II. Working With a Buyer as a Client or Customer

Page 16 of the Outline

A. Agency Representation, Client/Customer

- Client Duties
  - Blue Brochure (Agency Disclosure Brochure)
  - Buyer Representation Agreement
- Customer Duties
  - Blue Brochure

B. Real Estate Finance, Buyer's Ability to Purchase

1. Lending Concepts:

- a. Mortgage Law
  - A mortgage is a voluntary lien on real estate, that is, a person who borrows money to buy a piece of property voluntarily gives the lender the right to take that property if the borrower fails to repay the loan.
  - Interest is paid in arrears not ahead

Real Estate Financing

- Mortgage:
  - Mortgagor = Borrower
  - Mortgagee = Lender
- Deed of Trust:
  - Grantor/Trustor = Borrower
  - Beneficiary = Lender
  - Trustee = Title Co. (Third Party)

Lien or Title Theory States

- Lien Theory States – Idaho
  - The Borrower retains both legal and equitable title. The Lender has a lien for security of the debt.
  - The property is collateral for the loan.
- Title Theory States – Not Idaho
  - The Borrower actually gives legal title to the Lender and retains equitable title. Legal title is returned to the Borrower only when the debt is paid in full.

2. Provisions of a Note, Promise to Pay

a. Note, Negotiable Instrument – a borrower's personal promise to repay a debt according to agreed-upon terms. A negotiable instrument like a check.

Interest Rate & Usury Laws:

b. Interest – charge for the use of credit or money, usually figured as a percentage of the principal and computed annually.

- Simple interest is computed annually on the principal.
- If you borrow $1,000 at 6% for one year, when the note becomes due, you pay back $1,060.

c. Usury – is a law that limits how much interest can be charged.

In Idaho no limit on interest if agreed to in writing, 12% in the absence of an agreement.

d. Loan Origination Fees – a charge by most lenders to cover the expenses involved in generating the loan.

e. Discount Points

– Each “point” is equal to 1% of the mortgage loan

– Can be used to “buy down” the interest rate

f. Prepayment Penalty

– A charge for paying off the loan early

g. Hypothecation

– Pledging the property as security for the loan

3. Elements of Mortgage Deed of Trust

1. Names of Mortgagor/Trustor
2. Legal Description
3. Provision for Default and Remedy
   a. **An acceleration clause in loan allows the lender to declare all amounts owing, due and payable upon default by the borrower**
4. Waste Clause
5. Release
6. Tax and Insurance Reserves
7. Defeasance Clause ***Lender Must Record a Satisfaction when note is paid – Deed of Reconveyance)***
8. After Acquired Clause
   – Acceleration Cause (default),
   – Alienation Clause or Due on Sale (if sold)
   – Pre-payment
   – Assignment of Rents (rental income)

Elements of Mortgage or Deed of Trust

C. Recording of Documents
- Must be recorded in the county the property is located – also establishes priority

D. Priority of Mortgages or Deeds of Trust
- Usually determined by the order in which they were recorded – may be changed by a *subordination agreement*

Prime Interest Rate

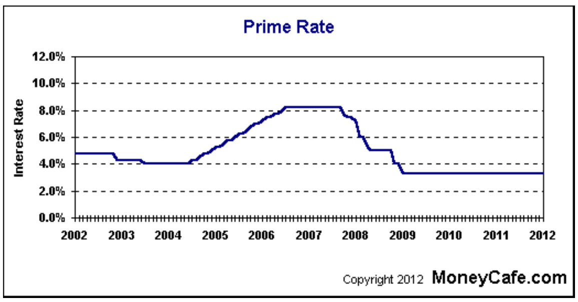
- The Prime Interest Rate is the interest rate charged by banks to their most creditworthy customers (usually the most prominent and stable business customers). The rate is almost always the same amongst major banks. Adjustments to the prime rate are made by banks at the same time; although, the prime rate does not adjust on any regular basis. The Prime Rate is usually adjusted at the same time and in correlation to the adjustments of the Fed Funds Rate….

Federal Funds Rate

- The Fed Funds Rate is a short-term rate objective of the Federal Reserve Board. The actual Fed Funds Rate is the interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight. The real rate changes daily but is usually close to the target rate desired by the Federal Reserve. Adjustments to the Federal Funds Target Rate are made by the Federal Open Market Committee (FOMC) usually at regularly scheduled meetings; but can also be adjusted at any time with an emergency meeting.

Prime Rate History

- December 1, 1947 - 1.75%
- July 5, 1974 - 12%
- January 20, 1975 - 9.75%
- October 13, 1978 - 10%
- December 19, 1980 - 21.5%
- June 18, 1985 - 9.5%
  - ***Between 1988 and 1990 Rates are Double Digit***
- June 27, 2003 - 4%
- ***The First Time Since September 11, 1958***
- April 16, 2008 – 5.25%
- February 1, 2013 – 3.25%



E. Foreclosure Methods For A <u>Mortgage</u>

- Judicial Foreclosure – allows the property to be sold by court order after the borrower has been given sufficient public notice.
- *In IDAHO <u>must</u> use for a Mortgage, <u>may</u> for a Deed of Trust*
  - Court Ordered Sheriff's Sale
  - <u>Borrower Redemption Rights</u>
    - Under 20 Acres – Six Months
    - Over 20 Acres – One Year
  - Deficiency Judgment

F. Foreclosure Methods For A Deed of Trust

- Nonjudicial Foreclosure – no court action is required
  - Notice of Default
  - Notice of Sale
  - Trustee's Sale – *No Redemption After the Sale*
    - No sooner than 120 days from the Notice of Default
  - Reinstate – Cure the default by the 115th day or pay the entire loan

G. Foreclosure on Deed of Trust in Idaho

- Notice of Default – must be recorded in all counties in which property is located
- Notice of Sale – to grantor, any person who has acquired an interest, lessee, and lien holder and must contain specific descriptions & dates
- Published in newspaper
- Sale – held at a designated time & place, conducted by trustee's attorney
- Idaho allows for a postponement of sale past the date it was scheduled – allows lenders to negotiate repayment (new rules September 2011)
- Trustee's Deed issued to purchaser

Foreclosures – **HB 331** by the Idaho Attorney General's Office

Along with a notice of default, the lender must provide:

- a notice of the potential ramifications of foreclosure
- a statement that the borrower can contact the lender about potential loan modification programs
- a modification request form which the lender must respond to within 45 days; the lender may not move forward with a foreclosure sale until responding
- 14-day notice - Rescheduling of postponed sale
- Does not address renters' rights – Federal law
- Effective Date: September 1st, 2011

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H. Deed in Lieu of Foreclosure – a voluntary foreclosure also known as a “Friendly Foreclosure” – carried out by mutual agreement rather than by lawsuit.

I. Redemption – borrower pays the lender the amount in default plus costs prior to foreclosure to reinstate the debt

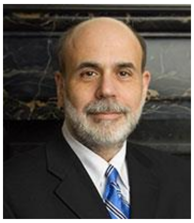
J. Deed to purchaser at sale – deed issued by sheriff to successful

- Deficiency Judgment – Mortgagee (lender) may be entitled to a personal judgment against the borrower for the unpaid balance if the foreclosure sale does not produce enough cash to pay the loan balance in full

Federal Reserve System

The Federal Reserve System is the central bank of the United States. It was founded by Congress in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial System.

Real Estate Finance



- Ben S. Bernanke

Chairman of the Federal Reserve

- Reserve requirements – the Federal reserve system requires that each member bank keep a certain amount of assets on hand as reserve funds. These funds are unavailable for loans or any other use.
- Discount rate –is the rate charged by the federal reserve when it lends to its member

4. Real Estate Mortgage Market

a. The Primary Mortgage Market is made up of the lenders that **originate** loans. These lenders make money available directly to borrowers.

- Income on the loan is realized from the following two sources:
  - Finance charges collected at closing (loan origination fees and discount points)
  - Recurring Income – the interest collected during the term of the loan

The Primary Mortgage Market

- Some of the major lenders include:
  - Thrifts, savings associations, and commercial banks.
  - Credit Unions
  - Pension and Endowment Funds
  - Mortgage Banking Companies (sell to investors and receive a fee for servicing the loans)
  - Mortgage Brokers (they are not lenders, but put borrowers and lenders together)

b. The Secondary Mortgage Market

- Where loans are bought and sold after they have been funded.
- Various agencies purchase a number of mortgage loans and assemble them into packages (called pools). These agencies purchase the mortgages from banks and savings associations.

Real Estate Finance

- **WHY WAS IT NECESSARY TO CREATE A SECONDARY MARKET?**

The Secondary Mortgage Market

- The Agencies
  - **Fannie Mae** (FNMA) – was previously a private subsidiary of the Federal Reserve System that buys Conventional, FHA and VA loans on the secondary market – established in 1938
  - Became a government-owned enterprise in 2008

The Secondary Mortgage Market

- The Other Agencies
  - **Freddie Mac** (FHLMC)– also a government-owned enterprise which purchases loans (mostly conv.) and does <u>NOT</u> guarantee payments.
  - **Ginnie Mae** (GNMA) – is a government agency – a division of HUD. Purchases loans (special assistance loans) and guarantees payments to investors.
- Fannie and Ginnie Guarantee, Freddie does not

Secondary Mortgage Market

- Rural Development or RDA (Formerly Farmers Home Administration)
- Private Conduits - A governmental or private entity that pools mortgages and issues pass-or pay-through securities in its own name, as a private conduit to investors. Many private conduits are now backed by mortgages, credit card receivables and other loans.

Conventional Loans

- Is generally a loan with equal monthly payments, a 30-year term, and a fixed interest rate established when the mortgage is created.
- **A conventional mortgage is also defined in terms of its "loan to value" ratio or LTV. An 80 percent LTV is the standard for conventional loans, a percentage which means that if a house costs $100,000, the lender will provide financing worth $80,000 (80 percent of the purchase price) and the borrower will put up $20,000 (20 percent). Closing costs are EXTRA AND ADDITIONAL above the $20,000.**

FHA-Insured Loans

- The Federal Housing Administration (FHA) operates under HUD (The Department of Housing and Urban Development) and they insure loans but do not lend money itself. These loans are made by FHA- approved lending institutions.
- Property appraised by an FHA-approved appraiser.
- Prepayment Privileges - can payoff without penalty.
- More info on pgs. 249 & 250

VA-Guaranteed Loans

- The Department of Veterans Affairs (VA) is authorized to guarantee loans for eligible veterans and their spouses
  - To qualify a veteran must meet any of the following requirements:
    - 90 days of active service
    - Minimum of 181 days of active service during interconflict periods
    - Two full years of service during any peacetime period after September 7, 1980
    - Six or more years of continuous duty as a reservist

VA-Guaranteed Loans

- Need the DD214 – “Discharge Papers” to get a “certificate of eligibility”
- VA loans are <u>not</u> subject to prepayment penalties
- Assumption rules
  - Loans made before March 1, 1988 are freely assumable with an assumption fee ($45 - $500)
  - After March 1, 1988 the VA must approve the buyer and assumption agreement.
  - (The veteran is not released from liability)

Types of Loans by Characteristics

- **Purchase Money - Seller Financing**
- **Land Sales Contract/Contract for Deed**
- **Package Loans** – real estate plus personal property (appliances, etc…)
- **Blanket Loans** – more than one parcel or lot (developments)
- **Wrap-Around Loans** – ability to get additional financing without paying off the first loan

Other Financing Terms

- **Wrap-Around Mortgage - Buying Property *<u>Subject</u>* To A Mortgage or Deed of Trust:**
  - The original borrower is still obligated for the debt
  - May result in the lender “calling the loan”

Other Financing Techniques

- **Buy Downs** – a way to temporarily or permanently lower the interest rate

Financing Techniques

- **Adjustable Rate Mortgages** – Originates at one rate of interest then fluctuates up or down during the loan term (based on some objective economic indicator).
  - Has an index (like the US Treasury securities) plus a margin
    - For example, if the index is 3.5 percent and the margin is 2 percent, the interest rate is 5.5 percent

Financing Techniques

- **Adjustable Rate Mortgages – Continued**
  - Rate caps – limit the amount of interest charged
  - Payment Cap – protects the borrower from unaffordable payments
  - The adjustment period – states how often the rate may change
  - Conversion option – permits the borrower to convert to a fixed rate at certain intervals during the life of the loan

Other Financing Techniques

- **Construction Loans** – payments made in draws (interim financing)
- **Home Equity Loans** – an alternative to refinancing (a fixed loan or an equity line of credit)

Financing Techniques

- **Straight Loan –** Interest Only Until the Loan is Due
- **Amortized Loans** – "Amortize" means to kill off slowly, over time. This pays off interest and principal at the same time.
  - Often referred to as the budget payment.

Financing Techniques

- **Balloon Payment** – a partially amortized loan with the final payment larger than the others. Example…………..

Financing Techniques

- Example: You borrow $100,000 at 6% interest. You pay for 10 years based on a loan over 30 years. At the end of the 10 years, you have to pay off the balance of $54,003.38.

Financing Techniques

- **Variable Rate**
  - Loan made at an interest rate that fluctuates based on a base interest rate such as the Prime Rate or LIBOR (London Interbank Offer Rate)
- Reverse Mortgage
  - A reverse mortgage lets a homeowner convert a portion of the equity into cash. But unlike a traditional home equity loan or second mortgage, no repayment is required until the borrower(s) no

Insurance on a mortgage

- Not required if the LTV is less than 80%
- MIP (Mortgage Insurance Premium)
  - The Mortgage Insurance charged is .5% per year of the loan amount and is charged to the homeowner each month. In addition, FHA charges an upfront mortgage insurance premium of 1.75%.
- PMI (Private Mortgage Insurance) – usually Conventional loans
- Can be removed once the borrower has built up equity equal to 22%.

6. Financing Legislation

$10,000 a day for each occurrence

- Truth in Lending A
  - Reg Z – Full Disclo
  - 3-day Right of Rescission - Refinance
  - Advertising – State the APR
  - Penalties
- Equal Credit Opportunity Act
  - Must provide reasons for denial
- Community Reinvestment Act
  - Ratings from the various bank regulatory agencies on how well they serve low- and moderate-income borrowers and neighborhoods

Financing Legislation

- RESPA – designed to protect consumers from abusive lending practices - ensures that buyer and seller are both fully informed of all settlement costs on a new federally-related first mortgage loan

7. Incentives (IREC Guideline #12)

OFFERING INCENTIVES TO POTENTIAL SELLERS OR BUYERS…

- **OFFERING INCENTIVES TO POTENTIAL SELLERS OR BUYERS**
- Section 54-2054, Idaho Code, allows a broker to share any part of a commission, fee or compensation received with the buyer or seller in a real estate transaction. However, no commission, fee or compensation may be split with any party to the transaction in a manner that would directly or indirectly create a double contract, or would otherwise mislead any broker, lender, title company or government agency involved in the transaction, regarding the source of the funds used to complete the transaction or regarding the financial resources or obligation of the buyer or seller.
- Splitting fees with unlicensed person ("bird-dog" fees) who are not a party to the transaction, is prohibited.
- Section 54-2054, Idaho Code, prohibits licensees from receiving **"illegal" kickbacks and rebates from title insurance companies, escrow companies and lenders.**

8. Computerized Loan Origination and Automated Underwriting

- Computerized Loan Origination – electronic network for handling loan applications through remote computer terminals linked to several lenders' computers – a real estate broker or salesperson can check rates and loan terms for a buyer and help them select a lender and apply for a loan directly from the broker's office

Computerized Loan Origination

- Incentives
  - A licensee shall not receive a kickback or unearned fee for directing any transaction to any lending institution, escrow or title company, as those practices are defined and prohibited by the real estate settlement and procedures act of 1974, as amended,
- Computerized Loan Origination
  - Licensees may earn fees for conducting part of the loan process.

Computerized Loan Origination

- Credit Scoring and Automated Underwriting
  - Used to predict prospective borrowers' likelihood of default.
  - Based on 850 point scoring system
  - 800's rare, 700's, 650 decent, 630, 620

Credit Scoring and Automated Underwriting

- Credit scoring has been used for many years:
  - Manually – involves useful objective standard to balance loan officer's subjective professional judgment
  - Automated – somewhat controversial in accuracy or fairness – may result in difficulty for low-income and minority borrowers

FICO Credit Scores

- 35% Payment History
- 30% Amount Owed
- 15% Length of Credit History
- 10% New Credit
- 10% Credit Mix

FICO Credit Scores

Payment History	35%	298
Amount Owed	30%	255
Length of History	15%	128
New Credit	10%	85
Credit Mix	10%	85

FICO Credit Scores

$150,000 +/-

Your FICO® Score	Your interest rate	Your monthly payment
760 - 850	6.01%	$900
700 - 759	6.23%	$922
680 - 699	6.41%	$939
660 - 679	6.62%	$960
640 - 659	7.05%	$1,003
620 - 639	7.6%	$1,059

9. Calculating Amount Buyer Can Pay

- Amount of Payment
- Financial Calculator Basics

Exercise Set INTEREST, LOAN AMOUNTS & PAYMENTS Pg. 45