Section 12 – Part 1

SLIDE 1 – Residential Mortgages (Cover Page)

SLIDE 2

Topics

In this section we will cover the following topics:

I. Mortgage Concepts
II. Essential Elements of the Mortgage
III. Common Mortgage Features
IV. Assignment of the Mortgage
V. Methods of Purchasing Mortgaged Property
VI. Default

SLIDE 3

Learning Objectives

Upon completion of this lesson, you should be able to:

- Distinguish between title theory and lien theory
- Describe the essential elements of the mortgage instrument and the note
- Describe the various features of a mortgage including down payment, loan-to-value ratio, equity, interest, loan servicing, escrow account, PITI, discount points and loan origination fee
- Explain assignment of a mortgage and the purpose of an estoppel certificate

SLIDE 4

- Explain the foreclosure process and distinguish between judicial and nonjudicial foreclosure
- Describe the mortgagor's and mortgagee's rights in a foreclosure
- Calculate loan-to-value ratio
- Explain the use of discount points and calculate approximate yield on a loan
- Distinguish among the various methods of purchasing mortgaged property

SLIDE 5

Key Terms

Here are some key terms we'll encounter in this lesson:

- **acceleration clause** – a clause within a mortgage or deed of trust stating the entire loan balance is immediately due from the borrower should they default under the terms and stipulation of the mortgagee. The lender has the legal right to call the loan and have full payment of the balance should the borrower fail to pay the loan under the terms of the mortgage note.
- **assumption** – a method of selling real estate where the buyer of property agrees to make the remaining payments due on an existing mortgage. The seller still remains liable unless the transfer of ownership has been properly completed by the title company

SLIDE 6

- **contract for deed** – also known as land contract or installment contract. Buyer gets title when house is substantially paid for. Until then, seller retains title
- **defeasance clause** – the clause in a mortgage that gives the mortgagor the right to redeem his property upon the payment of his obligation to the mortgagee, and declares the instrument null and void upon payment of debt when due
- **deed in lieu of foreclosure** – a means by which the lender is deeded property upon default of payment without court action as an alternative to foreclose. Deed

SLIDE 7

- **discount points** – a term used in government subsidized loans, such as FHA insured and VA guaranteed loans. The term refers to any "points" (one percent of the loan amount) paid in addition to the one percent loan origination fee
- **due on sale clause (alienation clause)** – a provision of a loan contract that stipulates that if the property is sold, the loan balance must be repaid. This bars the seller from transferring responsibility for an existing loan to the buyer when the interest rate on the old loan is below the current market. A mortgage containing a due-on-sale clause is not an assumable mortgage

SLIDE 8

- **equity** – in connection with real property, the difference between the value of the property including improvements and the balance of outstanding mortgage loans on that property
- **equity of redemption** – the common law right to redeem property during the foreclosure period. In some states the mortgagor also has a statutory right to redeem property after a foreclosure sale
- **escrow** – an agreement that money or other objects of value be placed with a third party for safe keeping, pending the performance of some promised act by one of the parties to the agreement
- **estoppel certificate** – a statement that in itself prevents its issuer from later asserting different facts

SLIDE 9

- **hypothecation** – to give a mortgage as security without giving up possession of the house
- **interest** – consideration in the form of money paid for the use of money, usually expressed as an annual percentage; a right, share, or title in property
- **lien theory** – a theory followed in several states that assumes a mortgage has only a lien on the mortgage property, and the mortgagor has legal title
- **lis pendens** – a legal document giving constructive notice that a law suit is pending
- **land development loans** – a loan obtained by the builder/developer for the purchase of land and to cover expenses for developing the property

SLIDE 10

- **blanket mortgage** – a mortgage secured by the pledging of more than one property as collateral
- **buydown** – a permanent buy-down is the payment of points in exchange for a lower interest rate. A temporary buy-down concentrates the rate reduction in the early years. The buy-down allows a loan to be made at less-than-market interest rates by paying front-end discounts. The interest rate is brought down for a temporary period, usually from one to three years. In order to acquire this discount, a lump sum is paid and held in an account used to supplement the borrower's monthly payment. After the discount period, the payment is calculated as the note rate

SLIDE 11

- **loan origination fee** – a one time set up fee charged by the lender
- **loan servicing** – a service performed by a lender to protect a mortgage investment, including collecting monthly payments from borrowers and dealing with delinquencies
- **loan-to-value ratio** – the relationship between the amount of the mortgage loan and the appraised value of the property expressed as a percentage
- **mortgage** – a written legal document evidencing the lien on a property taken by a lender as security for the repayment of a loan

SLIDE 12

- **mortgagee** – the lender in a mortgage agreement
- **mortgagor** – the borrower in a mortgage agreement
- **note** – a document that evidences a debt and a promise to repay. A mortgage loan transaction always includes both a note evidencing the debt and a mortgage evidencing the lien on the property, usually two separate documents
- **novation** – the substituting of a new obligation for an old one
- **partial release clause** – a clause in a security instrument allowing one or more of the parcels of property under a blanket lien to be released from the lien while other parcels remain subject to it

SLIDE 13

- **PITI** – shorthand for principal, interest, taxes and insurance, the components of the monthly housing expense
- **prepayment clause** – a clause in a mortgage or trust deed that provides for a penalty to be levied against a borrower who repays a loan before the specified due date
- **prepayment penalty** – a fee charged a mortgagor who prepays a loan before it is due. Not allowed for FHA or VA loans
- **receivership clause** – A mortgage clause that prevents the evaporation of value of a secured asset which provides for the orderly appointment of a receiver to take charge and to rent and manage property abandoned by the mortgagor

SLIDE 14

- **satisfaction of mortgage** – the recordable instrument given by the lender to evidence payment in full of the mortgage debt. Sometimes known as a release of deed
- **short sales** – an agreement between a mortgage borrower in distress and the lender that allows the borrower to sell the house and remit the proceeds to the lender. It is an alternative to foreclosure, or a deed in lieu of foreclosure
- **subject to** – when a borrower sells the security property without paying off the mortgage or deed of trust, and the purchaser takes title "subject to" the lien, but does not assume the loan

SLIDE 15

- **subordination agreement** – the act of a party acknowledging, by written recorded instrument, that a debt due is inferior to the interest of another in the same property. Subordination may apply not only to mortgages but to leases, real estate rights, and any other types of debt instruments.
- **take-out commitment** – the promise to make a loan at a future specified time. It is commonly used to designate a higher cost, shorter term, backup commitment as a support for construction financially, until a suitable permanent loan can be secured
- **title theory** – a theory followed in several states that the mortgagee has legal title to the mortgaged property and the mortgagor has equitable title

SLIDE 16 – Mortgage Concepts (Cover Page)

SLIDE 17

Title, Lien, and Intermediate Theories

In real estate financing, the real property is used as the collateral for the loan. The three theories to be discussed are all concerned with the title to the collateral property.

This originates from the lenders' demand for a guarantee of the return of funds loaned, or a property with value substantial enough to substitute for funds not returned.

SLIDE 18

States differ in their interpretation of who owns mortgaged property. Those that regard the mortgage as a lien held by the mortgagee (lender) against the property owned by the mortgagor (borrower) are called lien-theory states. Those that regard the mortgage document as a conveyance of ownership from the mortgagor to the mortgagee are called title-theory states. Some states interpret ownership of mortgaged property from a point of view that combines aspects of both title and lien theory.

A valid mortgage or trust deed financing arrangement requires:

A note as evidence of the debt

The mortgage or trust deed as evidence of the collateral pledge

SLIDE 19

In the very beginning of mortgage lending the lenders' rights were superior to those of the borrowers'.

As time went by, laws began to change in a way that gave borrowers the legal right to redeem property within an amount of reasonable time after the initial default or non-payment.

SLIDE 20

More than half of the states have since adopted periods for recovery of property, after the foreclosure sale.

This is known as statutory periods of redemption. These periods vary from state to state but can vary from three months up to two years.

SLIDE 21

Lien Theory

As times progressed and changed, the conflict of lenders' rights versus borrowers' rights has dramatically shifted to borrowers.

Most states have adopted the lien theory, which allows borrowers to retain their legal rights in their property and gives lenders reasonable rights in the collateral property.

SLIDE 22

In a lien theory state, the buyer holds the deed to the property during the term of the mortgage.

The mortgage becomes a lien on the property, but title remains with the buyer. The lender's lien is removed once the loan is paid off.

SLIDE 23

Intermediate Theory

Some states have recognized that borrowers can abuse the system by use of the lien theory. Therefore a lender can't recover their collateral and minimize their losses within a reasonable amount of time.

Some states have adopted a position between the title theory and lien theory – the Intermediate Theory.

SLIDE 24

With this intermediate position, some states allow the lender to take possession of collateral property in the event of a loan default.

This is accomplished without having to wait for foreclosure proceedings to result in a judgment for possession of the property.

SLIDE 25

Mechanics of a Loan Transaction

Note – In addition to executing a mortgage or trust deed, the borrower signs a promissory note for the amount borrowed. The amount of the loan is typically the difference between the purchase price and the down payment. A promissory note creates a personal liability for the borrower to repay the loan.

Mortgage – A mortgage is a legal document stating the pledge of the borrower (the mortgagor) to the lender (the mortgagee). The mortgage document pledges the borrower's ownership interest in the real estate in question as collateral against performance of the debt obligation.

SLIDE 26

Promissory Note

A borrower who executes a promissory note is the maker or payer of the note. The lender is the payee. To be properly executed, all parties who have an interest in the property should sign the note. The note sets forth:

- The loan amount
- The term of the loan
- The method and timing of repayment
- The interest rate to be paid
- The borrower's promise to pay

SLIDE 27

The note may also state that it is payable to the bearer, if used with a deed of trust, or to the mortgagee, if used with a mortgage. Other items in the mortgage document or deed of trust may be repeated in the promissory note, especially:

- The right to prepay the loan balance
- Charges for late payment
- Conditions for default
- Notifications and cures for default
- Other charges

A promissory note is a negotiable instrument, which means the payee may assign it to a third party. The assignee would then have the right to receive the borrower's periodic payments.

Section 12 – Part 2

SLIDE 1 – Flow of a Loan Transaction (Cover Page)

SLIDE 2

Flow of a Loan Transaction

The deed of trust – Conveys title to the property in question from the borrower (trustor) to a trustee as security for the loan. The trustee is a third party fiduciary to the trust. While the loan is in place, the trustee holds the title on behalf of the lender, who is the beneficiary of the trust. On repayment of the loan, the borrower receives the title from the trustee in the form of a deed of reconveyance.

SLIDE 3

Mortgage Document and Trust Deed

A borrower who executes a mortgage is a mortgagor. The lender named in the mortgage is the mortgagee. In a trust deed, the borrower is the trustor and the lender is beneficiary. The mortgage or trust document identifies the property being given as security, giving both its legal description and mailing address. The document contains much of the same information as the note, including:

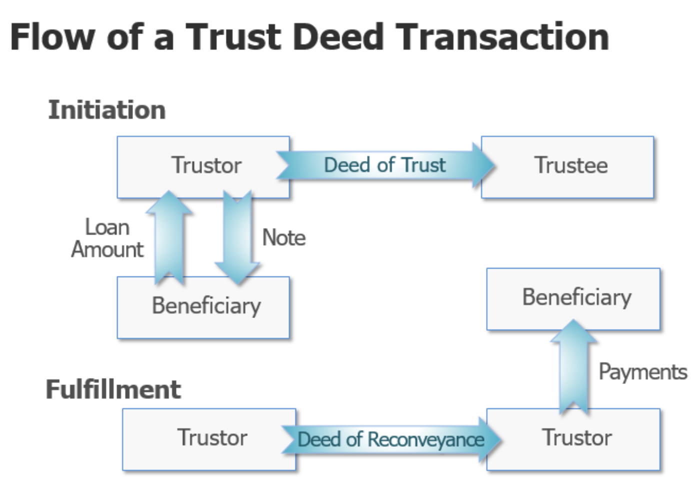
the debt amount

the term of the loan

method and timing of payments

The document does not usually provide details about the payment amount, interest rate, or charges.

SLIDE 4



SLIDE 5

Mortgage Concepts

Mechanics of a loan transaction – It is common to use borrowed money to purchase real estate. When a borrower gives a note promising to repay the borrowed money and executes a mortgage on the real estate for which the money is being borrowed as security, the financing method is called mortgage financing.

The term "mortgage financing" also applies to real estate loans secured by a deed of trust. The process of securing a loan by pledging a property without giving up ownership of the property is called hypothecation.

SLIDE 6

Lien Types

Senior and junior loans – When there are multiple loans on a single property, there is an order of priority in the liens which the mortgages create. The first, or senior, loan generally has priority over any subsequent loans. Second loans are riskier than first loans because the senior lender will be satisfied first in case of default. Therefore, interest rates on second mortgages are generally higher than on first mortgages.

SLIDE 7

Superior and inferior lien – The category of superior, or senior, liens ranks above the category of inferior, or junior, liens, meaning that superior liens receive first payment from the proceeds of a foreclosure.

The superior category includes liens for real estate tax, special assessments, and inheritance tax.

Other liens, including income tax liens, are inferior.

SLIDE 8

Lien Priority

Within the superior and inferior categories, a ranking of lien priority determines the order of the liens' claims on the security underlying the debt. The highest ranking lien is first to receive proceeds from the foreclosed and liquidated security.

The lien with lowest priority is last in line. The owner receives any sale proceeds remaining after all lienors receive their due

SLIDE 9

Lien priority is of paramount concern to the creditor, since it establishes the level of risk in recovering loaned assets in the event of default.

- Lien's categorization as superior or junior
- Recordation date of the lien

Superior liens in rank order

1. Real estate tax liens
2. Special assessment liens
3. Federal estate tax liens
4. State inheritance tax liens

Superior liens in rank order

- Federal income tax liens
- State corporate income tax liens
- State intangible tax liens
- Judgment liens
- Mortgage liens
- Vendor's liens
- Mechanic's liens (priority by date work is performed)

SLIDE 10

All superior liens take precedence over all junior liens regardless of recording date, since they are considered to be matters of public record not requiring further constructive notice. Thus, a real estate tax lien (senior) recorded on June 15 has priority over an income tax lien (junior) recorded on June 1.

A junior lien is automatically inferior, or subordinate, to a superior lien. Among junior liens, date of recording determines priority. The rule is: *the earlier the recording date of the lien, the higher its priority*.

For example, if a judgment lien is recorded against a property on Friday, and a mortgage lien is recorded on the following Tuesday, the judgment lien has priority and must be satisfied in a foreclosure ahead of the mortgage lien.

SLIDE 11

The mechanic's lien is an exception to the recording rule. Its priority dates from the point in time when the work commenced or ended, as state law determines, rather than from when it was recorded.

SLIDE 12

Subordination – A lienor can change the priority of a junior lien by voluntarily agreeing to subordinate, or lower, the lien's position in the hierarchy. This change is often necessary when working with a mortgage lender who will not originate a mortgage loan unless it is senior to all other junior liens on the property. The lender may require the borrower to obtain agreements from other lien holders to subordinate their liens to the new mortgage.

For example, interest rates fall from 8% to 6.5% on first mortgages for principal residences. A homeowner wants to refinance her mortgage, but she also has a separate home-equity loan on the house. Since the first-mortgage lender will not accept a lien priority inferior to a home equity loan, the homeowner must persuade the home equity lender to subordinate the home equity lien to the new first-mortgage lien

SLIDE 13

Senior or Superior Liens

Real estate tax lien – he local legal taxing authority annually places a real estate tax lien, also called an ad valorem tax lien, against properties as security for payment of the annual property tax. The amount of a particular lien is based on the taxed property's assessed value and the local tax rate.

Special assessment lien – Local government entities place assessment liens against certain properties to ensure payment for local improvement projects such as new roads, schools, sewers, or libraries. An assessment lien applies only to properties that are expected to benefit from the municipal improvement.

SLIDE 14

Federal and state inheritance tax liens – Inheritance tax liens arise from taxes owed by a decedent's estate. The lien amount is determined through probate and attaches to both real and personal property.

Section 12 – Part 3

SLIDE 1

Junior Liens

All tax liens other than those for ad valorem, assessment, and estate tax are junior liens.

They include:

Federal income tax lien

placed on a taxpayer's real and personal property for failure to pay income taxes

State corporate income tax lien

filed against corporate property for failure to pay taxes

State intangible tax lien

filed for non-payment of taxes on intangible property

State corporation franchise tax lien

filed to ensure collection of fees to do business within a state

SLIDE 2

Judgment lien – A judgment lien attaches to real and personal property as a result of a money judgment issued by a court in favor of a creditor. The creditor may obtain a writ of execution to force the sale of attached property and collect the debt.

After paying the debt from the sale proceeds, the debtor may obtain a satisfaction of judgment to clear the title records on other real property that remains unsold.

During the course of a lawsuit, the plaintiff creditor may secure a writ of attachment to prevent the debtor from selling or concealing property. In such a case, there must be a clear likelihood that the debt is valid and that the defendant has made attempts to sell or hide property.

Certain properties are exempt from judgment liens, such as homestead property and joint tenancy estates.

SLIDE 3

Mortgage and trust deed lien. In lien-theory states, mortgages and trust deeds secure loans made on real property. In these states, the lender records a lien as soon as possible after disbursing the funds in order to establish lien priority.

Vendor's lien. A vendor's lien, also called a seller's lien, secures a purchase money mortgage, a seller's loan to a buyer to finance the sale of a property.

Municipal utility lien.

A municipality may place a utility lien against a resident's real property for failure to pay utility bills.

Mechanic's lien. A mechanic's lien secures the costs of labor, materials, and supplies incurred in the repair or construction of real property improvements.

If a property owner fails to pay for work performed or materials supplied, a worker or supplier can file a lien to force the sale of the property and collect the debt.

Any individual who performs approved work may place a mechanic's lien on the property to the extent of the direct costs incurred. Note that unpaid subcontractors may record mechanic's liens whether the general contractor has been paid or not. Thus it is possible for an owner to have to double-pay a bill in order to eliminate the mechanic's lien if the general contractor neglects to pay the subcontractors. The mechanic's lienor must enforce the lien within a certain time period, or the lien expires.

In contrast to other junior liens, the priority of a mechanic's lien dates from the time when the work was begun or completed. For example, a carpenter finishes a job on May 15. The owner refuses to pay the carpenter in spite of the carpenter's two-month collection effort. Finally, on August 1, the carpenter places a mechanic's lien on the property. The effective date of the lien for purposes of lien priority is May 15, not August 1.

SLIDE 4

Liens

Liens have the following legal features:

A lien attaches to the property

- If the property is transferred, the *new owner acquires the lien securing the payment of the debt.* In addition, the creditor may take foreclosure action against the new owner for satisfaction of the debt.

A property may be subject to multiple liens

- There may be numerous liens against a particular property. The more liens there are recorded against property, the less secure the collateral is for a creditor.

The total value of all liens may approach or exceed the total value of the property.

SLIDE 5

Liens have the following legal features:

A lien does not convey ownership, with one exception

- A lienor generally has an equitable interest in the property, but not legal ownership. The exception is a mortgage lien on a property in a title-theory state. In these states, the mortgage transaction conveys legal title to the lender, who holds it until the mortgage obligations are satisfied. During the mortgage loan period, the borrower has equitable title to the property.
- A lien attaches to the property