Real Estate Principles of Georgia

Lesson 13: Applying for a Mortgage Loan

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Choosing a Lender

Types of lenders

Types of lenders include:
- savings and loans
- commercial banks
- savings banks
- credit unions
- mortgage companies

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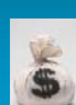
Types of lenders

Mortgage companies

Mortgage companies:
- not depository institutions
- act as loan correspondents (intermediary between investor with money to lend and home buyer seeking financing)
- act on behalf of large investors
- make the most mortgage loans



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Types of lenders
Mortgage companies

Mortgage Companies/Mortgage Bankers:
– sell their loans to investors on secondary market
– often service loan for fee

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Types of lenders
Mortgage companies

Mortgage company vs. Mortgage broker

A **mortgage broker** simply arranges loans, bringing borrowers and lenders together for a commission.

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Types of Lenders
Other financing sources

Seller financing: Seller extends credit to buyer.

Seller financing is important when:
- buyer's income is inadequate
- interest rates are high
- buyer has poor credit history

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Summary
Choosing a Lender: Types of Lenders

- Savings and loans
- Commercial banks
- Savings banks
- Credit unions
- Mortgage companies
- Mortgage brokers
- Other sources

Choosing a Lender
Loan costs

Loan costs include:
- interest charges
- origination fees
- discount points
- lock-in fees

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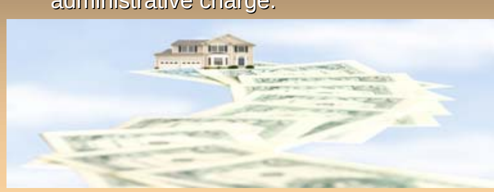
Loan Costs
Origination fees

Origination fee: Administrative charge for processing loan, paid at closing.
- Also known as loan fee, service fee, or administrative charge.



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Loan Costs
Discount points

Discount points: Fee paid to lender at closing to increase lender's yield (or profit) on loan and to lower Borrower's interest rate.

- One point is equal to 1% of loan amount.
  – Two points are equal to 2% of loan amount.

Buydown: Seller pays buyer's discount points to lower buyer's interest and make loan more affordable.

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Loan Costs
Discount Points

Effect of each discount point:

- Lowers borrower's interest rate by 1/8 of 1%
- Raises lender's yield by 1/8 of 1%

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Loan Costs
Lock-ins

Lock-in fee: Fee paid to lender by buyer to guarantee interest rate for a certain period.

– Without lock-in, lender may change loan's interest rate at any point before closing.

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Loan Costs
Truth in Lending Act

Truth in Lending Act (TILA): Federal consumer protection law requiring lenders to disclose total cost of obtaining loan.

– Implemented through Regulation Z, a Federal Reserve regulation.

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Loan Costs
Truth in Lending Act

TILA applies to consumer loans:

– for personal, family, or household purposes
– paid off in more than four installments or involving finance charges
– for $25,000 or less or secured by real property
– All real estate loans regardless of loan amount

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Loan Costs
Truth in Lending Act

TILA does NOT apply to:

– loans made to corporations or organizations
– loans made for business, commercial, or agricultural purposes
– seller-financed transactions/purchase money mortgage

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Loan Costs
Truth in Lending Act

If loan is covered by TILA, lender must disclose loan's:

- total finance charge
- annual percentage rate (APR)

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Loan Costs
Truth in Lending Act

Total finance charge:
Sum of all fees borrower must pay, including interest, origination fees, discount points, service fees, and mortgage insurance premiums.

- Does NOT include seller-paid points, appraiser fees, or credit report fees.

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Loan Costs
Truth in Lending Act

Annual percentage rate (APR): Cost of loan expressed as annual percentage of loan amount (also called **effective interest rate**).

- More accurate way to compare loan costs than by comparing nominal rates.

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Loan Costs
Truth in Lending Act

TILA also:

– requires good faith estimate of loan costs to be given to borrower (within three days of loan application)

– gives home equity borrowers and those who refinance right of rescission (within three days of signing loan agreement)

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Loan Costs
Truth in Lending Act

TILA advertising rules / Trigger Terms

– ad can list cash price or APR without triggering full disclosure requirements

– otherwise, it must also disclose:

- required downpayment
- points
- terms of repayment (i.e., loan balance and total number of payments)

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Summary
Choosing a Lender: Loan Costs

- Origination fee
- Discount points
- Lock-in
- Truth in Lending Act
- Total finance charge
- Annual percentage rate

Loan Application Process
Underwriting

Lender evaluates completed application according to its qualifying standards (**underwriting** the loan).

Underwriter assesses degree of risk loan would create and decides whether loan should be approved.

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Loan Application Process
Underwriting

Three main considerations:

- income
- net worth
- credit history

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Underwriting
Income

Underwriter uses income ratios to evaluate quantity of income. Two ratios:

- housing expense to income ratio
- debt service to income ratio

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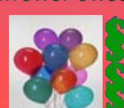
Summary
Loan Application Process

- Prequalification
- Loan application
- Stable monthly income
- Income ratios
- Credit history
- Subprime lending

Basic Loan Features
Amortization

Amortized loan: Requires regular installment payments of both principal and interest.

- **Fully amortized loan:** Monthly payments pay off entire debt at end of loan term.
- **Partially amortized loan:** Monthly payments not enough to pay off entire debt; borrower owes balloon payment at end of term.



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Basic Loan Features
Interest Only / Straight Term

- Payments include only interest
- Entire principal amount borrowed due at end of loan term

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Basic Loan Features
Loan-to-value ratios

Loan-to-value ratio (LTV): Relationship between loan amount and value of security property, expressed as a percentage.

– $80,000 loan on a property worth $100,000 would have an 80% LTV.

The lower the LTV, the greater the buyer's equity in the property.

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Basic Loan Features
Secondary financing

Buyer may use second mortgage loan to pay for part of downpayment and closing costs.

Source of secondary financing:
- institutional lender
- property seller
- private investor

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Basic Loan Features
Interest rates

Fixed-rate: Interest rate remains same throughout loan term.

6% 6% 6% 6% 6%

Adjustable-rate: Interest rate adjusted periodically throughout loan term to reflect current market interest rates.

6% 7.5% 8% 7% 9%

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ARMs
Elements

Elements of ARM:
- index
- margin
- adjustment periods
- caps

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Elements of an ARM
Margin

Margin: Difference between index rate and interest rate charged to borrower.
- Lender adds margin (i.e., 2 percentage points) to index rate to cover lender's expenses and profit.
- Margin stays same throughout loan term.

Interest rate – Index rate = Margin

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Elements of an ARM
Caps

Caps help prevent large payment increases that might force borrower into default.
- Interest rate cap: Limits amount interest rate may go up over a year, or over loan term.
- Payment cap: Limits amount lender can raise monthly payment amount.

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Elements of a GPM

Graduated Payment Mortgage

- Fixed Interest
- Lower than amortized payment in early years of loan
- Negative Amortization:
  - causes loan's principal balance to go up rather than down, as unpaid interest is added to balance
  - occurs if increases in monthly payment amount don't keep up with increases in loan's interest rate

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Summary

Basic Loan Features

- Loan term
- Amortization
- Loan-to-value ratio
- Secondary financing
- Fixed-rate mortgage
- ARMs
- Index
- Margin
- Rate and payment adjustment periods
- Rate and payment caps
- GPM - Graduated Payment Mortgage

Residential Financing Programs

Major types of residential financing:

- conventional loans
- FHA-insured loans
- VA-guaranteed loans

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Residential Financing Programs
Conventional loans

Conventional loan: Any institutional mortgage not backed by a government program.

- Most lenders follow Fannie Mae and Freddie Mac standards so loans can be sold on secondary market.

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Residential Financing Programs
Conventional loans

Nonconforming loan: Loan that doesn't meet Fannie Mae or Freddie Mac standards.

- Lender must keep nonconforming loan in its own portfolio.

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Conventional Loans
Loan-to-value ratios

Conventional loans are divided into 80%, 90%, and 95% loans.

- If loan falls between these percentages, round up to classify.
  - Loan with 81% LTV is a 90% loan.

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Conventional Loans
Loan-to-value ratios

Standard LTV is 80% for conventional loans.
- Loans with 90% or 95% LTVs represent added risk.
- Lender will require borrower to pay **private mortgage insurance** (PMI).

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Conventional Loans
Private Mortgage Insurance

Two Options of Payment:

- In Full at Closing

90% LTV: 2% of loan amount

95% LTV: 2.5% of loan amount

- Spreading

Part up front at closing

Balance in monthly installments

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Conventional Loans
Qualifying standards

Fannie Mae and Freddie Mac set underwriting standards for conventional loans.
- Include maximum housing expense to income ratio and maximum total debt service ratio.

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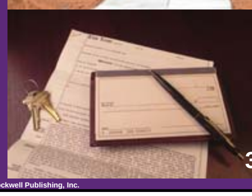
Conventional Loans

Assumption

Most conventional loans contain alienation clause.

– Prevents borrower from selling loan and having buyer assume loan without lender's permission.



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Summary

Conventional Loans

- Conventional loan
- Nonconforming loan
- Conventional LTVs
- Owner-occupancy
- Private mortgage insurance
- Qualifying standards

Residential Financing Programs

FHA-insured loans

Federal Housing Administration (FHA): Created in 1934 to promote home sales and financing for low- and middle-income homebuyers.

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Residential Financing Programs
FHA-insured Loans

FHA does not accept loan applications directly from borrowers.

- Borrowers apply to lender that is approved to make FHA-insured loans.

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FHA-insured Loans
Key characteristics

Key characteristics of FHA loans:

- Typically 30-year loans.
- Owner-occupancy, with 1-4 units.
- 1% origination fee.
- Qualifying standards are less stringent

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FHA-insured Loans
Key characteristics

- Low downpayment (often less than 3% of the loan amount).
  - 97.75% if sales price is above $50,000
  - 98.75% if sales price is $50,000 or less
- Mortgage insurance required for duration of loan term.
- Maximum loan amount varies from area to area.

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FHA-insured Loans
Programs

FHA programs:
- 203(b): Standard program to insure purchase/refinance loans on residences with up to 4 units.
- Other programs are variations of basic 203(b) program.

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FHA-insured Loans
Qualifying standards

Maximum income ratios are higher for FHA borrowers than conventional borrowers.

No maximum income limits: Buyer at any income level can qualify for FHA loan as long as loan amount doesn't exceed maximum allowed for area.

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FHA-insured Loans
Qualifying standards

FHA loans require both:
- one-time **Mortgage Insurance Premium (MIP)** paid at closing, and
- annual mortgage insurance premiums (usually paid each month).

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FHA-insured Loans
Assumption

FHA loans that closed before 1990 may be freely assumed.

Newer loans may be assumed only if buyer:
- meets FHA underwriting standards
- intends to occupy home as primary residence

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Summary
FHA-insured Loans

- Federal Housing Administration
- Owner-occupancy
- Maximum loan amount
- Minimum cash investment
- FHA qualifying standards

Residential Financing Programs
VA-guaranteed loans

VA loans: Loans guaranteed by Department of Veteran Affairs (if borrower defaults, government will reimburse lender for all or part of its loss).

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VA-Guaranteed Loans
Eligibility

VA borrower must have served period of active duty in U.S. armed forces.

- Spouses of deceased or missing veterans and long-term national guard or reserves members are also eligible.

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VA-guaranteed Loans
Loan process

Eligible veteran receives Certificate of Eligibility from VA.

Veteran applies to lender, not VA.

Property must be appraised according to VA guidelines (appraised value set forth in **Certificate of Reasonable Value**).

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VA-guaranteed Loans
Characteristics

Key characteristics of VA loans:

- No downpayment or maximum loan amount (100%).
- Qualifying standards even less strict than FHA standards.
- No mortgage insurance required.
- Loan applicant must intend to occupy property.
- Usually fixed-rate 30-year loans.
- Borrowers may opt to pay discount points.
- Funding Fee

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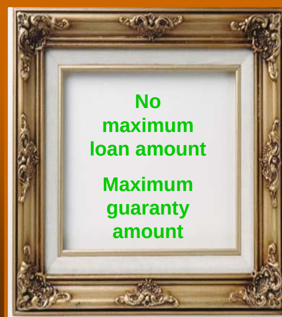
VA-guaranteed Loans
VA guaranty

- No maximum VA loan amount, but VA sets a maximum guaranty amount. Typically, lender will loan 4x this guaranty.
- For large loan, lender may require downpayment if purchase price exceeds maximum guaranty amount.



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VA-guaranteed Loans
Restoration of entitlement

If veteran pays off VA loan:
- full guaranty entitlement is restored
- can obtain another VA loan with maximum guaranty

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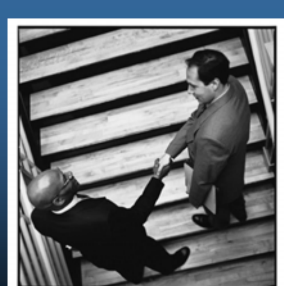
VA-guaranteed Loans
Restoration of entitlement

If VA loan is assumed, in order for seller's entitlement to be restored, buyer who assumes loan must be eligible veteran willing to substitute his entitlement.



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Summary
VA-guaranteed and RHS Loans

- VA-guaranteed loan
- VA eligibility
- Certificate of Reasonable Value
- VA guaranty
- Restoration of entitlement
- VA qualifying standards
- Funding Fee
- RHS Loans

Mortgage Fraud

- Felony violation in Georgia
  - Up to 20 years in jail
  - Fines up to $100,000
- Falsifying information
- Receiving compensation knowing law is violated
- Being part of conspiracy

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Mortgage Fraud
At the Closing

- Mysterious or unnecessary terms on closing statement
- Strange kickbacks or payouts of cash
- Buyer is immediately re-selling property for inflated price

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Mortgage Fraud
“Red Flags”

- Buyer offers more than listing price
- Contract price unrealistically high
- Borrower’s loan more than contract price
- False information included in contract

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