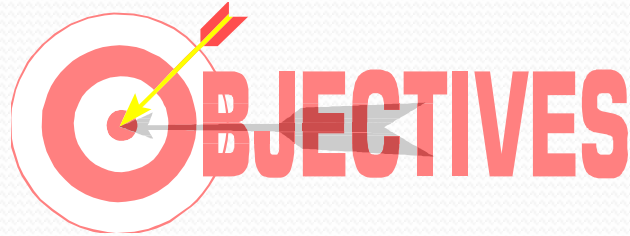


LESSON THREE

THE PRIMARY MARKET: NON-INSTITUTIONAL LENDERS

STUDENT LEARNING OUTCOMES (SLOs):



1. Contrast non-institutional with institutional lenders.
2. List five characteristics of non-institutional lenders.
3. Explain the purpose of the Mortgage Loan Brokers Law.
4. Explain the provisions of the Mortgage Loan Brokers Law.
5. Determine under what conditions interest payments are deductible on a homeowner's income tax return.

I. Non-Institutional Lender

- A. Differ from institutional and private lenders
 1. Non-institutional lenders are not as tightly regulated and supervised by federal and state agencies as institutional lenders.
 2. Non-institutional are usually informal in structure and organization, while institutional lenders are very formal, from organizational structure to lending policies and procedures.
 3. Institutional lenders receive deposits from others. Hence, they are referred to as depository institutions. In turn, they lend these deposits to others. As such, they act as intermediaries, pooling the funds of others.
 4. Non-institutional lenders invest their own funds directly into real estate loans, rather than through a financial intermediary.

B. Individual lender characteristics

1. Often inexperienced and therefore make subjective decisions when determining where and on what properties to lend.
2. Maximum interest rate is usually charged.
3. Usually heavy involvement in junior financing.
4. Prime loans and construction financing are virtually nonexistent.
5. Most loans are relatively small in size, secured by single-family dwellings.
6. The majority of loans are made within the geographic area of the lender.
7. Loans are of relatively short duration.
8. Risks are greater, but the potential rewards are also greater.

C. Mortgage Company Characteristics

1. Restricted in their lending activities to the same regulations that govern those they represent, their principals as well as the regulations governing the institutions they sell their originated loans to. Such institutions include Fannie Mae and Freddie Mac.
2. In California, mortgage companies **must be licensed as real estate brokers by the Department of Real Estate (DRE)** or the California Department of Corporations. Recent changes in federal law require a special endorsement to the real estate license.
3. Subject to the restrictions of the Real Property Loan Law.
4. Frequently act as **loan correspondents**.

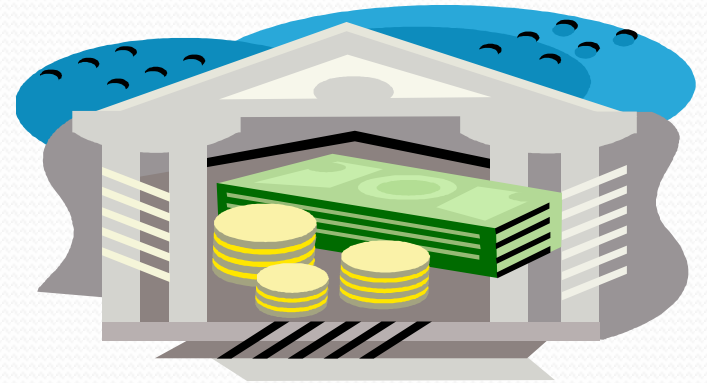
5. Banker - Broker

5. Mortgage Bankers:

- **may use their own funds or the funds of others**
- will either perform the entire loan process (referred to as 'Retail Mortgage Banking'), or
- will do all but preparation of the loan application and loan processing, in which case the Mortgage Banker is engaging in 'Wholesale Mortgage Banking'.
- Mortgage Brokers:
 - **Do not use their own funds** to make the loan
 - The loan application and loan processing may be performed by a Mortgage Brokers with funding from the Mortgage Banker or from an institutional lender

D. Real Estate Trusts

1. REITs have special tax benefits
2. Types of real estate trusts:
 - a. **REIT-Real estate investment trust**
 - b. REMT-Real estate mortgage trust
 - c. Hybrid trust
3. Semi-fiduciary. **Large size and pooling arrangement.**
4. Qualifying requirements:
 - Must be at least 100 investors who combine or pool their resources.
 - Of the gross income of a trust, 95% must originate from its investments.
 - Of the gross income of a trust, 75% must originate from real estate investments.
 - Of the gross income of a trust, 95% must be distributed in the year it is earned.



Others

E. Endowment Funds

1. College, university, hospital, charitable operation
2. finance commercial & industrial property

F. Sellers

1. Provide financing to sub-prime buyers
2. Junior, straight note, short-term loans



III. Real Property Loan Law

- Defined: an individual, corporation, partnership, or any other group of individuals however organized who either:
 - Negotiates or offers to negotiate, arrange, solicit, offer a mortgage loan on behalf of a borrower.
 - Holds himself out as being able to serve as an agent for any person in an attempt to obtain a mortgage loan.
 - Holds himself out as being able to serve as an agent or independent contractor to negotiate the terms or conditions of a mortgage loan on behalf of a lender, but not as a person employed as an employee or agent of a lender.

B. Purpose of Real Property Loan Law

- 1. **To protect borrowers of relatively small loan amounts this secured their homes.**
- 2. Requires that prospective borrowers be furnished with complete information concerning the loan through a Mortgage Loan Disclosure Statement by the broker *before* borrowers become obligated to go through with the loan.

C. Loan Disclosure Statement

- **Contents.** Contains information about reasonably *estimated* costs, expenses, and commissions to be paid by the applicant for a loan.
- **Data.** Informs borrowers of the approximate net amount of the loan after commissions, costs, expenses, and payoffs on existing loans secured by a dwelling which is defined of less than five residential units.

C. 2. a. exceptions to the law

- a) Loans secured by first trust deeds when the principal amount is \$30,000 or more.
- b) Loans secured by junior loans where the principal amount is for \$20,000 or more.
- c) Transactions where no real estate licensee is acting as a broker.
- d) Sellers, vendors and principals are exempt from the Mortgage Brokers Law (unless in the business, engaging in eight or more loans per year).
- e) Institutional lenders.

The LOAN BROKER LAW

Article 7

Loans Covered (Broker's Commission Is Limited)

1st Trust Deed
Less than \$30,000
5% less than 3 yrs
3 + years 10%

Junior less than \$20,000
2 years 5%
2 but less than 3 years 10%
3 + years 15%

● COSTS:

- Limits amount of costs and expenses
- Cannot be over 5% of the loan amount
 - Actual costs, or
 - \$390
- Cannot exceed \$700 for costs and expenses.



b. MAXIMUM COMMISSIONS

REAL PROPERTY LOAN LAW

TYPE OF LOAN	LESS THAN 2 YEARS	2 YEARS BUT LESS THAN 3	3 YEARS AND OVER	EXEMPT TRANSACTIONS
First Trust Deeds	5%	5%	10%	Loans of \$30,000 & over
Junior Trust Deeds	5%	10%	15%	Loans of \$20,000 & over

c. MAXIMUM CHARGES FOR OTHER COSTS AND EXPENSES

REAL PROPERTY LOAN LAW

LOAN AMOUNT	UNDER \$7,801	\$7,801 TO \$13,999	\$14,000 TO \$29,999	FIRST LOANS OF \$20,000 & OVER JUNIOR LOANS OF \$10,000 & OVER
MAXIMUM CHARGES	\$390	5% OF LOAN	\$700	NO LEGAL LIMITATIONS

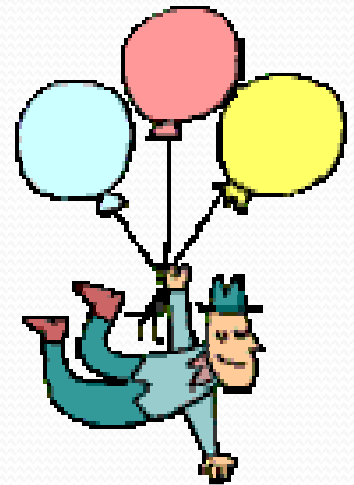
LIMITATIONS ON THE FOLLOWING COSTS AND EXPENSES

APPRAISAL FEES

- **ESCROW FEES**
- **NOTARY FEES**
- **CREDIT INVESTIGATION FEES**

d. Balloon payment

- balloon payment is when **any payment is more than twice the amount of the smallest installment**
 1. term of loan is for six years or less, *and*
 2. loan is secured by the borrower's residence.



e. Insurance requirements

1. **life and disability insurance**. Borrowers are not required to purchase credit, life, or disability insurance as a condition for obtaining a loan except for a Cal-Vet loan.
2. **fire and hazard insurance**. Lenders require fire and hazard insurance on the property until the loan has been repaid.
3. **mortgage insurance**. Required when the loan amount exceeds 80% LTV.



PRIVATE MORTGAGE INSURANCE

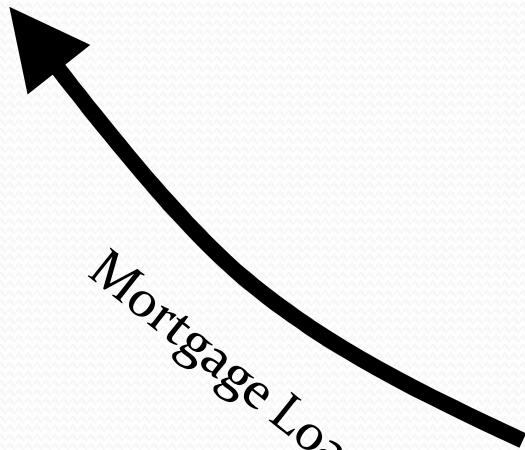
Annual Premium



Borrower



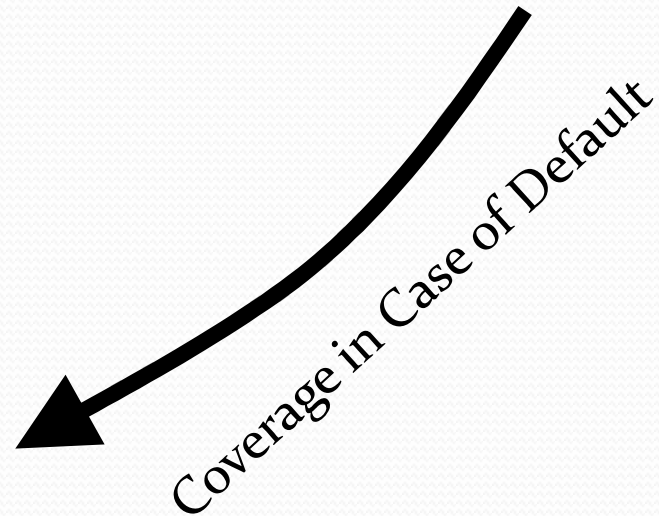
Private Mortgage Insurer



Mortgage Loan



Lender



Coverage in Case of Default

f. Other loan provisions

- Mortgage **brokers** are prohibited from charging loan **servicing** or collection fees to be paid by the borrower.
- **Late fee.**
 - a. Charges may not exceed \$5 or 10% of the principal and interest portions of installment payment, whichever is **greater**.
 - b. Borrowers are permitted a grace period of ten to fifteen days (depending on the contractual agreement with the lender) from the due date of any payment, during which time no late charges can be made.
- **Prepayment penalty.**
 - a. No prepayment penalty may be charged for loans over seven (7) years.
 - b. During the first seven years, borrowers on owner-occupied dwellings are allowed to pay up to 20% of the remaining principal balance of the loan during any twelve-month period without penalty.
 - c. Only the remaining balance may be subject to a maximum penalty of six months' unearned interest.

Prepayment Penalty

= 6 month's interest on the unpaid balance after 1st deducting 20%

Unpaid loan Amount

X 80%

(cannot charge on the top 20% of the loan)

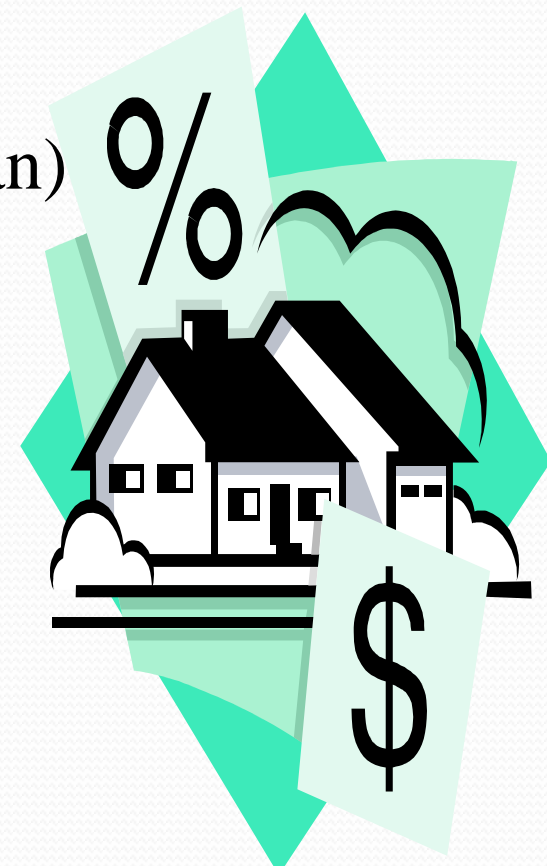
X Interest rate

To get interest for 12 months

= 1 year

÷ 2

To get one-half year



IV. Usury Law

- Usury is charging more interest than the law allows.
- In California, loans secured by real property may not exceed the greater of 10% *or* 5% above the Federal Reserve Bank discount rate.
- If the greater of these percentages is exceeded, it would be considered “**usurious**.”
- Not exempt from this law are individuals (that means you and me) loaning cold hard cash as opposed to those advancing credit (such as sellers).

Excluded from Usury Law

- A. All institutional lenders
- B. Real estate brokers
- C. Sellers who carry back loans secured by the properties they are selling
- D. Personal property brokers
- E. Credit unions
- F. Industrial loan companies
- G. Pawn brokers.

V. Loan interest & Income tax

- Tax Reform Act (TRA) of 1986 changed:
 - Interest deduction
 - Depreciation rules
 - Passive losses
- Agents are
 - obligation to disclose the possibility of property tax consequences
 - are required to tell the parties to obtain advice from qualified tax professional.
 - **REAL ESTATE LICENSEES MAY NOT GIVE TAX ADVICE.**



A. Interest expense deduction

1. Investment
2. Trade or Business
3. Personal
 1. Consumer
 2. Qualified residence
 1. Acquisition loan
 2. Home equity loan



B. Qualified Residence Interest

1. Qualified residence interest
 1. Principal or secondary residence
 2. House, condo, townhouse, mobile home, boat
2. Acquisition loan
 1. A trust deed or mortgage
 2. Used to acquire, build or substantially improve a qualified residence

C. Interest – tax deduction

- Loans made prior to 10/13/1987
 - The interest paid on real estate loans originated is fully tax deductible.
 - The interest paid on refinanced real estate loans is fully tax deductible.
- Loans made after 10/13/1987
 - The interest paid on real estate loans is tax deductible up to \$1,000,000 .
 - The interest paid on home equity debt is tax deductible up to \$100,000. This is over and above the acquisition debt.

Other tax items

D. Points, discounts, discount points, loan fees and loan original fee tax deduction is determined by a tax preparer who determines how the borrower used the funds.

E. Negative Amortization

This occurs when the total of the monthly payment includes interest only, but not the total of interest due for that time period.

The difference between the total interest paid and the total interest due is ADDED to the total loan balance, which creates the 'negative amortization'.

There is NO reduction in the total loan balance.

Loan index

