UNIT 14 KEY POINT REVIEW

Home affordability is a goal of both governments and businesses. Recent attempts to broaden home mortgage lending standards resulted in a record number of defaulting borrowers. The true cost of home ownership—from down payment to **PITI (principal, interest, taxes, and insurance)** and utility and maintenance costs—must be considered to determine whether it is a desirable alternative to renting a home. A prospective borrower's **credit report**, **credit score**, and **percentage of debt to income (DTI)** will be considered by a lender. There may be **tax benefits** to home ownership, but all factors should be considered. The difference between the amount owed on a property and its current market value is the property owner's **equity.**

A **mortgage loan** will require two instruments: the **financing instrument** and the **security instrument**. A **promissory note**, as a financing instrument, is a contract with a lender that sets out the terms under which a borrower promises to repay a debt. A promissory note is a **negotiable instrument** that can be transferred to a third party.

Interest is a charge for the use of money; charging an excessive rate of interest is called **usury**. **Discount points** are a percentage of a loan amount and are charged by a lender to increase the lender's yield on its investment. Most home loans are not subject to state usury protections because they are **federally related** and thus exempted from state usury laws. A mortgage loan may include a **prepayment penalty**.

A home mortgage loan is **secured** by the borrower's real property in the process called **hypothecation**. The borrower retains the right of possession and control of the property. The security agreement can be either a mortgage or deed of trust.

In a **mortgage**, the **mortgagor** (owner) borrows money from the **mortgagee** (lender), and the real estate purchased with the borrowed money is used as **security** for the debt.

Depending on state law, a **mortgage** on real property takes the form of a **lien** or **transfer of title**. In a **lien theory** state, a mortgage serves to place a lien on the specified property. In a **title theory** state, the mortgage conveys **legal title** to the mortgagee (or other designated individual) and the mortgagor retains **equitable title** and the **right of possession**.

A **deed of trust** transfers **title** from the **trustor** (property owner) to a **trustee,** who holds it on behalf of a **beneficiary** (lender).

The **borrower** under any mortgage or deed of trust must fulfill the terms of the promissory note, pay all real estate taxes on the secured property, maintain adequate property insurance, keep the property in good repair, and obtain the approval of the lender before making major alterations to the property.

When a mortgage loan is paid in full, a **defeasance clause** requires the lender to execute a **satisfaction** (**release** or **discharge**) that is **recorded** to clear title. If the borrower **defaults**, the lender can **accelerate** the due date of the remaining principal balance and all other payments and costs.
If the borrower continues in default, the lender can bring court action called **judicial foreclosure.**

A **deed of trust** executed by the borrower is **recorded** in the county in which property is located. The **trustor** transfers **legal title** to the **trustee** but retains equitable title and has the right to possession and use of the mortgaged property.

When the loan is paid in full, a **defeasance clause** requires the beneficiary to request the trustee to execute and deliver to the trustor a **deed of reconveyance** (release deed) to return legal title to the trustor.

If the borrower **defaults**, the lender can **accelerate** the due date of the remaining principal balance and all overdue costs. If the borrower continues in default, a **deed of trust with power of sale** allows the beneficiary (lender) to ask the trustee to conduct the **trustee's sale** without court action. A **mortgage with power of sale** also enables a sale without court action.

An **impound (escrow) account** may be required to create a reserve fund to ensure that future tax, property insurance, and other payments are made. **The lender** makes tax, insurance, and other payments on the **borrower's behalf**.

The **National Flood Insurance Reform Act of 1994** imposes obligations on lenders and loan servicers to set aside escrow funds for flood insurance on new loans for property in flood-prone areas.

When property with an outstanding mortgage or deed of trust is conveyed, the new owner may **take title** in one of two ways, if allowed by the loan document:

1. **"Subject to"—**the **new owner** makes payments on existing loans but is **not personally liable** if the property is sold on default and proceeds of the sale do not satisfy debt. "Subject to" is no longer in use.
2. **Assuming** the existing mortgage or deed of trust and agreeing to pay the debt—the **new owner** takes personal responsibility for existing loans and is subject to a **deficiency judgment** if the property is sold on default and proceeds of the sale do not satisfy the debt.

An **alienation clause (due-on-sale clause)** in a loan document requires full payment on the sale of the property and can prevent future purchasers of the property from assuming the loan.

Priority of mortgages and other liens is determined by the order in which they were recorded. **Priority** may be changed by **subordination agreement**.

Most forms of real estate financing provide for **amortization** of the loan payments so that the principal of the loan is paid off by the end of the loan term. A **straight loan** is an interest-only loan. With an **adjustable-rate mortgage (ARM)**, the interest rate changes over the term of the loan according to an identified economic indicator—the **index**. A **margin** is added to the index to determine the rate the borrower will pay and a **rate cap** sets the highest interest rate that can be charged at any point over the life of the loan. Rate **adjustments** are made monthly, quarterly, or annually, as agreed between borrower and lender. The loan might have a **conversion** option that allows it to be converted to a fixed-rate loan.

With a **growing-equity mortgage**, payments of principal are increased each month to pay off the loan more quickly. A **balloon payment** typically is a final loan payment that is at least twice as much as any other payment.

A **reverse mortgage** can be used by someone age 62 or older to receive one or more payments that result in a claim by the lender on the equity in the mortgaged property when the homeowner moves from the property, dies, defaults on one of the loan terms, or sells the property. The funds paid out by the lender accrue interest at the rate specified in the mortgage documents, all of which is repaid from the borrower's equity.

If a **judicial foreclosure** is granted, the **judge** orders the property sold. A **public sale** is advertised and the real estate is sold to the **highest bidder**.
The borrower has **equitable right of redemption** within a time period (before and/or after sale) allowed by state law. No court action is necessary to begin the sale process if the mortgage or deed of trust has a **power-of-sale** clause.

The mortgagee may have the right to a **deficiency judgment** against the borrower for an unpaid balance, **when allowed by state law**, if the sale proceeds are less than the amount owed. The court can **award title** to the **lender** and no sale occurs in a **strict foreclosure**. The lender may accept a **deed in lieu of foreclosure** from a defaulting borrower, but title is **subject to junior liens** that are eliminated in a foreclosure.

In a **short sale**, the lender agrees to accept less than the amount of the remaining indebtedness in order to allow the property to be sold. Recent federal legislation has allowed the homeowner subject to a short sale to avoid taxation on the amount of debt forgiven by the lender, but continuation of this benefit is uncertain. The Consumer Financial Protection Bureau has issued rules for mortgage lenders to follow to insure that borrowers in default receive adequate notice and assistance throughout the foreclosure process.

Homeowners insurance, which will be required by a mortgage lender, will protect against loss due to natural disasters, accidents, theft, and fire. Additional coverage can also be obtained. The **Comprehensive Loss Underwriting Exchange (CLUE)** database allows insurers to share information on a consumer's claims history. The **Federal Emergency Management Agency (FEMA)** administers the National Flood Insurance Program. Flood insurance is required for properties located in identified areas prone to flooding, and should be considered in many areas even when it is not required.