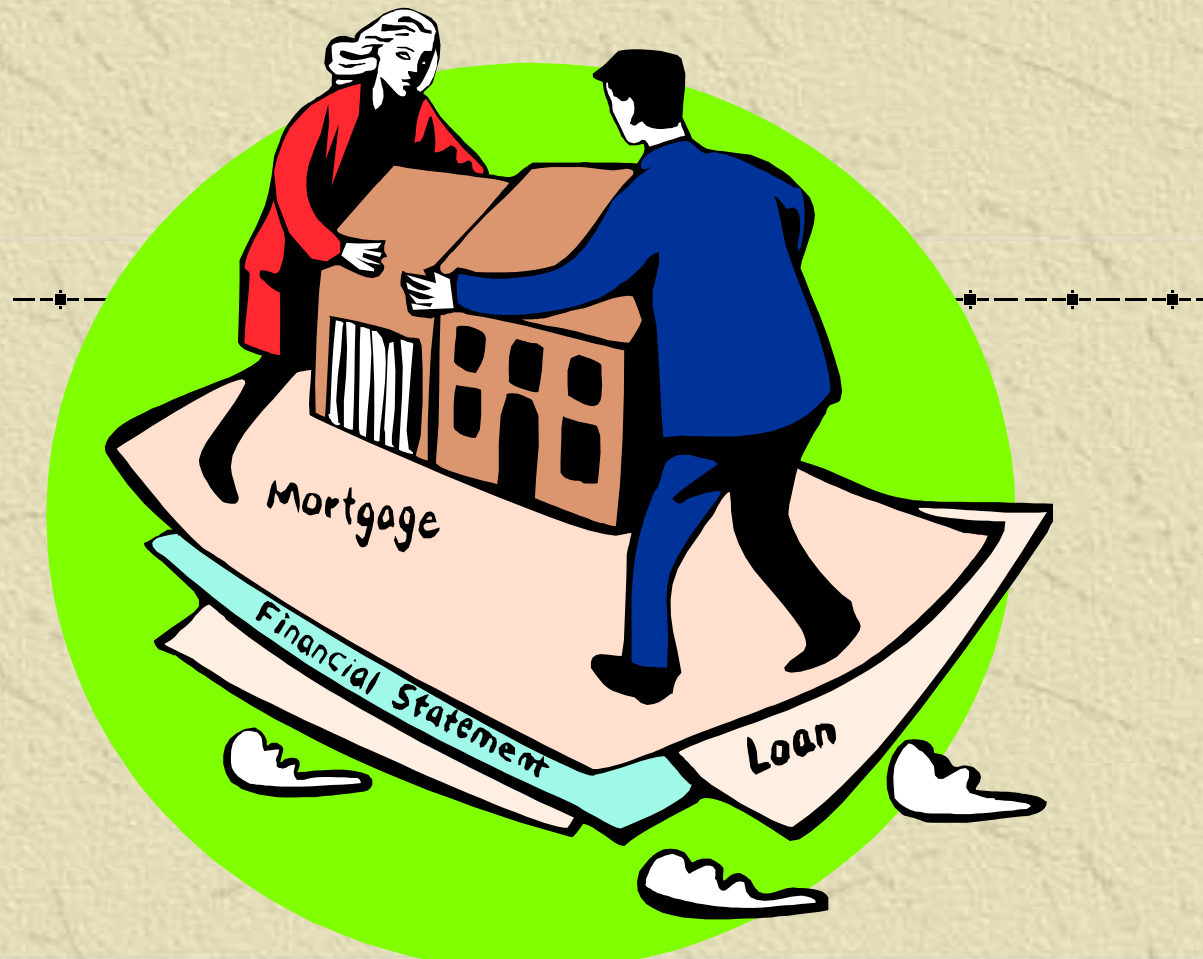
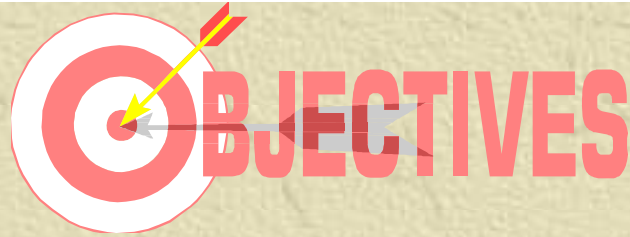


## Chapter 10

# Real Estate Financing





## STUDENT LEARNING OUTCOMES (SLOs):

1. Explain how straight, fully amortized and partially amortized notes differ.
2. Discuss various alternative financing instruments, types of interest rates and payment plans.
3. Compare a trust deed and a mortgage.
4. Explain the advantages and disadvantages of a Contract of Sale.
5. Define the clauses that frequently appear in loan documents.
6. Discuss usury and its importance in lending.
7. Explain the Truth in Lending Law and its consumer benefits.

# Financing Instruments

Note  
Promise to RePay

Hypothecate

Straight Note

Amortized Note

Partially Amortized

Fully Amortized

Installment Note

Security  
Collateral Lien

Mortgage

Deed of Trust

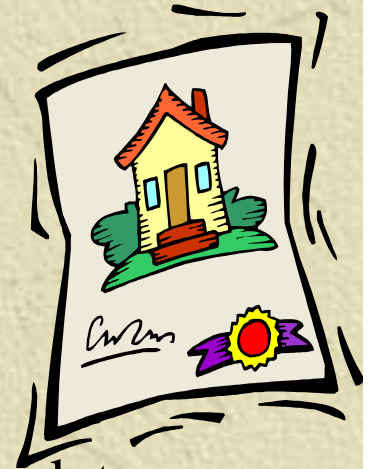
Land Contract

# I. Promissory Notes (SAIP)

A. Legal evidence for the debt

B.1. **S**traight Note – term note

- ◆ Payments of Interest Only
- ◆ Entire prin. and interest repaid on the final due date



2. **A**mortized Note

- ◆ Monthly payments which include both Principal and Interest
  - **I**nstallment Note or Fully amortized Note
    - ◆ Liquidates the debt with final payment
    - ◆ Periodic payment of principal & interest
  - **P**artially amortized or balloon payment type (requires larger final payment)

## II. Variable & Fixed Interest Rate Loans

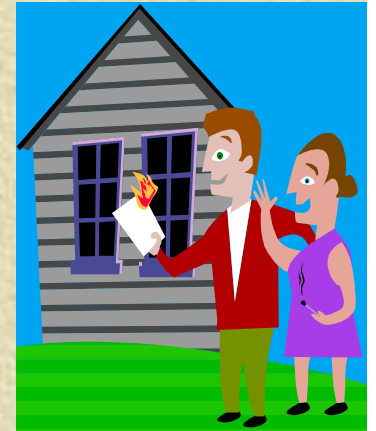
A.1. Fixed Rate - The interest rate does not change

### 2. Adjustable Rate Mortgage (ARM)-rate

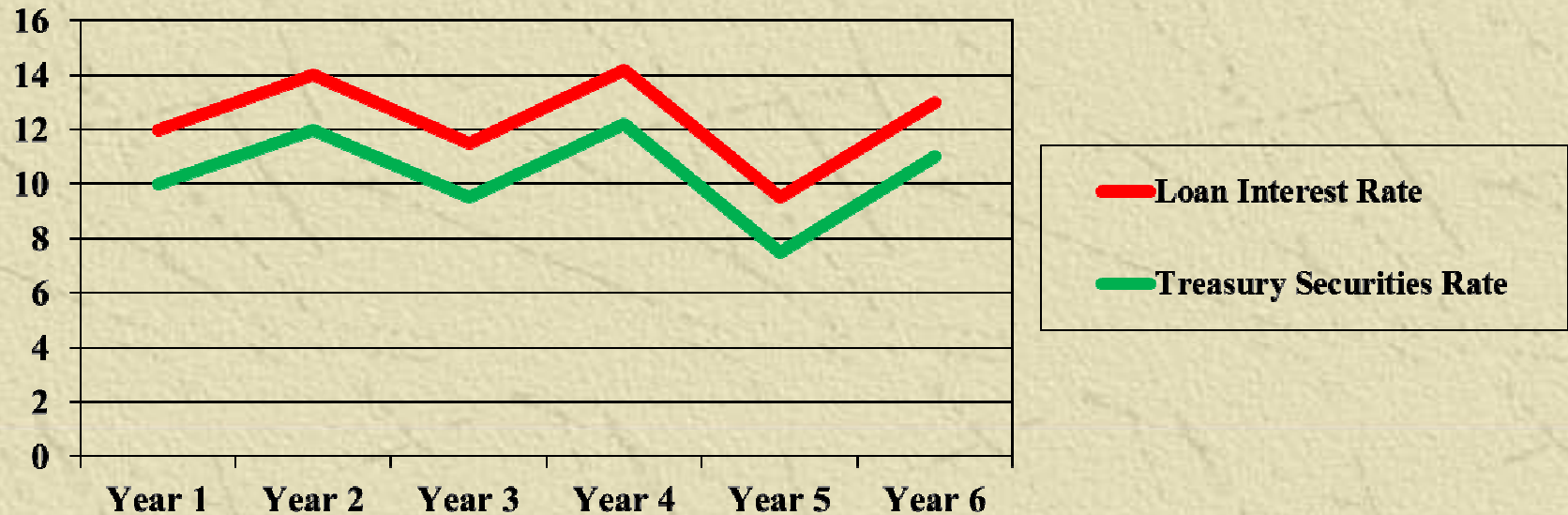
- ◆ Lower initial rate than fixed-rate mortgage
- ◆ Rate cap and payment cap
- ◆ Based on some an index (11<sup>th</sup> District etc.) plus a margin

### ✦ Variable Interest Rate (VIR)

- A lifetime rate cap or *life cap* is the highest the rate can go above the initial start rate. Frequently 5% to 8%
- A *period cap* is the maximum rate that may be charged, either up or down, from one adjustment period to the next. Frequently 1% to 2%.
- The index is tied to an pre-agreed upon interest rate, and is subject to that change. (i.e. LIBOR, 11<sup>th</sup> Dist, Fed Reserve).
- The margin is added to the index to determine the new rate at the beginning of the adjustment period. Usually 2% to 3%.



# VARIABLE PAYMENT PLANS



- ◆ The interest rate may change and as a result the following may be affected:
  1. Payments
  2. Principal owed
  3. Term (length of the loan)

# III. Alternative Financing



A. Adjustable Rate Mortgage (ARM)

B. B. Graduated payment Mortgage (GPM) -  
increasing

✦ Graduated Payment Adjustable Mortgage  
(GPAM)

C. Growing Equity Mortgage (GEM)- principal

D. Wrap Around, or All-Inclusive Trust Deed  
(AITD)

✦ Reverse Annuity Mortgage (RAM)

E. Seller financing: Installment sales contract,  
Contract of sale.

# Amortization Table

12 ½ % 30 Years Loan -  
\$155,700

1. Look down the 30 year column for the monthly payment on \$100,000
2. Next, determine the monthly payment for \$50,000, \$5,000 and \$700 using the same method
3. Then add the amounts together.

Amount	Payment
\$100,000	\$1,067.26
50,000	533.63
5,000	53.37
700	7.48
\$155,700	\$1,661.74

Term Amt	20 Years	25 Years	30 Years	40 Years
\$100	1.14	1.10	1.07	1.05
200	2.28	2.19	2.14	2.10
300	3.41	3.28	3.21	3.15
400	4.55	4.37	4.27	4.20
500	5.69	5.46	5.34	5.25
600	6.82	6.55	6.41	6.30
700	7.96	7.64	7.48	7.35
800	9.09	8.73	8.54	8.40
900	10.23	9.82	9.61	9.45
1000	11.37	10.91	10.68	10.49
2000	22.73	21.81	21.35	20.98
3000	34.09	35.72	32.02	31.47
4000	45.45	43.62	42.70	41.96
5000	56.81	54.52	53.37	52.45
6000	68.17	65.43	64.04	62.94
7000	79.53	76.33	74.71	73.43
8000	90.90	87.23	85.39	83.92
9000	102.26	98.14	96.06	94.41
10,000	113.62	109.04	106.73	104.90
20000	227.23	218.08	213.46	209.79
30000	340.85	327.11	320.18	314.68
40000	454.46	436.15	426.91	419.57
50,000	568.08	545.18	533.63	524.46
100,000	1136.15	1090.36	<b>1067.26</b>	1048.92

# IV. DEED OF TRUST (Trust Deed)

A. Easier, cheaper, faster foreclosure

1. Creates a lien to secure repayment of a note

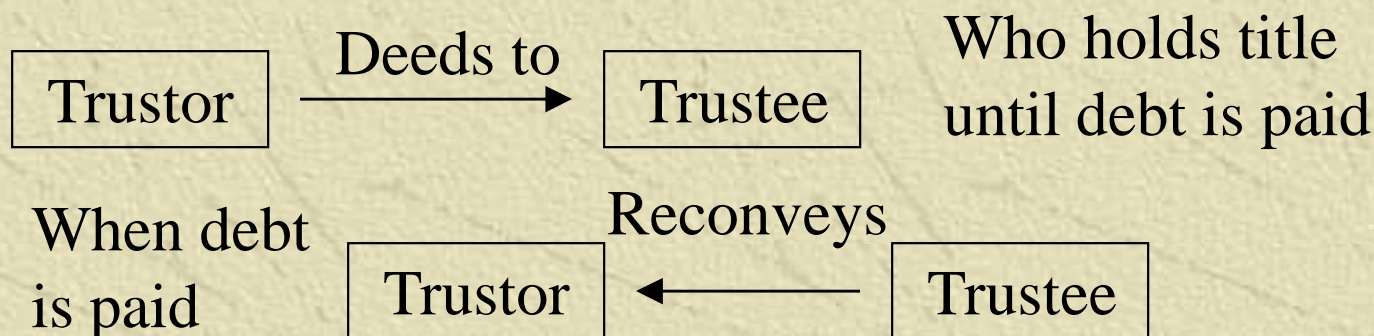
2.a. **Trustor** – Borrower

b. **Trustee** – Stakeholder or Titleholder

c. **Beneficiary** – BANK – Lender

Pg 10-2

3. Trustor deed **naked title** to **trustee** who holds loan for two things: (1) payoff; (2) default. Loan security=**hypothecation**



The trustee returns title to the trustor by a Deed of **Reconveyance**

Pg 10-3

# IV. MORTGAGE (A Contract)

A. MOrtgagOr – BOrrOwer

Mortgagee - Lender

✦ Loan Payoff

- ◆ Satisfaction of Mortgage

B. Foreclosure by default

- ◆ Law suit / Court order
- ◆ Decree of Foreclosure
- ◆ Notice of Sale
- ◆ Sheriff's Sale
- ◆ Sheriff's Deed
- ◆ Deficiency Judgment possible

E. One-year Period of Redemption



## IV. Clauses in Promissory Notes and Deeds of Trust

1. Acceleration  
Clause

2. Alienation  
(Due-On-Sale) Clause

or

Assumption  
Provision

Lock-In  
Clause

or

3. Prepayment  
Provision

**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 the interest for 12 months = 1 year

/ 2 (divide 1 year in half)

To get one-half year or 6 months

= Prepayment Penalty



## VII. Taking Over A Seller's Existing Loan

- A. Buyer assumes existing loan
- B. Substitution of Liability form or novation agreement
- C. Buyer takes title “Subject to” existing loan.

# SECURITY INSTRUMENTS

	<b>Mortgage</b>	<b>Deed of Trust</b>	<b>Land Contract</b>
Borrower Lender 3 <sup>rd</sup> Party	Mortgagor Mortgagee	Trustor Beneficiary Trustee	Vendee Vendor
Instruments	Mortgage Contract – Hypothecation of real property as security for debt  Mortgage Note: Evidence of debt	Trust Deed– Conveyance of title to trustee as security for the debt  Trust Note – Evidence of debt	AITD – Land Contract  Promissory Note
Title during loan term	Rests in – Mortgagee	Rests in – Trustee	Rests in – State of California Vet holds a lease
Protection	Abstract of Title or Certificate	Policy of Title Insurance	Policy of Title Insurance
Conveyance	Warrantee Deed	Grant Deed	Land Contract & Lease
Loan Payoff	Satisfaction of mortgage	Reconveyance Deed	Grant Deed

# TRUST DEED vs. MORTGAGE

Deed of Trust	Comparison	Mortgage
<p>If Foreclosure by Court Action: Same as for Mortgage</p> <p>Trustee's Sale - No Deficiency Judgment Possible</p>	<p>Lender's Rights</p>	<p>Possible Deficiency Judgment</p>
<p>If Foreclosure by Court Action: Same as for Mortgage</p> <p>Trustee's Sale</p> <p>Notice of Default – Owner may redeem by bringing payments current within three months</p> <p>Notice of Sale – Owner may redeem only by paying entire indebtedness in full</p> <p>Trustee's Sale final. No redemption</p>	<p>Owner's Rights of Redemption</p>	<p>Before Decree of Foreclosure</p> <p>Owner may redeem anytime by bringing payments current</p> <p>After Decree of Foreclosure and Sale</p> <p>Owner has one year "Equity of Redemption"</p> <p>Must pay indebtedness in full to redeem</p>
<p>Trust Note – Outlaws four years after due date</p> <p>Trust Deed – Never outlaws – Lender can always have trustee sell to recover unpaid balance</p>	<p>Stature of Limitations</p>	<p>Mortgage note and contract both outlaw four years from due date, or from date of last payment. No relief. Monies involved not collectable.</p>

# The Basic Rule of Finance

✦ If you don't pay ... they will take it away !



## VII. The TRUSTEE'S SALE (FORECLOSURE) PROCESS

1. Beneficiary requests trustee's to foreclose
2. Trustee records notice of Default
3. Three-month waiting period (Borrower has reinstatement period)
4. Advertise "notice of Sale" with date, time and place of sale
  - a) Notice is posted on the property and public place i.e. county courthouse
  - b) Publish once a week; minimum 3-week period (21 days)
  - c) Borrower has limited right to reinstate, 1st 16 days and last 5 days must pay entire loan
  - d) Sale to highest bidder for cash (loan amount + costs)
  - e) Trustee's deed is issued (all sales final; Pg 10-4  
borrower has no right of redemption)
5. Disbursement of funds Pg 10-5

# Mortgage versus Trust Deed

	Mortgage	Deed of Trust
Foreclosure	<p>Court action Only</p> <p>Equitable Redemption</p> <p>Notice of Default</p> <p>Lawsuit/Court</p> <p>Notice of Sale</p> <p>Statutory Redemption</p> <p>Sheriff's Sale</p> <p>Deficiency Judgment</p> <p>Sheriff's Deed</p> <p>1 year to redeem</p>	<p>Court Action or Trustee's Deed</p> <p>Reinstatement Period</p> <p>Notice of Default/3 months</p> <p>Notice of Sale</p> <p>21 day minimum publish</p> <p>Trustee's Sale</p> <p>All sales final</p> <p>Trustee's Deed</p> <p>No redemption</p>
Owner's Rights of Redemption	<p>Before Decree of Foreclosure</p> <p>Owner may redeem anytime by bringing payments current</p> <p>After Decree of Foreclosure and Sale</p> <p>Owner has one year "Equity of Redemption"</p> <p>Must pay indebtedness in full to redeem</p>	<p>If Foreclosure by Court Action:</p> <p>Same as for Mortgage</p> <p>Trustee's Sale</p> <p>Notice of Default – Owner may redeem by bringing payments current within three months</p> <p>Notice of Sale – Owner may redeem only by paying entire indebtedness in full</p> <p>Trustee's Sale</p> <p>Sale final. No redemption</p>

# IX. Junior Liens (2nds, 3rds, etc.)

Junior Lien – Purpose: Close the gap between the sales price and the first loan plus down payment

✦ Types: “Hard” money second – cash from lender  
“Soft” money second – credit from seller

✦ Default: Junior lienholder may foreclose

REQUEST FOR COPY OF  
*NOTICE OF DEFAULT  
AND SALE*

Purpose: To inform holders of junior liens when the holder of a senior lien (deed of trust) is about to foreclose



# X. CONTRACT SALE

## Land Contract, Contract for Deed, Installment Land Contract, Conditional Sales Contract and Real Estate

1. Buyer (Vendee) - Seller (Vendor)
2. Advantage of vendee:
  - a. Low down payment usually required
  - b. Buyer gets immediate possession
  - c. Allows marginal buyer to acquire real estate
3. Disadvantages for vendee:
  - a. Poor Collateral for a loan
  - b. Vendee may receive flawed title.
  - c. Buyer receives full legal title after loan paid off

## x. Contract Sale (cont.)

4. Other key points regarding a land contract:
  - a) Record Constructive notice of the buyer's interest
  - b) The contract cannot prohibit recording
  - c) Creates a **cloud** on vendor's title
  - d) Removed by court or vendee signing a **quitclaim** deed (NOT quick-claim; it is not fast!)
  - e) Vendee may assign all rights if no release from vendor
  - f) Vendor must bring a judicial foreclosure action
  - g) Cal-vet loans are special loans for veterans who are residents of California
  - h) Buyer usually receives equitable, insurable, recorded title

# XI. TRUTH IN LENDING Act (TILA)

## A. Regulation Z

B. Purpose – disclosure of credit

1. Annual Percentage Rate (APR) – cost of credit in percentage terms

✦ Right of rescission

✦ APR must be stated when advertising financing



# RESPA

- ✦ Federally related loans
- ✦ 1-4 unit residences
- ✦ Special Information Booklet
- ✦ Good faith settlement of costs
- ✦ Sent 3 days from loan application
- ✦ Must be presented no later than the day before the close of escrow/settlement date.

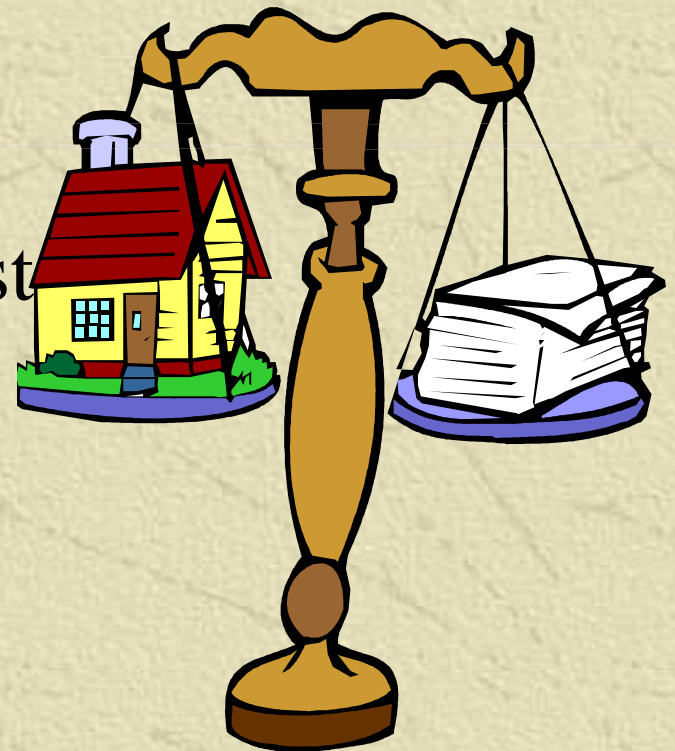


# XII. CREATIVE FINANCING DISCLOSURE LAW (AB 3531)

## A. Consumer protection in writing:

1. **Balloon** payment
2. Senior loan priority/status
3. Negative **amortization**
4. **All-Inclusive** Deeds of Trust  
(AITD)
5. Credit report data
6. Notice of default request
7. Brokers' checklist

Pg 10-6



Pg 10-7

# XIII. MORTGAGE LOAN BROKERAGE LAW (Article 7)

- A. For loans not “under the umbrella” the sky’s the limit- **hard** money (cash)
1. Borrower obligated. Broker must keep copy for **5** years.
  2. Sets costs and expenses that can be charged to the borrower for arranging the loan.

B.

Loans Covered  
Broker’s Commission Is Limited

1. 1<sup>st</sup> Trust Deed  
Less than **\$30,000**  
5% less than 3\_yrs  
3 + years 10%

2. Junior less than **\$20,000**  
**Two** years 5%  
2 but less than **Three** years  
10%  
**Three** + years 15%

# C. Mortgage Brokers Cost Limits

✦ COSTS: Limits amount of costs and expenses

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



# Sample Question: Commission Loan Fee

What is maximum amount a broker may charge for loan fees for a \$30,000 2<sup>nd</sup> due in 4 yrs with an interest rate of 12%?

- A) \$ 1,500
- B) \$ 3,000
- C) \$ 4,500
- D) None of the above**

# Sample Question: Maximum Loan Costs

Loan expenses on a \$30,000 loan:

Appraisal	\$300
Recording	\$ 15
Credit Report	\$ 25

What is the maximum loan charges the borrower may pay?

- A. \$1500
- B. \$ 700
- C. \$ 390
- D. ~~\$3400~~

# XIV. California Usury Law

## A. Maximum rate

◆ 10% or

◆ Federal Discount Rate + 5%

Pg 10-7

## B. Private lenders & borrowers-usury law

C. Exempt: banks, S & Ls, insurance co.

D. Exempt: Loans negotiated by a licensed real estate broker

E. Any loan carried by seller from buyer is also exempt.

Pg 10-8

# XV. The SAFE ACT

- A. The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE ACT) was passed July 30, 2008. This federal act mandated that states adopt legislation requiring the licensure of mortgage loan originators (MLOs).
  
- 1. Definition: A mortgage loan originator is an individual who for compensation or gain, or in the expectation of compensation or gain, takes a residential mortgage loan application or offers or negotiates terms of a residential mortgage loan.



# XV. The SAFE ACT (cont.)

2. The SAFE Act requires state-licensed MLO:
  - a. to complete 20 hours of pre-licensure education;
  - b. to pass a written test with a minimum 75% score;
  - c. to take annual continuing education courses;
  - d. to submit fingerprints to the Nationwide Mortgage Licensing System (NMLS) for submission to the FBI for a criminal background check;
  - e. to provide authorization for NMLS to obtain an independent credit report on MLO applicant.



- B. Federal legislation: California's Senate Bill 36 (SB36) requires licensure administered by the California Department of Real Estate to issue Mortgage Loan Originator Endorsements to real estate licenses

**I think I can See a better place  
(my pillow), so I'M GOING  
HOME.**

