Basics of Real Estate Finance

3 Correspondence Continuing Education Hours

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This course is designed with review questions throughout the material. These review questions are not graded; they are asked to help you judge your comprehension of the material. There will be a 30 question final exam at the end of the course.

The final exam will cover the following topics:

- Tax Advantages of Home Ownership
- The Secondary Market
- Credit Scores and Credit Repair
- Mortgage Qualification
- Popular Mortgage Products
- Closing Costs for Buyers and Sellers

You need a 75% or greater to pass the exam. If you pass the exam, you will receive your certificate of completion within 2 business days via email or within 10 business days via first-class mail.

If you fail the exam, you can retake an alternate exam at no charge.

Please be aware that this course is approved by the Missouri Real Estate Commission from __/__/____ to __/__/____.

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Introduction

This 3 hour program takes a quick look at the 'not-so-basic' basics of real estate finance. From the tax advantages of home ownership to an introduction into the Secondary Market, to the real estate mortgage process from qualification to closing, real estate professionals can take their business up a peg by becoming familiar with the world of real estate finance.

Module 1

Tax Advantages of Home Ownership

Most buyers don't cite "tax advantages" as their primary reason for buying a home. Certainly "desire to own my own home" trumps all other answers. Every year the National Association of Realtors® surveys Buyers and Sellers and publishes the results in the *Profile of Home Buyers and Sellers*. In the most recent version (2015), Financial Security and Tax Benefits, while not #1, ranked among the top 14 reasons for purchasing a home. And in the March 2016 *Consumer Reports Magazine*, it was reported that of the 1,573 millennials who were surveyed nationwide, the "wealth-building benefits of home ownership" ranked #3 in reasons they wish to own a home. So while Buyers enjoy the pride of home ownership, or just want a bigger/smaller home, or one closer to their new job/school/family, they do recognize that owning a home also reaps financial and tax benefits. And these benefits generally continue year after year.

Let's look at an example:

Bob and Betty Buyer are both 36 years old, have been married for five years and rent a nice 2 bedroom, 1 bath apartment at $1000 per month including heat and hot water. They enjoy dinner out and occasional short trips on the weekends but are committed to owning their own home by their 7th wedding anniversary so they may begin having a family. In fact, right after their wedding they opened a joint savings account earmarked for their future home purchase and deposited $5,000, some from individual savings and some from cash wedding gifts. A level-headed, somewhat conservative couple whose joint annual income is $65,000, they have contributed $10,000 each year to their joint savings account earmarked for their future home purchase.

With $55,000 to date they call the real estate agent who was recommended by Betty's friend at the office. Agent Rhonda Smith from ABC Real Estate meets with them and has them qualified by a lender. After looking at several homes they find one they really like priced at $220,000. The mortgage lender runs the numbers and reports that, if they purchase this home at full price ($220,000) and put 20% down ($44,000), they will have a $176,000 mortgage. Based on 30 years at 4.5%, (estimated higher than current market for the sake of this course) the monthly payment will be $891.77 per month for principal and interest. Adding $400 per month for real estate taxes ($4800 per year) and $60 for homeowner insurance ($720 per year), their total monthly payment (PITI- principal, interest, taxes and insurance) will total $1,351.77.

Again, and rounding off:

- $220,000 Purchase Price – $44,000 Down Payment (20%) = $176,000 Mortgage

- $176,000 fixed rate mortgage for 30 years at 4.5% interest rate = $892 per month for P&I (principal and interest)

- $892 per month for P&I + $400 per month for real estate taxes (based on $4800 annual) + $60 per month for homeowner insurance (based on $720 annual) = $1352 per month PITI (principal, interest, taxes and insurance)

NOTE: If Bob and Betty had put less than 20% down, they would have an additional PMI (Private Mortgage Insurance) payment each month, but for the sake of this example we will not include PMI. More on PMI later in this course!

Bob and Betty realize that this PITI (principal, interest, taxes, and insurance) amount of $1352 doesn't even include utilities which will bring the monthly number up to $1500 or so. That's $500 MORE per month than they're currently paying! And what about all the other maintenance and improvement expenses that come with owning a home? Plus they'll have decorating expenses and will need more furniture. Does this mean no more dining out or weekend trips? They begin getting cold feet and tell their agent Rhonda that maybe they should be looking at less expensive homes, or maybe they should stay put and keep saving. But this home really is perfect for them in every way. They love it and feel so torn.

Rhonda empathizes with them and tells them that they may be overlooking the tax advantages of home ownership which will bring the number down. She invites them to her company's Home Buying Seminar which just so happens to be scheduled for this week. They agree to attend and sit right in the front row, eager to learn if it really does make sense for them to move forward and buy the home they love. The presenter selects them as his sample buyer and uses their projected home purchase numbers as his example.

Here's what they learn:

Tax deductible items include mortgage interest and real estate taxes-
but that's not all…..

Using only the first month's numbers, when Bob and Betty pay $891.77 for principal and interest, $660 is all interest and therefore tax deductible. This is calculated by simple math:

- Loan Amount x Interest Rate = Interest per year.

- Divide that number by 12 = Interest per month.

(Note this is *exactly correct* for the first month and then a bit less each month for 30 years. In this example, the 12th payment will be $650 in interest, so for the sake of a simple exercise, let's say the amount is roughly the same for the first year.)

Again:

- **Loan Amount x Interest Rate = Interest per year ÷ 12 = Interest per month.**

- **$176,000 x 4.5% = $7,920 per year ÷ 12 = $660 per month**

Now this doesn't mean Bob and Betty will get back $660 per month from Uncle Sam, but it does mean that this amount is tax deductible in their own tax bracket which happens to be 28% according to Bob who recently met with their accountant. Also deductible is the $400 monthly real estate tax.

Monthly Tax Deductions:

- $ 660 for Mortgage Interest + $400 for Real Estate Taxes = $1060 Total Monthly Deductions

- $1060 Total Monthly Deduction x 28% (tax bracket) = **$296.80 BACK FROM UNCLE SAM per month**

Most people wait until they file their annual tax return to get the deductions back, but there are many who claim more exemptions so they can get more money in their weekly paychecks. (The accountant or tax specialist advises how and how many to claim.) So if Bob and Betty want to get the $296.80 back in their monthly paychecks, it's not only possible but maybe even a good idea to help them feel more comfortable with the stress of their increased monthly payment.

So: When Bob and Betty pay $1352 each month for PITI, it will be like they're paying $1055 when you consider the additional $297 they receive in their paycheck. And $1055 is pretty close to the $1000 they're paying now. Plus they will achieve their dream of home ownership and stop paying rent which can go up at each lease renewal.

- $1372 PITI – $297 Back from Uncle Sam = $1055 Actual monthly payment after tax reimbursement

And what about the equity they're building by owning their own home? Each month when they pay their mortgage, they also pay off some principal which is $232 for the first month and goes to $242 by the 12th month. Granted, the first year they pay off less than $3000 since the early payments apply more to interest than to principal, but the longer they live in the home, the more equity they build as long as the home values remains constant or increases. (Hopefully at the time of the writing of this course the real estate market will see nationwide appreciation for the near future since many markets are already improving.) So the $232 that pays down their principal each month is a lot like “saving” $232 each month. Now our $1055 is **theoretically** $823. (Please note this is *theoretical*.)

- $1055 New monthly payment after tax reimbursement – $232 Principal reduction (perceived as “saving” money each month) = $823 **Theoretical** monthly payment

Assuming the market will actually appreciate, we can take those numbers into account as well. So, to be conservative, let’s say that Bob and Betty’s $220,000 home were to appreciate by 1% for the first year. That means they would have built another $2200 in equity. Which is like saving $2200 per year or $183 per month. Wow………. now the $823 becomes $640 per month for the **theoretical** cost of home ownership. A far cry from their $1000 rent which can go up at any time.

- $823 Theoretical monthly payment considering principal reduction – $183 Monthly appreciation at 1% per year ($220,000 x 1% ÷ 12) = $640 **Theoretical** cost of home ownership

This was a ***theoretical*** example of the Tax Advantages of Home Ownership***.*** When Bob and Betty see the numbers and hear the explanation, they feel so much more confident in purchasing the home they love. A win-win!

Below is a form that allows the tax advantages to be shown in an orderly manner. Please note that the numbers have been rounded off for ease of reading and see the disclaimer to help you shift risk.

A blank form is in your resource section, but do not use it unless approved by your broker.

ANALYSIS OF HOME OWNERSHIP COSTS

Prepared for ***Bob and Betty Buyer*** Date _____________

By ____ Tel _______________

(Estimates only. Agent does not give financial advice or guarantee accuracy. Individual cases may vary; consult with your lender or tax advisor)

Sale Price of Home-	$220,000
Down Payment-	$44,000 (20%)
Mortgage Amount-	$176,000 for 30 years at 4.5 % interest

Monthly Payment – Principal and Interest	$ 892
Monthly Taxes	$ 400
Monthly Insurance	$ 60
Monthly PMI	+ $ 0
TOTAL MONTHLY INVESTMENT:	**$1352**

EXPENSES FOR INCOME TAX PURPOSES:

Interest (first month)	$660
Monthly Taxes	+ $400
TOTAL DEDUCTIONS	**$ 1060**

INCOME TAX SAVINGS

In **28%** Tax Bracket deduct cash savings per month- **$297**

(Use applicable IRS data. This example is only Federal, Married, and Filing Joint)

TOTAL MONTHLY INVESTMENT (from above)	$ 1352
SUBTRACT INCOME TAX SAVINGS	- $ 297
ACTUAL MONTHLY PAYMENT	=**$1055**

THEORETICAL / PHILOSOPHICAL ………………………

SUBTRACT EQUITY BEING GAINED MONTHLY (P&I – I)	- $ 232
NEW ACTUAL MONTHLY COST OF OWNING	= $ 823
LESS APPRECIATION (**1 %** X Purchase Price ÷ 12)	- $183
REAL MONTHLY COST OF HAVING OWNED HOME	= **$ 640**

(Estimate regarding future value and/or inflation)

(Mortgage interest decreases by small amounts each month; equity increases.)

Whether or not your broker permits you to use the Analysis of Home Ownership form, it's still a good a idea to remind buyers that, depending upon their income, tax bracket and other factors, they may claim real estate taxes and mortgage interest as tax deductions available to them. (Always shift this to their tax advisor.) But as an FYI here, mortgage interest tax deductions apply to the first $1 million of debt used to purchase, construct, or substantially improve a primary or second home. The mortgage loan must close within 90 days of title transfer to qualify for this deduction, otherwise the IRS considers the loan to be a home equity loan. On home equity loans, mortgage interest deductions apply to only the first $100,000 of debt.

In 1913, when Congress first passed laws to permit interest deductions, interest on all kinds of loans, even persoanl loans, was permitted. Later it included credit card interest, too. But the Tax Reform Act of 1986 eliminated the broad spectrum of interest deductions and left only the MID (mortgage interest deduction) to support home ownership. MID is challenged nearly every year by various levels of government, but the Realtor® Political Action Committee (RPAC) of the National Association of Realtors® successfully lobbys to keep MID in place. So if you're a Realtor® member remember to support RPAC each year through your donations and calls to action.

Module 1 Tax Advantages of Home Ownership

Review Questions:

1. Buyers cite tax advantages as the #1 reason for buying a home.
    a) True
    b) False

2. Interest on a mortgage used to purchase, construct or substantially improve a primary or second home is tax deductible up to
    a) The first $100,000 of debt
    b) The first $150,000 of debt
    c) The first $1 million of debt
    d) Any amount of debt

3. The IRS considers a mortgage loan to be a purchase loan as long as it is procured within these many days of title transfer:
    a) 30
    b) 60
    c) 90
    d) 120

4. A home equity loan allows for tax deductions up to
    a) The first 100,00 of debt
    b) The first $150,000 of debt
    c) The first $1 million of debt
    d) Any amount of debt

Module 2

The Secondary Market

Imagine if a local bank made lots of mortgage loans and then ran out of money to loan to others. Or what if banks in some parts of the country made very few loans while banks in other areas kept running short due to the demand? Our national housing market would be in turmoil.

What most people don't realize is that banks very often package up and sell their mortgage loans so that they can replenish the coffers and have money to continue loaning to others. These packaged or group loans are known as CMOs (collateralized mortgage obligations) or MBS (mortgage-backed securities) and are sold to investors like insurance companies, pension funds, and the secondary market. Mortgage-backed securities are often combined into CDOs (collateralized debt obligations) and can include others types of debts. The biggest players in the secondary market are Fannie Mae, Freddie Mac and Ginnie Mae.

Fannie Mae

www.fanniemae.com

In 1938 during the Great Depression, at the request of President Franklin D. Roosevelt, the Federal National Mortgage Association (FNMA aka Fannie Mae) was created as part of The New Deal. Fannie Mae's purpose was to provide liquidity and stability to the US housing markets by buying mortgage loans from the local lenders. Then, in 1968, FNMA was chartered by Congress as a private, shareholder-owned company. As a government-sponsored enterprise (GSE), Fannie Mae became one of the largest corporations in America and certainly the largest and most powerful GSE in the secondary mortgage market. Fannie has purchased trillions of dollars of mortgage loans to date. (That's *trillions*!) Fannie does not purchase government insured or government guaranteed (like FHA or VA) loans, but only conventional 1-4 family conventional residential mortgage loans that conform to specific underwriting guidelines.

But during the early 2000s the housing bubble was the fuel that lit the fire to ultimately cause the insolvency of Fannie Mae. Here's what happened: With low interest rates, the housing boom meant more mortgage loans. Which was then followed by relaxed mortgage qualification standards known as sub-prime lending. Fannie continued to purchase these loans, too, since they were neatly packaged with the rest of the loans. After buying billions of dollars of mortgage loans the market fell, and by 2007 the delinquencies and foreclosures started, particularly in the sub-prime arena. By September of 2008, the federal government, in order to save Fannie Mae, bailed it out, placed it under “conservatorship” which is similar to “bankruptcy,” and appointed new leadership. Protecting and preserving a secondary market was, and still is, deemed critical for the US to survive and allow the housing market and the economy to prosper.

Today Fannie Mae is thriving and continues to purchase over one third of all 1-4 family conventional residential mortgage loans in the US. In January 2016 they reached a benchmark of helping 2 million US households refinance through the HARP program (Home Affordable Refinance Program) created by the US Treasury Department and the Federal Housing Finance Agency in 2009.

For general info about Fannie Mae see www.fanniemae.com.

Note that Fannie does have loan limits regarding the mortgages they purchase. Per the Fannie website, “The Federal Housing Finance Agency (FHFA) publishes annual conforming loan limits that apply to all conventional mortgages delivered to Fannie Mae, including general loan limits and the high-cost area loan limits. High-cost area loan limits vary by geographic location.”

The general loan limits for a one unit property in the continental US is between $417,000 and $625,500, depending upon location. The chart below shows loan limits for 1 – 4 unit properties.

Fannie Mae Conforming Loan Limits

Maximum Original Principal Balance for 2016

Units	Contiguous States, District of Columbia, and Puerto Rico	Alaska, Guam, Hawaii, and the U.S. Virgin Islands
1	$417,000	$625,500
2	$533,850	$800,775
3	$645,300	$967,950
4	$801,950	$1,202,925

***Maximum Loan Limits for High-Cost Areas for Mortgages Acquired in Calendar Year 2016**

2016 high-cost area loan limits have increased for 39 counties due to a high-cost area adjustment or the county being newly assigned to a high-cost area.

*Amounts shown below are maximum limits allowed by the provisions of the Housing and Economic Recovery Act of 2008. The specific high-cost area loan limits are established for each county (or equivalent) by FHFA. Lenders are responsible for ensuring that the original loan amount of each mortgage loan does not exceed the applicable maximum loan limit for the specific area in which the property is located.

Units	Contiguous States, District of Columbia+	Alaska, Guam, Hawaii, and the U.S. Virgin Islands
1	$625,500	$938,250
2	$800,775	$1,201,150
3	$967,950	$1,451,925
4	$1,202,925	$1,804,375

+Puerto Rico and a number of other states do not have any high-cost areas in 2016.

Note that the loan limits apply based on the original loan amount, rather than the unpaid principal balance (UPB).

Source: www.fanniemae.com/singlefamily/loan-limits

To look up loan limits by county in each state, go to the spreadsheet available at this same link. Any loans that exceed the permitted limits are “jumbo” or “non-conforming” loans.

GINNIE MAE

www.ginniemae.gov

When Fannie Mae went private in 1968, the federal government created the Government National Mortgage Association (GNMA aka Ginnie Mae) to “to focus on providing a guaranty backed by the full faith and credit of the United States for the timely payment of principal and interest on mortgage-backed securities (MBS) secured by pools of government home loans. These loans are insured or guaranteed by the FHA, the U.S. Department of Housing and Urban Development’s (HUD), Office of Public and Indian Housing (PIH), the U.S. Department of Veterans Affairs’ (VA) Home Loan Program for Veterans, the U.S. Department of Agriculture’s (USDA) Rural Development Housing, and Community Facilities Programs and Rural Development Guaranteed Rural Rental Housing Program (RD). Ginnie Mae remains a self-financing, wholly owned U.S. Government corporation within HUD.” From its beginning Ginnie has concentrated on affordable housing, improving neighborhoods, and other socially significant causes.

Source:http://ginniemae.gov/inside_gnma/company_overview/Pages/our_history.aspx

Freddie Mac

www.freddiemac.com

In 1970, shortly after Fannie Mae had gone private, the Federal Home Loan Mortgage Corporation (FHLMC aka Freddie Mac) was chartered by Congress to join the efforts of Fannie in helping to stabilize and expand opportunities in the nation's residential mortgage market. While not as large as Fannie, Freddie Mac also buys loans from lenders and was hit with the same debacle during the early 2000 housing boom and subsequent economic crash. And like Fannie, Freddie is under a conservatorship since September 8, 2008 under the direction of the Federal Housing Finance Agency (FHFA). Some sources report that together, Fannie Mae and Freddie Mac continue to purchase about half of all residential loans in the US.

For more info see this *Freddie Mac and Your Mortgage* video:
https://www.youtube.com/watch?v=vNPl4CS4nnQ&feature=youtu.be

Underwriting Guidelines

So what does the secondary market have to do with real estate agents, and why is this important for us? Here's why: There's a sentiment in our business that "When Fannie talks, everybody listens!" So when Fannie sets conforming guidelines for the loans it's willing to buy, lenders, appraisers, and agent take heed. We know that the loan must meet the specific guidelines in place at that time or it will be denied. (In some cases the loan may be shifted to another mortgage program or to the lender's portfolio.)

Underwriting guidelines are very complex and subject to change, but some of the basics include:

- Loan to value ratio (LTV)
- Credit score
- Income & debt load ratio in relation to credit score
- Gift donor requirements
- Appraisal guidelines such as numbers of comps, distance from subject, title transfer dates of comps

Today lenders use Desktop Underwriter (DU) or Loan Prospector (LP), tools which provide a comprehensive credit risk assessment and determine whether a loan meets Fannie Mae or Freddie

Mac eligibility requirements. All the factors and data are inputted, and the results show if both the applicant and the property are approved or not.
For simplicity, here's an example of why knowing some of the Fannie Mae & Freddie Mac guidelines would be helpful to real estate agents:

When preparing a market analysis and presenting it to Seller clients, agents would be wise to use sold comps that also meet the Fannie/Freddie underwriting guidelines because the appraiser ultimately will need to follow those rules. Guidelines are market driven and change accordingly, but some current ones include staying in the same school district, # of miles from subject property, and sale date of sold comps.   So when the Seller prospect tells you that his neighbor's house sold 16 months ago at $x, a far greater number than the current sold comps are reporting, the agent can discuss the general underwriting guidelines lenders and appraisers must follow when selecting sold comps. For example, if at that time, Fannie is looking for sold comps within 6 months, then using the 16-month old sold comp wouldn't necessarily contribute to the current market value of the subject property. Since most buyers will need a mortgage, and since underwriting guidelines tend to follow Fannie, it just makes sense to follow the guidelines. Again, when Fannie talks, everyone listens!

So how can you keep up to date on the various guidelines and the changes? From time to time, call a local appraiser or invite one to your company sales meeting to discuss guidelines and updates. The more you know, the more value you add, and the more professional you will be.

Module 2 The Secondary Market

Review Questions:

1. Which of the following is the largest player in the secondary mortgage market?
   a) FNMA
   b) Fannie Mae
   c) The Federal National Mortgage Association
   d) All of the above

2. Freddie Mac is the nickname for
   a) Federal Mortgage Corporation
   b) Financing Mortgages for Americans
   c) Federal Home Loan Mortgage Corporation
   d) Financial Disposition of American Mortgages Corp

3. Some sources report than together, Fannie Mae and Freddie Mac continue to purchase about __________% of all residential loans in the US.
   a) 15%
   b) 25%
   c) 50%
   d) 75%

4. Fannie Mae publishes conforming loan limits for __________ family properties.
   a) 1-4
   b) 2-6
   c) 3-5
   d) 4-8

5. Ginnie Mae is a self-financing, wholly owned U.S. government corporation within ______________.
   a) IRS
   b) FTC
   c) HUD
   d) FNMA

6. Fannie Mae and Freddie Mac operate in a _______________ under the direction of the Federal Housing Finance Agency.
    a) Conservatorship
    b) Closed market
    c) Conspiracy
    d) None of the above

7. When Fannie talks…….
    a) Everyone listens
    b) Consumers take heed
    c) The IRS agrees
    d) Agents walk

Module 3

Credit Rating is Key!

A credit score isn't just important, it's everything. When a Buyer applies for a mortgage, the interest rate is determined by the applicant's credit score and the LTV or loan-to-value ratio. (Other factors will be discussed later.) The higher the credit score, the lower the interest rate. Having and keeping a high credit score impacts many areas of our lives……. loans of all kinds as well as credit card acceptance and rates, insurance quotes, and even employment application decisions. Here's how it works:

Reporting Bureaus

The Fair Credit Reporting Act (FCRA) was passed in 1970 to regulate how credit reporting agencies collect and use consumer information. Enforced by the Federal Trade Commission (FTC), there are strict requirements in order to protect consumers.
Whenever someone takes out an installment loan or revolving credit, the loan is reported to one of the three major credit reporting agencies in the US: Equifax, Experian (formerly TRW) and TransUnion. Each agency has its own scoring formula. The most common is the FICO® score. Not all creditors report to each agency, and many report at different times of the month, so scores can alter depending upon which agency and what time of the month. Mortgage lenders use the middle score (not the average) as the applicant's credit score. As an example, a homebuyer applies for a loan, and the lender pulls her credit and learns her 3 scores are 720, 742 and 755. The lender will use the middle score of 742, not the average of 739. Note there are other variables when an applicant has credit reporting in less than the 3 credit bureaus or if there is a discrepancy or reporting error. But overall, when a lender pulls credit, it has a service that pulls a "tri-merge" report which researches all 3 bureaus: Equifax, Experian and TransUnion.

According to the FTC, "The Fair Credit Reporting Act (FCRA) requires each of the nationwide credit reporting companies — Equifax, Experian, and TransUnion — to provide you with a free copy of your credit report, at your request, once every 12 months. The FCRA promotes the accuracy and privacy of information in the files of the nation's credit reporting companies. The Federal Trade Commission (FTC), the nation's consumer protection agency, enforces the FCRA with respect to credit reporting companies.

A credit report includes information on where you live, how you pay your bills, and whether you've been sued or have filed for bankruptcy. Nationwide credit reporting companies sell the information in your report to creditors, insurers, employers, and other businesses that use it to evaluate your applications for credit, insurance, employment, or renting a home.

To order your own free credit report or to learn more, go to: [www.annualcreditreport.com.](http://www.annualcreditreport.com)
(Note: The free report is just a report and does not include a credit score.)

Source: www.consumer.ftc.gov/articles/0155-free-credit-reports

To add value, real estate agents might want to add links to this info on their own websites and/or drip email marketing. See snag of FTC home page with link to free credit report:

Source: www.ftc.gov

Scoring Protocols

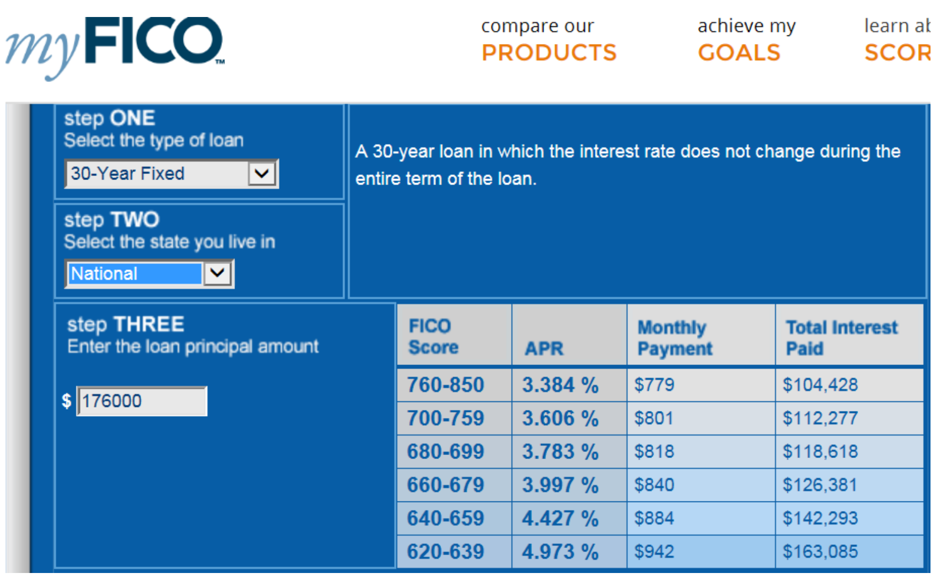
The most commonly accepted credit scoring model is the FICO® score. According to ***The Credit Road Map*** by Patrick Ritchie, an engineer named Bill Fair and a mathematician named Earl Isaac chipped in $400 each in 1956 and began building credit scoring systems with computers that, in the 1950's, were as large as someone's living room! Their company, the Fair Isaac Corporation created the FICO® score, and by 1991 their scoring protocol was being used by all three US credit reporting agencies. Then, in 1995, when Fannie Mae and Freddie Mac recommended that mortgage lenders use FICO® scores in their decision management, the FICO® score became a brand name. "Today the Fair Isaac Corporation is the leading provider of decision management solutions powered by advanced analytics."

Source: *The Credit Road Map*

Let's take a look at scoring protocols and how the analytics work. Bear in mind that decision management solutions and software are machines, not people. Lenders will receive the scores and ultimately make their own decision whether or not the applicant is a good risk.

First of all, credit scores range from 300 to 850. The higher the score, the better. As an example of how a credit score can impact interest rate and therefore the mortgage payment, there is a calculator at MyFico.com which demonstrates this point. You input a mortgage amount and loan term, and it computes the interest rates and corresponding payments that might apply. For demonstration purposes, a $176,000 mortgage for 30 years currently shows rates (APR) offered from 3.384% to 4.973% depending upon the FICO score. (Since a score under 620 will most likely not be eligible for a conventional mortgage, there is no payment shown for under 620.) The monthly payment in this example ranges from $779 to $942 which is a $163 PER MONTH differential. And having the highest score saves the borrower over $58,000 in interest over the life of the loan.

See chart:



FICO Score	APR	Monthly Payment	Total Interest Paid
760-850	3.384 %	$779	$104,428
700-759	3.606 %	$801	$112,277
680-699	3.783 %	$818	$118,618
660-679	3.997 %	$840	$126,381
640-659	4.427 %	$884	$142,293
620-639	4.973 %	$942	$163,085

This calculator can be found at www.myfico.com/CreditEducation/Calculators/loanrates.aspx

While a lender may look at your income, assets and down payment, and while it's certainly great to be strong in those areas, the key factor for the average consumer is credit.

There are five categories considered when computing a FICO score. (Again, this relates to the average consumer since there are always exceptions as well as what kind of debt is being requested.)

The five categories are:

1. Payment history	35%
2. Amounts owed	30%
3. Length of credit history	15%
4. Credit mix in use	10%
5. New credit	10%

These are explained in detail at myfico.com as well as in the plethora of sites and books about credit and credit scoring. But for the sake of our topic of mortgage finance and this brief section, it should be obvious that the first thing a mortgage lender will look for is if you've been paying your current mortgage on time. Late payments or delinquencies consider: how many, how low late they were, how much was owed, and how recently they occurred. Let's face it….. would *you* rather loan money to someone who has demonstrated a solid payment history or to someone who tends to miss payments? Not a hard question!

It is good to know that FICO scores do NOT consider race, color, religion, national origin, sex or marital status. The current US law prohibits credit scoring from considering these facts under the Consumer Credit Protection Act. Also not considered is where you live or your salary, occupation, title, employer, date employed or employment history….. but certainly the lender will consider most of these issues.

Credit Tips and Repair

Learning about the five categories that affect a FICO® score can not only help your customers and clients, but it can help agents and their own friends and family. There are countless tips and repair strategies that can help even further. To name a few:

1. Good debt vs bad debt: Home mortgages or education loans fall into the "good debt" category because they open doors (literally and figuratively) to future benefits. Homes offer tax advantages and generally increase in value. And most studies show that a college and advanced degrees add increased lifetime income. "Bad debt" might include credit card charges used to go out and/or buy things we might want but don't necessarily need. If the balances are paid in full each month, that's fine. But carrying balances causes the debt to accrue which ultimately may mean you're paying more for the item than what it originally cost. Plus the more money you owe on bad debt, the less money you will have to buy good debt!

2. Many mortgage lenders consider people with a FICO score of 720-760 or better to be very low-risk clients and therefore offer them their best interest rates.

3. If you do carry credit card balances, a good rule of thumb is to keep the balances under 40-49% of the available credit limit. The closer you get to the limit, the more likely the score will decrease.

4. Closing an account doesn't make it go away.

5. A foreclosure remains on a credit report for 7 years, but its impact does lessen over time. According to myfico.com, someone may rebound in as little as 2 years as long as other debts are paid on time.

6. Regularly check your credit report for errors. If you do report an error to one of the credit agencies, they must investigate and reply within 30 days. Or you can call them directly.

7. If your customers or clients have been shot down due to poor credit, there are many credit repair companies that have great success in this regard. Be a resource by encouraging them to seek credit repair services. Sometimes this can help increase credit scores in as little as a few months! This may mean your buyers can purchase a home after all. You'll be their hero and also will procure the sale. There are many credit repair companies, but the top rated ones include Lexington Law, CreditRepair.com, Blue Sky Credit Repair Services, Ovation Credit Repair and others. Always offer more than one name, and never "recommend" any of these, but rather say that these seem to be receiving high praise from several sources.

Module 3 Credit Rating is Key!

Review Questions

1. A tri-merge report pulls data from
   a) The past 3 years of credit
   b) Equifax, Interium and TransUnion
   c) Equifax, Experian and TransUnion
   d) Equifax, Experian and TRW

2. The FTC requires that the 3 major credit bureaus provide a free credit report
   a) Every 12 months
   b) Three times per year
   c) Every 24 months
   d) Whenever a lender requests one

3. The free, government sponsored credit report program is called
   a) Annualcreditreport.com
   b) Freecreditreport.com
   c) Usafreecreditreport.com
   d) Creditreport.com

4. The FICO® score was created by the
   a) FTC
   b) Fair Isaac Corporation
   c) Fair Credit Reporting Act
   d) Fannie Mae Corporation

5. Which category comprises 35% (the largest category) of the credit scoring model?
   a) Credit mix in use
   b) Payment history
   c) Amounts owed
   d) Type of employment

6. Regarding credit cards, a good rule of thumb is to
   a) Keep balances under half of the available credit limit
   b) Close accounts on cards you haven't used in 12 months
   c) Take out new cards to pay balances of other cards
   d) Increase limits whenever possible

7. Whenever someone takes out an installment loan, it is
   a) Reported to the IRS
   b) A lien on the property
   c) Reported to a credit bureau
   d) Considered a revolving charge

8. Earl Isaac and Bill Fair created
   a) IBM
   b) EIBF
   c) FACO
   d) FICO

9. Credit decision management solutions and software are machines, not people. Who will ultimately decide whether or not to make the mortgage loan?
   a) The Lender
   b) FICO®
   c) The Federal Trade Commission
   d) Fannie Mae

10. True or false? Credit scores range from 250 – 950.
    a) True
    b) False

11. A foreclosure remains on a credit report for
    a) 3 years
    b) 5 years
    c) 7 years
    d) 9 years

12. Credit repair services can help increase credit scores in as little as
    a) A few months
    b) 2 years
    c) 3 years
    d) 5 years

Module 4

Qualifying the Buyer

Before the days of computerized decision engines and desktop underwriting, the mortgage loan qualification process was a face-to-face meeting between the lender or lender's rep and the Buyer(s). Since most conventional loans required 20% down, there was little risk for the lender who was insured for the other 80%. And since home prices were pretty much always appreciating, there was a realistic expectation of equity build-up. This meant even less risk for all the parties. If buyers hit hard times and no longer could carry the monthly expenses, they could sell the home and scale down. In the rare case where a lender had to foreclose, the rise in home values covered the expense of selling. Short-sales were pretty much unheard of.

But let's fast-forward to current practices! Today, the first step a lender takes is to check a Buyer's credit. Based on the credit score the lender will know what mortgage products, down payment, and interest rate would best apply. They look at qualification ratios:

Front and Back End Ratios

When lenders refer to front and back end ratios, they're referring to the "debt-to-income" ratio: the amount of money buyers need to earn in order to comfortably carry the mortgage payment.

First, some vocabulary:

DTI = Debt-to-Income
PITI = Principal, Interest, Taxes & Insurance
GMI = Gross Monthly Income

For the sake of this example let's say we have a conservative lender who wants the ratios to be no greater than 31/43 on their conventional fixed rate mortgage.

(NOTE: There are mortgage loans written every day where the ratios are 40/45 or even 40/50, but these are for applicants who have very high credit scores, demonstrated ability to save, assets, significant net worth, and/or great jobs. For our examples in this course we will stay conservative and quote 4.5% as a competitive interest rate even though at the time the course was written the rates are in the low 3% area.)

Therefore:

- PITI cannot be greater than 31% of GMI
  AND (**not** or)
- PITI + monthly debt load cannot be greater than 43% of GMI

Let's bring back Bob and Betty Buyer whom we met at the beginning of this course. They were told their PITI would be $1352 if they bought the home they love for $220,000 and apply for a $176,000 conventional fixed rate loan for 30 years at 4.5%. Let's calculate how much money they will need to earn in order to be approved (considering their credit and other factors are okay).

Front-end ratio:

- PITI cannot be greater than 31% of GMI
- $1352 (PITI) cannot be greater than 31% x GMI
  (To solve this equation for GMI, divide both sides by 31%. The right side cancels out, and the left side becomes $1352 ÷ 31%.)
- **$1352 ÷ 31% = $4361 per month x 12 months = $52,332 per year**

To meet the front-end ratio Bob and Betty must prove they earn a minimum of $52,332 per year. This number is *GROSS* income, not what they take home. Lucky for them they earn $65,000 which we revealed earlier in the course.

But what about the back-end ratio which considers debt load?

First let's define debt load. Debt load is comprised of installment loans including student loans and revolving credit which includes credit cards. So let's say that Bob and Betty have the following monthly payments:

- $150 student loan - 60 months remaining
- $250 car loan - 22 months remaining
- $185 car loan - 38 months remaining
- $200 credit cards (total of minimum required payments no matter how much they actually pay.)
- **$785 per monthly total**

Back-end Ratio:

- PITI + monthly debt load cannot be greater than 43% of GMI
- \$1352 + \$785 cannot be greater than 43% x GMI
- \$2137 cannot be greater than 43% x GMI
- **\$2137 ÷ 43% = \$4970 per month x 12 = \$59,640 per year**

Since Bob and Betty must meet the most restrictive of both ratios, they will need to prove they earn a minimum of \$59,640 unless they pay down some debt. But even if all their debt was erased, they still would need to meet the front end ratio of \$52,332. Since they earn \$65,000, they're in good shape.

Let's use the DTI ratios another way.

What if Bob and Betty had been qualified <u>*before*</u> they even started looking for a home? Experienced agents reading this will agree that this makes the most sense because having qualified (or better yet, pre-approved) Buyers allows the real estate agent to show homes in the Buyers' financial range. This saves time for all the parties and helps agents stay in "real estate" instead of "wheel estate" (driving people around showing them houses they can't afford).

The same formula applies, but this time we're solving for the PITI since we already know the income. We know that Bob and Betty together have a gross annual income of \$65,000 or a gross monthly income (GMI) of \$5416. Their monthly debt is still \$785.

Let's fill in the same equation, this time solving for loan amount:

- PITI cannot be greater than 31% of GMI (\$5416)
  <u>AND</u> (**not** or)
- PITI + monthly debt load (\$785) cannot be greater than 43% of GMI (\$5416)

Front-end Ratio:

- PITI cannot be greater than \$1678

Back-end Ratio:

- PITI + \$785 cannot be greater than \$2328
- PITI + \$785 - \$785 cannot be greater than \$2328 - \$785
- PITI cannot be greater than \$1543

Now Bob and Betty can qualify for a mortgage where the PITI is up to $1543 per month. They must meet the more restrictive ratio. The lender or mortgage originator who qualifies Bob and Betty will need to use an average number for area taxes and insurance to solve for the PI. Let's use the taxes and insurance from the earlier story about Bob and Betty: $400 for real estate taxes and $60 for insurance = $460 per month.

Now input $460 TI to solve for the PI:

On the front-end ratio:

- PITI cannot be greater than $1678
- PITI – TI cannot be greater than $1678 - TI
- PI cannot be greater than $1678 - $460
- **PI cannot be greater than $1218**

On the back-end ratio:

- PITI cannot be greater than $1543
- PITI – TI cannot be greater than $1543 – TI
- PI cannot be greater than $1543 – $460
- **PI cannot be greater than $1083**

Unless they pay off some debts, Bob and Betty can't pay more than $1083 for their PI (Principal & Interest).

The next step is to have a handheld or online finance calculator to input the term (30 years), the interest rate (4.5%), and the principal and interest (P&I) payment of $1083, and then to solve for the loan amount. In this case the answer is $213,742, far above the $176,000 loan Bob and Betty are looking for.

Let's remember that Bob and Betty said they felt more comfortable paying somewhere in the range of their current rent, $1,000 per month, for PITI. They plan to start a family soon after moving into their new home, and there's even a chance that Betty may want to stay home for a few years. Because they're a conservative couple and don't want to over-extend, they think it makes sense to stay more conservative in their possible mortgage amount.

This is the pen-on-paper method of explaining and calculating mortgage qualification using front and back-end ratios. More likely these calculations will be done on DU (Fannie Mae's "Desktop Underwriter") or on LP (Freddie Mac's "Loan Prospector") or on any of the decision engines that lenders use today.

NOTE: Since, in our example, Bob and Betty have a 20% down payment, they will pay no monthly PMI (Private Mortgage Insurance). Also, they are buying a single family home and not a condo or PUD (planned unit development) where they would have monthly common charges. But it's important to note that PMI and monthly common charges are included in the PITI calculation. These extra fees will impact the monthly payment and therefore the maximum loan amount in the mortgage qualification process.

Knowing how this works through studying the above examples allows a real estate agent to conceptualize the process and even engage in intelligent discussions with Buyers and Sellers. Simply stated, **about one-third to one-half of someone's gross income is the acceptable maximum amount to be spent on Principal, Interest, Taxes and Insurance.** And about another 10-12% of one's income is acceptable debt. (Give or take.) Practice scripts to feel at ease in describing the basics of the mortgage qualification process. Then shift the conversation to the lender.

TRID Loan Estimate (LE)

Although the FTC (Federal Trade Commission) affords consumer protection in many areas and even enforces The Fair Credit Reporting Act (FCRA), the US Federal Government saw the need for additional protection and oversight after the financial crisis during the 2000's. To quote from the CFPB website, "In July 2010, Congress passed and President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Act created the Consumer Financial Protection Bureau (CFPB). The CFPB consolidates most Federal consumer financial protection authority in one place. The consumer bureau is focused on one goal: watching out for American consumers in the market for consumer financial products and services."

Source: http://www.consumerfinance.gov/the-bureau/creatingthebureau/

Because the CFPB believed that consumers weren't clear about the mortgage process or the forms they were signing, they created a "Know Before You Owe" campaign to simplify and standardize mortgage loan documents. Their major initiative was implemented in 2015 and is known as the TILA-RESPA Integrated Disclosure Rule. (TILA = the Truth in Lending Act/Regulation X, and RESPA = the Real Estate Settlement Procedures Act/Regulation Z.) The new TILA-RESPA Integrated Disclosure Rule is commonly known as TRID. In fact there are 2 websites which explain TRID in detail and offer sample forms.

The consumer based site is:
www.consumerfinance.gov/know-before-you-owe

The site for real estate professionals is:
www.consumerfinance.gov/know-before-you-owe/real-estate-professionals.

Essentially, the two key forms lenders now use in the mortgage process are the LE or Loan Estimate form, and the CD or Closing Disclosure form. These replaced the Truth In Lending and Good Faith Estimate documents and the HUD 1 Settlement Statement document that had been used for many years. A real benefit of the LE is that it covers the projected payments and closing costs in a clear, concise way so that Buyers will be informed, and hopefully not have any surprises at their closing.

To learn more about TRID and to see sample forms, go to the above mentioned websites, or to see the list of forms and links to samples, go to:
www.consumerfinance.gov/regulatory-implementation/tila-respa/#disclosures

Since this section of the course is about mortgage qualification, see the CFPB sample LE (Loan Estimate) that uses the example of a $162,000, 30-year fixed rate mortgage at 3.875%. It shows all the line items a buyer would need to truly understand every charge and why and how the charge is applied.

You can download this sample LE and study it to better understand the form:
http://files.consumerfinance.gov/f/201403_cfpb_loan-estimate_fixed-rate-loan-sample-H24B.pdf

This example shows a purchase price of $180,000 with a 10% down payment, thus the TRID LE shows a PMI (private mortgage insurance payment) of $82 per month.

Let's now include a discussion about PMI:

PMI Private Mortgage Insurance

When borrowers select an 80% LTV mortgage product, it means their loan-to-value must be at least 80% of the appraised value or the purchase price (whichever is lower) and their down payment is 20% or more. There is no extra mortgage insurance needed for an 80% LTV conventional loan. In our example of Bob and Betty, there was no additional PMI payment in their PITI because their down payment was 20%. But when borrowers put less than 20% down, the lender requires insurance to cover the extra amount that is financed over 80%. Private Mortgage Insurance Companies such as MGIC, Genworth, United Guaranty, Radian and others publish rate charts which apply to the various LTV levels, but also consider other variables in the algorithm. Some of these variables are: type of transaction (primary residence, second home, refi), housing type (single, multi, manufactured), number of borrowers, and, of course, the applicant's credit score.

The fees are different for the various LTV levels:

- 90.01 – 95% LTV is at the most risk, so there is a higher monthly PMI fee
- 85.01 – 90% LTV is at less risk, so a bit lower fee
- < 85% LTV and fees are even lower than above

For the sake of simplifying this course, the LE included on the CFPB sample shows a PMI payment of $82 per month for this example. Note it could be almost double that amount if the credit score of the applicant were 620-679. Each PMI company sets its own parameters for their fees and other details.

PMI is removed from the loan when the mortgage balance reaches 78% of the original appraisal amount. In the sample LE, it shows the PMI being removed by year 8 of the mortgage. But there are other avenues to having the PMI removed sooner. Speak to your loan originator for more details.

Module 4 Qualifying the Buyer

Review Questions

1. In calculating the back-end ratio, about this much of one's income is acceptable debt.
   a) 10-12%
   b) 20-30%
   c) 25-35%
   d) 31-43%

2. Simply stated, about one-third to one-________ of someone's income is the acceptable maximum amount to be spent on Principal, Interest, Taxes and Insurance.
   a) Half
   b) Fifth
   c) Fourth
   d) Tenth

3. The two key forms lenders now use in the mortgage process are the
   a) LE and the HUD1
   b) TIL and the HUD1
   c) LE and the CD
   d) LA and the CC

4. When lenders refer to the "back-end ratio" they are talking about
   a) Debt-to-income
   b) Credit card balances
   c) Installment loans
   d) The total of PITI plus debt load

5. GMI or Gross Monthly Income refers to ______________.
   a) Monthly take-home pay
   b) Monthly income less payroll tax
   c) Annual gross income divided by 12
   d) Annual net taxable income divided by 12

6. In the calculation of PITI, the last “I” stands for
   a) Insurance
   b) PMI
   c) Common charges
   d) All of the above

7. The Truth-In-Lending and Good Faith Estimate documents have been replaced by the
   a) CD
   b) LE
   c) TG
   d) FE

8. Monthly PMI fees are tied to many variables including
   a) Source of income
   b) Employment history
   c) Age of the home
   d) Number of borrowers

9. PMI is removed from the loan when the mortgage balance reaches ________% of the original appraisal amount.
   a) 78%
   b) 31%
   c) 43%
   d) 50%

Module 5

Popular Mortgage Products

Conventional Fixed Rate

A conventional mortgage is not guaranteed or insured by the federal government. Generally this type of mortgage follows the conforming guidelines set by FANNIE and FREDDIE so it can be sold to the secondary market. (If it's non-conforming, it still may be a conventional mortgage. For example, if the loan amount exceeds the FANNIE maximums, then it's a "jumbo" loan but is still considered conventional.) Conventional mortgages can be written for 1-4 family homes, manufactured, modular, planned unit developments, and approved condos, and they apply to primary, second homes, and even investment properties.

This section is titled Conventional Fixed Rate because it applies to not only conventional mortgage loans but more specifically to conventional loans that have a fixed interest rate. Fixed rate means that the initial interest rate remains the same for the life of the loan, and the monthly P&I payment will remain the same, too. Since taxes and insurance can and do fluctuate, the total monthly PITI may vary over the life of the loan, but the total of the Principal and Interest will always be the same number. At the beginning of the loan cycle more of the P&I payment is applied to Interest and less to Principal. As the loan amortizes (is gradually paid off), more is applied to Principal and less to Interest. But the total P&I payment remains the same each month. Borrowers tend to be more comfortable knowing what they can expect. That's why the fixed rate product is so popular. Borrowers, as long as they qualify, may select various terms such as 15 years, 20 years or 30 years. The 30 year is the most popular. (Note some borrowers send one extra mortgage payment per year and ask that it be applied to Principal. This causes the 30 year loan to be reduced by about 5 years. The decision to prepay a mortgage loan should be shifted to a tax advisor, not to the real estate agent)

Conventional ARM (Adjustable Rate Mortgage)

This type of conventional mortgage meets the same parameters as the one above, but in this case we're referring the Adjustable Rate Mortgage or ARM. Unlike the fixed rate mortgage, the ARM has a lower initial interest rate which may fluctuate up or down over the life of the loan.

Key terms to know when looking at the ARM are:

- Index
- Margin
- Adjustment Period
- Cap / Lifetime Cap

Index refers to what the interest rate is tied to. Examples of indexes are the LIBOR (London Interbank Offered Rate), T-Bills, Prime and others. The lender chooses the index. The index can go up or down, and this is disclosed to the borrower.

Margin is the amount the lender adds to the index to make a profit. The margin remains the same and is also disclosed to the borrower. The index + the margin = the initial interest rate.

Adjustment period refers to how often the payment may adjust. Most ARMS have adjustment periods every 3, 5, 7 or 10 years.

Cap refers to how much a rate may change from one adjustment period to the next.

Lifetime Cap refers to how much the interest rate may change over the life of the loan.

So for example, let's say the lender is offering a 3-Year ARM which is tied to the
1-Year Treasury Bill at .5%. The lender's margin is 2.5%, so adding them together, the initial interest rate for this loan product is 3%. The lender sets a cap of 2 for each adjustment period and a lifetime cap of 6. This means that, at the first adjustment, the interest rate could go up if the T-Bill rises, but it can never go up more than the cap of 2 (or 5%). At the second adjustment it could go up or down but never by more than 2, so the worst case scenario would be a rise to 7%. At the third adjustment it could go up or down again, but never higher than 9% (2 over the previous 7). But since the lifetime cap is 9, the interest rate can never go higher. That's because the lifetime cap is set at 6 over the initial rate of 3%.

An adjustable rate mortgage is just that…… adjustable! So consumers who don't like taking chances may not be drawn to this type of loan. A distinct benefit, however, is that the initial rate of an ARM is lower than a fixed rate mortgage. This appeals to borrowers looking to qualify for the most mortgage they can get and/or to borrowers who may not qualify at a higher rate. Whether or not the ARM is appealing, consumers do need to shop for not just the initial rate, but also for the index, margin, adjustment periods and caps. Uninformed consumers have been tricked by this loan product in the past. In fact there are some cautious lenders who ask that the borrower be qualified not at the initial rate but at the worst possible scenario first adjustment rate just to be sure the borrower doesn't fall short.

FHA

The US Department of Housing and Urban Development (HUD) has been offering government insured loans through their FHA division - the Federal Housing Administration - since 1934. Lower down payments and easier qualifying protocols often make this an attractive loan for many consumers.

In this course we will take a quick look at 3 of the many loans offered through the FHA:

- 203 (b) (Basic Home Mortgage Loan)
- 203 (k) (Rehab Loan)
- HECM and HECM for Purchase (Reverse Mortgage)

203 (b) Basic Mortgage Loan

The most popular of the FHA loans, this loan offers a 96.5% LTV which means the borrower may put only 3.5% down on a 1-4 family home. Your local lender originates the loan, but the FHA insures it, so the lender is at less risk. There are maximum loan limits set by how the FHA perceives the cost factors in counties across the nation. For a single family home in "low cost areas" the maximum loan amount is set at $271,050, while the "high cost areas" are set at $625,500.

The loan limit chart can be found at:
https://entp.hud.gov/idapp/html/hicostlook.cfm

The 203 (b) also has a mortgage insurance premium (MIP). Similar to Private Mortgage Insurance (PMI) this insurance is set by the FHA. If the LTV is over 90%, then the MIP remains for the life of the loan. If the LTV is 90 or less than 90%, then the MIP is cancelled after 11 years or at the end of the loan, whichever comes first. This has been the rule since 6/3/13.

Because of the flexible nature of this loan qualification process, many real estate agents recognize the benefit of working with lenders who offer this or other low down payment loan products.

203 (k) Rehab Loan

How often have you shown Buyers a home in a neighborhood they like, and the home is nearly perfect for them except for *these types of objections:*

- "If only it were in better shape."
- "If only the kitchen were more modern."
- "If only there were one more full-bath."
- "If only the yard were fenced in."
- "If only there were a bedroom on the first floor."

Well……… did you know there's an FHA mortgage product that may just be the solution? Enter the 203 (k) Rehab Loan through the FHA. Your Buyer can purchase a home in the neighborhood they love and fix it prior to closing with this loan.

According to the FHA site:

"The Section 203(k) program is FHA's primary program for the rehabilitation and repair of single family properties. As such, it is an important tool for community and neighborhood revitalization, as well as to expand homeownership opportunities.

FHA's Limited 203(k) program permits homebuyers and homeowners to finance up to $35,000 into their mortgage to repair, improve, or upgrade their home. Homebuyers and homeowners can quickly and easily tap into cash to pay for property repairs or improvements, such as those identified by a home inspector or an FHA appraiser. Homebuyers can make their new home move-in ready by remodeling the kitchen, painting the interior, or purchasing new carpet."

http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/203k

This product also may be used by homeowners to make property repairs, improvements, or prepare their home for sale.

To learn more about how this loan can work in your area, do contact an FHA Rehab Loan Specialist. There are many details and intricacies associated with this rehab product, so it's best to shift to a specialist. And note there's an energy efficient mortgage (EEM) that can combine with the 203(k) rehab loan to make even more home improvements.

HECM and HECM for Purchase (Reverse Mortgage)

With an ever increasing aging population and over 78 million Boomers, it's no surprise that the Reverse Mortgage (which the FHA calls "Home Equity Conversion Mortgage" – HECM) is so popular! Only available to homeowners who are 62 or older, this product allows borrowers to turn the equity in their principal residence into funds they can use now or just keep available in a line of credit. Unlike an ordinary home equity loan, there is no required monthly payment. Borrowers may make payments if they wish, but they are not required to pay off the loan and its accrued interest until they move out for more than one year, die, or sell the property. Maximum loan amounts are based on the appraised value of the property, the age of the borrower (the older you are, the more money you can borrow), and the current interest rate. Currently the maximum HECM is set at $625,500.

Note there are many intricacies in this loan product, and since the guidelines and parameters change frequently, it's best to contact a Reverse Mortgage Specialist for the most up-to-date rules.

The FHA guidelines can be found at:
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmabou

The top 10 reasons qualified homeowners seek the HECM are:

1. Retire existing mortgage
2. Increase monthly retirement income
3. Make home improvements / increase value
4. Buy a new or second home
5. Pay property or school taxes
6. Eliminate debt / credit
7. Cover daily or new health care
8. Fund long term health care
9. Estate planning/Life ins/investment funding
10. Charitable & family gifting

There are many myths that disparage the Reverse Mortgage, so here are a few that may help clear up the bad press:

Misconceptions #1: Reverse mortgages are only for desperate seniors or for the "House Rich, Cash Poor."
Not true. Many seniors use this product as an investment and retirement tool.

Misconceptions #2: Your home must be debt-free to qualify for a reverse mortgage.
Not true. The total amount available based on HECM guidelines will be used to pay off the existing mortgage. If there's any equity left for disbursement, the borrower may utilize it. Obviously, if the home is debt free, there will be more available loan proceeds.

Misconceptions #3: The bank owns the home after you get a reverse mortgage.
Not true. If you are in a lien theory state, the homeowner owns the home, and the mortgage is merely a lien on the property.

Misconceptions #4: When a reverse mortgage comes due the bank sells the home.
Not true. Since the homeowner owns the home, the homeowner or his estate sells the home or keeps the home as long as they pay off the loan.

Another common concern is that since this is a negative amortization loan and grows larger instead of smaller each month, the mortgage loan balance may eventually exceed the home's value. If that occurs, who owes the difference? Answer: The FHA insurance covers any shortfall. The homeowner or the estate only pays what it can from the proceeds of the sale. There may be no money left, but there is never a requirement that the homeowner or the estate pay the shortfall.

This loan product is particularly important for real estate agents to understand. Here are two distinct benefits why agents need to learn about the HECM:

1) Suppose you get a listing call from Sam and Sally Senior who think they HAVE TO sell their home because the monthly carrying costs are getting too high. You let them know that if they talk to reverse mortgage specialist, they may be able to get a reverse mortgage to pay off any existing mortgage balance and annual taxes and other expenses and still remain in the home and neighborhood they know and love. While you may not get the listing (which is why they called you) you will be a hero. Think of the good that will inevitably come your way when you commit a selfless act.
2) You can help seniors buy the retirement home or condo they think they can't afford. (This will give you a listing AND a sale!) Here's how it works:
   Sam and Sally Senior would love to sell their current 2-story home and buy a first level condo that would be great for their retirement years. No maintenance, a clubhouse, and many amenities to fill their time. It would be a dream come true! But if they sell their current home there won't be enough proceeds to buy the condo outright. And they no longer would qualify for a conventional mortgage since they have a minimal income and don't work anymore. So they believe the condo is just a dream. But then you remind them of the "**HECM for Purchase**" and connect them to a HECM specialist. They learn they can use some sale proceeds from the sale of their current home as a down payment on the condo and apply for a Reverse Mortgage (HECM for Purchase) for the balance of the condo price. Now they move into their condo (their new primary residence) and have no mortgage payment since it's a reverse mortgage! Once again you are a hero! Not to mention that you just had a listing and a sale. If the HECM for Purchase is tweaking your interest, do contact your local Reverse Mortgage Specialist.

More general info, including the common myths, can be found at the website of the National Reverse Mortgage Lenders' Association:

www.reversemortgage.org

VA

According to the government website for the Veterans Administration:

"The VA helps Service members, Veterans, and eligible surviving spouses become homeowners. As part of our mission to serve you, we provide a home loan guaranty benefit and other housing-related programs to help you buy, build, repair, retain, or adapt a home for your own personal occupancy.

VA Home Loans are provided by private lenders, such as banks and mortgage companies. VA guarantees a portion of the loan, enabling the lender to provide you with more favorable terms."

www.benefits.va.gov/homeloans/index.asp

VA loans offer 100% financing, including closing costs, for those who qualify. Rates are competitive, and there's no extra private mortgage insurance since there is a government guarantee. This is a loan product that agents need to tout in their drip marketing as a service to those who protect our freedom.

Module 5 Popular Mortgage Products

Review Questions

1. Conventional conforming mortgage loans are offered to finance
   a) Trailers
   b) Shopping centers
   c) Second homes
   d) 1-6 family homes

2. The initial interest rate of an ARM is calculated by
   a) Adding 1 point to the current Prime Rate
   b) Subtracting the margin from the index
   c) Adding the index and the margin
   d) The federal rate published monthly by the FHFA

3. A 5-Year ARM is offered at an initial rate of 1.5% with a cap of 2 and a lifetime cap of 6. This means:
   a) The interest may never exceed 7.5%
   b) May adjust up or down every 3 years.
   c) May rise to 4% at the first adjustment period.
   d) All of the above

4. Which of the following is true of an ARM index?
   a) It allows the lender to add some profit
   b) It can change
   c) It remains constant throughout the life of the loan
   d) It refers to how often the payment may adjust

5. The London Interbank Offered Rate (LIBOR) is a typical ARM
   a) Initial Rate
   b) Margin
   c) Index
   d) Cap

6. When shopping for an ARM, which of the following should be checked?
   a) Index
   b) Margin
   c) Adjustment period
   d) All of the above

7. FHA mortgages establish maximum mortgage limits based on
    a) Low and high cost areas
    b) An algorithm of credit, loan type, and LTV
    c) FANNIE & FREDDIE conforming guidelines
    d) Age, square footage and condition of the subject property

8. A major reason the FHA 203 (b) basic mortgage loan is popular is because
    a) Borrowers with a 300 credit score can be approved
    b) The subject property can be in major disrepair and still close
    c) The LTV is 96.5%
    d) Veterans can utilize the 100% finance option

9. In addition to principal, interest, taxes and homeowner insurance the FHA loan adds
    a) TIL
    b) HO
    c) PMI
    d) MIP

10. FHA's Limited 203(k) program permits homebuyers and homeowners to finance up to
    a) $25,000
    b) $35,000
    c) $50,000
    d) $100,000

11. The FHA 203 (k) mortgage is an important tool for which of the following?
    a) Community and neighborhood revitalization
    b) Providing housing opportunities

12. Unlike an ordinary Home Equity Loan or HELOC, the HECM
    a) Has no DTI ratios
    b) Does not require a monthly payment
    c) Has a limit of $625,500
    d) All of the above

13. When applying for a HECM, a 90 year old borrower would
    a) Be denied because the age maximum is 85
    b) Qualify for more than a 65 year old borrower
    c) Need a co-signer
    d) Automatically be approved

14. The HECM mortgage is limited to seniors who are 55 years or older.
    a) True
    b) False

15. Reasons qualified seniors seek the HECM include
    a) Buying a vacation home
    b) Helping family members
    c) Making aging-in-place improvements to their current home
    d) All of the above

16. The VA loan is
    a) Offered to active or retired military only
    b) Available for 1-4 family homes and investment properties
    c) Guaranteed by the federal government
    d) Provided by regional VA centers and not at local banks

17. VA Loans offer _________% financing and can build in the closing costs.
    a) 100%
    b) 96.5%
    c) 80%
    d) The VA does not offer loan financing

Module 6

Closing Costs for the Buyer and for the Seller

Buyer – TRID Closing Disclosure (CD)

As covered in the earlier section about TRID, "In July 2010, Congress passed and President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Act created the Consumer Financial Protection Bureau (CFPB). The CFPB consolidates most Federal consumer financial protection authority in one place. The consumer bureau is focused on one goal: watching out for American consumers in the market for consumer financial products and services."

Source: http://www.consumerfinance.gov/the-bureau/creatingthebureau/

In the fall of 2015 the CFPB instituted two key forms that lenders now use in the mortgage process: the LE or Loan Estimate, and the CD or Closing Disclosure. These replaced the Truth In Lending documents and the HUD 1 Settlement Statement documents that had been used for many years.

The CFPB rules state that borrowers must receive their CD at least 3 business days before closing so they can be better informed and prepared. Prior to this rule the HUD 1 closing document was often first introduced to a borrower at the actual closing table. This was an outrage to many borrowers and certainly to the CFPB.

Many consumers as well as real estate agents who are confused about the 3-day rule can find the answers at: http://files.consumerfinance.gov/f/201506_cfpb_factsheet_will-the-new-mortgage-disclosures-delay-my-closing.pdf

To quote a few here:

"Many things can change in the days leading up to closing. Most changes will not require your lender to give you three more business days to review the new terms before closing. The new rule allows for ordinary changes that do not alter the basic terms of the deal.

Only THREE changes require a new 3–day review:

1. The APR (annual percentage rate) increases by more than 1/8 of a percent for fixed-rate loans or 1/4 of a percent for adjustable loans. A decrease in APR will not require a new 3-day review if it is based on changes to interest rate or other fees.

2. A prepayment penalty is added, making it expensive to refinance or sell.

3. The basic loan product changes, such as a switch from fixed rate to adjustable interest rate or to a loan with interest-only payments.

The following circumstances *do not* require a new 3-day review:

1. Unexpected discoveries on a walk-through such as a broken refrigerator or a missing stove, even if they require seller credits to the buyer.

2. Most changes to payments made at closing, including the amount of the real estate commission, taxes and utilities proration, and the amount paid into escrow.

3. Typos found at the closing table."

We already looked at the LE, so now let's talk about the CD or Closing Disclosure that Buyers now receive.

Here is the link to the sample CD for the same loan covered in the sample LE:
A $162,000, 30-year fixed rate mortgage at 3.875%.

http://files.consumerfinance.gov/f/201403_cfpb_closing-disclosure_cover-H25B.pdf

According the sample CD, the Buyers' closing costs are $9,712.10 and are itemized in an orderly fashion listed A through J. The link to the sample CD shows the actual fees for the example noted above. The CD section titles are shown below:

A. Loan Origination (Points, application and underwriting fee)
B. Services Borrower Did Not shop For
   Appraisal
   Credit report
   Flood report
   Tax monitoring and research
C. Services Borrower Did Shop For
   Pest inspection
   Survey
   Title search and charges – Mortgage Policy
D. Subtotal of A, B & C
E. Taxes and Other Governmental Fees

Recording Fees

F. Prepaids
   Homeowner's Insurance Premium
   Mortgage Insurance Premium
   Prepaid Interest
   Property Taxes
G. Initial Escrow Payment at Closing
   Homeowner's Insurance
   Mortgage Insurance
   Property Taxes
H. Other
   Homeowner Association Fees
   Home Inspection
   Title – Owner's Policy
I. Total Other Costs (Subtotal of E, F, G & H)
J. Total Closing Costs – Borrower Paid

When you look at the sample CD, the total Buyer paid closing costs of $9,712.10 are about 6% of the mortgage amount. This number includes bank closings costs, pre-paids, escrows, and extra costs a Buyer may opt for. Real estate agents are wise to shift closing cost questions to the lender's rep, but a ballpark estimate for closing costs can range from 5 – 8% of the mortgage amount. Note the number may be larger if there are high discount points and/or high real estate taxes.

Seller's Net Proceeds

So what about the Seller? While the Sellers don't face mortgage finance fees and costs, they do have selling expenses that affect their real estate transaction. As listing agents we have an obligation to discuss the approximate costs our Sellers will face before they decide to sign that listing contract. It's not enough for Sellers to learn their probable selling price. What Sellers really want and need to know is the approximate amount they will NET when they walk out of the closing. That's what we refer to as "Seller's Net Proceeds." The simple formula is:

Selling Price *minus* the following *(where applicable)*:

- Existing first mortgage
- Additional mortgages
- Other liens
- Transfer tax

- Attorney
- Broker
- Concessions (closing credit, points, buydown, warranty, etc)

Equals Seller's Net

Most agents are familiar with this process, so no need to beat a dead horse! But if you're not, then do speak to your Broker or to an experienced agent in your office to find out how they handle this discussion at the listing presentation.

Module 6 Closing Costs for the Buyer and for the Seller

Review Questions

1. The Consumer Financial Protection Bureau is focused on one goal: watching out for American consumers in the market for consumer financial products and services.
   a) True
   b) False

2. The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed by Congress and signed by
   a) President George W. Bush
   b) President Bill Clinton
   c) President Barack Obama
   d) None of the above

3. The Buyer's closing costs include bank closings costs, pre-paids, escrows and ______________.
   a) Transfer tax
   b) Tips for the title service
   c) Appraisal fee
   d) Other buyer related services the borrower has opted to buy

4. When Buyers ask their real estate agent to explain closing costs in detail, the best answer would be _____________.
   a) "Sure. Call me as soon as you receive the CD."
   b) "Why not ask your lender or your attorney? They would be the best source."
   c) "If you go to the CFPB website, you can see the detailed explanation."
   d) "It's illegal for me to interfere with your loan process, so I just can't help."

5. A lender requires the borrower to pay for
   a) Transfer Tax
   b) Broker commission
   c) Lender's title insurance
   d) Home Warranty

6. If the Seller tries to renegotiate the broker's commission at the closing table, TRID rules require another 3-day review notice.
   a) True
   b) False

7. The following circumstance ***does not*** require a new 3-day review:
   a) Addition of a pre-payment penalty
   b) The APR increases by .25%
   c) Total amount allotted to escrow payments
   d) None of the above

8. The following circumstances ***do not*** require a new 3-day review of the CD:
   a) An added pre-payment penalty
   b) An increase in the interest rate of 1%
   c) A decrease in the interest rate
   d) A change from a Fixed Rate Mortgage to an ARM

9. The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed in July 2010, created the _____________.
   a) FNMA
   b) FHFA
   c) CFPB
   d)CCLA

10. The CD or Closing Disclosure must
   a) Be given to the buyer at least 3 days before the closing date
   b) Include the agent's license number
   c) Include the broker's license number
   d) All of the above

11. A rough estimate for Buyer closing costs is 5 – 8% of the mortgage amount.
   a) True
   b) False

8. Self-Evaluation / Action Steps

There we have it- a quick look at the not-so-basic basics of real estate finance.
From tax advantages of home ownership to an introduction into the Secondary Market to the real estate mortgage process from qualification to closing, real estate professionals can take their business up a peg by becoming familiar with the world of real estate finance. Ask yourself which of these areas you need to study a bit more, and then go back to the many website links that have been provided in this course. Read and re-read until you feel comfortable enough to write down some questions. Then contact your trusted real estate mortgage specialists to engage them in discussions. As the finance world is constantly changing, be sure to shift your risk by always reminding your customers and clients that you are *not* the source, but rather the resource- good luck!

RESOURCES (in order of course appearance)

- 2015 Profile of Home Buyers and Sellers, National Association of REALTORS®, www.realtor.org
- *The Real State of Real Estate*, Consumer Report Magazine, March 2016
- Federal National Mortgage Association (FNMA) www.fanniemae.com
- Federal Home Loan Mortgage Corporation, (FHLMC) www.freddiemac.com
- Government National Mortgage Association (GNMA) www.ginniemae.gov
- Credit Bureau www.myfico.com
- Free credit report (does not include a credit score)
  www.annualcreditreport.com
  www.consumer.ftc.gov/articles/0155-free-credit-reports
- *The Credit Road Map* by Patrick Ritchie (at www.amazon.com)
- TILA-RESPA Integrated Disclosure (TRID) info for the real estate professional:
  http://www.consumerfinance.gov/know-before-you-owe/real-estate-professionals/
- TRID info for the consumer:
  http://www.consumerfinance.gov/know-before-you-owe
- TRID Forms: www.consumerfinance.gov/regulatory-implementation/tila-respa/#disclosures
- for FHA Insured Mortgage Programs (www.hud.gov)
  - FHA Loan Limit Chart https://entp.hud.gov/idapp/html/hicostlook.cfm
  - 203 (b) Mortgage:
    http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/ins/sfh203b
  - 203 (k) Rehabilitation and Streamline:
    http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/203k
  - Reverse Mortgage: HECM:
    http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmabou
  - National Reverse Mortgage Lenders' Association - www.reversemortgage.org
- VA Home Loans
  http://www.benefits.va.gov/homeloans/index.asp

Final Exam Instructions

The Final Exam Review Questions you just completed are designed to prepare you for the online final exam.

Once you have completed the review questions, you will need to take the final exam online to receive credit for this course.

To access the final exam, go to: www.pdhrealestate.com

Then follow these step:

1. Select Missouri

2. Purchase your courses

3. Start your final exams

Before you begin the test, you will be asked to sign an affidavit attesting to the following:

1. You have spent the required time (3 hours) studying the course material

2. You will personally complete the final exam

We look forward to seeing you at: www.pdhrealestate.com

Basics of Real Estate Finance Final Exam

1. PITI stands for
    a) Principal, Interest, Taxes & Insurance
    b) Principal, Interest, Tenure & Increases
    c) Payments, Income, Tenure & Increases
    d) Payments, Income, Time & Interest Rate

2. Which of these are tax deductible?
    a) Principal and interest
    b) Interest, real estate taxes and insurance
    c) Interest and real estate taxes
    d) Principal, interest, taxes and insurance

3. Which of the following is true?
    a. Most buyers don't cite "tax advantages" as their primary reason for buying a home
    b. In the latest *Profile of Home Buyers and Sellers* financial security and tax benefits were ranked among the top 14 reasons for purchasing a home
    c. In *Consumer Reports Magazine* the "wealth-building benefits of home ownership" ranked 3rd in reasons millennials wish to own a home
    d. All of the above are true

4. Banks package and sell their mortgages to
    a) The secondary market
    b) Canada and the UK
    c) The IRS
    d) All of the above

5. Fannie Mae was created in 1938 in order to provide liquidity and stability to the US housing markets by ______________________.
    a) Ending the Great Depression
    b) Buying mortgage loans from the local lenders
    c) Giving low cost loans to markets that saw the most foreclosures
    d) Grouping mortgage loans and selling them to the IRS

6. The largest player in the Secondary Mortgage Market is
    a) Ginnie Mae
    b) Freddie Mac
    c) Sonnie Mae
    d) Fannie Mae

7. When preparing a market analysis and presenting it to Seller clients, agents should use sold comps that also meet the Fannie/Freddie underwriting guidelines because _________________.
    a) The local MLS requires this
    b) It would otherwise violate the Code of Ethics
    c) The FHFA requires this of agents and appraisers
    d) The appraiser ultimately will need to follow those rules

8. Credit scores impact:
    a) Employment application decisions
    b) Credit card limits and rates
    c) Mortgage rates and LTV
    d) All of the above

9. The higher the credit score, the __________ the interest rate.
    a) Lower
    b) Higher
    c) Worse
    d) Credit score does not impact the interest rate

10. The largest category considered in computing a credit score is
    a) Amounts owed
    b) Length of credit history
    c) Payment history
    d) Credit mix in use

11. Credit scores range from
    a) 250 - 800
    b) 300 - 850
    c) 0 - 800
    d) 250 – 850

12. Credit scores do not consider
    a) Marital Status
    b) Source of income
    c) Occupation
    d) Any or all of the above

13. Who enforces how credit reporting agencies collect and use consumer information?
    a) The Federal Trade Commission
    b) TRW
    c) Fannie Mae
    d) HUD

14. When lenders refer to front and back end ratios, they're referring to
    a) Income-to-debt ratio
    b) Income-to-credit ratio
    c) Debt-to-income ratio
    d) Debt-to-credit ratio

15. For the average buyer, a 30 year conventional fixed rate mortgage would need DTI ratios in this area:
    a) 15/25
    b) 31/43
    c) 45/55
    d) 50/60

16. In calculating back-end ratios, debt load includes which of the following?
    a) Revolving credit
    b) Student loans
    c) Car loans
    d) All of the above

17. Principal, interest, taxes and insurance should not exceed a certain percentage of the __________.
    a) GMI
    b) PMI
    c) DWI
    d) GPA

18. The CFPB likes to refer to their TILA-RESPA Integrated Disclosure Rule as
    a) Know Before You Show
    b) Know Before You Go
    c) Know Before You Slow
    d) Know Before You Owe

19. Today the first step a lender takes is to check the borrower's
    a) Demonstrated ability to save
    b) Employment history
    c) Net worth
    d) Credit

20. A conventional mortgage
    a) Is not insured by the federal government
    b) Can meet conforming loan limits
    c) Can exceed conforming loan limits
    d) All of the above

21. A jumbo loan is a loan that
    a) Exceeds FANNIE & FREDDIE maximum loan limits
    b) Combines a first and a second mortgage
    c) Is for $1 million or more
    d) Applies to homes over 5,000 SF

22. With a fixed rate mortgage the initial interest rate ______________ for the life of the loan.
    a) Remains the same
    b) Fluctuates with the housing market
    c) Is re-assessed in either 3, 5, or 7 year increments
    d) Is regulated by the FHA

23. The FHA 203 (k) mortgage loans can be used to
    a) Repair, improve or upgrade an investment property
    b) Purchase carpeting, furniture and appliances
    c) Make repairs and improvements to prepare a home for sale
    d) All of the above

24. Maximum loan amounts for the HECM are based on
    a) Appraisal, age of borrower and prevailing interest rate
    b) Appraisal, age of the home, and health status of the borrower
    c) Age of the borrower, prevailing interest rate and maximum county limit
    d) Interest rate, PITI ratios and FHA maximums

25. The HECM for Purchase allows the qualified borrower to
    a) Buy an investment property to enhance their wealth
    b) Purchase a home for minor children
    c) Buy a home and reverse its mortgage at closing
    d) All of the above

26. A VA loan may be used to
    a) Buy a personal residence
    b) Build a personal residence
    c) Repair or adapt a personal residence
    d) All of the above

27. Which of the following would require a new 3-day review:
    a) The APR (annual percentage rate) increases by more than 1/8 of a percent for fixed-rate loans or 1/4 of a percent for adjustable loans.
    b) A prepayment penalty is added, making it expensive to refinance or sell.
    c) The basic loan product changes, such as a switch from fixed rate to adjustable interest rate or to a loan with interest-only payments.
    d) All of the above

28. The CFPB rules state that borrowers must receive their CD at least 3 business days before closing so that the _____________.
    a) Seller will have enough notice to pack and clean out the house
    b) Lender will have time to book a location for the closing
    c) Parties can schedule their time accordingly
    d) Borrower may be better informed and prepared.

29. It’s not enough for Sellers to learn their probable selling price. What Sellers really want and need to know is the ______________.
    a) Broker commission
    b) Net proceeds
    c) Tax deductions
    d) Title search fee

30. A Buyer’s closing costs as shown on the CD include which of the following?
    a) Origination charges
    b) Initial escrow payments
    c) Prepaids
    d) All of the above