SLIDE 4 - Methods of Purchasing Mortgage Property (Cover Sheet)

SLIDE 5

Provisions Under Subject to the Mortgage

When a purchaser buys subject to a mortgage but does not endorse the same or assume to pay the mortgage, a purchaser cannot be held for any deficiency if the mortgage is foreclosed and the property sold for an amount not sufficient to cover the note.

Agreement by a buyer to assume to liability under an existing note secured by a mortgage or deed of trust. The lender usually must approve the new debtor in order to release the existing debtor (usually the seller) from liability

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When default occurs under a Note for a Deed of Trust, the borrowers become subject to an automatic action known as the Power of Sale.

Borrowers must be given adequate notice and an appropriate period in which to redeem their property.

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Provisions Under an Assumed Mortgage

Assumable Mortgage

An agreement between a buyer and a seller where the homebuyer takes over an existing mortgage is called an Assumable Mortgage.

The lender usually requires credit approval on the buyer and may impose a fee for the assumption.

The buyer merely assumes the original terms of the mortgage and accepts the liability.

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Unless there is a due-on-sale clause, a mortgage or deed of trust can be immediately assumed by the buyers of the property held as security for the mortgage.

For example:

Purchase Price - $100,000.00

Existing Loan Amount to be assumed – $50,000.00

Balance to Mortgage or Cash Payment – $50,000.00

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Assumption

In an assumption, the buyer and any subsequent assumers of the loan, in addition to the original borrower (the seller), become personally liable for the loan to the lender for its full repayment.

If there is a default on the loan, the lender will sue the original borrower and any others who assumed the loan if a deficiency results from the foreclosure sale.

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Due on Sale Clause

States that the loans full balance may have to be paid in full the if the property is sold or transferred.

This clause generally states that a borrower can not sell, transfer, encumber, assign, convey or in any other way dispose of the property being used as collateral in the loan without first acquiring the permission and express written consent of the lender.

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Provisions Under an Assumed Mortgage

A contract benefit might be transferred to a third-party by **assignment**. This doesn't transfer the contract obligations.

In a **novation**, the third party picks up both the assignment and the burden of the contract obligations.

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Contract For Deed or Land Contract

A **Contract for Deed** can also be known as:

- A real estate contract
- A land contract
- A contract for sale
- An agreement for deed
- A bond for deed
- An installment contract
- Articles of agreement

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In a Contract for Deed there are two parties:

- Vendee – buyer/borrower
- Vendor – seller/lender

Under a Contract for Deed the seller or vendor remains the legal owner of the property.

The buyer or vendee obtains full legal title to the property when all of the conditions and terms of the agreement have been satisfied.

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Since a Contract for Deed does not have an accompanying note so it is imperative that all conditions of the sale are included in the contract, including the price and all the terms for the loan.

Proof of satisfaction of the contract debt will require two things:

- Delivery of the Deed
- Recording of the Deed

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If the vendee breaches the contract, all payments up to that point are forfeited. The seller or vendor can recover the property and any losses by choosing to:

- Bring suit for specific performance of the agreement
- Pursue any other legal remedies as spelled out in the contract

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A Contract for Deed gives a seller or lender a great deal of foreclosure power in the case of default.

- A vendor may be able to recover property under a Contract for Deed in as little as 30 days, depending on the specific circumstances.
- This compares favorably with the property recovery periods of up to two years specified in the mortgage form and four months under a Deed of Trust.

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Common Loan Structures

Variations in the structure of interest rate, term, payments, and principal payback produce a number of commonly recognized loan types. Among these are the following.

Amortizing loan. – Amortization provides for gradual repayment of principal and payment of interest over the term of the loan. The borrower's periodic payments to the lender include a portion for interest and a portion for principal. In a fully amortizing mortgage, the principal balance is zero at the end of the term. In a partially amortizing loan, the payments are not sufficient to retire the debt. At the end of the loan term, there is still a principal balance to be paid off.

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Negatively amortized loan – Negative amortization causes the loan balance to increase over the term. This occurs if the borrower's periodic payment is insufficient to cover the interest owed for the period. The lender adds the amount of unpaid interest to the borrower's loan balance. Temporary negative amortization occurs on graduated payment loans, and may occur on an adjustable rate mortgage.

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Adjustable and fixed rate loans – Loans may have fixed or variable rates of interest over the loan term. Adjustable rate mortgages (ARMs) allow the lender to change the interest rate at specified intervals and by a specified amount. Federal regulations place limits on incremental interest rate increases and on the total amount by which the rate may be increased over the loan term.

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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.

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Fixed and graduated payment loans – Loans may have variable payment amounts over the term of the loan, or a single fixed payment amount. With a graduated payment mortgage, the payments at the beginning of the loan term are not sufficient to amortize the loan fully, and unpaid interest is added to the principal balance. Payments are later adjusted to a level that will fully amortize the loan's increased balance over the remaining loan term.

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Interest-only loan – In an interest-only loan, periodic payments over the loan term apply only to interest owed, not to principal. At the end of the term, the full balance must be paid off in a lump-sum, "balloon" payment. Since these loans have no periodic principal payback, their monthly payments are smaller than amortizing loans for the same amount at the same rate of interest.

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Buydown loan – A buydown loan entails a prepayment of interest on a loan. The prepayment effectively lowers the interest rate and the periodic payments for the borrower. Buydowns typically occur in a circumstance where a builder wants to market a new development to a buyer who cannot quite qualify for the necessary loan at market rates.

By "buying down" a borrower's mortgage, a builder enables the borrower to obtain the loan. The builder may then pass the costs of the buydown through to the buyer in the form of a higher purchase price.

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Seller Financing

The seller may provide some or all of the financing for the buyer's purchase. Some of the most common methods of seller financing are purchase money mortgages, including the wraparound, and the contract for deed.

Purchase money mortgage – With a purchase money mortgage, the borrower gives a mortgage and note to the seller to finance some or all of the purchase price of the property. The seller in this case is said to "take back" a note, or to "carry paper," on the property. Purchase money mortgages may be either senior or junior liens.

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Wraparound – In a wraparound loan arrangement, the seller receives a junior mortgage from the buyer, and uses the buyer's payments to make the payments on the original first mortgage. A wraparound enables the buyer to obtain financing with a minimum cash investment.

It also potentially enables the seller to profit from any difference between a lower interest rate on the senior loan and a higher rate on the wraparound loan. A wraparound is possible only if the senior mortgagee allows it.

Contract for deed – Under a contract for deed arrangement, the seller retains title and the buyer receives possession and equitable title while making payments under the terms of the contract. The seller conveys title when the contract has been fully performed.

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Other Loan Situations

Home equity loan – The ostensible purpose of this type of loan is to obtain funds for home improvement. Structurally, the home equity loan is a junior mortgage secured by the homeowner's equity.

For some lenders, the maximum home equity loan amount is based on the difference between the property's appraised value and the maximum loan-to-value ratio the lender allows on the property, inclusive of all existing mortgage loans.

Thus if a home is appraised at $100,000 and the lender's maximum LTV is 80%, the lender will lend a total of $80,000. If the owner's existing mortgage balance is $65,000, the owner would qualify for a $15,000 home equity loan.

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Package loan – A package loan finances the purchase of real estate and personal property. For example, a package loan might finance a furnished condominium, complete with all fixtures and decor.

Construction loan – A construction loan finances construction of improvements. This type of loan is paid out by the lender in installments linked to stages of the construction process. The loan is usually interest-only, and the borrower makes periodic payments based on the amount disbursed so far. As short-term, high-risk financing, the interest rates are usually higher than those for long-term financing.

The borrower is expected to find permanent ("take out") financing elsewhere to pay off the temporary loan when construction is complete.

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Bridge loan – A bridge, or gap, loan is used to cover a gap in financing between short-term construction financing and long-term permanent financing. For instance, a developer may have difficulty finding a long-term lender to take out the construction lender.

However, as the construction loan is expensive and must be paid off as soon as possible, the developer may find an interim lender who will pay off the construction loan but not agree to a long-term loan.

Participation loan – In a participation loan, the lender participates in the income and/or equity of the property, in return for giving the borrower more favorable loan terms than would otherwise be justified.

For instance, the borrower makes smaller periodic payments than the interest rate and loan amount require, and the lender makes up the difference by receiving some of the property's income. This type of loan usually involves an income property.

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Permanent (take-out) loan – A permanent loan is a long-term loan that "takes out" a construction or short-term lender. The long-term lender pays off the balance on the construction loan when the project is completed, leaving the borrower with a long-term loan under more favorable terms than the construction loan offered.

Reverse annuity – In a reverse annuity mortgage, a homeowner pledges the equity in the home as security for a loan which is paid out in regular monthly amounts over the term of the loan.

The homeowner, in effect, is able to convert the equity to cash without losing ownership and possession.

Blanket – A blanket mortgage is secured by more than one property, such as multiple parcels of real estate in a development.