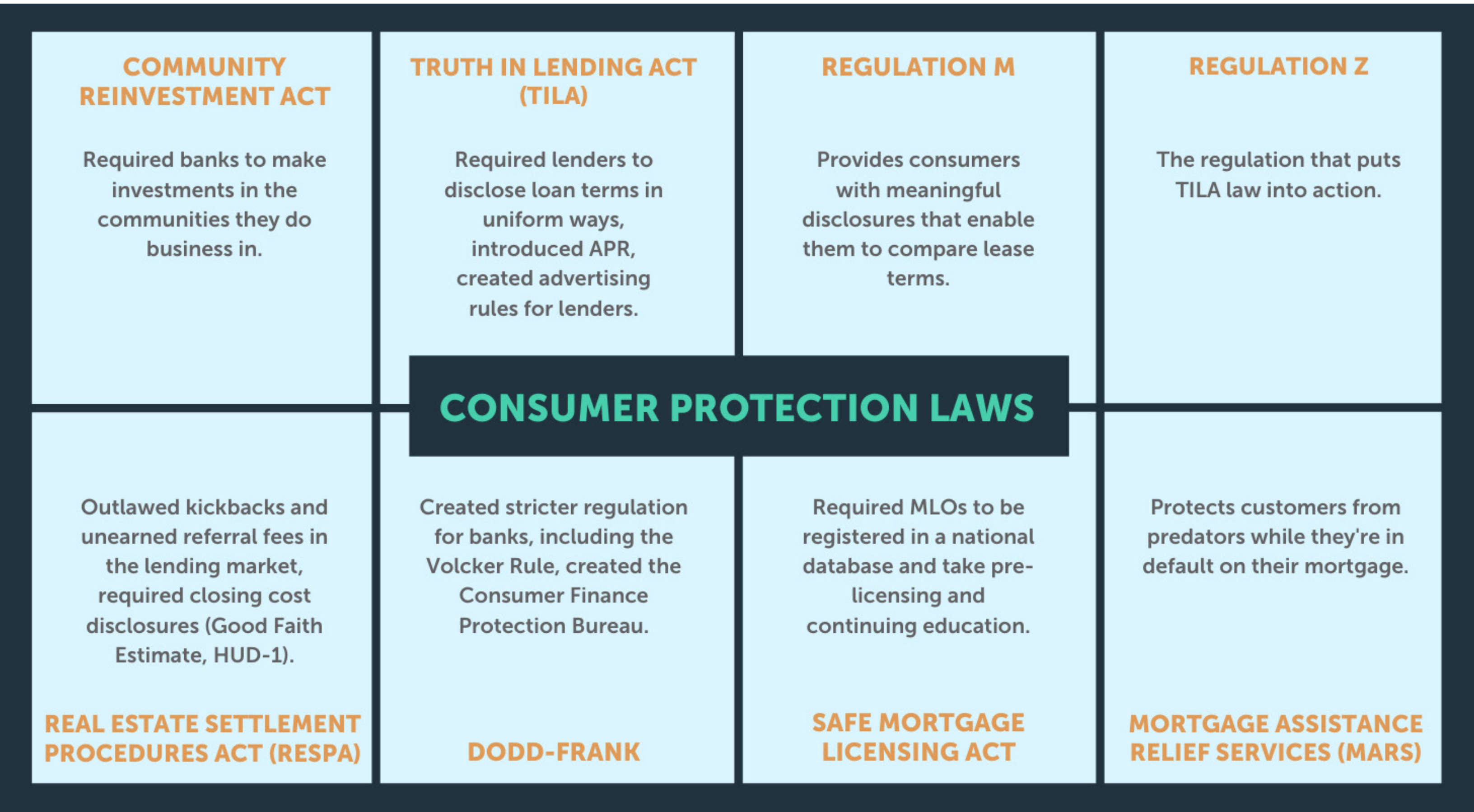
Foreign Investment in Real Property Tax Act

The **Foreign Investment in Real Property Tax Act of 1980, or FIRPTA** addresses real estate transactions by non-citizens.

If a seller is not a citizen, then the buyer (or their representative) must withhold 15% of the sale proceeds and send it to the IRS within 10 days of closing. A comprehensive purchase and sale agreement should include a paragraph that explains FIRPTA, to ensure that all parties are advised of their responsibilities in this regard.

Exceptions to the Foreign Investment in Real Property Tax Act

There are, however, exceptions to FIRPTA. One of the most common exceptions releases a transferee (or a purchaser or a buyer) from the obligation to withhold tax in cases in which the buyer purchases real estate for use as their home and the purchase price is not more than $300,000.



Key Terms

Administrative Procedure Act

governs the way administrative agencies of the federal government may propose and establish regulations

annual percentage rate (APR)

the ratio of the total cost of financing to the loan amount (not to be confused with the interest rate)

Community Reinvestment Act (CRA)

legislation that ensures depository institutions meet the credit needs of low- and moderate-income families

Consumer Financial Protection Bureau (CFPB)

an independent agency created under the Dodd-Frank Wall Street Reform Act to supervise financial companies, banks, and credit unions as well as enforce federal consumer financial laws

Dodd-Frank Act

created a new consumer watchdog to prevent mortgage companies and payday lenders from exploiting consumers

Internal Revenue Service (IRS)

the revenue service of the U.S. federal government

Mortgage Assistance Relief Services (MARS)

makes it illegal to charge upfront fees and requires specific disclosures in ads and when you forward a lender's offer to a homeowner

Regulation M

protects people when they use consumer leases, including by mandating certain notices and disclosures

Regulation Z

the part of the Truth in Lending Act (TILA) that seeks to protect consumers by requiring proper disclosures and fair lending practices

Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act

legislation passed in 2008 that gave states one year to pass legislation requiring the licensure of mortgage loan originators (MLOs) that met national standards and the participation of state agencies on the Nationwide Mortgage Licensing System and Registry (NMLS)

Truth in Lending Act (TILA)

legislation that educates and protects consumers against inaccurate and unfair credit billing and credit card practices by requiring lenders to standardize how costs associated with borrowing are calculated and disclosed

Volcker Rule

federal regulation prohibiting banks from conducting certain investment activities with their own accounts; also limits their ownership of and relationship with hedge funds and private equity funds (called covered funds)

State and Local Programs

Chapter Objectives **Explain the ways Housing Finance Agencies increase housing opportunities for low-income communities | List the many things TDHCA does to help the community, including the First Time Homebuyers' program | Identify what the Texas Mortgage Credit Certificate does | Guide a buyer client through finding a program for veterans**

Housing Finance Agencies (HFAs)

Housing Finance Agencies, or HFAs, are state-chartered entities designed to **increase housing opportunities for lower-income and underserved people through the financing, development, and preservation of affordable housing**.

HFAs operate in every state, the District of Columbia, Puerto Rico, and the Virgin Islands, and **in Texas, the department that serves as an HFA is called the Texas Department of Housing and Community Affairs**.

Texas Department of Housing and Community Affairs

The **Texas Department of Housing and Community Affairs, or TDHCA** is a state program that was **created to help Texans achieve an improved quality of life through the development of better communities**. TDHCA is concerned with housing and community development issues like:

- Economic development
- Infrastructure for rural communities
- Energy assistance
- Manufactured housing

First Time Homebuyers' Program

One program offered through TDHCA is the **First Time Homebuyers'** program. (A consumer is considered a first-time buyer if they haven't owned a home for a three-year time period.) **A first-time homebuyer program is essentially a way for first-time homebuyers to receive financial assistance when making their first investment in a new home.**

The umbrella of "first-time homebuyers" includes more than someone who has never owned a home. It also includes single parents and/or displaced homemakers, as well as those who, along with their spouse, have not owned a home in the past three years.

TDHCA SERVICES

ISSUE	PROGRAM OFFERED
Homebuyer Assistance	My First Texas Home
Rental Housing Development	Housing Tax Credit
Rent Payment Assistance	Section 8 Housing
Energy Efficiency	Comprehensive Energy Assistance Program
Home Repair and Development	Homeowner Rehabilitation Assistance

My First Texas Home Program

The **My First Texas Home** is one such program that assists low-to-moderate income homebuyers buy their first home. Through My First Texas Home, first-time buyers can sign up for mortgage loans with down payment and closing cost assistance, typically in the amount of 5% of the mortgage amount.

Texas Mortgage Credit Certificate Program

Another TDHCA program is the **Mortgage Credit Certificate, or MCC**, which offers tax credits for income tax purposes for multiple years.

The Texas Mortgage Credit Certificate Program was **created to help make ownership of new and existing homes more affordable for individuals and families in Texas of low and moderate income, especially first-time buyers**.

A **Mortgage Credit Certificate, or MCC,** allows a homebuyer to **claim a tax credit for some portion of the mortgage interest paid per year.** So basically, it is a dollar-for-dollar reduction against their federal tax liability.

Texas State Affordable Housing Corporation

Another important state organization in Texas is the **Texas State Affordable Housing Corporation, or TSAHC**. TSAHC programs **target housing needs of low-income families and other underserved populations in Texas who don't have acceptable housing options through conventional financial channels.**

TSAHC Home Buyer Programs

- **Homes for Texas Heroes Home Loan Program:** The **Homes for Texas Heroes Home Loan Program** provides homebuyer assistance specifically to teachers, police and correctional officers, firefighters and EMS personnel, and veterans.
- **Loans and Home Down Payment Assistance Programs:** TSAHC also provides low, fixed-rate mortgage loans and home down payment assistance grants to help qualified home buyers purchase a home. Benefits include:
    - A 30-year fixed interest rate mortgage loan
    - Down payment assistance % is based on the total mortgage loan amount
    - No upfront points or fees are taken out of the down payment assistance

Texas Veterans Eligible for Special Loan Program for Land

Texas veterans may be eligible for the **Texas Veterans Land Board, or VLB**, a loan program that offers Texas veterans the opportunity to buy land at below-market rates with low down payments. (VLB considers any veteran who is a resident of Texas a "Texas Veteran.")

With VLB, Texas veterans can buy one acre or more of land (with a maximum value of $125,000) with a 5% down payment on a 30-year, fixed rate mortgage. Additionally, the Land Board can finance homes with an application for a Texas Veterans loan at the time of purchase. The loan is made from a mortgage lender that is approved by Texas Veterans.

Key Terms

Housing Finance Agencies (HFA)

the many government agencies dedicated to providing fair housing standards and practices

Mortgage Credit Certificate (MCC)

a certificate issued by certain state or local governments that allows a taxpayer to claim a tax credit for some portion of the mortgage interest paid during a given tax year

Texas Department of Housing and Community Affairs (TDHCA)

responsible for homeownership, affordable rental housing, community and energy assistance programs and activities serving primarily low-income Texans

Texas Veterans Land Board (VLB)

finances land, home loans, and home improvement loans for Texas veterans and active military members who are eligible under VLB requirements

Agricultural Lending

Chapter Objectives **Describe how agricultural credit presents bankers with a unique set of risks** | **Identify the differences between agricultural lending and residential lending** | **Explain what the USDA does to meet the needs of farmers and ranchers** | **Explain eligibility for Section 502 Loans**

U.S. Department of Agriculture (USDA)

The United States Department of Agriculture, or USDA, is the federal executive department responsible for developing and executing laws concerning farming, agriculture, forestry, and food.

USDA Rural Housing Program

The USDA has a program called the **Rural Housing Program**. This program seeks to improve and build housing and community facilities in rural areas.

The USDA **Single Family Housing Programs** give direct loans or loan guarantees to help low- and moderate-income rural Americans buy safe and affordable housing in rural areas. USDA also offers loans and grants to help rural residents make health and safety repairs to homes.

Section 502 Loans

Section 502 Loans, commonly known as Single Family Housing Direct Home Loans, are loans that **help low- and very-low-income applicants get decent and safe housing in eligible rural areas by providing payment assistance to increase an applicant's repayment ability.**

(Payment assistance is a type of subsidy that reduces the mortgage payment for a short time. The amount of assistance given is determined by the adjusted family income.)

USDA Rural Development Guaranteed Housing Loan Program

The USDA's **Rural Development Guaranteed Housing Loan Program** is a program that **assists approved lenders with providing low- and moderate-income households with the opportunity to own safe and sanitary housing as their primary residence in eligible rural areas.**

Through the program, applicants can "build, rehabilitate, improve or relocate a dwelling in an eligible rural area." The program gives a 90% loan note guarantee to approved lenders to reduce the risk of extending 100% loans to eligible rural homebuyers.

Multi-Family Housing Program

The **Multi-Family Housing Programs** offer loans to provide affordable rental housing for very-low-, low- and moderate-income residents, the elderly, and persons with disabilities.

Funds can be used to buy and improve land or to provide necessary facilities like water and waste disposal systems.

The USDA also provides rental assistance to help eligible rural residents with their monthly rental costs.

USDA Farm Loans

Another department of the USDA is the Farm Service Agency, or FSA. This department serves farmers and ranchers who are unable to get credit to start, purchase, sustain, or expand a family farm. These FSA loans are temporary, but the goal is to get the farmer or rancher a start on building their own commercial credit.

Direct Farm Ownership Loans

The first type of USDA farm loan is the Farm Ownership loan. Like the name clearly suggests, this loan helps in purchasing a ranch or farm.

Key Terms

United States Department of Agriculture (USDA)

responsible for developing and executing federal laws related to farming, agriculture, forestry, and food

Review of Loan Estimate

Chapter Objectives Identify the updates to Know Before You Owe | Explain what two forms are replaced by the Loan Estimate form (Bye-bye TIL and GFE!) | Give a section-by-section tour of the Loan Estimate form

The Loan Estimate Form

The Loan Estimate form replaces the Truth in Lending and Good Faith Estimate forms. The Loan Estimate is a document that must be provided to the consumer within three business days after application. Below is a useful timeline to help you determine when it must be provided to the consumer.

Following is a link to a blank copy and walkthrough of the Loan Estimate form

Loan Estimate Form

Rate Lock

Some lenders will lock in the interest rate as part of issuing the Loan Estimate while others will not. If they do, this is where the lock "window" expiration date is published. If the lender isn't willing to lock in the rate, the buyer should find out why. Remember, you have a fiduciary responsibility to put your client's interest first — and that could mean looking at other lender options to get that rate locked.

Loan Terms

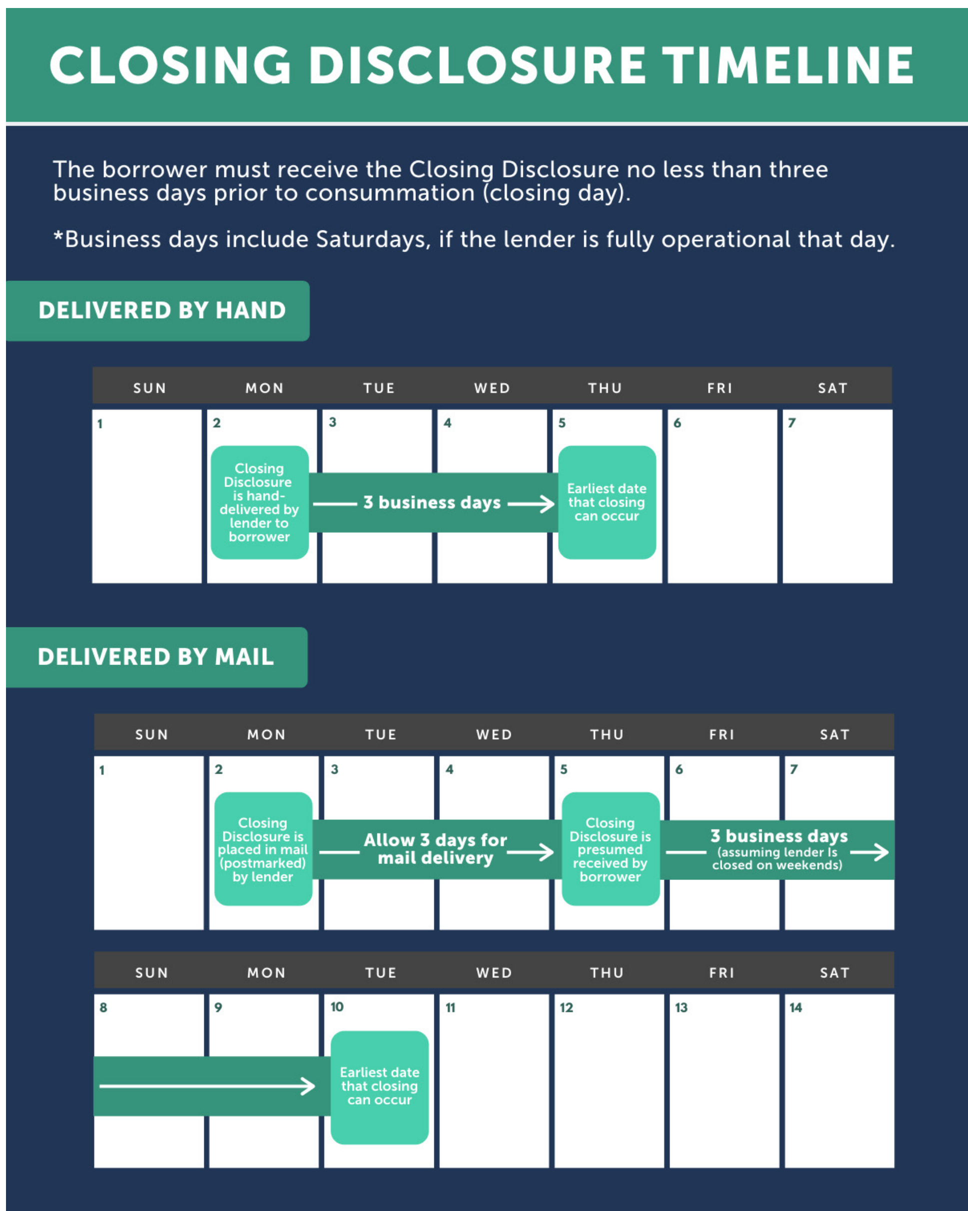
The **Loan Terms** section will outline the loan amount and interest rate, and will also give the total of the PI (Principle and Interest), and state whether there is prepayment penalty or balloon payment.

Projected Payments

The next section explains the applicant's projected payments. This part begins with a Payment Calculation for the first 1-7 years of the loan as well as years 8-30 for the costs of Principal and Interest, Mortgage Insurance, and Estimated Escrow. Payments can decrease once the individual is no longer required to pay private mortgage insurance.

This section also shows Estimated taxes, Insurance, and Assessments. In this subsection, it's determined if the estimate includes costs like Property Taxes and Homeowner's Insurance, as well as whether or not they are in escrow.

This section also states whether property taxes and homeowner insurance are escrowed or not. It is suggested to have taxes and insurance escrowed since the borrower will then not worry about paying these annual bills. Property Taxes in Texas are higher than other states. You want to prepare your client to try to save money for paying these annual bills. They may cost extra not to escrow.



Costs at Closing and Services

The next section of the form contains many subsections, beginning with **Costs at Closing.** It shows you totals for Estimated Closing Costs and Estimated Cash to Close and then breaks down the charges.

Closing Cost Details

Here's where things get really detailed. In Closing Cost Details, we have subsections: Loan Costs, Other Costs, and Calculating Cash to Close.

Loan Costs breaks down into:

1. Origination Charges
2. Services You Cannot Shop For
3. Services You Can Shop For (to reduce your costs)
4. Total Loan Costs (A+B+C)

Services You Cannot Shop For

The **Services You Cannot Shop For** section could include an appraisal fee, a credit report fee, and the tax status fee. There is a zero tolerance for extra fees paid to the creditor or to third party companies for services the consumer cannot shop for. This cost cannot increase from the Loan Estimate to the Closing Disclosure.

Services You Can Shop For

The **Services You Can Shop For** section includes fees that can include survey, inspection, and title fees.

As far as the title fees go, most of those fees are regulated, but the processing fee may differ. If the services the borrower shops for are from a list supplied by the lender, they may increase in total up to 10% from the estimate at closing. If the service providers are not chosen from the lender's list, these fees can increase without limits.

Calculating Cash to Close

This section gives the total of the closing cost and down payment. It will credit the deposit that will be placed in escrow at the execution of the loan. It could also include credit from the borrower, gift funds, grants, and lender credit.

The two items are brought to the bottom of the page that shows the Total Closing Cost and the total of the Estimated Cash to Close.

If the loan is an ARM, the bottom of the second page will contain a table to provide information about loans with adjustable payments or adjustable rates. This table is not present if the loan is a fixed-rate loan.

Comparisons

The Comparisons section shows how to compare this loan with other possible loans, specifically in the following terms:

- **In Five Years:** How much will the applicant have paid over a five year period, including principal, interest, mortgage insurance, and loan costs? How much will be paid off at this point?
- **APR:** This is not the interest rate, but rather the loan term expressed as a rate. This is the total amount of interest that will be paid over the loan term as a percentage of the loan amount.

Review of Closing Disclosure

Chapter Objectives Explain how the Closing Disclosure improves the closing process | Describe the Closing Disclosure step-by-step

The Closing Disclosure

The Closing Disclosure is a form that effectively replaces the Final TIL Disclosure and the HUD-1 Settlement Statement.

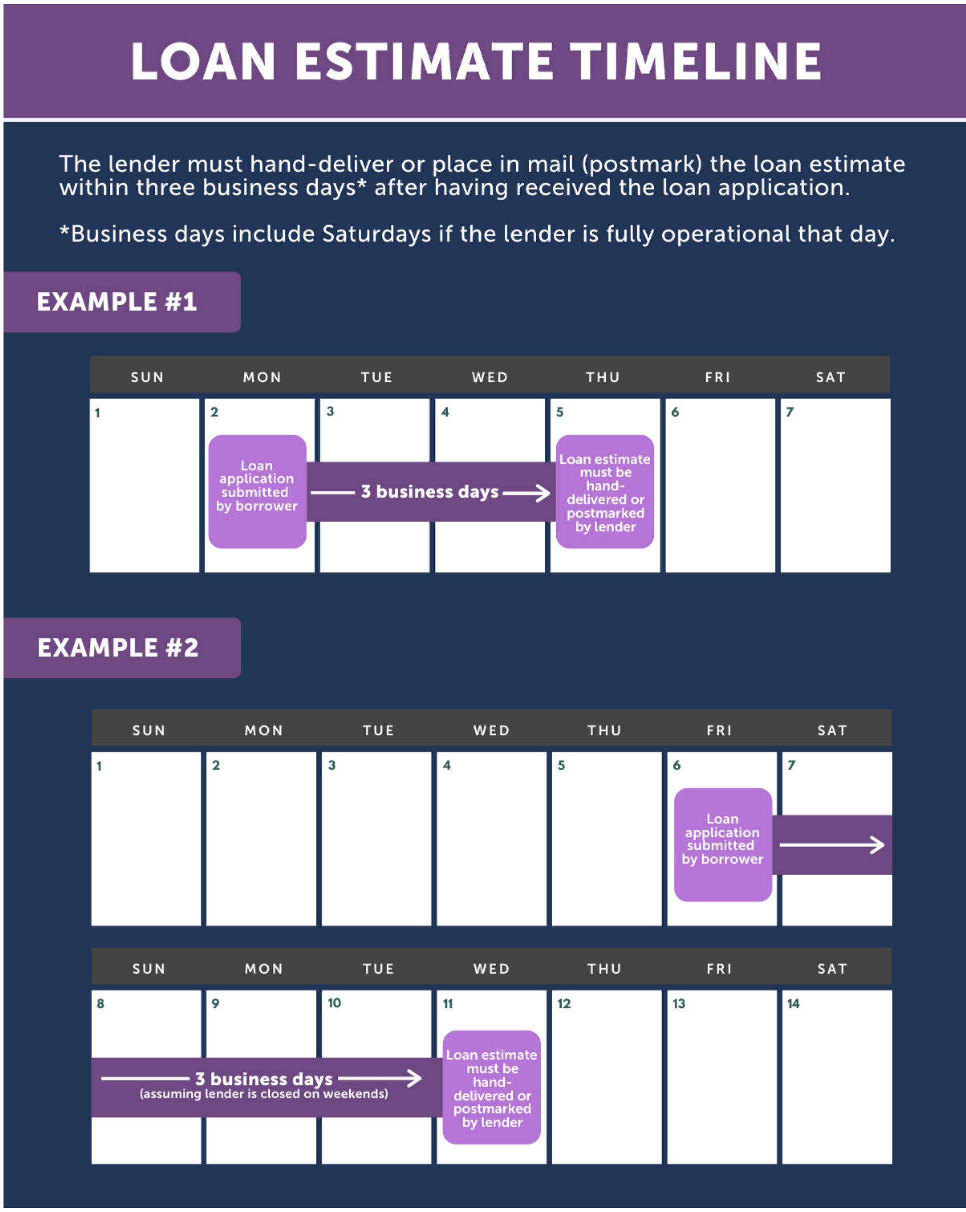
The Closing Disclosure makes it easy to see what you're being charged, what you'll owe each month and what your liability will be in the event of foreclosure. It tells you whether your lender will accept partial payments and whether your loan has a negative amortization feature that would increase the loan amount over time. In short, it makes it easier to see how much flexibility you have and to identify red flags like prepayment penalties and negative amortization.

The purpose of the Closing Disclosure form is to help consumers understand their loan options and to avoid costly surprises at the closing table. The Closing Disclosure is the document that both the seller and the buyer will sign at the closing table.

The document is then **prepared and filled in by either a title company representative or a real estate attorney**. The information on the document either comes from the contract or the loan documents sent to the title to prepare for closing.

When this document is prepared (depending on the lender), the agent may see it before closing. The CFPB requires that t**he buyer or seller gets three business days before the closing to review the Closure Disclosure**. All documents need to be sent to the title company in time for this review.

Here is a timeline that breaks down when you can expect it to be delivered and when closing can occur:



Key Terms

Closing Disclosure

a five-page form used to itemize services and fees charged to the borrower by the lender when applying for a real estate loan

escrow account

an account set up by a mortgage company for paying property taxes and insurance during the term of the mortgage

settlement statement

statement that summarizes all the fees and charges that both the homebuyer and seller face during the settlement process of a housing transaction

05

The Secondary Mortgage Market

Major Participants in the Secondary Market

The Government-Sponsored Enterprises

Real Estate Mortgage Investment Conduits (REMICs)

Major Participants in the Secondary Market

Chapter Objectives **Define the primary and secondary markets | Identify the major players in the secondary market | Explain how loans are originated**

Primary Mortgage Market

The mortgage market has a two-tiered structure:

1. **The primary mortgage market:** where lenders underwrite loans to borrowers seeking to purchase real property.
2. **The secondary mortgage market:** where the notes themselves are bought and sold.

Most home purchase loans are made by one of these types of primary lenders:

- Savings and loan associations
- Commercial banks
- Savings banks
- Mortgage bankers
- Credit unions
- Private lenders

Mortgage Loan Origination

Loans originate in the primary mortgage market.

Two common types of mortgage originators are mortgage bankers and mortgage brokers:

1. **Mortgage Bankers:** Mortgage bankers usually work for a financial institution and are able to loan the money of that institution.
2. **Mortgage Brokers:** Mortgage brokers have no money to lend. They bring lenders and borrowers together. (The mortgage broker usually does business with many lenders.)

History of the Secondary Mortgage Market

The secondary mortgage market came about as a byproduct of the Great Depression. Because of the economic devastation, many homeowners were having trouble making their mortgage payments, resulting in widespread foreclosure.

Because of this, Congress created a secondary market for mortgages, where the actual mortgages could be easily bought and sold. This is known as **mortgage liquidity**.

When a bank is able to sell the mortgages they make, they are able to take the money from the sale and originate more mortgages. **The secondary market makes mortgages more available to borrowers.**

The Major Players in the Secondary Mortgage Market

Fannie Mae

In 1938, the Federal National Mortgage Association (FNMA), also known as Fannie Mae, was created by the RFC. While continuing to support FHA and VA fixed-rate mortgages, Fannie Mae also began supporting assistance for lower-income housing, even though that didn't generate very much money for private investors. Then they began rolling out brand new, riskier mortgage options, such as longer-term loans with minimal borrower equity required.

Ginnie Mae

This was a lot for one entity to do, so the Government National Mortgage Association (GNMA), also known as Ginnie Mae, was created in 1968 as an offshoot of Fannie Mae.

Ginnie Mae took over Fannie Mae's part in the housing assistance and support programs under the Department of Housing and Urban Development (HUD), which is where Ginnie Mae's focus still is today.

Freddie Mac

Congress created the Federal Home Loan Mortgage Corporation (FHLMC), fondly known as Freddie Mac, as part of the Emergency Home Finance Act of 1970.

The focus for Freddie Mac was on conventional loans, even though they were still authorized to buy FHA and VA loans.

Secondary Mortgage Market

The secondary market helps to stabilize the primary market by replenishing the funds that primary lenders have lent out and keeps money circulating in the finance industry. The entire system is driven by the interest rates of these mortgages.

The secondary market is the place where mortgages are bought and sold.

The mortgages are created in the primary mortgage market, then the primary lender sells them off into the secondary mortgage market, where they are bought by investors. They can be government-backed entities, such as Fannie Mae and Freddie Mac, or they can be private investors.

FHA, VA, and conforming conventional loans are all eligible to be packaged and sold on the secondary mortgage market.

Non-conforming loans, like jumbo loans, are not eligible.

Conforming Guidelines

These conforming guidelines have a further benefit to the secondary market, in that they make loans easy to value and compare.

These guidelines are established by three agencies that are the chief operators in the secondary market:

- The Federal National Mortgage Association (FNMA or Fannie Mae)
- The Federal Home Loan Mortgage Company (FHLMC or Freddie Mac)
- The Government National Mortgage Association (GNMA or Ginnie Mae)

Secondary Mortgage Market Activities

The secondary market agencies have two main activities:

1. Buying loans
2. Issuing mortgage-backed securities

Mortgage-backed securities are investment instruments that have mortgages as collateral.

A secondary market agency creates mortgage-backed securities by buying a large number of mortgage loans, pooling them together, and pledging the pool as collateral for the securities.

The securities are sold to investors, who receive a return on their investment in the form of periodic payments (usually monthly) from the agency. Mortgage-backed securities can be easily traded.

The secondary market agency obtains the funds to make payments to the investors from the borrowers' repayment of the mortgage loans that back the securities.

Secondary Mortgage Market Participants

There's a lot that goes into getting a client a home mortgage, and a lot of folks who make it happen:

- **Mortgage originator:** Mortgage originators are either mortgage banks (who supply their own funds) or mortgage brokers (who do not supply their own funds).
- **Aggregator:** Aggregators are next level originators. Not only do they originate loans, but they also purchase newly-originated loans from smaller originators. Aggregators work with government-sponsored enterprises, such as Freddie Mac and Fannie Mae, and create mortgage pools that turn into mortgage-backed securities (MBSs).
- **Securities dealers:** They usually come in after the MBSs have been created because they buy the MBSs. The reason they do this is to sell these MBSs to investors, but in order to do this, they create asset-backed securities (ABS), collateralized debt obligation (CDO), and collateralized mortgage obligation (CMO). While CMOs are backed by mortgages, CDOs are backed by mortgages *plus other debts*.
- **Investors:** Investors include insurance companies, banks, pension funds, foreign governments, hedge funds, and government-sponsored enterprises. Investors choose investments based on their amount of risk and prepayment penalties.

Key Terms

primary mortgage market

market in which mortgages are first created by connecting lenders to borrowers

secondary mortgage market

market in which loans and servicing rights are sold to investors

The Government-Sponsored Enterprises

Chapter Objectives **Describe the role government-sponsored enterprises play in the secondary mortgage market | Differentiate between the major government-sponsored enterprises**

Government-Sponsored Enterprises

Government-sponsored enterprises (GSEs) are the major participants of the purchase and sale of mortgages in the secondary market. GSEs are a mix of **both public and private**. They are created by the government and exist for public use, but are privately owned.

They are accountable first and foremost to the stockholders and investors, not the government or the public.

Purpose of GSEs

The **GSEs provide liquidity** (the ready access of affordable funds) to the thousands of banks, savings and loans, credit unions, and mortgage companies that make loans in the primary mortgage market.

These government-sponsored enterprises were created by Congress to **limit the risk of capital losses to those investors supplying money for mortgage loans.**

GSEs also **help to keep interest rates low by increasing mortgage availability**, which is another primary reason for their creation.

GSEs act as **financial intermediaries** to assist lenders and borrowers in housing and agriculture.

Mortgage-Backed Securities

Two of the most prominent GSEs, Fannie Mae and Freddie Mac, purchase mortgages from lenders and package them into mortgage-backed securities (MBS) to sell to investors. These bundles of loans carry the financial backing of the GSEs that create them.

Selling a security means that what you're selling is backed by a *pool* of mortgages.

Underwriting Guidelines & Risk

Fannie Mae and Freddie Mac set the underwriting guidelines for the secondary market. If the mortgage pool (MBS) meets their underwriting guidelines (comprised of conforming loans), it may be sold with their backing.

Loans that do not fit Fannie Mae or Freddie Mac guidelines are called non-conforming loans.

Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac are both what is known as a government-sponsored enterprise (GSE), created by Congress to provide liquidity, stability, and affordability to the mortgage market. They are "sponsored" enterprises because, in spite of the fact that they were created by the government and operate under a government charter, they are publicly traded companies.

Today, the only significant difference between Fannie Mae and Freddie Mac is the size of the financial institutions from which they purchase their mortgage loan bundles. Fannie Mae deals with larger commercial banks whereas Freddie Mac works with the smaller "thrift" banks.

Guaranteed Securities

In the case of Fannie Mae and Freddie Mac, they do not necessarily own or sell the securities.

A lender can also bring a mortgage package to Fannie Mae/Freddie Mac and they exchange the guaranteed securities for the mortgages.

These guaranteed securities are attractive to investors for two reasons:

- First, they **cost less** than purchasing an entire loan and are more **easily liquidated**.
- Second, they are **guaranteed**. That is, the holder of the security receives the full payment from it, whether or not the borrowers of the mortgages held as collateral pay their loans in full.

For this guarantee, investors take slightly lower profits from the mortgages than if they held them themselves, through the payment of a guaranteed fee.

Ginnie Mae

In 1968, **Ginnie Mae** was created as a result of the same HUD Act that initiated the second reorganization of Fannie Mae.

Unlike Fannie Mae, Ginnie Mae was established as a **government-owned corporation within HUD** (and maintains that status to this day). **Because Ginnie Mae is government-owned, it is NOT considered a GSE.**

The Differences Between Ginnie, Fannie, and Freddie

Ginnie Mae deals exclusively with **FHA, VA, and other government-supported mortgage loans**.

Fannie Mae and Freddie Mac engage primarily in **conventional conforming mortgage loans**.

Freddie Mac and Fannie Mae's loans are guaranteed by Freddie Mac and Fannie Mae, but **Ginnie's loans are guaranteed by the U.S. government**.

Implicit Guarantee

There is an **"implicit guarantee"** that important institutions like Freddie Mac and Fannie Mae would not be allowed to fail or default on debt.

The subprime mortgage crisis tested this implicit guarantee. And the result was that the U.S. government had to bail out and put into conservatorship Fannie Mae and Freddie Mac in September 2008.

Conservatorship means that another entity took over control of these corporations to ensure they wouldn't go bankrupt. The government did this because if these entities collapsed, it would have had a hugely negative impact on the American economy.

Because of conservatorship, 90% of mortgages are still owned by the government.

Farmer Mac

Farmer Mac is a secondary market **for agricultural loans and not a direct lender**. Like Fannie Mae and Freddie Mac, Farmer Mac also buys and pools loans to create mortgage-backed securities. Farmer Mac guarantees these securities as well.

MAJOR PLAYERS IN THE SECONDARY MORTGAGE MARKET

	FANNIE MAE	FREDDIE MAC	GINNIE MAE	FARMER MAC
FORMAL NAME	Federal National Mortgage Association (FNMA)	Federal Home Loan Mortgage Corporation (FHLMC)	Government National Mortgage Association (GNMA)	Federal Agricultural Mortgage Corporation (FAMC)
TYPE OF ENTERPRISE	Government-sponsored enterprise	Government-sponsored enterprise	Government-owned enterprise	Government-sponsored enterprise
SPECIALIZATION	Buying loans from large, commercial banks	Purchasing loans from smaller "thrift banks"	Buying loans to help housing assistance and support programs	Making credit available for agricultural and rural loans

Key Terms

conservatorship

when one entity takes control over a corporation to ensure they don't go bankrupt

Government National Mortgage Association (Ginnie Mae)

a government-owned entity that supports the secondary mortgage market by guaranteeing mortgage-backed securities (MBSs) insured by the U.S. government

government-sponsored enterprises (GSEs)

the major participants of buying and selling mortgages in the secondary market; includes: Fannie Mae, Freddie Mac, Farmer Mac, and the Federal Home Loan Bank

mortgage-backed security (MBS)

a pool of mortgages packaged together and sold

non-conforming loans

a loan that does not follow Fannie Mae and Freddie Mac guidelines and thus will not be purchased by them on the secondary market

Real Estate Mortgage Investment Conduits (REMICs)

Chapter Objectives Define what a Real Estate Mortgage Investment Conduit is | Compare and contrast REMICs and CMOs

The Three Functions of a REMIC

1. **Hold Commercial and Residential Mortgages in Trust:** On the primary mortgage market, banks and credit unions give loans to approved homebuyers. Investment banks then buy these loans from lending banks (that is what they mean by holding them in trust).
2. **Assemble Mortgages into Pools:** After investment banks buy the loans from the banks and credit unions, they then assemble the loans into pools based on risk. These risk levels and classes are known as **tranches**, which comes from the French word for "slice" or "portion." The tranches of a REMIC are organized with different maturities, coupons, and priorities of payment — all of which allow the issuer of the REMIC to structure distinct bond classes for investors to choose from.
3. **Sell Securities to Investor:** From these assembled pools of loans, REMICs then sell securities to investors. The selling of securities on the secondary mortgage market both:
    - Allows investors to invest in the mortgage market and
    - Allows investment banks (and hence banks) to give more loans to potential homebuyers with money given to them by investors

REMICs vs. CMOs

Collateralized mortgage obligations (CMOs) are bundles or pools of mortgage-backed securities (MBS) created by government agencies or investment banks and issued as investment-grade bonds.

CMOs are a security, REMICs are an organization, a business entity. And that difference in structure results in very different tax benefits for REMICs.

Tax Reform Act and REMICs

The Tax Reform Act eliminated the double taxation of income earned at the corporate level of the insurer and the dividends paid to securities holders.

Why That's Important: This act made REMICs exempt from federal taxes. And while the dividends given to investors of REMICs are fully taxable, REMICs themselves are exempt from federal taxes. (Bye-bye double taxation.)

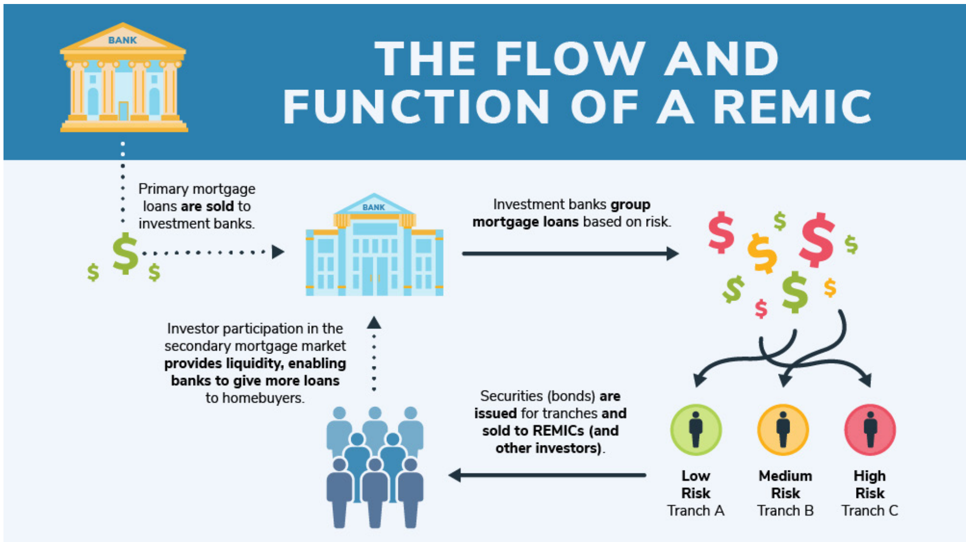
Because of this tax exemption status, most people on wall street prefer to create REMICs to sell mortgages (and not CMOs).

REMIC Guidelines

To be exempt from federal taxes, REMICs have to follow strict guidelines.

A REMIC may invest only in qualified mortgages and permitted investments such as:

- Single-family or multifamily mortgages
- Commercial mortgages
- Second mortgages
- Mortgage participations
- Federal agency pass-through securities



Key Terms

collateralized mortgage obligations (CMOs)

collateralized debt obligations (CDOs) made up of bundles or pools of mortgage-backed securities (MBS) that have been created by government agencies or investment banks and issued as investment-grade bonds

real estate mortgage investment conduit (REMIC)

an investment vehicle that holds commercial and residential mortgages in trust, assembles said mortgages into pools based on risk, and then issues bonds (securities) on these pools to sell to investors on the secondary mortgage market

06

Sources of Funds

Commercial Banks

Life Insurance Companies

Pension and Retirement Programs

Credit Unions

Mortgage Bankers & Brokers

Real Estate Trust (REIT, REMT)

Real Estate Bonds

Private Lenders

Foreign Lenders

Commercial Banks

Chapter Objectives **Name the functions and services performed by banks | Describe regulations banks must abide by | Determine banks' role in the primary mortgage market**

The Primary Mortgage Market

The primary mortgage market is the market in which mortgage lenders and borrowers come together to negotiate and create new mortgages. The various businesses that meet this consumer need for mortgages are called loan originators.

Savings and Loan Associations

Savings and loan associations, aka thrift lenders, were originally established by the government for the purpose of offering long-term, single-family home loans. In the past, most conventional mortgage lending was done by the savings and loan industry.

S&Ls: The Bailout

By 1989, the savings and loans industry was in such bad shape that Congress and President George H.W. Bush agreed on a bailout, a measure called the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). It cost $50 billion to close the failed banks and put an end to losses. The act also restored regulations to prevent future fraud and bad investments.

Resolution Trust Corporation (RTC)

Another function of FIRREA was the creation of the Resolution Trust Corporation (RTC), a new government agency. Duties of the Resolution Trust Corporation included:

- Reselling savings and loan assets
- Paying back the depositors with the proceeds

S&Ls: Today's Market

Today, S&Ls are much like commercial banks and offer a wide variety of financial services. However, S&Ls are chartered by the government and must meet the qualified thrift lender (QTL) test to retain that charter and receive benefits from the Federal Home Loan Bank System.

Commercial Banks

Commercial banks provide financial services to the general public and businesses. This ensures stability, both economic and social, and sustainable economic growth. Commercial banks accept deposits from their customers and the public. These deposits are returned when the customer requests it or after a certain time period has passed.

Commercial banks also provide secured and unsecured loans and advances to customers.

Secured vs. Unsecured Loans

A **secured loan** is a loan that has collateral. The collateral may be an automobile, a house, or something else of value. If the borrower defaults on the loan, the lender can take the collateral and sell it to recover their loss.

An **unsecured loan** is not connected to any particular asset. Unsecured loans include things like credit cards, overdraft protection, lines of credit, etc.

Bank Regulations

The government regulates aspects of bank activities with the stated goal of protecting consumers, taxpayers, and the stability of the industry itself.

- **The Glass-Steagall Act (passed in 1933):** separated investment and commercial banking activities in response to 1929 stock market crash, repealed in 1999
- **The Gramm-Leach-Biliey Act (passed in 1999):** allowed banks to offer a variety of services, including underwriting
- **The Dodd-Frank Act (passed in 2010):** created the Consumer Financial Protection Bureau (CFPB) and Financial Stability Oversight Council (FSOC)

Consumer Financial Protection Bureau (CFPB)

The primary goals of the CFPB are:

- Creating easier-to-use mortgage disclosure forms
- Improving consumer understanding
- Aiding in comparison shopping for borrowers
- Preventing surprises at the closing table, aka “Know Before You Owe”

Bank Reserves

Bank reserves, a.k.a. reserve accounts, are banks' holdings of deposits in accounts with their central bank (the Federal Reserve), plus the currency that is physically held in the bank's vault. Central banks may set minimum reserve requirements, meaning banks have to hold deposits at the central bank equivalent to at least a certain percentage of their liabilities.

Commercial Banks’ Place in the Industry

Commercial banks are the largest source of investment funds in the United States. They offer demand, time, and savings deposits. **Most of the mortgages created by commercial banks are sold to buyers on the secondary market.** Still, some mortgages may be kept as portfolio loans.

Key Terms

commercial banks

a type of depository institution designed to be safe depositories and lenders for a multitude of commercial banking activities

primary mortgage market

the arena in which borrowers and lenders meet up for the purposes of negotiating the loan terms of a mortgage transaction

savings and loan associations

originally established by the government for the purpose of offering long-term, single-family home loans, aka thrift lenders

secured loan

a loan tied to collateral that the lender can sell to compensate for their loss if the borrower defaults

unsecured loan

a loan that is not tied to an asset that serves as collateral

Life Insurance Companies

Chapter Objectives **Describe how insurance works and how premiums are invested | Explain insurance as a source of financing | Compare the benefits and risks of borrowing from life insurance**

How Insurance Works

Customers make payments (aka **premiums**) to an insurance company in exchange for a policy. The payments are usually made monthly or annually. The companies put those premiums to work by investing them.

The insurance company then has the responsibility to pay for specific, predetermined costs incurred by individuals, governments, or businesses as necessary.

Investing Insurance Premiums

The actual task of investing is handled by either an in-house team of experts (more common with large insurance companies) or contracted out to external investment professionals (more common with small insurance companies). For the most part, insurance companies invest in bonds. The two other types of assets are common stock and first-lien mortgages.

Life Insurance Investments

Life insurance companies have the challenge of investing customer payments to ensure they will have funds available to satisfy claims and withdrawals when customers make claims on or withdrawals from their policies. As a result, **many life insurers invest in a collection of long-term assets.**

Real Estate Holdings

Life insurance companies' three biggest holdings are stocks, bonds, and real estate. **The majority of their real estate exposure comes in the form of financing commercial, multifamily real estate investments.**

Corporate Bonds

The largest share of life insurer assets is comprised of corporate bonds. They invest in a variety of industries, with significant investments in industrial and manufacturing firms, financial firms, and real estate-related securities.

Borrowing Against Life Insurance

If you have a permanent life insurance policy, you can take out a loan against your life insurance to purchase real estate. Some buyers choose to use money from their life insurance policies for the down payment on a home.

Net Negative

Borrowers continue to accrue interest on their accounts, even against the borrowed amount. Depending on the policy, the blended interest being repaid may be lower than the loan interest for each individual loan. This may create a **net negative**, which is a condition in which the value of liabilities on the policy exceeds its asset value.

Primary and Secondary Mortgage Markets

Unlike other sources of funds, **life insurance companies participate in both the primary mortgage market AND the secondary mortgage market.**

Key Terms

net negative

a condition in which the value of liabilities on the policy exceeds its asset value

premiums

payments made to an insurance company in exchange for a policy

Pension and Retirement Programs

Chapter Objectives **Describe how pension and retirement programs work | Advise buyers who want to invest their own retirement savings in the real estate market**

Using Retirement Funds to Qualify for a Loan

Top credit officials at Freddie Mac, the giant federally controlled mortgage investment company, said that a "little known" policy revision now allows seniors and others to use certain retirement account balances to supplement their income for underwriting purposes — without actually tapping those balances or drawing down cash.

If a debt-ratio problem is preventing a senior from getting a new, low-interest-rate mortgage and they've got substantial untapped retirement funds, that might help qualify them on income.

Investing with Retirement Funds

Everyone's financial circumstances are different, and some people like the option of growing their retirement savings by investing in real estate. They can do this by using money that has already been placed in a self-directed retirement account.

A **self-directed IRA** is a retirement account that allows for alternative investments (like real estate) that traditional IRAs do not.

Pension and Retirement Programs

There are companies out there that collect money for seniors' retirement accounts and use those funds to invest in the real estate lending industry.

Many pension fund investment groups serve the dual purpose of supplying homebuyers with loan funds and also getting returns for the people who invest their retirement funds with that company.

Key Terms

holding cost

the investor's cost of owning a property for the time period before it is sold

self-directed IRA

a retirement account that allows for alternative investments (like real estate) that traditional IRAs do not

Credit Unions

Chapter Objectives **Compare and contrast credit unions and commercial banks** | **Describe the origin of credit unions** | **Evaluate the option of getting financing from a credit union**

Credit Unions

A credit union is a financial cooperative that is created to serve its members' needs, not for profit. Some other names for credit unions include cooperative banks, credit associations, and people's banks.

Credit Unions vs. Banks

Credit unions provide essentially the same services as banks. These services include:

- Checking and savings accounts
- Loans and home mortgages
- Online banking and bill payment

Key Differences

Despite offering the same services as banks, credit unions seek to differentiate themselves from banks by putting people and community before profits. Another difference between credit unions and banks is that credit unions grant ownership and membership (with voting rights) to their account holders. Members must apply to join a credit union, and there may be requirements on where members live or work.

Investing

Instead of giving a profit to shareholders, credit unions invest the members' money to gain more in interest than the individual members could by investing it on their own. The credit union may dip into that pool of money in order to give its members loans at a competitive interest rate. The rest (minus the reserves, of course) can be invested externally.

Depository Institutions

Banks, credit unions, and savings and loan associations (S&Ls) are all examples of **depository institutions**. They use money from their depositors to loan out for mortgages.

Retaining Loans

While credit unions do sometimes sell the loans they make on the secondary mortgage market, they are more likely than other lenders to hold the loans.

Key Terms

credit union

a not-for-profit, member-owned financial institution that provides many of the same services, including loans, as a commercial bank at low rates for their members

depository institutions

refers to organizations that extend mortgage loans from funds made available from that organization's consumer savings account desposits

Mortgage Bankers & Brokers

Chapter Objectives **Summarize what mortgage companies do | Differentiate between a mortgage banker and a mortgage broker**

Mortgage Bankers

Mortgage bankers receive money to fund mortgages from a variety of sources. Often it is borrowed from a warehouse lender or from one of the financial institutions that provide them with capital.

The money is then used to fund mortgages for their clients. **A mortgage banker's primary business is to earn the fees associated with loan origination.** Mortgage banks control the greatest share of the primary lending market.

Originate, Then Sell

After a mortgage is originated, a mortgage banker might service the mortgage or they might sell the servicing rights to another financial institution. A mortgage banker will probably sell the mortgage to an investor. It goes from the primary market to the secondary market *quickly*.

Mortgage Brokers

A mortgage broker is a licensed professional who originates mortgage loans that are financed by one of several lenders that broker works with.

Many mortgage brokers deal exclusively within the residential home loan process, so they are highly specialized and can be beneficial in several ways to potential buyers.

Broker or Banker?

Mortgage brokers don't fund loans. They simply bring lenders and borrowers together and are paid a commission for doing so.

Mortgage bankers, on the other hand, close mortgages in their own names, using their own funds.

MORTGAGE BANKER	MORTGAGE BROKER
• Can be a company or an individual • Originates mortgage loans using their own or borrowed funds • Earns fees associated with loan origination	• Licensed professional • Originates mortgage loans that are financed by lenders they work with • Brings lenders and borrowers together; doesn't fund loans

Mortgage Loan Originators

A mortgage loan originator is anyone who helps consumers get mortgage loans. They can specialize in either the commercial or residential (RMLO) market.

Licensure

MLOs must complete a 20-hour course to obtain a license. All MLOs must be licensed and registered in the national database.

Loan Officers

Loan officers are like mortgage loan originators in that they facilitate the mortgage loan process and often receive a commission for their services. The difference is that **loan officers are employed by one specific financial institution.** They usually specialize in commercial or residential loans, contacting potential clients to persuade them to apply for a loan from their sponsoring institution.

Key Terms

loan officer

people who facilitate the mortgage loan process and are employed by one specific financial institution (in contrast to mortgage brokers, who may work with many different lenders)

mortgage bankers

companies or individuals that originate mortgages, using their own or borrowed funds (as opposed to depositor funds)

mortgage brokers

companies or individuals operating as intermediaries to bring together mortgage borrowers and mortgage lenders; does not use its own funds to originate mortgages

mortgage loan originator (MLO)

a licensed professional that helps consumers get mortgage loans

Real Estate Trust (REIT, REMT)

Chapter Objectives Define and differentiate between REITs and REMTs | Describe the struggles of investing directly in real property and explain how REITs can be a good alternative | List tests that REITs must pass and rules they must follow | Define interest rates and ratios that are important to investors

What is a REIT?

A real estate investment trust (REIT) is a registered company that owns and operates commercial real estate. Investors can take advantage of the benefits of owning real estate, such as hedging against inflation, by buying and selling shares in REITs.

Types of REITs

There are three types of REITs:

- **Equity REITs**: trusts that hold income-producing properties
- **Mortgage REITs**: trusts that extend credit to the owners of real estate
- **Hybrid REITs**: a combination of both equity REITs and mortgage REITs

The Appeal and Benefits of REITs

Many investors like REITs because **they allow them to invest in real estate but avoid some of the hassles and risks involved with traditional real estate investment** (such as going out and buying a duplex to rent out to tenants).

REITs allow investors to mitigate some risk by spreading their ownership interest across all the properties the REIT owns.

What is a REMT?

A real estate mortgage trust (REMT) is a type of REIT that buys and sells real estate mortgages instead of real property. Real property is the house. The mortgage is the loan.

REMTs make income via origination fees, interest, and profits from buying and selling mortgages.

The Price-to-Earnings Ratio

A common method of predicting the price of a stock is the price-to-earnings ratio (P/E). The P/E tells an investor the expected return per dollar of stock purchased.

Returns and Type of REITs

A REIT that principally holds apartment complexes or mortgages might receive higher returns during a period of gradually increasing interest rates.

A REIT that principally holds malls and shopping centers might receive higher returns during a period of gradual inflation when a lot of money is being spent on retail goods.

Hybrid REITs might be more versatile investments, but they often have less opportunity of seeing large returns.

Key Terms

price-to-earnings ratio (P/E)

a metric that tells an investor the expected return per dollar of stock purchased

real estate investment trust (REIT)

a trust that invests in, owns, or acquires real property and is owned by investors who share the trust's profits according to shares

real estate mortgage trust (REMT)

a type of REIT that buys and sells real estate mortgages instead of real property

Real Estate Bonds

Chapter Objectives **Identify the pros and cons of real estate bonds** | **Describe how real estate bonds are created**

Real Estate Bonds

A real estate bond, or mortgage bond, is a bond that is secured by a mortgage or group of mortgages. This type of bond might be secured by personal property (like valuable equipment) in addition to real estate.

The bonds are backed with these valuables so that, in the event of the borrower defaulting, the bondholders can take the property. They may keep the property, or (more likely) sell it to get their investment funds back.

Mortgage-Backed Securities

Mortgage-backed securities are asset-backed securities that are secured (collateralized) by either a mortgage or a group of mortgages. **Real estate bonds are one type of mortgage-backed security (MBS)** sold in the secondary mortgage market.

A large percentage of newly originated mortgages are sold by their originators into this large and liquid market where they are packaged into MBS and sold to public and private investors. Such investors include Fannie Mae, Freddie Mac, pension funds, insurance companies, mutual funds, and hedge funds.

The Appeal of Real Estate Bonds

A lot of investors like real estate bonds because they are tied to a physical and valuable asset. They feel confident about investing in real estate bonds because the property securing the bond can be sold to compensate for a default if necessary. Relatively speaking, **bonds are a low-effort, low-risk way to invest.**

Lower Return for Lower Risk

Low risk often equals low rewards when it comes to investing. The rate of return on real estate bonds is usually smaller than it is for corporate bonds.

Key Terms

mortgage-backed securities

asset-backed securities, where the underlying asset is a single mortgage or a bundle of mortgages that serve to back the securities

real estate bond

a bond that is secured by a mortgage or group of mortgages; aka mortgage bond

Private Lenders

Chapter Objectives **Explain how buyers sometimes get financing from the seller of the home | Describe how private mortgages and gift funds are applied | Differentiate between hard money and soft money loans**

Seller Financing

Sellers have the option to provide all the financing for the person who is buying their home.

Seller Financing Rules

The process of seller financing can be an option if the home is **free and clear of liens and there is no mortgage on it.** The owner of the home can, in a sense, take the bank's place and finance the home for the buyer.

You cannot have a balloon note on this type of loan.

Down Payment Gifts

Some homebuyers receive the down payment amount (or a portion of it) as a gift from relatives. This is allowed no matter what type of loan the buyer is using, including conventional and government loans. However, there is a maximum amount set for gift funds, and that maximum may vary by loan type.

Gift Amount Limits

Please note that the IRS sets an annual gift tax exclusion limit for individuals and married couples. Donations above that amount must be reported to the IRS and will count towards lifetime gift tax exclusion amounts. (As always, refer clients to their tax advisor before taking any actions.)

Gift Rules & Requirements

Gifts are acceptable for primary residences (and sometimes second homes), but not investment properties. The way the gift funds are transferred is important. Buyers must receive the gift properly with thorough documentation of the source of the gift.

Hard Money Loans

Hard money loans are:

- Secured by real estate, not by good credit and the promise to pay them back
- Short term loans (usually one to five years)
- Provided by one or more private investors (not banks or credit unions)

Portfolio Lenders

Most lenders offer mortgages to homebuyers and then sell those mortgages to the secondary market.

Portfolio lenders, on the other hand, originate mortgages and then hold onto them and service them. They **seek to make their profits from the loan origination and interest payments**.

Portfolio loans are common for renovation loans. They may also be a good option when the buyer is blocked from traditional loans due to their strict, standardized guidelines. The **underwriting guidelines are different when the loan is staying in-house**.

Soft Money Loans

Soft money loans are most often obtained by investors who *just* miss the bank qualifications necessary for a more traditional loan.

The underwriting for soft money loans is done manually. The lenders in this process use bank statements, property cash flow, profit and loss forms, and/or tax returns to qualify borrowers.

LOANS PROVIDED BY PRIVATE LENDERS

Hard Money	Soft Money	Seller Financing
• Asset-based • Short-term • High interest rates and fees • Lenders are private investors	• Credit-based • Long-term • Low interest rates and fees • Lenders are banks	• Flexible requirements and terms • High interest rates and fees • Lender is private investor (seller) who earns interest

Key Terms

hard money loan

a type of asset-based loan financing through which a borrower receives funds secured by real property

Foreign Lenders

Chapter Objectives **Describe the scope of real estate purchases by foreign buyers and financing by foreign lenders**

Foreign Lenders

Sources of financing aren't limited to the United States. Lenders who are based in other countries have financed the purchase of all sorts of properties all over the U.S. According to a 2016 Forbes report, some of the most active foreign lenders are banks in Canada, China, Switzerland, and the United Kingdom. They tend to finance commercial real estate (offices, retail stores, and multi-family complexes) rather than single-family homes.

Tax Incentives

There are a few reasons why foreign lenders may want to provide their services in the United States. One is favorable tax policies that make U.S. lending an attractive option. Another reason is that real estate financing in our country can be reliably profitable for these companies. Lending their funds in the U.S. is even more attractive for lenders whose home countries are facing uncertain economic conditions.

Approval to Operate

Foreign banks may operate U.S.-based branches if they have the approval of the Federal Home Loan Bank and the Federal Reserve Board. The branch must have been in operation since September 29, 1994 or meet the time requirements of the state law.

Designation on International Real Estate

Real estate agents can earn a designation in international real estate if they wish. One option is the National Association of REALTORS® Certified International Property Specialist (CIPS) designation, which requires the completion of five courses: two core courses and three electives. Interested agents must also submit a designation application and show proof of international real estate experience.

07

Instruments of Real Estate Finance

Encumbrances and Liens

Chapter Objectives **Identify the functions of various types of encumbrances: liens, encroachments, easements, etc.**

Encumbrances

An encumbrance encumbers (prevents) a property owner from having full control over their property. Encumbrances will often block a sale until resolved.

Easements

An easement is a condition which allows a property owner to convey a right to another party while retaining full legal title. For example, if there was a footpath on your property that was used by the public or a fishing hole on your property that a neighbor has the right to use, an easement would allow these people to use your property.

Affirmative and Negative

Easements can be affirmative or negative:

- **Affirmative easements** give the right for people to use a property for a specific purpose.
- **Negative easements** prevent a property owner from performing an otherwise legal activity.

Dominant and Servient Estates

The party that has the burden of granting the other party access is known as the **servient estate** (as in, their land is subservient to the other party). The party that is gaining access to the servient estate's land is known as the **dominant estate**.

Easement Appurtenant vs. Easement in Gross

Another way we can categorize easements is that an easement is either an easement appurtenant or an easement in gross.

- **Easement appurtenant** applies to the land regardless of the owner
- **Easement in gross** applies to the person or entity, not the specific land

The Creation of Easements

There are three main ways to categorize easements based on their creation:

- **Express:** created by a written agreement between two or more parties
- **Implied:** created as logical features of the land

TYPES OF EASEMENTS

EASEMENT TYPE	DEFINING CHARACTERISTICS	EXAMPLE
Easement appurtenant	Runs with the land; applies to neighboring properties	Joy is allowed to use a portion of Rob's driveway; the right runs with their land.
Easement in gross	Is attached to a person, but is not transferable	Rob can use Joy's dock to access his, but the next owner of his home cannot.
Affirmative easement	Allows a non-property owner to use a property for a specific purpose	Rob has an easement through Joy's property. It allows him to drive across her driveway to access his own.
Negative easement	Prevents a property owner from doing something to or building something on their property	Rob's lot is on a beachfront. Joy's house is behind Rob's. Joy has a negative easement that prohibits Rob from building any structure that would block her view of the water.

- **Prescriptive:** occur when a dominant party has been using the servient party's land continually, notoriously, out in the open, for a statutory amount of time without anyone telling them that they could not

Encroachments

An encroachment occurs when a party that is not the property owner interferes with the property owner's land.

Leases

A lease is an encumbrance because the party residing in the property does not own the title to the property. In other words, the owner's (or, the lessor's) use of the property is significantly limited.

Restrictive Covenants

A restrictive covenant is a type of encumbrance that restricts how a buyer could use the property they are buying.

Liens

A lien is a right to possession of a property by someone other than the owner until a legal duty is satisfied by the owner. In addition, liens fall under the category of security interests.

The Three Types of Liens

There are three general categories that every lien falls under:

- **Voluntary liens:** both parties agree to the terms of the lien — a mortgage is the best example of a voluntary lien
- **Statutory liens:** obtained through legal action, like a tax lien or mechanic's lien
- **Judgment liens:** nonconsensual and is created through the power of a court

Specific Liens and General Liens

Another way that you can classify liens is that they are either specific or general.

COMPARING LIENS

LIEN TYPE	GENERAL	SPECIFIC	VOLUNTARY	INVOLUNTARY
Mortgage	✗	✓	✓	✗
Vendor's	✗	✓	✗	✓
Construction	✗	✓	✗	✓
Judgment	✓	✗	✗	✓

A **specific lien** is one that is specific to a certain property: a mortgage on a home, property taxes on that property, etc.

General liens attach to everything a person owns.

Priority of Liens

There is a priority of liens that refers to the order in which loans will be paid off in the event of foreclosure. The highest priority lien is paid by foreclosure proceeds before any other lien and then down the line.

In general, liens are prioritized by the date that they are recorded, but there are certain liens that will take priority. For example, a property tax lien will take priority over everything, including mortgage liens.

Recording Documents

There are certain documents involving encumbrances that need to be recorded in the public record. These include deeds, deeds of trust, judgment liens, and mechanic's liens. These documents should be recorded so that the history and background of a property can be available for reference.

Key Terms

affirmative easement

an easement that gives someone the right to use someone else's land for a specific purpose

dominant estate

the party that is gaining access to the servient estate's land in an easement

easement

an interest in, or a right to use, another individual's land or property, generally for a specific, limited purpose

easement appurtenant

an easement that applies to the land regardless of the owner

easement in gross

an easement that applies to the person or entity, not the specific land

encroachment

physical property that crosses the boundary into a neighboring landowner's property

encumbrance

a non-possessory interest in a property that burdens the title

express easement

an easement created by a written agreement between two or more parties

floating easement

an easement that does not have a clearly marked, fixed location to which access is granted

general lien

a lien for which the real estate AND personal property may be sold to satisfy the debt

implied easement

an easement created as a logical feature of the land

judgment lien

general, involuntary liens given by courts at the conclusion of lawsuits

lien

the claim made by a creditor against real or personal property pledged by a debtor as collateral

mortgage lien

a lien on property that was purchased with money borrowed from a lender

negative easement

an easement that prevents someone from doing or building something

prescriptive easement

easement created when a dominant party has been using the servient party's land continually, out in the open, for a statutory amount of time

restrictive covenant

a type of provision in a deed limiting the use of the property and prohibiting certain uses

security interest

a legal claim of collateral in exchange for a loan

servient estate

the party that has the burden of granting the other party access in an easement

specific lien

a lien that applies to a certain property only

statutory lien

a lien brought by a government entity such as a tax lien

voluntary lien

a lien that is created with the consent of the owner of the property in question

Notes, Mortgages, and Deeds of Trust

Chapter Objectives Explain the importance of the promissory note in acquiring a home loan | Compare the differences between a mortgage and a deed of trust | Summarize how the title is transferred through each mortgage document | Describe the difference between a lien theory state and a title theory state

The Promissory Note

A borrower receives the funds to purchase real property from a lender in exchange for signing a promissory note. In a promissory note, which is sometimes referred to simply as a note, the borrower acknowledges their debt and promises to repay the holder of the note.

At the close of the transaction, the seller owns the note.

Transferrable to Future Lenders

Another party could end up holding the note, because promissory notes are a **negotiable instrument** that can be sold to another investor or lender.

Loan Terms

The promissory note specifies:

- The amount of the debt
- The rate of interest
- The date on which interest charges are to begin
- The amount and terms of repayment

The note is the complete contract or agreement of the loan terms between the borrower and the lender.

Secured or Unsecured

Promissory notes are either secured or unsecured:

- A **secured note references a security instrument** (mortgage or deed of trust) as security for the loan.
- An unsecured note does not reference a security instrument.

Security Instruments

A security instrument is a generic term that refers to any document that gives lenders a claim to a borrower's property in order to secure a loan. In real estate, **security instruments take the shape of mortgages and deeds of trust.**

Mortgagor (Borrower) and Mortgagee (Lender)

Mortgage documents are two-party instruments, and those two parties are:

- **Mortgagor**: the person who takes a loan out from a bank (the borrower)
- **Mortgagee**: the organization or person who lends money (the lender)

Deed of Trust: Three Parties

There are three parties involved in a deed of trust:

Trustor: the person who takes a loan out from a bank (the borrower)

Trustee: a third party holding the right to the property, usually a trust, escrow, or title company, but under Texas law, a trustee can be anyone who has the legal right to hold and transfer property

Beneficiary: the organization or person who lends money (the lender)

SECURITY INSTRUMENT COMPARISON

	MORTGAGE	DEED OF TRUST
LIEN OR TITLE THEORY	Lien	Title
NUMBER OF PARTIES	1. Borrower (mortgagor) 2. Lender (mortgagee)	1. Borrower (trustor or grantor) 2. Lender (beneficiary) 3. Trustee
WHO HOLDS TITLE	Borrower	Trustee
FORECLOSURE TYPE	Judicial	Nonjudicial

Acceleration Clause

Most security instruments contain an acceleration clause, which makes the entire loan amount due immediately upon default. Default occurs when the borrower violates any of the terms of the loan agreement, which is most often in the form of delinquent payments.

Lien Theory vs. Title Theory

States are divided into two classes, depending on their legal treatment of security instruments. States are either lien theory states or title theory states.

Lien Theory State

- **Security Instrument**: uses mortgages as security
- **Borrower Rights**: mortgagor has the title
- **Lender Rights**: mortgagee only has a lien on the property; mortgage is strictly collateral
- **Foreclosure**: mortgagee must go through formal foreclosure procedures in order to obtain legal title

Title Theory State

- **Security Instrument**: uses deeds of trust
- **Borrower Rights:** trustor has **equitable right** (secondary) to the title
- **Lender Rights:** beneficiary has legal title to the property
- **Foreclosure**: simpler and faster for a lender (beneficiary) to foreclose on a property

Texas is a title theory state.

Warranty Deeds

The instrument that transfers ownership (the title) into a new owner's name is called a warranty deed. There are two types:

- **General warranty deed:** promises that the grantor is conveying the property and warrants to forever defend the property being conveyed to the grantee, also called full covenant and warranty deed
- **Special warranty deed**: only guarantees there is nothing against the property since the seller has owned the property (not prior to that time)

Key Terms

acceleration clause

a clause in a security instrument (mortgage/deed of trust) that makes the entire loan amount due immediately upon default

beneficiary

a lender in a deed of trust transaction; the person or party for whom a trust operates

deed of trust

a security instrument that pledges the property being purchased as the collateral for the promissory note and conveys the title to a trustee until the debt is paid off

general warranty deed

the transfer or claim of interest in the title free and clear of all liens and encumbrances to real property in public records per state law; aka full covenant and warranty deed

lien theory state

state that employs security instruments allowing the borrower to retain title while the lender places a lien on the property to secure the loan

mortgage

security instrument that creates a mortgage lien on mortgagor's property in exchange for loan

mortgagee

the organization or person who lends the money in a loan (the lender)

mortgagor

the person who takes out the loan (the borrower)

promissory note

a negotiable financial instrument that is evidence of a debt and a promise to pay that debt; aka note

secured note

a promissory note that references a security instrument

security instrument

document that gives lenders a claim to a borrower's real property as collateral in order to secure a loan (mortgage or deed of trust)

special warranty deed

limited warranty that guarantees there are no defects against the title since the seller has owned the property

title theory state

state that conveys the title to the lender or, more commonly, to a third-party trustee (operating on behalf of the lender) for the life of the loan

trustee

one to whom something is entrusted and who holds the legal title to a property for the benefit of the beneficiary

trustor

a borrower in a deed of trust transaction; one who places property in a trust

unsecured note

a promissory note that does not reference a security instrument

Contract for Deed (Land Contract)

Chapter Objectives **Demonstrate how a contract for deed is considered an executory contract | Identify the unique features of a contract for deed, as well as what happens when a default occurs**

Executory Contracts

Executory contracts are contracts that have not yet been fully performed. This includes any transaction that defers material action by either party that pertains to ownership or possession of real property into the future.

Texas Property Code

Since 2005, contracts for deed, lease-purchases, and lease options have been considered executory contracts, and are heavily regulated under Chapter 5 of the Texas Property Code.

Contract for Deed

The classic executory contract is the contract for deed (or land sales contract), where the seller keeps the title upon completion of the sale and the buyer gets the title after making payments over a period of years.

Key Terms

contract for deed

an executory contract in which the seller keeps the title upon sale; the buyer gets the title after making payments over a period of years

executory contract

a contract that has not yet been fully performed (both sides have not yet completed their obligations)

Subordinate Finance Instruments

Chapter Objectives **Explain how the Freddie Mac Subordination Agreement works to prioritize multiple mortgages on a property | Illustrate how payments in a wraparound mortgage are issued**

Mortgage Subordination Agreement

The mortgage subordination agreement is a legal document used to sort out situations when there are two mortgages on a home, and the homeowner wants to refinance the first mortgage. The mortgage subordination agreement works to identify which mortgage will take precedence over the other.

Refinancing With a Home Equity Loan

Subordination agreements are often used when a homeowner with two loans refinances their primary loan, to keep the primary loan first in lien priority over the secondary loan.

Wraparound Mortgage

A wraparound mortgage is an arrangement in which a subordinate mortgage is created on a home that already has a mortgage. In this situation, the seller holds a note for which the buyer is responsible. The lender still holds the original note, and the seller is still responsible. The buyer pays the seller, and the seller pays the lender. Anything leftover each month belongs to the seller.

Wraparound mortgages are not insured by FHA.

Key Terms

subordination agreement

a legal document used to sort out situations when there are two mortgages on a home, and the homeowner wants to refinance the first mortgage

wraparound mortgage

an arrangement in which the seller of a property extends a mortgage to a buyer; the seller maintains their original loan and continues to pay it while also receiving mortgage payments from the buyer

Special Provisions in Mortgage Lending Instruments

Chapter Objectives **Explain a number of the provisions that can be attached to a mortgage**

Prepayment Privilege

A prepayment privilege means that the borrower can pay off the loan early if they want.

Late Payment Penalty

If the borrower is late on their payment, they will be charged a set late fee.

Lock-in Clause

A lock-in clause prohibits prepayment by the borrower.

Due-on-Sale Clause

Pretty much every mortgage in the United States contains a due-on-sale clause, sometimes called an alienation clause. The primary purpose of this clause is to prohibit a new buyer from being able to assume the terms of the original loan without the lender's approval and involvement.

Assumption Loans

An assumption loan is a loan that is transferred (or, assumed) by another party, usually the buyer. An assumed loan has to happen with the full acknowledgment and consent of the lender.

Subject-to Loans

Another way of transferring the mortgage to another party is through a subject-to transaction. This type of transaction gives the buyer the title to the property but lets the seller's financing remain in place.

Subordination Clause

When there are multiple encumbrances secured by the same property, a subordination agreement orders them in the sequence that the loans will be paid off. The subordination agreement is made available through the subordination clause.

Exculpatory Clause

In an effort to limit any personal liability, a party (usually the borrower) can include an exculpatory clause in the loan contract.

Non-Recourse Clause

With a non-recourse clause, if a borrower defaults, the lender can only seize the property that the loan is secured by. If not enough money is made from that sale to satisfy the loan, then the lender is all out of luck.

Recourse Clause

If a loan has a recourse clause, then the lender has the right to pursue the remaining deficit through the seizure of the borrower's other assets.

Key Terms

assignment

the transference of rights and obligations in a contract from one party to another

assumption loan

a loan that is transferred (assumed) by another party, usually the buyer, with the full acknowledgment and consent of the lender

due-on-sale clause

a clause stating that if a property is sold, then the mortgage must be repaid in full

exculpatory clause

a clause that relieves the borrower of personal liability to repay the loan

late payment penalty

a late fee to be charged to buyers if they are late on their payment

lock-in clause

a provision that prohibits a borrower from making early payments on a loan for a specified period of time

non-recourse clause

a clause that prohibits a lender from seizing any property outside of the property that the loan was secured with

prepayment privilege

provision that allows a borrower to pay off their loan early

recourse clause

a clause that states that if a lender still has a deficit after seizing the secured property, then they have the right to seize other assets of the buyer

subject-to loan

a loan that gives the buyer the title to the property but lets the seller's financing remain in place

Review of the Note

Chapter Objectives **Explain how the promissory note is secured** | **Recognize the different sections of a standard promissory note**

What's a Promissory Note?

The promissory note is the common document for all loans, not just the ones commonly referred to as mortgages. It is an agreement between the obligor, maker, or payor (borrower) and the obligee or payee (lender), and it is the written agreement of the borrower's personal promise to repay the lender. In the note, the borrower acknowledges the debt, and the agreement provides for all of the terms of repayment.

Secured vs. Unsecured

Promissory notes can be secured or unsecured. A secured note refers to a mortgage that pledges rights (a lien or title, depending on state law) against a property as security for the debt. The note will, when applicable, refer to the mortgage or deed of trust that is security for it.

Review of the Deed of Trust

Chapter Objectives **Recognize many of the standard sections of a deed of trust form** | **Explain in detail the function of a deed of trust**

Uniform Covenants

Uniform covenants are standardized terms for mortgage documents that exist in a number of states and are used in both mortgages and deeds of trust. There is also a Non-Uniform Covenant section that is state-specific.

Defeasance Clause

A title theory state, like Texas, uses deeds of trust. The deed of trust has a “defeasance clause” that explains that the title will be transferred to the borrower after all payments are made.

In a lien theory state, no defeasance clause is needed since the borrower already owns the property. Lien theory states use mortgages instead of deeds of trust. The mortgage document uses a release clause saying that the lender releases the lien when all the payments are made.

08

Scenario Based-Learning Exercise: Not So Easements

Scenario levels are not included in the study guide. Please refer back to the course for further review on this topic.

09

Loan Types, Terms & Issues

Interest

Chapter Objectives Differentiate between amortization and negative amortization | Describe important RESPA disclosure rules | Define Annual Percentage Rate (APR) | Identify some of the components of a monthly mortgage payment | Define what discount points are and how they are used

Interest

When someone borrows money from a lender, they must pay the borrowed amount back, plus interest. Interest is a fee charged by the lender, generally stated as a percentage of the borrowed amount. Interest rates are determined by the market (the individual lenders) but are influenced by the Federal Reserve System's open market activities, reserve requirements, and its primary lending discount rate.

The primary lending discount rate is the interest rate the Fed charges to other banks. Rates are also limited by usury laws, which prohibit lenders from charging excessive interest on a loan.

Amortized Loans

If the note is to be amortized, there will be equal monthly payments that contribute to both principal and interest until the entire loan is paid.

Negative Amortization

With amortized loans, the interest is paid in arrears. This means that the borrower is paying interest for the use of funds already issued to them.

If the payment being made is not sufficient to cover the interest due for any payment period (let alone the principal), the unpaid interest is added to the principal balance. This is known as negative amortization or deferred interest.

Annual Percentage Rate (APR)

The Real Estate Settlement Procedures Act (RESPA) requires lenders to disclose the annual percentage rate (APR) to borrowers in the Truth-in-Lending Disclosure Statement.

The APR is not the same as the interest rate: it is the ratio of the total cost of financing to the loan amount. The cost of financing includes interest paid, discount points, and loan fees. It does not include other fees that would have to be paid regardless of financing (for example, title insurance or home inspection fees).

Important Disclosures

Regulation requires that the terms "finance charge" and "annual percentage rate" be disclosed more conspicuously than any other required disclosure. **The finance charge and APR, more than any other disclosures, enable consumers to understand the cost of the credit and to comparison shop for credit.**

Discount Points

Discount points are fees that the lender charges to lower the interest rate of the loan. They are expressed as percentages of the loan amount.

One discount point is equal to 1% of the loan.

HOW DO DISCOUNT POINTS AFFECT YOUR LOAN?

LOAN AMOUNT: $200,000

	LOAN A NO POINTS	LOAN B 1 POINT	LOAN C 2 POINTS
Cost per point(s)	0	$2,000	$4,000
APR	4.5%	4.25%	4%
Monthly payment	$1,013.37	$983.88	$954.83
Monthly payment savings	N/A	$29.49	$58.54
Break even (time to recover point costs)	N/A	68 months	68 months
Total payment savings on a 30-year loan	**N/A**	**$10,616.40**	**$21,074.40**

Key Terms

primary lending discount rate

the interest rate the Fed charges to other banks

amortization

the process of paying off a debt/mortgage in regular installments based on a fixed payment schedule

negative amortization

when a borrower's payment is not large enough to cover the interest due on a loan, the unpaid interest is added to the principal balance

annual percentage rate (APR)

the ratio of the total cost of financing to the loan amount (not to be confused with the interest rate)

arrears

payment that occurs at the end of a period to compensate for charges accrued during that time

discount points

fees that the lender charges to lower the lending rate; one point is 1% of the loan amount

Types of Loans

Chapter Objectives Differentiate between conforming and non-conforming conventional loans | List the pros and cons of adjustable-rate mortgages (ARMs) | Explain the features of different types of mortgages

Conventional Loans

A conventional loan is any loan that is neither insured by the government nor guaranteed by the government.

Conforming vs. Non-Conforming

Conventional loans are divided into two categories: conforming loans and non-conforming loans.

Conventional conforming loans are loans that conform to the guidelines set by Fannie Mae and Freddie Mac and thus can be sold on the secondary market to those government-sponsored enterprises (GSEs).

Conventional non-conforming loans are loans that do not follow Fannie Mae and Freddie Mac guidelines and thus will not be purchased by Fannie and Freddie on the secondary market (although other secondary market buyers may choose to purchase them).

Adjustable-Rate Mortgages

An adjustable-rate mortgage (ARM) is a loan with an interest rate that can increase and decrease periodically throughout the life of the loan. An ARM typically has an introductory interest rate that is lower than the market rate for conventional loans.

An ARM's initial interest rate is locked for a certain amount of time — this is called the initial rate period. After the initial rate period ends, the lender can then adjust the loan rate every new adjustment period.

Three Important Time Periods

An ARM loan has three important time periods:

- **Initial Rate Period:** The introductory period of an Adjustable Rate Mortgage loan in which the interest rate is locked at the initial rate.
- **Adjustment Period:** Set periods of time in which the ARM loan's interest rate can be adjusted.
- **Lookback Period:** The date when the index rate for the upcoming adjustment period is selected.

Index

Each ARM loan selects an external economic indicator, such as the Treasury bond yield rate, as the index for the loan.

Index Rate

The index value published on the ARM's lookback date is the value that will be used to figure the rate on the mortgage for the next adjustment period — this is called the **index rate**.

Margin

The lender will add the index rate on top of a fixed value called the **margin** at the lookback date to determine the ARM rate for any particular adjustment period.

Fully Indexed Rate

The index rate is added on top of the margin to get the **fully indexed rate**. The fully indexed rate represents the actual interest rate that the ARM borrower will pay.

Floor Rate

Most ARMs will have a **floor rate**. This is the lowest the interest rate can go, even if the market moves lower. This protects the lender.

Rate Cap

- An **adjustment period cap** limits the amount that the interest rate can increase in any given adjustment period.
- A **lifetime cap** puts a hard limit on the amount the interest rate may increase over the lifetime of the loan, no matter how high the index may increase.

Float-to-Fixed Rate Loans

Float-to-fixed rate loans have initial interest rates determined by a margin and an index. After the initial float rate period (one or two years, typically) the loan converts to a fixed-rate loan. These loans allow borrowers to take advantage of the lower earlier rates (as with ARMs) but avoid the risk of later rate increases.

80-10-10 Piggyback Loans

An 80-10-10 loan, also known as a piggyback loan, is really two mortgages in one. Instead of giving the borrower one fixed-rate loan at the current market rate, the borrower receives two loans, one larger loan for 80% of the sale price at the market rate and a smaller loan for 10% of the sale price at a higher interest rate.

Balloon Mortgage

A **balloon mortgage** is not fully amortizing. It has a short term, usually five or seven years, but payments based on a longer term, as if it were 30 years, for example. At the end of the loan's term, the often-large remaining balance of the mortgage is due as a lump sum. At this time, the borrower can refinance this amount (if they qualify).

Reverse Mortgages

A reverse mortgage is designed for borrowers over the age of 62.

- **The borrower does not have to qualify for the loan.** This is because the lender's protection is in the property.
- **The borrower still owns the home.** The lender has a lien on the property just like they would with other mortgage loans.
- **There are no monthly payments.** Interest is added to the amount borrowed every month (negative amortization). The longer the borrower has the loan, the higher the balance will get. It is very possible that if the borrower lives a ong life, the balance could exceed the value of the property.
- **When the borrower passes away, the title to the property passes to the heir(s) with the borrower's estate.** If there is any equity (the difference between what the property will sell for and the mortgage on the property) left in the property, it belongs to the heirs.

Non-Recourse Loans

Reverse mortgages are **non-recourse loans.** There is no personal liability. If the borrower lived a long life and the balance on the loan now exceeds what the property will sell for, the lender cannot force anyone to pay for the loss.

If the heirs choose to let the lender have the property rather than pay the debt, the lender will foreclose on the property, sell it for what they can, and **the rest of the loss is the lender's.**

Blanket Mortgage

Blanket mortgages have more than one collateral property that acts as security for the loan. These mortgages typically are used by land developers and commercial investors.

Home Equity Loans

A **home equity loan** is a loan in which funds are borrowed using the homeowner's equity for collateral.

Construction Mortgage

One important type of **open-end mortgage is the construction mortgage**.

In a construction mortgage, the lender pays funds to a borrower in installments, called draws, as the construction progresses. The sum total of these draws is typically 75% of the value of the property when it is completed.

TYPES OF MORTGAGE LOANS

ADJUSTABLE RATE MORTGAGE (ARM)	Features an interest rate that can adjust throughout the life of the loan
GRADUATED PAYMENT	Features a low initial interest rate that increases gradually
GROWTH EQUITY	A fixed-rate mortgage where monthly payments increase over time and are applied toward the principal
BALLOON	Large balance due as a lump sum at the end of the loan
PURCHASE-MONEY	Buyer borrows part or all of the purchase price from the seller
WRAP-AROUND	Seller keeps their original mortgage and extends a loan to the buyer
REVERSE	A homeowner pledges equity to a lender in exchange for periodic payments from the lender of that pledged equity
BLANKET	More than one property is used as collateral
BIWEEKLY	Loan payments are made every two weeks rather than once per month
PACKAGE	Bundles the mortgage with another loan that finances one or more articles of personal property
OPEN-END	Allows borrower to borrow additional funds at a later date
CONSTRUCTION	A temporary mortgage used to finance a construction project
SALE-LEASEBACK	Owner of a parcel of real estate sells it and immediately leases it back

Permanent Buydown

A permanent buydown is known as buying points.

Temporary Buydown

Under a buydown plan, the subsidizing party — the borrower, seller, builder, or other party — establishes a buydown fund, which is collected in cash at closing. The required portion of the payment is paid from the buydown fund on a set schedule. The borrower then makes payments at the bought-down effective rate, which is lower than the actual lending rate. When the temporary buydown period is over, the lending rate returns to normal.

Seller Financing

Seller financing is when the seller finances the property they are selling themselves. To qualify for seller financing, the seller must own the home free and clear, with no liens.

Seller Financing: FHA or VA Assumption

Seller financing can also be the assumption of an FHA or VA loan. If the qualifying buyer does not have the cash available to buy the seller's equity but would like to assume the seller's first-lien mortgage, the seller could carry part of the equity on a second lien.

Key Terms

conventional loan

any loan that is neither insured by the government nor guaranteed by the government

conforming loan

a loan that meets the standards of purchase for Fannie Mae and Freddie Mac

non-conforming loan

a loan that does not follow Fannie Mae and Freddie Mac guidelines and thus will not be purchased by them on the secondary market

adjustable-rate mortgage (ARM)

a mortgage with an interest rate that can be adjusted based on fluctuations in the cost of money

float-to-fixed rate loan

a loan that has an initial interest rate determined by a margin and an index, and after the initial float rate period the loan converts to a fixed-rate loan

balloon mortgage

a type of loan, at the end of which the (often large) remaining balance of the mortgage is due as a lump sum

blanket mortgage

a loan for which more than one collateral property acts as security

home equity loan

a loan in which funds are borrowed using the homeowner's equity for collateral; the funds can be used for any purpose

Private Mortgage Insurance

Chapter Objectives **Define Private Mortgage Insurance** | **Describe how and when PMI is purchased** | **Discuss why borrowers should avoid PMI and how to avoid it**

Private Mortgage Insurance (PMI)

Private mortgage insurance, also called PMI, is a type of mortgage insurance you might be required to pay for if you have a conventional loan. Like other kinds of mortgage insurance, PMI protects the lender — not you — if you stop making payments on your loan.

When It's Required

PMI is arranged by the lender and provided by private insurance companies. PMI is usually required when you have a conventional loan and make a down payment of less than 20% of the home's purchase price. If you're refinancing with a conventional loan and your equity is less than 20% of the value of your home, PMI is also usually required.

FHA Loans

Mortgage insurance is always required for FHA loans with down payments of less than 20%, but this is a different product called a Mortgage Insurance Premium, or MIP.

Canceling PMI

By federal law, most monthly private mortgage insurance premiums for loans originated on or after July 29, 1999, are **automatically canceled when the borrower builds up 22% equity in their home (based on the original loan balance), or 20% equity if the borrower requests cancellation at that time.**

Key Terms

private mortgage insurance (PMI)

insurance that protects the lender if a borrower defaults on a conventional loan; usually required when the borrower has less than 20% equity

Refinancing Existing Conventional Loans

Chapter Objectives Define refinancing | Explain the benefits of refinancing | Identify refinancing scams

Refinancing

Refinancing is the process of obtaining a new mortgage in an effort to reduce monthly payments, lower interest rates, take cash out of a home for large purchases or change mortgage companies. Most people refinance when they have decent equity in their homes.

Reasons for Refinancing

Borrowers might consider refinancing for several different reasons:

A lower monthly payment

Shortened loan terms

Changing from an ARM to a fixed rate

Avoiding balloon payments

Getting rid of PMI

Cashing out equity or consolidating debt

Key Terms

refinancing

the process of obtaining a new mortgage in an effort to reduce monthly payments, lower interest rates, take cash out of a home for large purchases, or change mortgage companies

equity

the portion of a property's total value owned outright by the holder to title

Subprime and Predatory Lending

Chapter Objectives Explain subprime mortgages | Identify predatory lending | Recognize the warning signs

Prime Lending

Prime lending is based on what's called a **prime rate**. The prime rate is the interest rate that's issued for mortgage borrowers with what lenders deem "good credit." This rate is usually three percentage points above the federal funds rate, which is set by the government.

Federal Funds Rate

The federal funds rate is the interest rate that banks charge other banks for overnight loans, so adding three percent to that gives you the prime rate.

Subprime Lending

A subprime mortgage is a type of mortgage that is normally made to borrowers with lower credit ratings. As a result of the borrower's low credit rating, the lender offers a mortgage with a higher interest rate because the lender views the borrower as having a larger-than-average risk of defaulting on the loan.

Predatory Lending

Predatory lending includes the unfair, deceptive, or fraudulent practices of some lenders during the loan origination process. While there are no legal definitions in the United States for predatory lending, an audit report on predatory lending from the office of inspector general of the FDIC broadly defines predatory lending as "imposing unfair and abusive loan terms on borrowers."

Predatory Lending Warning Signs

There are some red flags to watch for with predatory lending:

- Above-average or confusing fees
- Too-good-to-be-true interest rate
- Pressure to act fast
- Pressure to take on unwanted risk
- Lying on the application

Predatory Lending Schemes

- **Equity Stripping:** The lender makes a loan based upon the equity in your home, whether or not you can make the payments. If you cannot make payments, you could lose your home through foreclosure.
- **Bait-and-switch schemes**: The lender may promise one type of loan or interest rate but without good reason, give you a different one. Sometimes a higher (and unaffordable) interest rate doesn't kick in until months after you have begun to pay on your loan.
- **Loan Flipping**: A lender refinances your loan with a new long-term, high-cost loan. Each time the lender "flips" the existing loan, you must pay points and assorted fees.
- **Packing:** You receive a loan that contains charges for services you did not request or need. "Packing" most often involves making the borrower believe that credit insurance must be purchased and financed into the loan in order to qualify.
- **Hidden Balloon Payments:** You believe that you have applied for a low-rate loan requiring low monthly payments only to learn at closing that it is a short-term loan that you will have to refinance within a few years.

Key Terms

subprime

a mortgage with an interest rate higher than prime mortgages due to the higher risk associated with a less qualified borrower

prime rate

the short-term interest rate charged to a bank's largest, most creditworthy customers; strongly influenced by the Fed's discount rate

federal funds rate

the rate a bank charges when lending funds to other banks within the Federal Reserve System

predatory lending

the imposition of unfair and abusive loan terms on borrowers

Participation Agreements

Chapter Objectives **Define what a participation agreement is | Identify who the participants of the agreement are**

Participation Agreements

Sometimes lenders like to offer to sell interests in their loans to various participants. The agreement that governs this type of sale, and the rights and obligations of the seller and buyer of an interest in the loan, is called a **participation agreement**.

Participant Fees & Loan Documentation

In addition to making the one-time participation payment, the participant also pays the lender a **participation fee,** which is a monthly servicing fee based on the outstanding principal balance of the loan and the participant's percentage share of any expenses incurred by the lender in connection with the enforcement of the loan.

Key Terms

participation agreement

the agreement that governs the sale of a portion of an interest in an existing loan, plus the rights and obligations of the seller and buyer of an interest

participation fee

a monthly servicing fee based on the outstanding principal balance of the loan and the participant's percentage share of any expenses incurred by the lender in connection with the enforcement of the loan

Tax Impacts in Mortgage Lending

Chapter Objectives **Discuss the Mortgage Debt Relief Act of 2007** | **Describe the tax requirements on capital gains**

Mortgages and Taxes

Interest on their mortgage loan is deductible for income tax purposes if it's a primary residence or an investment property.

If a homeowner has a Mortgage Credit Certificate on their mortgage loan, part of their interest is a tax credit.

Capital Gains Tax Exemption

Capital gains is a type of tax that is usually levied against investors, however homeowners get an exemption for a primary residence:

- Up to **$250,000** of the capital gains from selling a home is exempt for individuals.
- Up to **$500,000** of the capital gains from selling a home is exempt for for a married couple.

Review of Fixed/ Adjustable Rate Note

Chapter Objectives **Identify the differences between fixed-rate and adjustable-rate mortgages | Explain the advantages and disadvantages of fixed-rate and adjustable-rate mortgages | Understand what your client should know before choosing a mortgage**

Fixed-Rate Mortgages

In a fixed-rate mortgage the amount of interest stays the same, or is fixed, for the entire life of the loan.

Adjustable-Rate Mortgages

Adjustable-rate mortgages are mortgages whose interest rate is set to adjust after a certain amount of time.

Initial Rate of Interest

Usually, there's a fixed rate at the beginning of this type of mortgage, known as the initial interest rate. After this period, the interest will adjust based on the ARM margin, which is a benchmark and additional spread added to the initial rate.

The Benchmark

The benchmark (also known as index) is a way for investors to compare how this mortgage is doing compared to other similar types of mortgages.

ARM Margin

The spread, also known as the margin, is a fixed amount above the index which the borrower will pay. This is given as a percentage to be added on top of the index. For example, if the spread on a loan is 3%, then the borrower is always paying 3% above whatever the index is at the last adjustment. The rate you get when you add the index and the spread is the **fully-indexed rate.**

Choosing an Index and Margin

The important thing to know about margin/index amounts is that the higher the margin, the lower the index level, and vice versa.

How ARMs Are Written

ARMS are written as fractions, for example 2/28 or 4/1.

The first number will always be the number of years that the interest rate is fixed for. So for the first example, the fixed rate will be for two years. In the second one, it will be for four. The second number doesn't always mean the same thing.

In the first example of 2/28, the second number probably means that the interest rate floats/changes for the remaining 28 years after the two year initial fixed period.

For the second example of 4/1, the 1 means that the rate will adjust every year. BUT, you could also see 4/6, which might mean that the rate could change every six years or every six months.

Rate Cap

The stopping point for the interest on an ARM is called a **rate cap**. These can limit how high the interest rate can go and also how big the difference can be between old and new payments.

Three Kinds of Caps

There are three kinds of caps:

- **Periodic rate cap:** limits the change in interest rate year over year
- **Lifetime rate cap:** limits the increase of interest rate for the life of the loan
- **Payment cap**: limits the amount of the monthly loan payment for the borrower, which is stated in dollars and not in interest rate percentage

Key Terms

fixed-rate mortgage

a mortgage for which the interest rate stays the same, or is fixed, for the entire life of the loan

benchmark

a figure that allows investors to compare how a given mortgage is doing compared to other similar types of mortgages based on qualities like risk and investment type; aka the index

Mortgage Fraud

Chapter Objectives **Define the types of mortgage fraud, including flipping and buyer rebates | Identify red flags in mortgage lending**

Mortgage Fraud

Almost anyone involved in a home buying transaction could be involved in committing fraud: the agents, mortgage broker, appraiser, or title company.

The mortgage lenders are usually the victims.

Flipping Fraud

When a property is purchased and then quickly resold at a value that is artificially inflated by false appraisals, loan fraud has taken place. No significant repairs or improvements have been made to the property, and the higher resale price is not fair.

Buyer Rebates

Anything during the transaction that causes money to go back to the buyer, either at or after closing, without the knowledge of the lender, is illegal. This is known as a **buyer rebate.**

Sometimes the money comes from the seller, sometimes from the real estate agent or a mortgage loan broker, and sometimes through a third-party vendor.

Most Common Rebate

One of the common forms of rebates happens when the contract calls for money to be paid to a certain vendor for future improvements to be done to the property after closing.

Mortgage Fraud Red Flags

Mortgage fraud red flags include:

- Inflated price or appraisal
- Real estate agent is asked to remove the property from MLS (a violation of MLS rules) or being asked to increase the price in MLS to a higher price to match the sales price
- False financial statements by the buyer
- Contract calling for payments at closing for future improvements
- High fees to the mortgage broker, real estate broker, or both
- No fee for a title policy on the closing statement
- A title company you have never heard of before
- Last-minute amendments to the contract, increasing the sales price

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Scenario Based Learning Exercise: Michigan J. Fraud

Scenario levels are not included in the study guide. Please refer back to the course for further review on this topic.

11

Government Loans

Federal Housing Administration

FHA Insured Loan Program

Underwriting Guidelines

Most Frequently Used FHA Loans

Direct Endorsement

FHA Contributions to Real Estate Finance

VA Loan Guaranty Program

Additional VA Loan Programs

Federal Housing Administration

Chapter Objectives Summarize the history of the Federal Housing Administration | Describe the role of the U.S. Department of Housing and Urban Development | List the requirements needed to qualify for FHA loans

Federal Housing Administration (FHA)

The Federal Housing Administration (FHA) is a part of the United States Department of Housing and Urban Development (HUD) and is charged with:

- Increasing homeownership
- Facilitating the financing of home sales and home repairs
- Contributing to building healthy neighborhoods and communities

The FHA Doesn't Make Loans

The FHA insures private loans made to consumers by qualified lenders from the primary market.

The FHA does NOT make loans; they insure them. That's why we call FHA loans government-backed loans.

Qualifications

Anyone who is a legal resident of the United States might qualify for an FHA loan. The only absolute qualification for an FHA loan is that the borrower be a U.S. citizen or hold a green card.

Advantages of FHA Loans

Some FHA advantages compared to conventional loans include:

- Borrowers who don't qualify for a conventional loan might be able to qualify for an FHA loan.
- Mortgages can be made on a graduated payment schedule, with low monthly payments that increase over time.
- FHA-insured loans are not allowed to carry a prepayment penalty.
- FHA loans can be assumed by other borrowers.
    - However, since 1986, the assumptor has had to go through the same underwriting process—verification of debts and income, etc., as the original borrower to prove their creditworthiness.

First-Time Homebuyer

First-time homebuyers often find FHA loans their best) way to get into a home. The FHA defines a first-time homebuyer as someone who has never owned a home before or who has not owned a home for at least the last three years.

Disadvantages of FHA Loans

FHA loans have several disadvantages when compared with conventional loans.

- There is a maximum loan amount on FHA loans, and this can be limiting.
- The mortgage insurance premiums must either be paid upfront at closing or be financed.
- The FHA loan program only insures loans to owner-occupants.
- FHA loans require that the house meet certain conditions and must be appraised by an FHA-approved appraiser.
- Because an FHA loan does not have the strict standards of a conventional loan, it requires two kinds of mortgage insurance premiums:
    - One is paid in full upfront (it can be financed into the mortgage)
    - The other is a monthly payment

The Types of Loans That Are Insured

FHA mortgage insurance only applies to single-family or multi-family homes. The FHA insures more mortgages in the world than anybody else, insuring over 34 million home mortgages and 47,205 multifamily projects since their birth in 1934. They insure all types of loans with a variety of terms.

Loans the FHA insures:

- Loans for repair/rehabilitation of homes
- Loans for condominiums
- Adjustable rate mortgages (ARMs)
- Graduated equity mortgages

Loans the FHA does NOT insure:

- Wraparound mortgages
- Subprime mortgages
- Jumbo loans

Mortgage Insurance Premium

For FHA loans, borrowers must pay a **mortgage insurance premium (MIP)**.

No matter what the loan-to-value ratio (LTV) of the loan is, all borrowers are required to pay a 1.75% MIP. These MIPs are how the FHA program is funded — no taxpayer money is used whatsoever. The funds from these premiums are stored in an account and used to fund the entire FHA operation.

The upfront MIP can be financed into the mortgage, but the borrower will still be responsible for paying the annual premium.

Key Terms

government-backed loan

a loan that is insured by the Federal Housing Administration (FHA), guaranteed by the Veterans Administration (VA), provided by the U.S. Department of Agriculture (USDA), or provided by special programs created by individual states or local jurisdictions

mortgage insurance premium (MIP)

borrower-paid insurance required for FHA loans; insures lender in case of borrower default/foreclosure

FHA Insured Loan Program

Chapter Objectives Identify why FHA loans may appeal to consumers

FHA 203(b) Loans

When a borrower is getting an FHA loan, they are most likely getting the loan that falls under the Section 203(b) program, called the **FHA 203(b). This is the most popular type of FHA loan.**

For these FHA guaranteed loans, lenders offer loan terms at 15 or 30 years. The FHA does not set interest rates for these loans, instead they are negotiated between the borrower and lender.

FHA Loan Down Payment

FHA mortgages **require a down payment as low as 3.5%**, which can be paid for by the borrower or the FHA allows it to come from a family member or charitable organization in the form of a gift.

Allowable Closing Costs

The FHA has outlined specific rules regarding the closing costs that can be allocated to the purchaser by the lender and overages must be waived or paid by the seller.

Here are the potential costs HUD allows the buyer to be charged:

For all loans:

- Appraisal fee
- Credit report
- Compliance inspection fee for FHA appraisal (limited to $75)
- Energy efficient mortgage (EEM) report fee
- Escrow fee (limited to 50% of the total amount, and no more than the seller pays)
- Home inspection fee up to $200
- Notary fee
- Origination fee (limited to 1% of the loan amount)
- Title insurance

For refinancing:

- Beneficiary statement
- Courier fee
- Reconveyance fee
- Wire transfer fee

Non-Allowable Costs

Non-allowable closing costs are those that may not be charged to the buyer but may be charged, for example, to the seller, or be paid with gift funds. They include the following:

- Buydowns
- Document preparation fee
- Flood certification fee
- Processing fee
- Tax service fee
- Underwriting fee

Underwriting Guidelines

Chapter Objectives **Explain the process of underwriting FHA loans**

Qualifying for the FHA Loan

FHA loans are the easiest type of real estate mortgage loan to qualify for. The FHA loan requirement guidelines for loan qualification are the most flexible of all mortgage loans that require less than a 5% down payment.

Basic FHA Loan Requirements

Here are the requirements to qualify for an FHA loan:

- Two years of steady employment, preferably with same employer
- Last two years' income should be the same or increasing
- Credit report should typically have less than two 30-day late payments in last two years, with a minimum credit score of 580 or higher (or in some cases, no credit score is required at all)
- Bankruptcies must be at least two years old, with good credit since discharge
- Foreclosures must be at least three years old, with no 30-day late payments since
- The new mortgage payment should be approximately 30% of the borrower's gross (before taxes) income

Debt-to-Income Ratio

In most cases, the debt-to-income ratio limit that lenders end up using is 45%. This means that a borrower's debt can only take up 45% of their entire income. At times, the lender may be able to go all the way up to 56% if the applicant's credit score is higher.

Credit Score

According to FHA, the current credit score that qualifies a borrower to pay the minimum of 3.5% down is 580. If the borrower has a credit score between 500 and 579, they would be required to put down at least 10%. This doesn't mean that they should only put 3.5% down if they're allowed to — the borrower should always put down as much as they can.

FHA Appraisal

The loan cannot be taken out until the property has been appraised by an FHA-approved appraiser. Appraisal fees are usually about $375 for a house that is about 2,000 square feet.

Maximum insurable loan amounts are computed on the FHA appraised value of the property or sale price (whichever is less). The difference between actual sale price and maximum loan amount must be paid in cash by the borrower as a down payment at closing or the borrower can choose not to buy the home.

Most Frequently Used FHA Loans

Chapter Objectives **Explain and identify the most popular FHA loans**

Section 203(b)

203(b) is the Federal Housing Administration's main program. It insures fixed interest rate loans for owner-occupied, one- to four-family properties. Terms are available for 10, 15, 25, and 30 years. The loan requires at least a 3.5% down payment (gift funds are allowed) and a credit score as low as 580.

Features of Section 203(b)

Section 203(b) loan features of lower down payments, higher allowed total debt ratios, and underwriting consideration of compensating factors all improve the chances for many to achieve their dream of homeownership.

Section 203(b) loans can also be used for the purchase of condominium and cooperative units.

203(k) for Rehabilitation Loans

Non-investors who need a loan in excess of $5,000 to rehabilitate or repair their one-to-four family residences can use a **203(k) loan.** The purchaser is required to put 3.5% of the loan amount down and have a 640 credit score or better.

If purchasing a property that requires rehabilitation, the borrower can receive one fixed- or adjustable-rate loan that includes the purchase price and the cost of rehabilitation. The funds of the loan are paid into an escrow account from which they are disbursed by the lender upon completion of the rehabilitations.

The loan amount for a 203(k) is based on the home value including renovations.

203(b) vs. 203(k) Memory Trick

- Imagine the b stands for boring. 203(b) loans are your standard, boring FHA loan.
- Imagine the k stands for kitchen. 203(k) loans allow a borrower to take out money to purchase a property and do repairs on it, like fixing up the kitchen.

Section 251: Adjustable-Rate Mortgage Insurance

The FHA adjustable-rates mortgages (ARMs) are available to purchasers of one-to-four family dwelling units. The down payment, maximum loan amount, and qualifying standards are the same as for 203(b) and may be written for 30 years.

Benefits of FHA ARMs

An FHA ARM has much of the same appeal over a conventional ARM that a fixed-rate FHA loan has over a conventional fixed-rate loan. Here are a few reasons why:

- FHA ARMs have lower down payment requirements.
- Lenders consider them safer investments than conventional ARMS.
- In addition, ARM borrowers can switch over to a fixed-rate loan without refinancing.

Streamline Refinance

Since 1980, the FHA has permitted insured mortgages to be streamline refinanced.

Streamline refinance is the process of refinancing an FHA mortgage to get a better rate, without borrowers having to:

- Verify income/employment
- Share bank or asset information
- Have a minimum credit score
- Get a home appraisal

Although closing costs still apply, the amount of documentation and underwriting is greatly reduced.

Less Common FHA Loans

- Section 203(h): Mortgage insurance for disaster victims (100% financing available; must file within one year after declaration of disaster)
- Section 203(n): Mortgage insurance for purchase of a unit in a cooperative housing project
- Section 221(d)(3) and (4): Mortgage insurance for multifamily rental or cooperative projects
- Section 223(e): Mortgage insurance for older, declining areas
- Section 234(c): Mortgage insurance for condominium projects
- Section 255: Mortgage insurance for Home Equity Conversion Mortgage (reverse mortgage)
- Section 811: Supportive housing for persons with disabilities (provides direct funding to nonprofit organizations to support housing for low-income adults with disabilities)
- Energy Efficient Mortgage (EEM)
- Home Equity Conversion Mortgage (HECM)
- Good Neighbor Next Door
- Homeownership Vouchers
- Native American Housing
- Manufactured Home Financing
- Disaster Relief

Key Terms

streamline refinance

an option for borrowers who want to take advantage of low interest rates, get out of an adjustable-rate mortgage (ARM) or graduated-payment mortgage (GPM)

Direct Endorsement

Chapter Objectives Explain direct endorsements

Direct Endorsement

Some lenders have the authority to approve FHA loans in-house without submitting the file to the FHA regional office for prior approval. This is known as a **direct endorsement (DE)** and it can save quite a bit of time in processing the loan.

The Basics of the Direct Endorsement

The FHA can grant lenders unconditional Direct Endorsement authority to close loans without prior FHA approval.

But before a lender is granted unconditional Direct Endorsement authority, they have to submit a specified number of loan files for review and approval by the FHA. The FHA will then review each loan file and then notify the lender of the acceptability of the mortgage.

Key Terms

direct endorsement

when a lender has the authority to approve FHA loans in-house without submitting the file to the FHA regional office for prior approval

FHA Contributions to Real Estate Finance

Chapter Objectives **Summarize the historical background of the FHA** | **Identify the contributions FHA makes to real estate finance**

Origin of the FHA

The National Housing Act of 1934 created the Federal Housing Administration (FHA) to stabilize the housing industry that had been devastated by the Great Depression.

The FHA's goals are to:

- Facilitate the financing of repairs, additions, and sales of existing homes
- Increase homeownership

Funding for the FHA is provided through the proceeds of mortgage insurance premiums paid by borrowers and not taxpayer money.

FHA's Role in the Market

The FHA is credited with the advent of fully amortized 20, 25, and 30-year mortgages, which weren't widely available before it came along.

VA Loan Guaranty Program

Chapter Objectives **Explain the Veterans Association Loan Guaranty Program | Identify the eligibility requirements for the program | Explain what VA loans can be used for**

VA Loans

The Department of Veterans Affairs (VA) is authorized to guarantee loans to purchase or construct homes for eligible veterans and their spouses.

What VA Loans Can Be Used for

These loans can be used for **owner-occupied houses or condominiums, improvements, manufactured homes, land, farms, and refinancing or assuming VA loans.** Typically, there is no required down payment. Veterans qualify on the basis of their debt-to-income ratio, which must not exceed 41%.

Eligibility

A veteran who meets the established time-in-service criteria is eligible for a VA loan. VA-guaranteed loans help veterans finance a home purchase with little or no down payment. This means VA loans can be used for 100% of the purchase price. However, residential property must be owner-occupied.

The VA Doesn't Lend Money, It Insures Loans

Like the FHA, the VA does not lend money — it guarantees loans made by approved, qualified lending institutions approved by the agency. Therefore, the term VA loan refers to a loan that *is not made by the agency but guaranteed by it.*

Qualifications

VA loans are principally for discharged military personnel with wartime service of a specified duration or certain peacetime service, active-duty personnel, and reservists with six years in the reserves or National Guard.

A veteran and their spouse (including a common-law spouse) may co-sign a guaranteed loan together. However, an unmarried partner who is a co-borrower with a veteran may not have their portion of the loan amount guaranteed by the VA.

Service Requirements

To be eligible for the VA loan program, a veteran must have been discharged other than dishonorably. They must have served actively for 90 days or have been discharged due to a service-related disability during the following wartime periods:

- World War II: September 16, 1940, to July 25, 1947
- Korean War: June 27, 1950, to January 31, 1955
- Vietnam War: August 5, 1964 to May 7, 1975

Similarly, a veteran who has served 180 days of continuous active duty or been discharged for a service-related disability during the following peacetime periods also is eligible:

- Peacetime Dates After World War II: July 26, 1947, to June 26, 1950
- Korean War: February 1, 1955, to August 4, 1964
- Vietnam War: May 8, 1975 to September 7, 1980 (or October 16, 1981, for officers)

Certificate of Eligibility

Obtaining a VA loan requires a Certificate of Eligibility, which only the VA may issue. These certificates must be obtained each time the veteran applies for a loan, applies to have their entitlement restored, or applies to refinance their VA loan.

Maximum Loan and Guaranty

To make these low-down or no-down loans acceptable to lenders, the VA guarantees the first 25% of the loan.

This creates a loan product that has the equivalent of a 75% loan-to-value — at least in terms of the risk or exposure of the lender taking on the loan.

There is no VA limit on the amount of loan a veteran can obtain, rather the limit is determined by the lender. The VA simply limits the amount of loan it will guarantee in the event that a veteran defaults on their loan.

VA Entitlement Amount

Each veteran receives at least $36,000 of basic home loan entitlement, provided they meet the established service requirements. However, the specific amount of loan that would be guaranteed is based on the loan amount and prior use of the entitlement for another VA loan.

Remaining Entitlement

Veterans who had a VA loan before may still have "remaining entitlement" to use for another VA loan. Most lenders require that a combination of the guaranty entitlement and any cash down payment must equal at least 25% of the reasonable value or sales price of the property, whichever is less.

VA Loan Limits

The maximum guaranty amount equals 25% of the conforming loan limits, which are adjusted yearly. VA's loan limits are the same as the Federal Housing Finance Agency's conforming loan limits. As of June 2020, the conforming loan limit was $510,400 for all counties in Texas.

Entitlement Math

VA guaranty limits are linked to the FHA conforming loan limits. Those limits are presently set at $510,400 in Texas. To figure out the maximum guaranty amount, find 25% of that loan limit.

$510,400 x 0.25 = $127,600

That means that 25% of the conforming limit of $510,400 would be $127,600, which is the **maximum guaranty amount**.

Secondary Entitlement Amount

To make up the gap between that amount and the basic entitlement amount of $36,000, we need to find the secondary entitlement amount. We can find this by subtracting the **basic entitlement amount** ($36,000) from the **maximum guaranty amount** ($127,600).

$127,600 - $36,000 = $91,600

This means that we can have a secondary entitlement amount of up to **$91,600**.

In some of the more expensive areas of the country, the conforming loan amounts have been raised beyond $510,400. In places where this is the case, the VA guaranty limits have raised as well. The VA guaranty limits will be the lesser of:

- 25% of the mortgage loan amount, or
- 25% of the VA loan limit (the FHA conforming loan limit) for that county

Restored Entitlement

A veteran's remaining entitlement can be "restored" to them under certain conditions.

First, if the original VA loan amount is repaid in full or the loan is assumed by another eligible veteran, the first veteran may apply to have their entitlement restored. If the veteran has their entitlement restored, they can apply for new loans and take full advantage of their entitlement as though they had never used it before.

Appraisal and Closing

After an appraisal is done by a VA-approved appraiser, the VA issues a **Certificate of Reasonable Value** (CRV), which is **an estimate of the market value on the date of inspection for the property being purchased**. The CRV, which allows for a comparison between the sales price and the market value, places a ceiling on the amount of a VA loan allowed for the property.

The VA Option Clause

In the event that the purchase price is greater than the amount cited in the CRV, the veteran may withdraw from the contract without penalty and have the earnest money refunded. They also have the option of paying the difference between the purchase price and the CRV as a down payment. These options are only available if the sales agreement contains a **VA Option Clause**.

Funding Fee

In order to cover the cost of administering the VA home loan program, every applicant must pay a funding fee to the VA at closing. The amount of the funding fee varies depending on regular or reserve military status, amount of down payment, and whether it is a first or subsequent use of VA financing.

Key Terms

VA loan

loan to purchase or construct homes for eligible veterans and their spouses

Additional VA Loan Programs

Chapter Objectives **Explain details about VA loan assumptions**

Assuming VA Loans

Anyone (veteran or nonveteran, investor or not) may assume a VA loan. There is no limit to the number of VA loans an individual may assume.

VA loans originated before March 1, 1988, are fully assumable with no qualifying and no change in terms. VA loans originated after March 1, 1988, are assumable only with a full qualification process on the borrower.

Fees

A 0.5% funding fee will be charged on all assumptions of VA loans originated after March 1, 1988. Up to a $500 lender's processing fee also will be charged. The person assuming the loan may be either an owner occupant or an investor.

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Lender Loan Process

Qualifying the Borrower

Chapter Objectives **Identify how to qualify a borrower based on financial qualifications of the loan applicant and the value of the property** | **Describe how underwriters look at credit scores** | **Summarize the two Computerized Loan Origination Systems (CLO) used by Fannie Mae and Freddie Mac**

Underwriting

Underwriting is when a mortgager gathers information in order to perform a financial analysis to determine the loan and interest rates they should provide. It's part of the loan approval process.

Qualifying the Property

In order to determine a buyer's financial qualifications, lenders need to evaluate and qualify both the buyer and the property. For the property, the underwriter will evaluate the value of the property to determine whether it is adequate collateral for the loan.

Qualifying the Buyer

For the buyer, an underwriter will typically look at five aspects of the applicant (sometimes called the "underwriter five"):

- Income
- Credit
- Assets
- Debts
- Net worth

Sources of Income

Underwriters look for a two-year employment history, including a consistent working pattern that provides a good indication that the applicant's income will continue.

Verification of Employment Form

All income reported by the applicant should be verified by the underwriter. Employers should be sent verification of employment forms, which request the length of the applicant's employment, gross salary, additional income (such as overtime, bonuses, and royalties), and the likelihood of continued employment.

Credit Scores

Credit scores are numerical expressions that are based on a level analysis of an individual's credit files, representing the "creditworthiness" of that person. This score is based mostly on credit information sourced typically from credit bureaus.

Interest Rates

The factor most likely responsible for a high interest rate is that borrower's credit score.

Credit Reports

To check a potential borrower's credit, the lender will evaluate the individual's credit report. Credit reports are statements issued by one of the three credit reporting bureaus: **Equifax, Experian**, or **TransUnion**.

Net Worth

Lenders also consider the net worth of an applicant in order to make a loan decision. A person's net worth is the sum of all of their assets minus (-) all of their liabilities.

Computerized Loan Origination Systems (CLO)

HUD encourages the use of Computerized Loan Origination Systems (CLO), which is computer software that allows an employee to enter information about a buyer and property to determine the likelihood of that person defaulting on the loan.

CLOs help minimize the variations of human judgment in loan qualification. It expedites the process and can save the borrower money.

CLO: Desktop Underwriter

Desktop Underwriter (DU) is Fannie Mae's CLO.

No Credit Scores

DU does not use FICO credit scores in its analysis.

CLO: Loan Prospector

Freddie Mac's **Loan Prospector (LP)** is the equivalent of Fannie Mae's Desktop Underwriter.

Manual Underwriting

Desktop Underwriter and Loan Propsector **do not reject applicants**. Instead, if they can't approve the loan, they send the applicant to a **manual underwriter** (human underwriter).

The Equal Credit Opportunity Act (ECOA)

Lenders are required to abide by the **Equal Credit Opportunity Act (ECOA),** which makes it unlawful for a creditor to discriminate against any applicant, with respect to any aspect of a credit transaction, on the basis of race, color, religion, national origin, sex, sexuality, gender presentation, marital status, or age.

Loan companies **may not ask about marital status** beyond inquiring if the borrower is married or single. For example, lenders may NOT ask if an applicant is widowed or divorced.

Key Terms

credit report

contains information regarding an individual's credit history (loan payments, etc.) as well as the present credit status of all open credit accounts

credit score

numerical representation of an individual's creditworthiness based on an analysis of their credit files

net operating income (NOI)

a property's annual income that remains after paying its operating expenses

verification of employment form

a form that requests the length of the applicant's employment, gross salary, additional income, and the likelihood of continued employment

Qualifying the Collateral

Chapter Objectives **Outline the steps of the appraisal process** | **Illustrate three methods for how value is calculated in real estate**

Collateral

Collateral is something pledged as security for repayment of a loan, that can be forfeited in the event of a default. A borrower's financial qualifications and creditworthiness cannot be the only things considered when lending. A loan underwriter also must consider **the value of the property that will act as security (collateral) for the loan**.

Property Valuation

For non-income-producing properties, value can be ascertained using a property valuation from an appraiser. Property valuation is the process of developing an opinion of value for real property, usually at market value.

For income-producing properties, the underwriter must be able to verify that the property will be able to consistently produce the cash flows necessary to amortize the loan over its term.

Appraisal

A professional real estate appraiser evaluates the worth of a property.

Market Value

An appraiser is trying to determine the current market value of a property. Market value is the price for which a property will sell if offered openly under normal conditions.

APPRAISAL PROCESS CHECKLIST

- [ ] 1. State the objective.
- [ ] 2. List the data needed.
- [ ] 3. Gather and record data.
- [ ] 4. Determine the highest and best use.
- [ ] 5. Estimate the land value.
- [ ] 6. Estimate property value using applicable approaches.
- [ ] 7. Reconcile the final value estimate.
- [ ] 8. Complete and present the value report.

Characteristics of Value

We assess the value of a property based on four key characteristics. To help you remember, think of the acronym DUST.

- D stands for **demand**: In order for a property to have value, there has to be a strong **demand** for it. Otherwise, it offers little to no value.
- U is for **utility**: The property fulfills a need or is useful.
- S means **scarcity**: The more rare property is, the more valuable it becomes.
- T is for **transferability**: A property that can't be transferred lacks value.

VALUE APPROACHES

WITH ACRONYMS AND FORMULAS

THE SALES COMPARISON APPROACH

Most likely used for **residential** properties

Formula:
Comparable Property Sales ± Adjustments = Subject Property Value

THE INCOME CAPITALIZATION APPROACH

Most likely used for **commercial** properties

Formula:
Net Operating Income (I) ÷ Cap Rate (R) = Value (V)

THE COST APPROACH

Most likely used for **new construction** and **specialized buildings**

Formula:
Reproduction Cost - Depreciation + Value of Land = Property Value

Sales Comparison Approach

The first way to approach value calculation is the **sales comparison (or direct sales comparison) approach**, also referred to as the market data approach.

With this method, the factor most relevant to an appraiser is market demand. An appraiser focuses on recent sales to find the value of the subject property using at least three comparison sales, or comparables (often called comps).

Value Principles

The sales comparison approach to appraisal uses two value principles:

- **The principle of substitution:** A person will pay only as much for a property as they must pay to acquire a comparable property (a substitute).
- **The principle of contribution:** An improvement to a home is worth only as much as it adds (or contributes) to the property's market value and does not always relate to the improvement's actual cost.

Applying the Sales Comparison Approach

Appraisers rely heavily upon the sales comparison approach for appraising owner-occupied residential properties and vacant land

Cost Approach

The cost approach involves an appraiser's estimation of the current cost of reconstructing the property with improvements (known as the cost of reproduction), the depreciation value, and the land value.

When to Use the Cost Approach

Typically, most residential appraisals do not use the cost approach. However, the cost approach is a great approach to value for appraisers to use on new construction.

The cost approach is also the method to use for determining the value of highly specialized buildings, such as **museums** or **public libraries.**

Income Approach

The income approach is only used to put a value on property that produces income. It uses the income generated by the property to arrive at a value for the property.

Appraisers generally use this method for commercial buildings like **shopping centers, office buildings, and large apartment buildings.**

Key Terms

collateral

something of value that is pledged to a lender as a promise to repay a loan

D.U.S.T.

an acronym for the characteristics of value (demand, utility, scarcity, transferability)

market value

the price for which a property will sell if offered openly under normal conditions

property valuation

the process of developing an opinion of value for real property, usually at market value

Review of Sample Credit Report

Chapter Objectives Interpret a credit report | Identify which rights the Fair Credit Reporting Act grants to consumers

Residential Mortgage Credit Report (RMCR)

To meet the specific needs of residential mortgage lenders, credit reporting agencies have developed the **residential mortgage credit report, or RMCR**, which contains all of the information needed to underwrite a loan to sell on the secondary market.

These reports not only contain information about a loan applicant's employment history and residence, but they also include the requisite verifications for underwriting.

Fair Credit Reporting Act Protections

The Fair Credit Reporting Act grants certain rights to consumers. Here is a summary of those rights:

- Consumers must be told if information in their file has been used against them.
- Consumers have the right to know what is in their file.
- Consumers have the right to ask for a credit score.
- Consumers have the right to dispute incomplete or inaccurate information.
- Consumer reporting agencies must correct or delete inaccurate, incomplete, or unverifiable information.
- Consumer reporting agencies may not report outdated negative information.
- Access to consumer files is limited.
- Consumers must give their consent for reports to be provided to employers.
- Consumers may limit "prescreened" offers of credit and insurance they get based on information in their credit report.
- Consumers may seek damages from violators.
- Identity theft victims and active-duty military personnel have additional rights.

The Equal Credit Opportunity Act

The **Equal Credit Opportunity Act (ECOA)** prohibits creditors from discriminating against any applicant, with respect to any aspect of a credit transaction, on the basis of race, color, religion, national origin, sex, marital status, or age.

It also mandated that loan companies may not ask about marital status beyond inquiring if the borrower is married or single.

ECOA rules apply to any person who regularly participates in making credit decisions, like banks, retailers, bankcard companies, finance companies, and credit unions.

Assets

An underwriter will often consider a borrower's **assets** when underwriting the loan application. Assets are property owned by a person or company. These assets hold value to meet debts, commitments, or legacies.

Gifts

A borrower who does not have sufficient funds for closing may use **gift funds**. In this context, a gift is cash that the borrower receives from a relative, fiancé, or domestic partner that does not need to be repaid. Some gifts can come from charitable or nonprofit organizations.

Retirement Vehicles

It's also possible for a borrower to own one or more retirement vehicles, such as a 401(k) plan or an Individual Retirement Account (IRA) that contain funds with which they may purchase real property under certain conditions.

Housing Expense Ratio

The **housing expense ratio** (also sometimes referred to as the **housing-expense-to-income ratio** or the **front-end ratio**) is a simple ratio that compares housing expenses to pre-tax income. The formula to determine the ratio is this:

Annual PITI payment ÷ Borrower's annual income = Housing expense ratio

Total Debt Service Ratio

The second qualifying ratio lenders use is known as the total **debt service ratio**, or the **debt-to-income ratio (DTI)** or the **back-end ratio**. This formula for this ratio is:

(PITI + Long-term liabilities) ÷ Gross monthly income = Total debt service ratio

Long-time liabilities refer to the sum of all debts paid monthly (for example, monthly car payments, student loan payments, credit card payments, etc.). The total debt service ratio can also be expressed as:

Total monthly expenses ÷ Gross monthly income = Total debt service ratio

Fannie Mae's Debt Service Ratio

Fannie Mae requires a back-end ratio not to exceed 45%. In order to qualify for the loan, the total house payment plus all the person's long-term debt cannot exceed 45% of their gross monthly income.

Debt-to-Equity Ratio

Lenders will sometimes (especially for business loans) have a qualifying **debt-to-equity ratio**, also known as a **total-liabilities-to-net-worth ratio.**

This ratio is a measure of the extent that the net worth of an enterprise can offset its liabilities. Generally, 400% is the maximum debt-to-equity ratio a lender will allow. In other words, a business must not owe more than four times the value of all its assets.

The debt-to-equity ratio can be found using this formula:

Total liabilities ÷ Net worth = Debt-to-equity ratio

Net Worth

A person's net worth is the sum of all of their assets minus all of their liabilities:

Assets - Liabilities = Net worth

Interest Rates

Interest rates that are not fixed but are instead tied to the market are called floating rates. The **float rate** is the interest rate at any particular moment.

Lock-In Fee

Many lenders allow borrowers to pay a **lock-in fee** to lock in the float rate at the time of the loan's approval.

Key Terms

assets

property owned by a person or company; holds value to meet debts, commitments, or legacies

Equal Credit Opportunity Act (ECOA)

a fair lending law that aims to bar discriminatory lending practices

Fair Credit Reporting Act (FCRA)

legislation that promotes accuracy, fairness, and privacy of consumer information in the files of consumer reporting agencies

gift

cash the borrower receives from a relative, fiancé, or domestic partner that does not need to be repaid

residential mortgage credit report (RMCR)

report containing information needed to underwrite a loan to sell on the secondary market

Review of the Uniform Residential Loan Application

Chapter Objectives **Fill out a Uniform Residential Loan Application**

The Application

The loan process begins with the loan application. A borrower first meets with a mortgage broker or loan officer to fill out the application. After the application is filed, its information needs to be verified.

For example, the salary and employment information is checked against the Verification of Employment Form, sent to the applicant's employer. The loan officer then will order an appraisal and send the verified application and the appraisal to the underwriter.

The Uniform Residential Loan Application

The Uniform Residential Loan Application is the standard application used by banks to determine someone's ability to secure a mortgage loan.

Key Terms

Uniform Residential Loan Application (URLA)

standard application used by banks to determine someone's ability to secure a mortgage loan

Review of Request for Verification of Deposit

Chapter Objectives **Demonstrate how a Request for Verification of Deposit form should be filled out**

Verification of Deposit (VOD)

Verifications of Deposit, or VODs, are requests sent to banks by state and federal agencies, including the Veteran's Administration and the Social Security Administration, to verify whether a customer qualifies for any of the following:

- Subsidized housing
- Food stamps
- Medicare
- Medicaid

Mortgage lenders send a verification of funds on deposit to determine if the consumer has the cash that will be needed for the down payment and closing costs when processing a mortgage loan application.

What's in a VOD

A Verification of Deposit typically includes information such as the current balance, the average balance for the previous two months, and the date the account was opened.

Borrower's Certification and Authorization Form

A Verification of Deposit for a refinance or a new mortgage MUST be accompanied by both a Borrower's Certification and an Authorization Form signed by the borrower.

Review of the Verification of Employment (VOE)

Chapter Objectives **Demonstrate how to properly complete the Request for Verification of Employment form**

Verification of Employment

Mortgage lenders send a **Verification of Employment (VOE)** to a potential borrower's current employer to verify their employment. The lender is verifying the person's income, that they actually work where they said they did, and whether or not that employment is likely to continue in the future.

Employers Don't Have to Comply

Employers are not required by law to complete VOEs from mortgage lenders, but employers typically try to comply with the request.

Review of Uniform Residential Appraisal Report

Chapter Objectives **Explain the requirements of the Uniform Residential Appraisal Report (URAR)**

Uniform Residential Appraisal Report (URAR)

A **Uniform Residential Appraisal Report**, also known as URAR, is a common form used in real estate appraisal, created to allow for standard reporting and analysis of single-family homes or single-family homes with an "accessory unit." (A URAR is also okay to use for a building in a planned unit development, but not meant to be used for appraisals of manufactured homes or condos.)

Fannie Mae Form 1004

You'll most likely see URAR listed as the **"Fannie Mae Form 1004."** The report covers a full appraisal process that includes all three approaches to value: the cost approach, the sales comparison approach, and the income approach.

Requirements

URAR has several important requirements. The report needs to include:

- An interior and exterior inspection of the subject property
- A street map showing the location of the subject property and all comparable properties used by the appraiser
- An exterior building sketch of the improvements, indicating dimensions
- Clear and descriptive photographs of the subject property and comparable sales used

Key Terms

appraisal

a written estimate of a property's market value completed by an appraiser

Universal Residential Appraisal Report (URAR)

form used in real estate appraisal to allow for standard reporting and analysis of single-family homes or single-family homes with an accessory unit

Required Lender Notices

Chapter Objectives **Explain the role a loan servicer plays in the mortgage loan process | Describe the key requirements of loan disclosures**

Loan Disclosures

Because of RESPA, borrowers must receive many different disclosures throughout the process of acquiring a loan. These many disclosures tell the borrower about things like:

- Settlement costs that may be associated with the mortgage
- Responsibilities involved in the lender servicing and escrow account
- How different settlement service providers work together

TILA-RESPA Integrated Disclosures Rule (TRID)

On August 1, 2015, it was decided that effective October 3, 2015, the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) would be combined, creating the **TILA-RESPA Integrated Disclosures**, or TRID. TRID requires that lenders give borrowers two disclosures: the **Loan Estimate** and the **Closing Disclosure.**

- The **Loan Estimate** form would replace the Good Faith Estimate and Truth-in-Lending Disclosure
- The **Closing Disclosure** would replace the HUD-1 and final Truth In Lending form

Loan Estimate

The Loan Estimate is an estimate of what the terms of the loan will be and how much it will cost.

- It must contain a good faith estimate of credit costs and transaction terms.
- The creditor must deliver or place it in the mail **no later than the third business day after having received the consumer's application.**
- It must also be delivered or placed in the mail no later than the seventh business day before consummation of the transaction.

The Closing Disclosure

The **Closing Disclosure** (also called the closing statement) is a form used to itemize services and fees charged to the borrower by the lender when applying for a real estate loan.

For loans that require a Loan Estimate and that proceed to closing, creditors must provide the Closing Disclosure reflecting the actual terms of the transaction. The creditor is **required to ensure that the consumer receives the Closing Disclosure no later than three business days before consummation of the loan.**

The Closing Disclosure should contain the **actual terms and costs of the transaction**.

The Closing Disclosure Must Be Accurate

If the actual terms or costs of the transaction change prior to closing, the creditor must provide a corrected disclosure that contains the actual terms, which results in a **new three-day waiting period before closing.**

No Fee

For loans subject to RESPA, **no fee may be charged** for preparing the Closing Disclosure, Loan Estimate, escrow account statement, or any other disclosures required by the Truth in Lending Act.

Servicers and Escrow Accounts

When it comes to escrow accounts, the servicer has these responsibilities to the borrower:

- A servicer must submit an **annual statement of each escrow account** to the borrower within 30 days of the completion of the computation year.
- Then, the servicer needs to conduct an **analysis of the escrow account**. After that, they can submit it to the borrower.

Key Terms

consummation

the point at which the consumer becomes contractually obligated to the creditor on the loan

disclosure

the act of supplying previously unknown information to a party in a transaction

servicer

the company to which mortgage payments are sent

Qualifying the Title

Chapter Objectives **Compare the differences between a title search, chain of title, and abstract of title | Illustrate to your client reasons why they may need title insurance | Explain the importance of a clear title | Define "marketable" title**

What Is Title?

In real estate, **title** is the actual ownership of a real property in which a party may own a legal or equitable interest. It includes the bundle of rights. To hold the title is to hold legal ownership of a property. It also gives someone the right to use the property. A title is not a physical object, instead it is a collection of rights of ownership a person has.

Title Search

When an individual performs a **title search**, they examine available public records to ensure that no clouds on the title exist. This way, the property owner can legally transfer ownership of the property.

The title search begins with the present owner and traces the lineage back to the original owner (or grantor), thereby examining each ownership to ensure that no encumbrances, forged documents, or gaps in ownership exist. **Lawyers, qualified title searchers, or insurance companies usually perform title searches for prospective buyers or mortgagees.**

Abstract of Title

An **abstract of title is an abbreviated history of a property**, including info on any transfers, grants, wills, conveyances, liens, and encumbrances. An abstractor prepares the document by performing a title search, which will return the title's history. From this information, the abstractor summarizes all events that previously affected the title as well as current liens and encumbrances and their status.

The abstractor will also attach a document to the abstract of title that lists the records that they used or did not use to generate the abstract.

Chain of Title

While an abstract of title is a condensed version of a title's history, **a chain of title is the full history of a title**. It includes all of the information available about the property's title.

Title companies and abstractors can use a chain of title to search for any possible discrepancies or lien issues.

Attorney's Opinion of Title

If a prospective borrower or buyer wants to use **an attorney's opinion of title** as evidence of title, the borrower must first hire an abstractor to prepare an abstract, which contains a summary of all of the events that have affected or currently affect the title, as well as a listing of records that they did and did not use.

Abstractors do not give opinions concerning the condition of the title.

Title Insurance

Title insurance protects a policyholder from any events that occurred before the issuance of the policy. This protects the policyholder against any losses that may arise from defects in the title, such as a forged title.

Written Notice

In Texas, real estate license holders are required to give every buyer a written notice that says they should have the abstract examined by an attorney of their choice or get a policy of title insurance.

Title Plant

A title plant is a collection of title records that is privately owned and maintained, usually by a title insurance company.

Clear Title

It is important that everyone gets a **clear title** when they purchase property. This means that people must be informed about any claims against the land so that they can make certain they are cleared up before they buy. And it means they must be protected against any undiscovered claims that may arise to threaten their title and the possession of their property. **Title insurance provides this protection.**

Marketable Title

A marketable title:

- Allows the recipient of the title to exercise ownership rights without having to defend those rights through litigation
- Shows that the property can be sold or mortgaged at fair market value by a practical and knowledgeable individual
- Does not have any defects that have not been openly accepted by the buyer
- Does not have any liens or encumbrances that have not been openly accepted by the buyer

Key Terms

abstract of title

an abbreviated history of a property, including information on any transfers, grants, wills, conveyances, liens, and encumbrances

title

the actual ownership of a real property that includes the bundle of rights in which a party may own a legal or equitable interest; not an actual document

title plant

a collection of privately owned and maintained title records

title search

an examination of all public records in the county to determine who has rights in the property and whether any defects exist in the chain of title

Review of the Title Commitment

Chapter Objectives **Describe what a title commitment does** | **Explain the different parts of a title commitment**

Different Types of Title Insurance Policies

Title insurance companies offer many different types of policies to accommodate the different types of customers who need title insurance.

- **Lender's title policy:** The lender's title insurance policy covers the *lender* in the case of any title defect uncovered after closing, and it's issued on the dollar amount of the loan. This is also sometimes called the *mortgagee policy*.
- **Owner's title policy:** The owner's policy of title insurance is a title insurance policy that insures the *buyer* against title defects. It's usually issued for the sales price of the property instead of the loan price, since the buyer needs coverage for the entire cost of the property if a title defect means they lose the home.
- **Leasehold title policy:** Leasehold title insurance is a policy that assures lessees that they have a valid lease.
- **Certificate of sale policy:** Certificate of sale title insurance is a policy that is issued during court sales and protects the buyer's interest in property sold by the court.

Standard Title Insurance Policies

Standard title insurance policies can protect policyholders against the following:

- Fraud
- Forgery
- Abstract of title errors
- Incompetent grantors
- Foreclosure
- Unmarketable titles

Title Commitment

Before a buyer gets a title insurance policy, they'll get a **title commitment**.

A title commitment is a pre-closing document that lists all of the terms, conditions, and exclusions that will be listed on the title policy. Consider it a "preview" of the final title insurance policy, which is given after closing.

The ABCD's of Title Commitment

The title commitment is divided into four sections called schedules — A, B, C, and D.

- **Schedule A**: Actual facts (names, legal, price, lender)
- **Schedule B**: Buyer's notice of things not covered by the title policy, i.e., utility easements, etc.
- **Schedule C:** Clear this list; here, the title agent lists their requirements that must be cleared in order for them to issue the final title insurance policy
- **Schedule D**: Disclosure of all parties who will share any part of the title insurance premium

Key Terms

owner's policy of title insurance

title insurance policy that insures the buyer against title defects

title commitment

a pre-closing document that lists all of the terms, conditions, and exclusions of the title policy; a "preview" of the final title insurance policy

Lender Closing Costs

Chapter Objectives **Explain how expenses are allocated in a typical real estate transaction** | **Demonstrate how to calculate prorated expenses**

Closing Disclosure

The **Closing Disclosure** (formerly known as a "settlement statement") is a document that provides a detailed list of each party's expenses as well as how much they have already contributed to the transaction thus far.

Check the Contract

Most closing cost expenses are agreed to in the sales contract. **The title company will use the sales contract to determine how the parties have agreed to allocate the expenses.**

Credits and Debits

A closing statement provides a detailed accounting of each party's debits and credits.

Credits

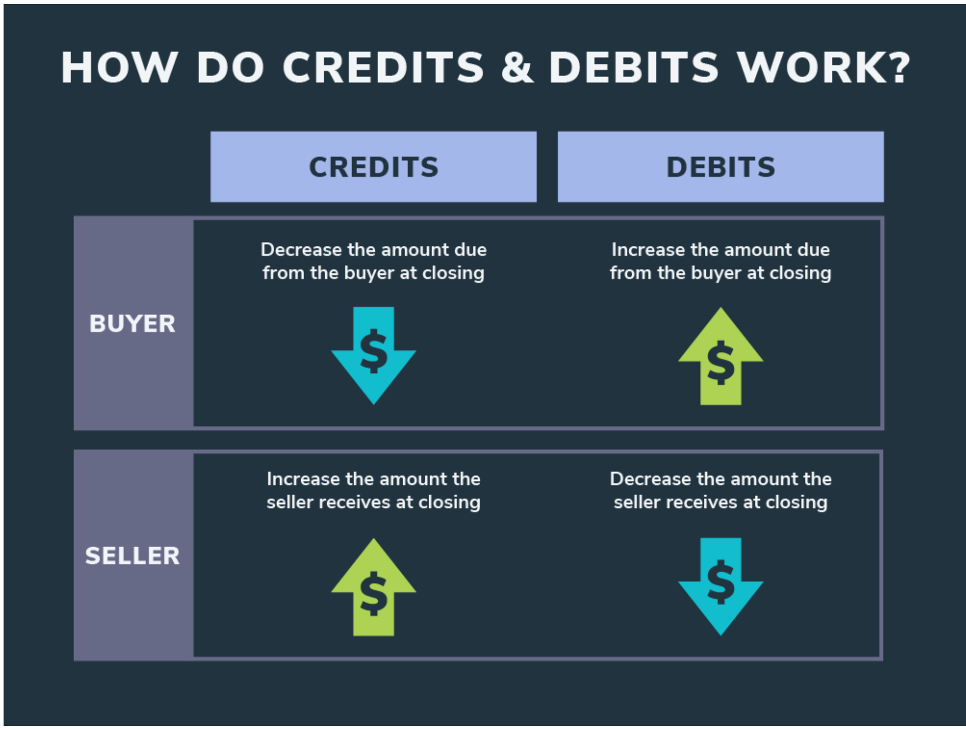
A **credit is a positive balance or a positive amount.** It is a figure entered in a party's favor when determining the overall costs associated with a transaction. On closing statements, credits reflect expenses that have been paid by a particular individual or expenses that are owed to that individual.

Debits

A debit is a negative balance or a negative amount. A debit is an amount due from or owed by a particular individual when determining the overall costs associated with a transaction. On closing statements, debits reflect charges made to the parties involved in the transaction.

How Credits and Debits Affect Buyers and Sellers

- A debit to the buyer increases the amount due from the buyer at closing.
- A credit to the buyer decreases the amount due from the buyer at closing.
- A debit to the seller decreases the amount the seller receives at closing.
- A credit to the seller increases the amount the seller receives at closing.



Finding the Buyer's Total

The actual amount that a buyer is to pay at closing is calculated by subtracting the buyer’s total credits (such as prepaid earnest money or the balance of a loan that the buyer will assume from the seller) from the buyer’s total debits (such as the purchase price). The remaining total is the amount that the buyer must bring to the closing to complete the transaction.

Finding the Seller's Total

To determine how much money a seller will receive from a transaction, we subtract the seller’s total debits (such as the balance of a mortgage loan) from the seller’s total credits (such as the purchase price). The remaining total is the amount that the seller will receive.

Seller's total credits - Seller's total debits = What the seller receives

Prorating Expenses

The proration process is a method of dividing accrued items and prepaid items between a seller and a buyer.

Accrued Items

Accrued items are costs that are owed by a seller (such as real estate taxes in a state where these are not prepaid), but which will ultimately be paid by a buyer after they receive title to a property. These expenses have been (or are being) incurred at the time of sale but need not be paid at the time the sale closes.

Prepaid Items

A **prepaid item** is an item that has been paid for ahead of time, generally by the seller.

Accrued items are generally debited to the seller and credited to the buyer, and prepaid items are credited to the seller and debited to the buyer.

Carried Through the Closing Date

In Texas, prorations are calculated through the closing date. That means that the seller pays for closing day when dealing with prorated items.

Daily Prorations

It may be necessary to calculate a daily charge for a prorated item. In this case, there are two methods commonly used to calculate daily charges:

- **A 360-day year**: The 360-day year is known as a "banker's year;" it is commonly used in banking and other financial calculations, and is divided into 12 months of 30 days each. To figure daily charges using a 360-day year, you can divide the yearly charge by 360 or divide the monthly charge by 30.
- **A 365-day year**: The 365-day year is sometimes also called the “conventional calendar year,” because its divisions reflect the actual months of the calendar that most of us use.

Key Terms

arrears

payment that occurs at the end of a period to compensate for charges accrued during that time

credit

a positive balance or a positive amount

debit

a negative balance or a negative amount

13

Defaults & Foreclosures

Defaults

Chapter Objectives **Define what it means to default | Describe the different types of default | Identify the requirements to maintain and insure a property**

Defining Default

A default is any breach of a valid contract. Most defaults in mortgage contracts are on the side of the borrower. Not all defaults, however, are caused by a failure to make a payment on the loan. Defaults can also come from:

Nonpayment of taxes

Lack of required insurance

Improper use of the property

Damage to the property

The Acceleration Clause

A note usually contains an acceleration clause to protect the lender in the event of default. This clause states that whenever there is a breach of contract on the part of the borrower, the lender may make the entire amount of the loan due immediately.

Tax Clause

Real estate loans include a tax clause that states the borrower's obligation to pay property taxes in full when they become due. Most residential mortgage loans use escrow accounts to collect taxes (and insurance payments) month by month, allowing the lender to closely monitor and ensure the payment of taxes.

Foreclosure Option

If a borrower fails to make the requisite tax payments, the government could foreclose on the property and sell it to recover back taxes.

Delinquency

A borrower is said to be **delinquent** on their payments if they fail to pay the principal, interest, taxes, or insurance for a loan on time or at all.

Adjustments and Modifications

Chapter Objectives **Describe loan adjustments and loan modifications | Discuss alternatives to foreclosure | Identify market factors when making decisions on a property**

Moratorium

A **moratorium** is the suspension of loan payments for a period of time.

Forbearance

When the lender may legally foreclose due to default but chooses not to, it is called **forbearance**. The borrower can work with a lender to develop a payment plan to make up for the missed moratorium payments.

Recasting

Sometimes moratoriums involve **recasting**, or a change of the loan terms. A lender may recast a loan in place of a payment moratorium or may recast in addition to the moratorium. If there is a moratorium, the borrower will owe more money than what will be covered by the remaining monthly payments. A plan for catching up with the loan is necessary.

Paying for Moratorium

The lender can:

- Increase the monthly payments after the moratorium
- Extend the term of the loan
- Allow for a balloon payment at the end of the current loan term

These methods also may be combined. For example, the lender could increase the monthly payments slightly and extend the term of the loan.

Recasting Without Moratorium

If there is no moratorium period, the lender may recast the loan in such a way as to allow for the borrower's distressed financial situation: the lender may lower the monthly payments and extend the loan term, adjust interest rates, or provide for a graduated payment structure.

Short Sales

If the property owner cannot afford to keep the property and there is not enough equity to market the property, the lender may agree to a **short sale.** A short sale is a sale in which the lender will agree to accept less than what is actually due on the mortgage before the property goes into foreclosure.

Short Sale Types

There are two types of short sales:

- **The lender forgives the debt.** (This is considered debt forgiveness and at times has been taxable income for IRS purposes; clients should check with a tax consultant.)
- **The lender requires the buyer to sign a note to repay the difference between the amount due on the mortgage and the amount they receive at the time of the sale.** In this instance, the debt is not forgiven.

Deed in Lieu of Foreclosure

A borrower who cannot make the monthly payments for a loan may voluntarily transfer title to the lender to avoid foreclosure.

This arrangement, called a **deed in lieu of foreclosure**, has several advantages:

- The borrower's credit is not as damaged, as in the case of a foreclosure.
- The borrower need not worry about a deficiency judgment as long as it is written into the arrangement that the deed in lieu of foreclosure is "in full satisfaction of" the debt.
- The lender does not have to incur the expense of a foreclosure.

A disadvantage of a deed in lieu of foreclosure is that it does not eliminate junior lien holders the way that foreclosure does.

Properties in Distress

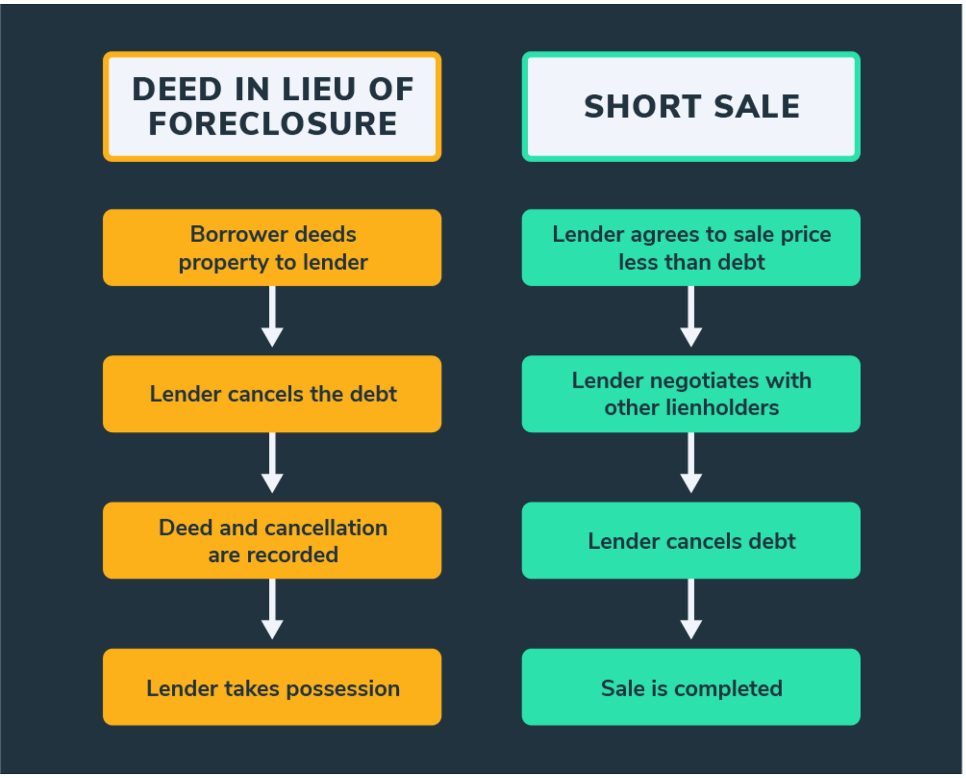
A property in distress is one that is in poor condition either physically or financially. The task of managing these properties often falls to a lender who has foreclosed on a property for default.

Physical Distress

A physically distressed property may be in poor repair. It may be dilapidated, infested with termites, have a mold problem, or it may have environmental liabilities, such as lead-based paint, asbestos, radon, or other toxic hazards.

Financial Distress

A financially distressed property may have low returns or even be running at a loss.



Asset Managers

Asset managers deal with investment properties and their goal is to maximize the return of such properties. When a lender receives a distressed property through foreclosure, the task of making the right decisions to minimize losses and, if possible, increase returns often falls to an asset manager.

Property Managers

If the title of a distressed property falls to a lender who has foreclosed the property, they may not have the managerial experience necessary to run the property. Such a titleholder may seek to hire a **property manager.**

Types of Foreclosures

Chapter Objectives **Explain and discuss judicial, non-judicial, and strict foreclosure**

What is Foreclosure?

Foreclosure is the legal process whereby a lender takes control of a property held by a borrower in default and sells it to recover the lender's losses.

Foreclosure usually happens only when the alternatives provided by moratoriums and recasting are not enough to allow the borrower to repay the loan amount.

The Foreclosure Process

There are specific steps that take place in a foreclosure in Texas.

1. The lender sends a demand letter to the homeowner, who has 20 days to pay the past due amount.
2. After the 20 days have passed (and at least 21 days before a foreclosure sale), more foreclosure notices must be sent.

Judicial Foreclosure

At the foreclosure proceedings, all creditors with a claim against the property appear and present evidence of their claim. The court recognizes the claims and their priority and then orders a public sale of the foreclosed property. A foreclosure that is processed through the court is called a **judicial foreclosure**.

HOA Foreclosures

HOA foreclosures are the most common use of judicial foreclosure. A homeowners association in Texas may foreclose its assessments lien judicially by filing a lawsuit.

Redemption Period

A statutory redemption period is the time after your home has already been sold at a foreclosure sale when you can still reclaim the property.

Texas Right of Redemption

There is a right of redemption in Texas, but it only applies to:

- **HOA foreclosure of an assessment lien**
- **Sales for unpaid ad valorem taxes**. In this case, the former owner of the homestead or agricultural property gets the right of redemption for two years (compared to 180 days for commercial property).

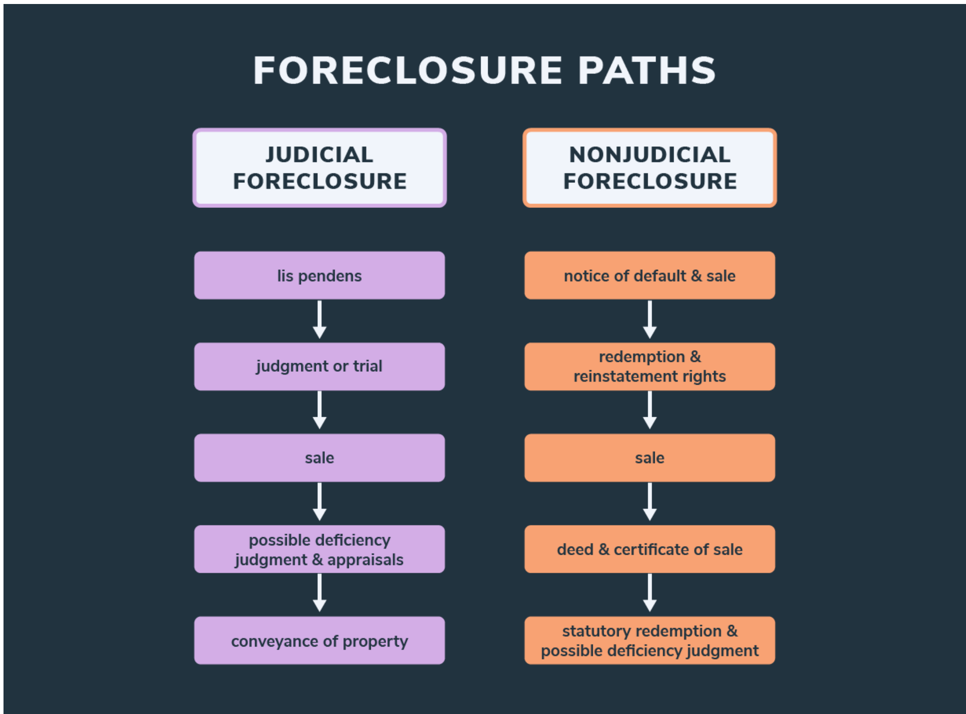
Note that in Texas, these are the only instances where statutory redemption is possible. There is NO statutory redemption for lender foreclosures.

Power of Sale Clause

Non-judicial foreclosure is the primary method of foreclosure in Texas. Except for certain notice provisions, this type of foreclosure does not involve court action. **A deed of trust or mortgage document will usually contain a provision called a power of sale clause.** This clause allows the lender to bypass the courts and take possession of and sell a collateral property when the borrower defaults on their loan.

Acceleration Clauses

Acceleration happens when the lender demands immediate payment in full due to a borrower defaulting on a loan. The lender may also invoke the "power of sale," which is what authorizes the non-judicial foreclosure.



Deficiency Judgments

Chapter Objectives **Explain what deficiency judgments are and how they work | Differentiate between equitable vs. statutory redemption**

Deficiency Judgments

Lenders sometimes seek a **deficiency judgment** against a defaulted borrower, guarantor on a loan, or endorsers if a foreclosure sale does not generate enough money to pay off the loan and cover the costs of the foreclosure. **A deficiency judgment requires the defaulted borrower to pay any remaining balance owed to the lender.**

Limits on Deficiency Judgments

Deficiency judgments are limited somewhat by Texas law. **The Texas Property Code says that an action brought to recover a deficiency must be brought within two years of the foreclosure sale.**

Redemption on Mortgage Foreclosures

There are two types of redemption: equitable and statutory.

For mortgage foreclosures (also called lender foreclosures), **Texas allows equitable redemption (before the auction) but does not allow statutory redemption (after the auction).** Statutory redemption allows debtors to redeem (regain possession of) their property after the auction.

When There Is Statutory Redemption in Texas

There's no statutory redemption for LENDER foreclosures in Texas.

If the foreclosure is due to unpaid property (or ad valorem) taxes or an unpaid HOA assessment lien, the homeowner does get a statutory redemption period in Texas. In the case of the property taxes, that statutory redemption period is **two years long.**

Purchaser Receives Deed

If the debtor does not redeem a property during the statutory redemption period, or if the state does not permit a statutory redemption period, then the purchaser at the foreclosure sale receives a deed to the property. The deed is NOT encumbered by the debt, but the title transfers as is.

Tax Impact of Foreclosure

Chapter Objectives **Identify IRS involvement in debt** | **Explain the Mortgage Debt Relief Act**

Forgiven But Not by the IRS

If a borrower owes a debt to someone else and they cancel or forgive that debt, **the canceled amount may be treated as taxable income by the IRS.**

From the years 2008 through 2014, there was relief given to homeowners that had debt forgiveness on their primary residences. That relief is presently expired.

Cancel or Convert the Debt

There are two basic ways a lender can handle a foreclosure. The lender can cancel the debt or it can turn the debt into an unsecured loan that the borrower still owes. If it becomes an unsecured loan (depending on the laws) the lender can charge interest on the note. Since it is now an unsecured loan, this is not a write-off.

If the lender forgives the debt, they must report it to the IRS as income in the year it was canceled.

Capital Gain Taxes

If the homeowner has a gain on the foreclosure, they may have to pay taxes on it. **Profits from foreclosure are currently taxed and exempted identically to profits on any other type of sale.**

Additional Study Resources

The Licensing Process

How to Get Your Texas Salesperson License

After you ace the final exam for each of the six courses, you've still got some work to do to get your license. Take a look at this list for an overview of the process.

Make sure you qualify

- You are at least 18 years old.
- You are a citizen of the United States or have the legal right to work in the U.S.
- You are honest, trustworthy, and a person of integrity.

Complete your education requirements

- Complete 180 hours of TREC-approved pre-licence courses (like Aceable)!

File your application

- Pay the applicaiton fee and submit by mail or online.

Get fingerprinted

- Use the TREC entity number from your application to enroll for fingerprinting.

Take and pass the state exam

- Apply online or by mail.
- Pay the exam fee.
- Schedule the exam.

Pass background check

- An investigation may be necessary to get background check approval.

Find a sponsoring broker and activate your license

- Until you register with a broker, your license will be inactive.

Exam Content Outline

110 Questions

70% Passing

Notes

Texas Real Estate Salesperson Examination Content Outline

The national portion of the real estate exam is made up of eighty (80) scored items, which are distributed as noted in the following content outline. The national examination also contains five (5) pretest items that are not counted toward the score.

I. REAL PROPERTY CHARACTERISTICS, LEGAL DESCRIPTIONS, AND PROPERTY USE (SALES 9; BROKER 9)

A. Real property vs. personal property

1. Fixtures, trade fixtures, emblements
2. Attachment, severance, and bill of sale

B. Characteristics of real property

1. Economic characteristics
2. Physical characteristics

C. Legal descriptions

1. Methods used to describe real property
2. Survey

D. Public and private land use controls – encumbrances

1. Public controls – governmental powers
   a. Police power, eminent domain, taxation, escheat
   b. Zoning ordinances
2. Private controls, restrictions, and encroachments
   a. Covenants, conditions, and restrictions (CC&Rs), HOAs
   b. Easements
   c. Licenses and encroachments

II. FORMS OF OWNERSHIP, TRANSFER, AND RECORDING OF TITLE (SALES 8; BROKER 8)

A. Ownership, estates, rights, and interests

1. Forms of ownership
2. Freehold estate
   a. Fee simple absolute
   b. Fee simple defeasible, determinable, and condition subsequent
   c. Life estate
   d. Bundle of rights

Notes

3. Leasehold estates and types of leases
    a. Estate for years and from period to period (periodic estate)
    b. Estate at will and estate at sufferance
    c. Gross, net, and percentage leases
4. Liens and lien priority
5. Surface and sub-surface rights

B. Deed, title, transfer of title, and recording of title

1. Elements of a valid deed
2. Types of deeds
3. Title transfer
    a. Voluntary alienation
    b. Involuntary alienation
4. Recording the title
    a. Constructive and actual notice
    b. Title abstract and chain of title
    c. Marketable title and cloud on title
    d. Attorney title opinion, quiet title lawsuit, and title insurance

III. PROPERTY VALUE AND APPRAISAL (SALES 11; BROKER 10)

A. Concept of value

1. Market value vs. market price
2. Characteristics of value
3. Principles of value

B. Appraisal process

1. Purpose and steps to an appraisal
2. Federal oversight of the appraisal process

C. Methods of estimating value and Broker Price Opinions (BPO)

1. Sales comparison approach (market data)
2. Cost approach
    a. Improvements and depreciation
    b. Physical deterioration, functional, and economic obsolescence
    c. Reproduction or replacement costs
3. Income approach
4. Gross rent and gross income multipliers
5. Comparative Market Analysis (CMA)
6. Broker Price Opinion (BPO)
7. Assessed value and tax implications

Notes

IV. REAL ESTATE CONTRACTS AND AGENCY (SALES 16; BROKER 17)

A. Types of contracts

1. Express vs. implied
2. Unilateral vs. bilateral

B. Required elements of a valid contract

C. Contract performance

1. Executed vs. executory
2. Valid vs. void
3. Voidable vs. unenforceable
4. Breach of contract, rescission, and termination
5. Liquidated, punitive, or compensatory damages
6. Statute of Frauds
7. Time is of the essence

D. Sales contract

1. Offer and counteroffer
2. Earnest money and liquidated damages
3. Equitable title
4. Contingencies
5. Disputes and breach of contract
6. Option contract and installment sales contract

E. Types of agency and licensee-client relationships

F. Creation and termination of agency

G. Licensee obligations to parties of a transaction

V. REAL ESTATE PRACTICE (SALES 14; BROKER 13)

A. Responsibilities of broker

1. Practicing within scope of expertise
2. Unauthorized practice of law

B. Brokerage agreements between the broker and principal (seller, buyer, landlord, or tenant)

1. Seller representation – Types of listing agreements
   - **a.** Exclusive right-to-sell and exclusive agency listing
   - **b.** Non-exclusive or open listing
   - **c.** Net listing (conflict of interest)
   - **d.** Multiple listing service (MLS)
2. Buyer representation
3. Property management agreement
   - **a.** Accounting for funds
   - **b.** Property maintenance
   - **c.** Leasing property
   - **d.** Collecting rents and security deposits

Notes

4. Termination of agreements
5. Services, fees, and compensation

C. Fair Housing

1. Equal opportunity in housing
2. Protected classes
3. Fair housing laws
4. Illegal practices, enforcement, and penalties
5. Prohibited advertising
6. Housing and Urban Development (HUD)
7. Americans with Disabilities Act (ADA)

D. Risk management

1. Supervision
2. Compliance with federal regulations; including Privacy and Do Not Contact
3. Vicarious liability
4. Antitrust laws
5. Fraud and misrepresentation
6. Types of insurance
   a. Errors and Omissions
   b. General Liability

VI. PROPERTY DISCLOSURES AND ENVIRONMENTAL ISSUES (SALES 8; BROKER 8)

A. Property conditions and environmental issues

1. Hazardous substances
   a. Lead-based paint
   b. Asbestos, radon, and mold
   c. Groundwater contamination and underground storage tanks
   d. Waste disposal sites and brownfields
   e. Flood plains, flood zones, and flood insurance
2. Clean Air and Water Acts
3. Environmental Protection Agency (EPA)
   a. Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)
   b. Superfund Amendment and Reauthorization Act (SARA)
   c. Environmental site assessments (including Phase I and II studies) and impact statements
   d. Wetlands protection

B. Disclosure obligations and liability

Notes

VII. FINANCING AND SETTLEMENT (SALES 7; BROKER 7)

A. Financing concepts and components

1. Methods of financing
   a. Mortgage financing – conventional and nonconventional loans
   b. Seller financing – land contract/contract for deed
2. Lien theory vs. title theory and deed of trust
3. Sources of financing (primary and secondary mortgage markets, and seller financing)
4. Types of loans and loan programs
5. Mortgage clauses

B. Lender Requirements

1. FHA requirements
2. VA requirements
3. Buyer qualification and Loan to Value (LTV)
4. Hazard and flood insurance
5. Private mortgage insurance (PMI) and mortgage insurance premium (MIP)

C. Federal Financing Regulations and Regulatory Bodies

1. Truth-in-Lending and Regulation Z
2. TILA-RESPA Integrated Disclosures (TRID)
   a. Consumer Financial Protection Bureau (CFPB)
   b. Loan Estimate (LE)
   c. Closing Disclosure (CD)
3. Real Estate Settlement Procedures Act (RESPA)
   a. Referrals
   b. Rebates
4. Equal Credit Opportunity Act (ECOA)
5. Mortgage fraud and predatory lending

D. Settlement and closing the transaction

VIII. REAL ESTATE MATH CALCULATIONS (SALES 7; BROKER 8)

A. Property area calculations

1. Square footage
2. Acreage total

B. Property valuation

1. Comparative Market Analysis (CMA)
2. Net Operating Income (NOI)
3. Capitalization rate
4. Gross rent multiplier- Broker Only
5. Gross income multiplier- Broker Only
6. Equity in property

Notes

7. Establishing a listing price
8. Assessed value and property taxes

C. Commission/compensation

D. Loan financing costs

1. Interest
2. Loan to Value (LTV)
3. Fees
4. Amortization, discount points, and prepayment penalties

E. Settlement and closing costs

1. Purchase price and down payment
2. Monthly mortgage calculations- principal, interest, taxes, and insurance (PITI)
3. Net to the seller
4. Cost to the buyer
5. Prorated items
6. Debits and credits
7. Transfer tax and recording fee

F. Investment

1. Return on investment
2. Appreciation
3. Depreciation
4. Tax implications on investment

G. Property management calculations

1. Property management and budget calculations
2. Tenancy and rental calculations

Notes

The state law portion of the Texas Sales Agent Real Estate Examination consists of thirty (30) scored items. The examination also contains 5-10 pretest items. Pretest items are not identified and will not affect a candidate's score in any way.

I. COMMISSION DUTIES AND POWERS (2 ITEMS)

A. General Powers

1. Composition, Duties, and Powers
2. Real Estate Advisory Committees

B. Handling of Complaints

1. Investigations
2. Hearings and Appeals

C. Penalties for Violation

1. Unlicensed Activity
2. Authority for Disciplinary Actions
3. Recovery Trust Account

II. LICENSING (2 ITEMS)

A. Activities Requiring License

1. Scope of Practice
2. Exemptions
3. Business Entities
4. Inspectors and Appraisers

B. Licensing Process

1. General Requirements (fitness, sponsor, etc.)
2. Education
3. Examination
4. Grounds to Deny an Application
5. Appeals of Denial

C. License Maintenance and Renewal

1. Continuing Education
2. Change of Sales Agent Sponsorship
3. Inactive Status
4. Assumed Names

III. STANDARDS OF CONDUCT (7 ITEMS)

A. Professional Ethics and Conduct
B. Grounds for Discipline
C. Unauthorized Practice of Law
D. Trust Accounts
E. Splitting Fees
F. Rebates
G. Advertising

Notes

IV. AGENCY/BROKERAGE (8 ITEMS)

A. Disclosure
B. Intermediary Practice
C. Duties to Client (including Minimum Services)
D. Broker-Sales Agent Relationships
E. Broker's Responsibility for Acts of Sales Agent
F. Appropriate Use of Unlicensed Assistants

V. CONTRACTS (7 ITEMS)

A. Promulgated Contracts, Forms, and Addenda
B. Statute of Frauds
C. Seller Disclosure Requirements

VI. SPECIAL TOPICS (4 ITEMS)

A. Community Property
B. Homestead Protections and Tax Exemptions
C. Deceptive Trade Practices Act
D. Wills and Estates
E. Landlord-Tenant Issues
F. Foreclosure and Short Sales
G. Recording Statutes
H. Mechanic's and Materialman's Liens
I. Veterans Land Board
J. Home Owners Associations
K. Equitable Interest

Study Tips

Final Exams

After you complete this study guide, you will take your final exam for this course. The final exam is cumulative and consists of **60 questions.** To pass this course, you must achieve at least a **70% minimum score** on the exam. In other words, you must answer at least **42 questions** correctly.

To pass the state licensing exam, you must answer at least **56/80 questions** correctly on the national section and **21/30 questions** correctly on the state section on the exam. You got this!

Additional Resources

You can also check out the resources tab (where you found this document) to review all the key terms and important concepts you learned.

Here are our best tips for Ace-ing your exam:

Sign up for our free Quizlet class.

- We have free study tools on Quizlet! Quizlet helps students learn through fun and interactive learning methods like flashcards, recall activities, matching exercises, and (other fun) games.
- Quizlet is a great place to practice both for your level and final exams as there are practice sets for your level key terms and a cumulative set with all of the key terms for the final exam.
- To join your course class, select the "Quizlet" tab under Resources — you know, the menu bar where you found the "Study Tips" document.

Take the practice tests.

- Our practice tests are designed to prepare you for the final exam, so they are a great tool to use when studying for the final exam.
- When taking the practice tests, write down the questions you answer incorrectly so you can identify which concepts are in need of review.
- We strongly recommend taking them repeatedly until you're scoring over 90% multiple times.

Review all the key terms.

- We recommend printing out the Key Terms Index PDF as a resource.
- To familiarize yourself with the key terms, consider using the PDF to review and create scenarios with the key terms.
- You will also see each chapter's key terms at the beginning of each chapter.

Use Mastery Tracking to identify concepts for review.

- Lightning bolts on a chapter signify that you struggled to correctly answer that section's pop-up questions.
- This Mastery Tracking feature gives you a great idea of areas in need of review.
- You can find your Mastery Tracking results in the Table of Contents on the app. There, you'll also find more detailed instructions for using this feature.

Suggested Study Schedules

In the pages that follow, you'll find three suggested study schedules that will take you through the Texas Real Estate Pre-License coursework within anywhere from 7 to 22 days.

Meet Your Milestones

Look at you, getting all organized and setting a plan for success. That's what's going to make you the very best of agents! We'd like to reward your initiative with a menu of suggested study schedules that will help you set your pace and keep your dreams on track.

If the licensing package is your journey to getting your real estate license, then the **6 courses** it contains are the major milestones that you'll encounter along the way:

Principles of Real Estate I (30 Hours)

Principles of Real Estate II (30 Hours)

Real Estate Finance (30 Hours)

Law of Agency (30 Hours)

Law of Contracts (30 Hours)

Promulgated Contracts (30 Hours)

Each course is capped off with a final exam that you'll need to pass. (Fear not — between the level assessments, practice tests, and a host of other tools at your disposal, you'll be well prepared for those final exams.)

Once you've completed and passed the **180 total course hours**, you'll be eligible to take — and pass — the state Texas Real Estate Salesperson Pre-License exam. Then, you'll apply for your license.

And that's it! Hooray, you!

7-Day Study Plan

Goals

- ○ ______________________
- ○ ______________________
- ○ ______________________
- ○ ______________________
- ○ ______________________

Notes

Day	Material to Review
1	The Nature and Cycle of Real Estate Finance; Scenario-Based Learning Exercise: Oldtown; Money and the Monetary System; Additional Government Influence; The Secondary Mortgage Market
2	Sources of Funds; Instruments of Real Estate Finance; Scenario Based-Learning Exercise: Not So Easements
3	Loan Types, Terms & Issues; Scenario Based Learning Exercise: Michigan J. Fraud; Government Loans
4	Lender Loan Process; Defaults & Foreclosures
5	Review
6	**Take Texas Real Estate Finance Final Exam**
7	**Take Texas Real Estate Salesperson Exam or continue any remaining pre-license course needed (Real Estate Law of Agency is recommended)**

Approximately 5 Hours per Day

9-Day Study Plan

Goals

- ○ ______
- ○ ______
- ○ ______
- ○ ______
- ○ ______

Notes

Day	Material to Review
1	The Nature and Cycle of Real Estate Finance; Scenario-Based Learning Exercise: Oldtown; Money and the Monetary System
2	Additional Government Influence; The Secondary Mortgage Market
3	Sources of Funds; Instruments of Real Estate Finance; Scenario Based-Learning Exercise: Not So Easements
4	Loan Types, Terms & Issues; Scenario Based Learning Exercise: Michigan J. Fraud
5	Government Loans
6	Lender Loan Process; Defaults & Foreclosures
7	Review
8	**Take Texas Real Estate Finance Final Exam**
9	**Take Texas Real Estate Salesperson Exam or continue any remaining pre-license course needed (Real Estate Law of Agency is recommended)**

Approximately 3 Hours per Day

22-Day Study Plan

Goals

- ○ ____________________
- ○ ____________________
- ○ ____________________
- ○ ____________________
- ○ ____________________

Notes

Day	Material to Review
1-2	The Nature and Cycle of Real Estate Finance; Scenario-Based Learning Exercise: Oldtown
3	Money and the Monetary System
4-5	Additional Government Influence
6-7	The Secondary Mortgage Market
8	Sources of Funds
9-10	Instruments of Real Estate Finance; Scenario Based-Learning Exercise: Not So Easements
11-13	Loan Types, Terms & Issues; Scenario Based Learning Exercise: Michigan J. Fraud
14-15	Government Loans
16-18	Lender Loan Process
19	Defaults & Foreclosures
20	Review
21	**Take Principles of Real Estate II Final Exam**
22	**Take Texas Real Estate Salesperson Exam or continue any remaining pre-license course needed (Law of Agency is recommended)**

Approximately 1 Hour per Day

Create Your Own Study Plan

Goals

- ○
- ○
- ○
- ○
- ○

Notes

Day	Material to Review

Progress Tracker

Use this page to track your study progress by chapter so you know what to review for the exam!

		1	2	3	4	5	6	7	8	9	10	11	12	13	14
01	The Nature and Cycle of Real Estate Finance		○	○	○	○	○	○							
02	Scenario-Based Learning Exercise: Oldtown	○													
03	Money and the Monetary System	○	○	○	○	○	○	○							
04	Additional Government Influence	○	○	○	○	○	○	○							
05	The Secondary Mortgage Market	○	○	○	○										
06	Sources of Funds	○	○	○	○	○	○	○	○	○	○				
07	Instruments of Real Estate Finance	○	○	○	○	○	○	○	○						
08	Scenario Based-Learning Exercise: Not So Easements	○													
09	Loan Types, Terms & Issues	○	○	○	○	○	○	○	○	○	○	○			
10	Scenario Based Learning Exercise: Michigan J. Fraud	○													
11	Government Loans	○	○	○	○	○	○	○	○	○	○	○			
12	Lender Loan Process	○	○	○	○	○	○	○	○	○	○	○	○	○	
13	Defaults & Foreclosures	○	○	○	○	○	○								

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