

**Residential and Commercial  
Property Financing**

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**Financing Property**

- Understanding the Mortgage Concept
  - Secured vs unsecured debt
  - History of the mortgage concept
    - Mortgage - pledge of property to secure a debt
      - Mortgagor - property owner
      - Mortgagee - lender
    - Hypothecation - leaving borrowers in possession of their property

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**Financing Property**

- Modern Mortgage Concepts
  - Title theory - Immediate Transfer
  - Lien theory - Foreclosure

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### Financing Property

- Promissory Note
  - Written promise to pay monies owed
  - Prepayment clause
    - Right to prepay with or without penalty
  - Acceleration clause
    - In case of default, entire note is due
  - Due on sale clause
    - Immediate payment due if property is sold

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### Financing Property

- Foreclosure
  - Seizing collateral to satisfy a defaulted debt
    - Statutory Equity Right of Redemption
    - Mortgagee keeps only the mortgage amt + fees
  - Deed in Lieu of Foreclosure

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### Financing Property

- Alternative Security Instruments
  - Deed of Trust
  - Land contract (Contract for Deed)
    - Seller Financed
    - Title transfers when paid off

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## Financing Property

- Structure of the US Housing Finance System
  - Lending process
    - Loan origination (creating new loans)
    - Primary mortgage market (originations)
    - Secondary mortgage market (selling of mtgs.)

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## Financing Property

- Housing Finance System
  - Federal Housing Administration (FHA)
    - FHA-insured loan
    - Insurance fees
  - Private mortgage insurance
    - PMI vs FHA-insured
  - VA Loan Guarantee Program

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## Financing Property

- Secondary Mortgage Markets (GSA's)
  - Federal National Mortgage Association (FNMA)
    - Private Corp.
  - Government National Mortgage Association (GNMA)
    - Operates through FHA Loan Programs
    - Direct Subsidized Loans for Low Income Borrowers
    - Mortgage-backed securities
  - Federal Home Loan Mortgage Corporation (FHLMC)
    - Conventional Loans
    - Set up to help S&L's & Credit Unions
    - Private Corp.

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## Financing Property

- Mortgage Market Participants
  - Mortgage originators and investors
    - Mortgage bankers
    - Mortgage brokers
    - Commercial banks
    - Savings and Loan institutions
    - Credit unions
  - Purchase Money Mortgage

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## Financing Property

- Understanding the Mortgage Loan Origination Process
  - FNMA/FHLMC Uniform Residential Application
    - Securitization – consistent underwriting guidelines
  - Duties of the originator
    - Equal Credit Opportunity Act
      - Prohibits Discrimination
      - Requires decisions in 30 days
    - Consumer Credit Protection Act
      - Truth in Lending
      - APR vs. Contract Rates

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## Financing Property

- Real Estate Settlement and Procedures Act (RESPA)
  - HUD guide for home buyers
  - “Good faith estimate of closing costs”
  - Right to a copy of the appraisal
  - Prohibits kickbacks (no other loans)
  - Secondary market disclosure (securitized?)
  - Maximum amount of escrow withholdings
    - AV tax, insurance, etc.
  - Residential mortgage credit report
    - Credit Scoring

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## Financing Property

- Mortgage Underwriting
  - Evaluating applicant and property
    - Qualifying an applicant
    - Qualifying the property
      - Appraisal
      - Title Inspection
      - Building Inspections

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## Financing Property

- Risk Assessment
  - Loan to value ratio guidelines
    - A percentage or ratio ie: 75% or .75
  - Down payment source guidelines
    - No additional Undisclosed loans (No Down payment)
    - Gifts
  - Income ratio guidelines
    - Mortgage debt ratio
      - Gross monthly income (28%)
    - Total debt ratio
      - 36%
    - FHA 29/41

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## Financing Methods & Techniques

- Mechanics of the Fixed Rate Mortgage
  - Payment to Amortize a FRM
    - Interest (Contract) Rate
    - Amortization Term (payment frequency)
    - Mortgage Constant ( $R_m$ )

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## Financing Methods & Techniques

- Mechanics of the Fixed Rate Mortgage
  - Effective Borrowing Costs (APR & APY)
    - Statutory Costs
      - Recording Fees
    - Third Party Costs
      - Appraisal, Inspection, termite bonds, Title Policy
    - Additional Lender Costs
      - Discounting of Mortgage Loans (Points)
      - Prepayment Penalties (Back-end Points)

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## Financing Methods & Techniques

- Mechanics of Altern. Financing Instr.
  - Varying Rate Mortgages
    - Variable Rate Mortgages
      - Change in Payment
      - Change in Maturity
    - Adjustable Rate Mortgage
      - More Flexible than the VRM
    - Renegotiable Rate Mortgages
      - Longer Adjustment Term (Two Step Mtg.)

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## Financing Methods & Techniques

- Mechanics of Altern. Financing Instr.
  - Graduated Payment Mortgage
    - Payments Increase on a Scheduled Basis
    - Borrower expected to have higher income
  - Wraparound Mortgage
    - Second Loan Subordinate to First
    - Second Loan makes payments for First
  - Participation Mortgages
    - Shared Appreciation Mortgage (SAM)
    - Income -Equity Participation Mortgage

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**Financing Methods & Techniques**

- **Mechanics of Altern. Financing Instr.**
  - Joint Ventures
    - Like a participation Mtg. but Lender also puts up equity
    - This is not as common with commercial banks as with pension funds and insurance companies
    - Developers are the active project managers
    - Formed under various ownership structures

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**Financing Methods & Techniques**

- **Mechanics of Altern. Financing Instr.**
  - Real Estate Syndications
    - Pool of Investors
    - Usually a Limited Partnership or LLC
    - Limited vs. General Partners

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**Financing Methods & Techniques**

- **Mechanics of Altern. Financing Instr.**
  - Lease and Sale-Leaseback
    - Lease payments are tax deductible
    - Frees up Capital for the Lessee
    - Sale-Leaseback: Owner sells and then leases back the property.
      - Common with many types of retail stores (Lowe's)
      - Often these are internal transfers (synthetic leases)

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## Financing Methods & Techniques

- Mechanics of Altern. Financing Instr.
  - Other Financing Methods
    - Loan Assumptions
      - Buyer pays difference in selling price and outstanding balance then assumes the existing loan terms
      - Lenders are generally reluctant to allow this without charging certain fees
      - Due on Sale clauses prevent this in most mortgages, since it is implicit unless forbidden

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## Financing Methods & Techniques

- Mechanics of Altern. Financing Instr.
  - Other Financing Methods
    - Junior Mortgages
      - Second, Third, Fourth
      - Subordinate to Higher Mortgages
      - Riskier - Higher rate
    - Buy-Down Mortgages
      - Like using discount points
      - Seller pays a fee for the reduction in payment in the early period of the loan
      - Used in high interest rate periods

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## Financing Methods & Techniques

- Mechanics of Altern. Financing Instr.
  - Other Financing Methods
    - Zero Interest Mortgages
      - Similar to a short term Buy-Down
      - Lenders return is made on a large discount payment up front
    - Growing Equity Mortgage
      - Base FRM combined with a GPM
      - Allows greater equity payments through increasing equity portions over the life of the loan
      - Shortens the term of a mortgage

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## Financing Methods & Techniques

- Mechanics of Altern. Financing Instr.
  - Other Financing Methods
    - Reverse Annuity Mortgage
      - Used by retirees to supplement income
      - Mortgage amount is paid out to the borrower over an extended period of time
      - Balance is paid off when the property is sold or owner dies
        - Risky if property values decline (Unless Insured)

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