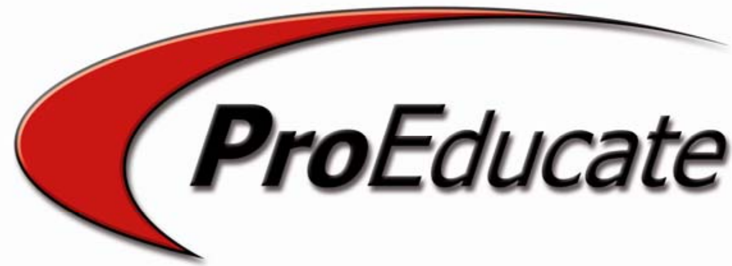

Financing Residential Real Estate: SAFE Comprehensive – 20 Hours

COURSE ORGANIZATION and DESIGN

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Executive Director

Module 1: Finance and Investment

Overview:

Mortgage loans are a type of investment, one of many types that compete for a share of the available investment funds. This lesson provides an overview of investing and explains some of the underlying investment considerations that determine what kinds of loans mortgage lenders are (and are not) willing to make.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Identify the key characteristics of any investment
- Explain how home buyers use loans to purchase homes, and how the principles of investment affect residential financing
- List the types of investments (ownership, debt, and securities)
- Distinguish between the features and benefits of each investment type
- Discuss how the key characteristics of investments (safety, liquidity, and yield) interact to affect investment risk
- Discuss the concept of diversification and how it affects risk
- Describe the types of risks assumed by mortgage lenders, including risk of default, risk of loss, interest rate risk, and prepayment risk
- Summarize market interest rates and explain how they affect mortgage lending

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 1 - 14

Module 2: The Primary and Secondary Markets

<u>Overview</u>:

This lesson explains the two markets and the relationship between them. It will also discuss the major secondary market agencies (Fannie Mae, Ginnie Mae, and Freddie Mac) and the mortgage-backed securities that are traded in the secondary market.

<u>Lesson Objectives</u>:

Upon completion of this lesson, each student will be able to:

- Describe how lending takes place in the primary market
- Discuss the effect of real estate cycles on real estate markets
- Explain the relationship between the primary and secondary markets, including how mortgage funds flow from investors to lenders to home buyers
- List the major secondary market agencies and explain the concept of a government-sponsored enterprise (GSE)
- Explain mortgage-backed securities and their function in the secondary market
- Discuss the importance of underwriting guidelines established by secondary market agencies
- Give examples of the benefits of secondary market agencies and their efforts to increase the availability of mortgage funds
- Summarize the most recent developments with the GSEs in the wake of the mortgage and economic crisis

<u>Recommended Reading Assignment</u>:

Financing Residential Real Estate textbook: Pages 45 - 60

Module 3: Residential Mortgage Lenders

Overview:

This lesson will take a closer look at the primary market. It will start with an overview of the different types of residential mortgage lenders. Then it will discuss how two historical events, the Depression and the savings and loan crisis, changed the mortgage industry. Finally, it will describe some recent trends in the mortgage industry, including the dominance of giant nationwide lenders and the growth of subprime mortgage lending.

Lesson Objectives:

After completing this lesson, students should be able to:

- Explain the basic steps in the mortgage process
- Distinguish between different types of loan originators and the ways they help borrowers get funds
- Describe new government regulations affecting loan originators at both the national and state level
- List the different types of mortgage lenders and the ways their businesses have changed over time
- Discuss important historical events in the mortgage industry, including the Depression and the savings and loan crisis, and the government's response to these events
- Summarize the factors leading up to the mortgage and financial crisis, and the impact it may have on the mortgage industry

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 69 - 88

Module 4: Government Policy and Real Estate Finance

Overview:

The federal government has many ways of influencing the economy as a whole, and real estate finance in particular. This lesson will take a look at some them. For instance, the government oversees the secondary mortgage market and regulates lending institutions. It also influences the cost of borrowing money through fiscal and monetary policy, which is the primary subject of this lesson.

Lesson Objectives:

After completing this lesson, students should be able to:

- Recall the two ways in which the federal government influences the cost of borrowing money
- Define fiscal policy and the branches of government that determine and implement it
- Describe how government spending and the federal deficit are covered using debt financing
- Explain how taxation is used to carry out social policy with respect to real property ownership
- Summarize the historical reasons for government regulation of depository institutions
- Outline the organization of the Federal Reserve System
- Discuss the relationship between the Federal Reserve's actions, inflation, and the health of the economy
- List the tools used by the Federal Reserve to implement monetary policy

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 23 - 36

Module 5: Finance Instruments

Overview:

This lesson is only an introduction to finance instruments, to give the student a basic understanding of their purpose and the differences between them.

Note provided to student: *The information presented here should not be used as the basis for personal action or to advise clients or customers regarding particular documents. The laws governing creditor-debtor relations vary substantially from one state to another, and they are also subject to change by judicial or legislative action. As a result, it is important to consult an attorney for current, state-specific advice concerning the effect of these instruments in any particular transaction.*

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Identify the parties to and the basic provisions of a promissory note
- Distinguish between a straight note and an installment note
- Explain the purpose of having a security instrument accompany a loan
- Define hypothecation and its relationship to the possession of property used as collateral
- Compare the parties involved in a mortgage with those involved in a deed of trust
- Contrast the advantages of judicial foreclosure and non-judicial foreclosure
- Describe the three basic alternatives to foreclosure
- List typical clauses found in real estate finance instruments and describe their effects
- Discuss how an alienation clause affects the assumption of a loan
- Name the major types of mortgage loans and identify their characteristics

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 99 - 131

Module 6: Basic Features of a Residential Loan

Overview:

To understand the financing options available to home buyers in your area at a given time, you first need to understand the basic features of a mortgage loan. It's variations in these features that distinguish one loan program from another and determine which type of loan is right for a particular buyer. The basic features of a mortgage loan include: how the loan is amortized; the length of the repayment period; the loan-to-value ratio; whether there is mortgage insurance or a guaranty; whether there is secondary financing; and whether the interest rate is fixed or adjustable.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Identify the basic features of a mortgage loan, including amortization, repayment period, loan-to-value ratio, mortgage insurance or guaranty, and fixed or adjustable rate
- Explain how different forms of amortization work, and the concept of a balloon payment
- Discuss the relationship between a loan's repayment period and its interest rate
- Calculate a loan-to-value ratio
- Explain the purpose of mortgage insurance or loan guaranties
- Give an example of the restrictions a primary lender might place on secondary financing
- Name the issues adjustable-rate mortgages were designed to address
- List the features of an adjustable-rate mortgage, including those used to control interest rate and payment adjustments
- Describe the circumstances under which negative amortization can result

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 143 - 165

Module 7: The Financing Process

Overview:

Getting a mortgage loan can be a straightforward, painless experience, or it can turn into a complicated, time-consuming hassle that ends in disappointment. In most cases, of course, the process of getting a loan falls somewhere between those two extremes. How smoothly it goes depends on many factors, including the buyers' financial situation, how expensive a home they want, and the lender they choose. Helping buyers get through the process as easily as possible, given the circumstances, is part of a real estate agent's job. The financial process can be broken down into these stages, and this lesson will look at each of them in turn: shopping for a loan; applying for a loan; application processing; and closing.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Distinguish between prequalification and preapproval
- Perform the steps in the prequalification process
- Understand loan costs, such as origination fees and discount points
- Discuss the purpose and the requirements of the Truth in Lending Act and RESPA
- Describe the steps in the loan application process
- Understand the reasoning behind the underwriting process
- Explain the purpose of and the procedures used in the closing process

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 173 - 207

Module 8: Qualifying the Buyer

Overview:

Before agreeing to make a real estate loan, a lender will evaluate both the buyer and the property to determine whether they qualify for the loan—that is, whether they meet the lender's minimum standards. This evaluation process is called "loan underwriting"; the person who performs the evaluation is called a "loan underwriter" or "credit underwriter". The primary purpose of the evaluation is to determine the degree of risk that the loan would represent for the lender. This lesson explains the factors an underwriter takes into account in evaluating a home buyer's financial situation, as well as general information about the underwriting process.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Describe the basic steps in the underwriting process
- Understand the purpose of underwriting (qualifying) standards
- Define the different classifications used in an automated underwriting report
- Discuss an underwriter's main considerations: credit reputation, income, and net worth
- Define quantity, quality, and durability of income
- List the types of income that qualify as stable monthly income
- Explain how to use income ratios to measure the adequacy of income
- Calculate net worth using an applicant's assets and liabilities
- Understand credit history and credit scores
- List other underwriting considerations, such as LTV, repayment period, and property type
- Summarize the concepts of subprime lending and risk-based pricing

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 218 - 257

Module 9: Qualifying the Property

Overview:

After qualifying the buyer, the underwriter's second major task is qualifying the property. Qualifying a property involves an analysis of its features to determine whether it has sufficient value to serve as collateral for the purpose of the loan. An underwriter is concerned with both the present value of the property and whether it will maintain its value in the years to come. Before approving the loan, the underwriter will need to make certain that the property is worth enough to protect the lender's investment. This lesson explains how a home is appraised and how an underwriter uses the appraised value to set the loan amount.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Explain the role of an appraisal in determining a property's market value
- Describe how loan-to-value ratios affect the lender's risk
- List the steps in the appraisal process
- Discuss the three basic methods for estimating a property's value: sales comparison, replacement cost, and income
- Define the five elements that are considered when evaluating a property's suitability as a comparable
- Understand the difference between replacement cost and reproduction cost
- List the three different types of depreciation
- Calculate a property's value using a gross income multiplier
- Prevent and/or respond to problems caused by a low appraisal

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 267 - 301

Module 10: Conventional Financing

Overview:

Loans made by institutional lenders (such as banks, savings and loans, and mortgage companies) can be divided into two main categories: conventional loans and government-sponsored loans. A "conventional loan" is any institutional loan that is not insured or guaranteed by a government agency. Conventional loans will be covered in this lesson.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Distinguish between conforming and nonconforming loans
- List the key features found in most conventional loans
- Understand conforming loan limits and why they are important
- Summarize the concept of risk-based loan fees
- Explain when private mortgage insurance is needed and when it can be canceled
- Discuss the restrictions commonly placed on secondary financing
- Calculate the debt to income ratio and housing expense to income ratio
- List compensating factors that may justify loans with higher ratios
- Describe ways to make a loan more affordable, such as buydowns and accelerated payment plans

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 317 - 346

Module 11: FHA-Insured Loans

Overview:

The federal government has two main home financing programs: the FHA-insured loan program and the VA-guaranteed loan program. These programs were established to encourage residential lending and make housing more affordable; they are available to eligible home buyers throughout the United States. Many state, county and city governments offer similar programs for their own residents. These are commonly called "bond programs". Although the state and local bond programs sometimes resemble FHA or VA financing, each one has rules of its own. This lesson is going to focus on FHA-insured loans.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Discuss the purpose of the FHA-insured loan program
- Identify key rules governing FHA-insured loans
- List the different types of FHA loan programs
- Understand the role of maximum loan amounts, and how they vary by location
- Discuss how a borrower can meet the minimum cash investment requirement
- Calculate upfront and annual mortgage insurance premiums
- Identify when secondary financing may be used in the context of an FHA loan
- Explain when an FHA loan may be assumed
- Describe the underwriting requirements for an FHA loan, including the income ratios

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 365 - 393

Module 12: VA-Guaranteed Loans

Overview:

The VA home loan program was established to help veterans finance the purchase of their homes with affordable loans. For the eligible veteran, a VA-guaranteed loan is an excellent financing choice. VA financing offers many advantages over conventional financing and has few disadvantages. In this lesson, the characteristics of VA loans, the eligibility requirements, and the underwriting standards use to qualify loan applicants will be discussed.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- List the characteristics that distinguish VA-guaranteed loans
- Describe the criteria for eligibility for a VA loan
- Define the role of the VA guaranty and how it affects the VA loan amount
- Illustrate how a substitution of entitlement works
- Calculate how much of a down payment will be needed for a particular loan
- Describe VA underwriting guidelines
- List compensating factors that might help a marginal applicant obtain a VA loan

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 409 - 429

Module 13: Seller Financing

Overview:

Institutional lenders are not the only source of residential financing; home sellers are another important source. The wide variety of ways in which a seller can finance a buyer's purchase is the subject of this lesson. This lesson will begin with a basic explanation of how seller financing works and why it is used. Then the lesson will examine the forms seller financing can take, looking first at how it can function as secondary financing, and then at how it can function as primary financing. The lesson will also briefly consider a few alternatives to seller financing—ways a seller can help the buyer without actually financing the purchase. The last section of the lesson will discuss the real estate agent's responsibilities in a seller-financed transaction.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Discuss when and why seller financing might be used and how it works
- Define "seller second" and describe how it can be used to supplement either a new loan or an assumption
- Understand how seller financing might be used as primary financing
- Describe how a land contract differs from a mortgage or deed of trust
- Explain how wraparound financing works
- List alternatives to seller financing, such as buydowns or lease arrangements
- Summarize an agent's responsibilities in a seller-financed transaction

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 441 - 474

Module 14: Fair Lending and Consumer Protection

Overview:

This lesson will cover several federal laws that are intended to promote fairness, clarity, and honesty in residential mortgage lending. Some of these are fair lending laws, which make it illegal for lenders to discriminate when they evaluate loan applications and make loan approval decisions. Consumer protection laws also apply to mortgage lending. These laws are designed to help buyers understand the lending process and make wise financing decisions. In spite of these laws, unscrupulous lenders and mortgage brokers often manipulate vulnerable and unsophisticated borrowers into taking out loans that are not in their own interests. The problem of predatory lending is discussed at the end of this lesson.

Lesson Objectives:

Upon completion of this lesson, each student will be able to:

- Describe the purpose of the Equal Credit Opportunity Act
- List discriminatory acts and protected classes under the Fair Housing Act
- Explain the goals of the Community Reinvestment Act
- Discuss the role of the Home Mortgage Disclosure Act in preventing redlining
- Summarize the purpose of the Truth in Lending Act
- Describe TILA's disclosure requirements, such as the annual percentage rate and total finance charge, and state how the right of rescission works
- Explain the disclosure requirements and prohibited practices provisions in the Real Estate Settlement Procedures Act
- Define predatory lending and give examples of predatory practices
- Summarize the laws regulating predatory lending

Recommended Reading Assignment:

Financing Residential Real Estate textbook: Pages 487 - 515