Chapter 7

Lenders & Mortgages

Chapter 7 Goals:

- Understand market forces which make the concept of leverage possible
- Understand the financing aspect of real estate
- Recognize different mortgage products
- Understand the documents that are used in financing real estate
- Understand the roles of the different federal agencies which regulate the mortgage market
- Recognize the rule of the Federal Reserve

Chapter 7: Lenders & Mortgages

Key Terms

acceleration clause	FICO score	points
Adjustable-Rate Mortgage	fixed-rate mortgage	prepayment penalty
(ARM)	government securities	prime rate
amortization	holder in due course	principal
balloon payment	hypothecation	private Mortgage Insurance
basis points	institutional lender	(PMI)
capacity (credit)	interim loan	promissory note
commercial bank	joint and severe liability clause	purchase-money mortgage
construction loan	land contract	Real Property Loan Law
credit	leveraging	Renegotiable-rate mortgage
credit union	life insurance company	Reverse Annuity Mortgage
discount rate	Loan-To-Value (LTV)	(RAM)
due-on-sale clause	lock-in clause	savings and loan association
Electronic Signatures in Global	mortgage	security instrument
and National Commerce Act	mortgage assumption	standby commitment
Equal Credit Opportunity Act	mortgage broker	standby fee
Fair Credit Reporting Act	mortgage company	straight note
(FCRA)	mutual savings bank	subject to
Federal Deposit Insurance	nonbanking institution	take-out loan
Corporation (FDIC)	open-ended mortgage	transferee
federal funds rate	negative amortization	trust deed
Federal Home Loan Bank	negotiable instrument	Uniform Residential Loan
System	nominal rate	Application
Federal Reserve	non-institutional lender	wraparound mortgage

The Federal Reserve

The **Federal Reserve** is the central bank of the United States that controls the country's money supply and governs its monetary policy. Also known as "The Fed", it is a quasi-private, non-public institution that is run independently of the government.

Among the Federal Reserve's primary functions are:

1. *Discount Rate.* The Federal Reserve provides loans to member banks that those banks then use to lend to borrowers. The interest rate that the Federal Reserve charges for its loans is known as the **discount rate**. The Reserve adjusts the discount rate based on current and forecasted market trends.

The discount rate has a ripple effect on the **federal funds rate** charged by each member bank and the **prime rate** charged by other banks. The prime rate is the rate given to a bank's best clients, such as large companies, investors with excellent credit standing, and other commercial borrowers.

The discount rate has a direct affect on the interest rates offered to consumers. These interest rates either increase or decrease consumer demand for loans and affect the flow of money into the economy.

2. *Government Securities.* The Federal Reserve also affects the flow of money into the economy based on how many government securities it purchases. The more securities the Federal Reserve purchases, the more money there is in the economy. Too much money, however, can cause inflation. The Federal Reserve must therefore strike a delicate balance between generating sustainable growth and creating inflation.

3. *Member Bank Requirements.* The Federal Reserve can also alter reserve requirements for member banks. The stricter the requirements are, the less money that flows into the market.

4. *Currency Creation.* The Federal Reserve is responsible for creating U.S. currency and dictating the amount of money that is available in the economy at any given time. Population size, average population age, birth and death rates, and employment rates greatly affect the speed at which the Reserve creates new currency.

Federal Home Loan Bank System

The **Federal Home Loan Bank System** was created in 1932 with the approval of Congress. Its inception ushered in a new era of banking after the Great Depression.

The FHL Bank System includes twelve regional Federal Reserve Banks. A seven-member Board of Governors heads each bank. Board members serve 14-year terms. They are appointed by the President and confirmed by the Senate.

The various Federal Reserve Banks work with one another to promote the best money supply practices for states they represent.

The Federal Reserve Bank that oversees California, Nevada, and Arizona is located in San Francisco. As California is considered the sixth largest economy in the world, its Federal Reserve Bank has a profound role in the world economy.

Each state or federal bank contributes a certain amount of money to the capital reserves of the Federal Reserve Banks by buying capital stock. This money is then lent to different institutions based on need. Need is determined by projections from The Federal Reserve.

Federal Deposit Insurance Corporation (FDIC)

The **Federal Deposit Insurance Corporation (FDIC)** was created with the approval of Congress in 1933. Its purpose was to protect consumers by insuring consumer savings accounts.

Today, the FDIC protects depositors by up to $250,000.

Lenders

Lenders loan money in order to make money. Originating mortgage loans grows the economy, which benefits mortgage lenders even if they lose money on some loans.

Lenders make a profit by charging:

- *Fees for originating loans.* Borrowers may have to pay fees, or **points**, based on the principal loan amount. One point equals 1% of the loan amount. **Basis points**, which are used in mortgage, loan, and credit card interest rates, are one hundredth of 1%. The **nominal rate** refers to a loan's actual interest rate minus fees, points, and mortgage costs.
- *Interest on principal loan amounts.* Lenders base interest rates on a few factors, including a borrower's credit, the particular mortgage program, and The Fed's discount rate. The higher a lender's risk, the higher the interest rate they will charge.

Futhermore, lenders use a property as collateral to secure their investment. In the event that a borrower does not pay back a loan, a lender can foreclose on the borrower's property and sell it to recoup its losses.

Lenders fall under two categories:

- Institutional lenders
- Non-institutional lenders

Traditionally, institutional lenders are best suited for borrowers who meet standard loan qualifications, whereas non-institutional lenders are better suited for borrowers with unique financial circumstances.

Institutional Lenders

The overwhelming majority of loans originate from institutional lenders.

An **institutional lender** is a large investment group that invests a significant amount of investor capital into purchasing or originating mortgage loans. A group can only become an institutional lender when it has originated such a significant number of loans as to affect the overall health of the economy.

In order to protect consumers, all institutional lenders must be members of The Federal Reserve.

Institutional lenders include:

- Commercial banks
- Savings and loan associations
- Life insurance companies
- Mutual savings banks

Commercial Banks

Commercial banks are institutions that offer a vast network of financial services to the general public, including savings and checking accounts, credit cards, and consumer loans.

Commercial loans include mortgage loans, construction loans, and home improvement loans. Commercial banks also offer loans to help borrowers pay off credit card debt and make business or personal investments.

Due to their large financial backing, national banks have no limit as to how much they can lend at any given time. The only limit is a borrower's income and qualifications.

To prevent widespread economic retraction due to bad loans, the U.S. Controller of Currency supervises the commercial bank market. There are also certain laws and practices in place that regulate national and state banks. The National Bank Act protects national banks, whereas the California Banking Law protects state banks.

These laws will be discussed further in Chapter 8.

Savings and Loan Associations

Savings and loan associations – also known as "thrifts" or "S&Ls" – are financial institutions that fund consumer loans.

S&Ls use deposits in customers' savings accounts to provide loans to prospective or current homebuyers. They then use the interest that is charged on those loans to pay back their customers.

Savings and loan associations are members of the Federal Home Loan Bank System. The Federal Reserve regulates minimum bank reserve requirements and controls the interest rates that are paid on deposits.

State law requires S&Ls to have funds insured through the Federal Deposit Insurance Corporation (FDIC). This insurance is intended to create stability in an otherwise volatile market and prevent widespread instability in the broader economy.

Life Insurance Companies

Life insurance companies are large institutions that provide commercial lending capital. They contribute roughly 10% of the overall outstanding commercial loan debt in the United States.

Life insurance companies typically provide long-term investments that finance large commercial real estate projects.

They also buy loans from other mortgage companies, invest in government-backed mortgages, and provide mortgage insurance for a significant percentage of purchase and refinance loans.

Life insurance companies are regulated on the state and federal level.

Mutual Savings Banks

A **mutual savings bank** is a member-owned financial fund that invests member deposits in order to fund loans and other debt. Profits are divided amongst members.

Mutual savings banks allow members to save their money and earn dividends on their original deposit.

Although mutual savings banks have been around for some time, they are relatively new in California.

Non-Institutional Lenders

Non-institutional lenders are private lenders that do not accept deposits from the general public and are not are heavily regulated by the government.

With more freedom than institutional lenders, these lenders have the ability to offer innovative or creative mortgage products to borrowers. In many instances, borrowers who have a difficult time proving income or who have bad credit can qualify for loans from non-institutional lenders.

Non-institutional lenders include:

- Credit unions
- Mortgage companies
- Nonbanking institutions
- Private investors

Credit Unions

A **credit union** is a member-owned community bank that provides financial services and competitive loans to its members.

Member deposits provide the necessary capital to provide these services. Consequently, credit unions are able to provide competitive rates.

Credit unions also do not own stock. Therefore, they are able to concentrate on stable, long-term mortgage solutions instead of the potentially lucrative, but risky investments that typically appeal to stockholders.

As the mortgage market has shifted and many banks have gone out of business, credit unions have taken a larger role in the overall mortgage market.

Mortgage Companies

Mortgage companies provide more loans in California than any other lending institution. Unlike banks, which provide many financial services, mortgage companies focus solely on originating, servicing, buying, and/or selling mortgages.

Typically, most mortgage companies fund mortgage loans with the intention of selling them on the secondary mortgage market in the near future. In this case, they do not originate a loan for themselves, but rather, they initiate a loan on behalf of other mortgage professionals. For this reason, mortgage companies rarely originate loans that do not conform to government guidelines, as many of the companies to which they sell their loans conform to government guidelines.

The secondary mortgage market and government guidelines will be discussed further in Chapter 9.

Mortgage companies may also take out loans from commercial banks in order to provide loans to clients solicited through the open market.

The government federally backs mortgage companies.

Nonbanking Institutions

A nonbanking institution is a financial institution that provides financial services without a banking license.

Nonbanking institutions have easier loan approval guidelines than standard banks. They provide loans primarily on the basis of equity, rather than income and credit.

A nonbanking institution cannot accept deposits. Their scope is limited to lending, underwriting, and retirement.

The following are nonbanking institutions:

- Mortgage investment companies
- Pension funds
- Universities
- Trusts, including real estate investment trusts (REITs)
- Estates
- Corporations

Private Investors

Private investors and nonbanking institutions provide a large segment of the overall loan market. They contribute nearly 25% of all mortgage debt.

Typically, private investor loans are based on how much equity a borrower has rather than a borrower's income or credit. Therefore, obtaining a loan from a private investor is usually less time-consuming than a traditional loan. As this makes such loans riskier, however, interest rates are often higher than standard loans.

Generally, borrowers apply to private investors for a loan after being denied a loan from a traditional lender.

Mortgage Brokers

A **mortgage broker** is a mortgage professional who finds the most competitive mortgage loans and qualifies borrowers for those that best meet their needs.

Mortgage brokers typically have relationships with various lenders and banks. Their unique insights into various lenders, approval processes, and loan qualification criteria allows them to procure the best mortgage programs and interest rates.

The **Real Property Loan Law** gives mortgage brokers the authority to:

- Solicit loans from borrowers
- Negotiate the terms of a loan on behalf of a borrower

A mortgage broker maximizes a borrower's chances of obtaining a loan if traditional lenders initially deny the borrower.

Mortgage brokers must provide borrowers with loan disclosures. These disclosures provide consumers with the information they need to understand a loan's terms, fees, source of funds, and payment schedule.

In some instances, mortgage brokers may provide loans themselves.

Brokers get paid through a commission or points. As previously stated, one point represents 1% of the total loan amount. A mortgage broker's commission depends on the following factors:

- Loan amount
- Loan term
- If a loan is a first or second mortgage

Maximum Mortgage Commission			
Type of Security	Loan Amount	Loan Term	Maximum Commission
First mortgage	Less than $30,000	Three or more years	10%
	$30,000 or more	Three years or less	5%
Second mortgage	Less than $20,000	Three or more years	15%
	$20,000 or more	Two to less than three years	10%
		Less than two years	5%

Borrower Loan Qualification

Nearly nine out of ten home purchases require some form of financing. Therefore, a buyer's ability to get approved for a loan will ultimately determine whether the buyer is able to buy a property.

Every lender has specific qualification guidelines. Furthermore, every lender has the ability to offer various loan programs with different interest rates to different buyer types (i.e. primary residence, investment property).

In order to minimize risk and maximize profit, most lenders utilize the three Cs of the loan qualification process:

- Credit
- Capacity
- Collateral

Credit

Lenders use a borrower's credit history as evidence of his or her financial stability. The three credit bureaus used to determine an applicant's creditworthiness are Equifax, Experian, and Transunion.

FICO Score

A prospective borrower's **FICO score** is often used as evidence of that credit history. It includes:

- How long a borrower has had established credit
- Percentage of credit used vs. available credit
- Payment patterns
- Total debt (i.e. school loans, car loans, credit cards, mortgages)
- Late payments
- Negative credit experiences

A borrower's FICO score ranges from 300-850. A 600 score is considered a poor credit rating, whereas a 750+ score is excellent.

A 720 credit score is the minimum qualifying score for most traditional mortgage programs.

Equal Credit Opportunity Act

The **Equal Credit Opportunity Act** prohibits discrimination of credit applicants on the basis of race, religion, sex, marital status, or the fact that part or all of their income derives from public assistance.

If a borrower meets a lender's eligibility requirements, he or she must be approved for a loan.

Fair Credit Reporting Act (FCRA)

The **Fair Credit Reporting Act (FCRA)** requires lenders to provide borrowers who are denied a loan with a written explanation as to why their application wasn't approved.

This explanation must be provided within 30 days of the denial.

An applicant also has the right to access the credit report used to determine his or her eligibility.

Capacity

Before providing a loan, a lender must determine whether a borrower has the income and financial stability (or "capacity") to afford monthly mortgage payments throughout the duration of the loan.

The **Uniform Residential Loan Application** (Form 1003) is the standard loan application for residential mortgages. It is used to determine a borrower's loan eligibility.

In 2000, Congress passed the **Electronic Signatures in Global and National Commerce Act**. This law gave the same validity to electronic signatures as standard signatures on a written contract.

The Act was prompted by the rise in online mortgage origination. It allows borrowers to obtain loans without ever leaving their homes. Certain documentation, however, such as foreclosure notices and foreclosure-related documentation, still require a standard signature.

A prospective borrower must supply a lender with his or her entire financial situation, including:

- Employment/Income

- Assets
- Account balances
- Debt obligations
- Debt-to-income ratio
- Down payment amount
- Loan-to-value (LTV) ratio

Loan-To-Value (LTV)

A **loan-to-value (LTV)** ratio is the value of a loan compared to the value of the property purchased with the loan. The higher the LTV percentage, the greater the risk is for a lender and the lower the likelihood a borrower will be approved for a loan.

If a borrower has an LTV of higher than 80%, he or she will be required to purchase private mortgage insurance.

Private Mortgage Insurance (PMI)

Private mortgage insurance (PMI) refers to an insurance coverage a borrower must purchase if his or her LTV is above 80% or he or she has less than 20% equity (i.e. less than 20% down payment).

PMI protects a lender against losses resulting from a borrower's default.

Once a borrower has paid down his or her debt and his or her LTV falls below 80%, the borrower can cancel the PMI.

Collateral

A lender requires a sizable down payment in order to minimize its risk. A large down payment ensures that a borrower has a vested interest in a property and provides a lender with cash collateral in the event that the borrower defaults.

A lender also requires a security instrument. A **security instrument** is collateral that secures a lender's financial investment when originating a mortgage loan.

Lenders hire licensed property appraisers to determine the current and projected value of the property for which a loan is being obtained. The property's appraised value serves as collateral for a lender's loan. If in the event that the borrower defaults on mortgage payments, the lender has the legal right to sell the collateral in order to recoup its losses.

A security instrument gives a lender partial interest in a property.

The most common forms of security instrument are:

- Mortgages
- Trust Deeds

Mortgages

A **mortgage** is a loan provided to a borrower by a lender in exchange for the borrower paying back the principal loan amount with interest. A borrower pledges a security instrument without giving a lender title or possession of a property. This is known as **hypothecation**.

Mortgage financing is at the cornerstone of residential real estate purchases. Without mortgage loans, most buyers would be unable to purchase a home.

Trust Deeds

A **trust deed** – also known as a deed of trust – transfers the title of a borrower's property to an independent third party in order to secure a loan that has been provided by a lender.

A trust deed involves three parties:

- A borrower (trustor)
- A lender (beneficiary)
- An independent third party (trustee)

The independent third party is typically an escrow company. An escrow company holds a trust deed on behalf of a lender until the mortgage on a property is paid off. It also administers payment collection, sends letters and bills, and answers borrower questions on behalf of a lender.

If a property owner/borrower pays off his or her mortgage, the escrow company releases the trust deed or deed of reconveyance and the borrower becomes the exclusive interest holder of the property.

A trust deed is the most common form of security for lenders, investors, and banks.

Trust Deeds vs. Mortgages

As both use a mortgage and a trust deed use real property as collateral to secure a loan, they are often used synonymously. The difference between the two lies in the parties involved, how a property is vested, and the foreclosure process.

A standard mortgage is between a borrower and a lender. A trust deed involves three parties: a borrower, lender, and third party.

With a mortgage, a borrower controls the title to a property. With a trust deed, a property's title is vested with the escrow company.

If a borrower falls behind on loan payments secured by a mortgage, a judicial foreclosure process must be used. If a borrower falls behind on loan payments secured by a trust deed, the escrow company is responsible for implementing the foreclosure process. This non-judicial foreclosure process is typically much faster and easier.

RECORDING REQUESTED BY:

WHEN RECORDED MAIL TO:

ORDER NO.
ESCROW NO.

SPACE ABOVE THIS LINE FOR RECORDER'S USE

SHORT FORM DEED OF TRUST AND ASSIGNMENT OF RENTS

APN: ______________

This Deed of Trust, made this ______________________, between ____

____

herein called **TRUSTOR**, whose address is ____,

____, a California Corporation, herein called **TRUSTEE**, and

____ herein called BENEFICIARY,

Witnesseth: That Trustor **IRREVOCABLY GRANTS, TRANSFERS AND ASSIGNS TO TRUSTEE IN TRUST, WITH POWER OF SALE**, that property in __________________ County, California, described as:

For complete legal description, additional terms and conditions, see exhibit "A" attached hereto.

TOGETHER WITH the rents, issues and profits thereof, SUBJECT, HOWEVER, to the right, power and authority given to and conferred upon Beneficiary by paragraph (10) of the provisions incorporated herein by reference to collect and apply such rents, issues and profits.

For the Purpose of Securing: 1. Performance of each agreement of Trustor incorporated by reference or contained herein. 2. Payment of the indebtedness evidenced by one promissory note of even date herewith, and any extension or renewal thereof, in the principal sum of $__________ executed by Trustor in favor of Beneficiary by order. 3. Payment of such further sums as the then record owner of said property hereafter may borrow from Beneficiary, when evidenced by another note (or notes) reciting it is so secured.

To Protect the Security of This Deed of Trust, Trustor Agrees: By the execution and delivery of this Deed of Trust and the note secured hereby, that provisions (1) to (14), inclusive, of the fictitious deed of trust recorded under date, in the book and at the page of Official Records in the office of the county recorder of the county where said property is located, noted below opposite the name of such county, viz.:

COUNTY	BOOK	PAGE	COUNTY	BOOK	PAGE	COUNTY	BOOK	PAGE	COUNTY	BOOK	PAGE
Alameda	435	684	Kings	792	833	Placer	895	301	Sierra	29	335
Alpine	1	250	Lake	362	39	Plumas	151	5	Siskiyou	468	181
Amador	104	348	Lassen	171	471	Riverside	3005	523	Solano	1105	182
Butte	1145	1	Los Angeles	T2055	899	Sacramento	4331	62	Sonoma	1851	689
Calaveras	145	152	Madera	810	170	San Benito	271	383	Stanislaus	1715	456
Colusa	296	617	Marin	1508	339	San Bernardino	5567	61	Sutter	572	297
Contra Costa	3978	47	Mariposa	77	292	San Francisco	A332	905	Tehama	401	289
Del Norte	78	414	Mendocino	579	530	San Joaquin	2470	311	Trinity	93	366
El Dorado	568	456	Merced	1547	538	San Luis Obispo	1151	12	Tulare	2294	275
Fresno	4626	572	Modoc	184	851	San Mateo	4078	420	Tuolumne	135	47
Glen	422	184	Mono	52	429	Santa Barbara	1878	860	Ventura	2062	386
Humboldt	657	527	Monterey	2194	538	Santa Clara	5336	341	Yolo	653	245
Imperial	1091	501	Napa	639	86	Santa Cruz	1431	494	Yuba	334	486
Inyo	147	598	Nevada	305	320	Shasta	684	528			
Kern	3427	60	Orange	5889	611	San Diego	Series 2, Book 1961, Page 183887				

FOR SIGNATURE(S) SEE SHORT FORM DEED OF TRUST SIGNATURE PAGE ATTACHED HERETO AND MADE A PART HEREOF.

SHORT FORM DEED OF TRUST SIGNATURE(S) PAGE

ORDER NO.
ESCROW NO.

(which provisions, identical in all counties, are printed on the reverse hereof) hereby are adopted and incorporated herein and made a part hereof as fully as though set forth herein at length; that he will observe and perform said provisions; and that the references to property, obligations, and parties in said provisions shall be construed to refer to the property, obligations, and parties set forth in this Deed of Trust.

The undersigned Trustor requests that a copy of any Notice of Default and of any Notice of Sale hereunder be mailed to him at his address hereinbefore set forth.

X______________________________ ______________________________
Signature of Trustor Print Name of Trustor

X______________________________ ______________________________
Signature of Trustor Print Name of Trustor

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached and not the truthfulness, accuracy, or validity of that document.

DATE:

STATE OF CALIFORNIA

COUNTY OF ____________________

On____________ before me, ____, a Notary Public, personally appeared____
____,

who proved to me on the basis of satisfactory evidence to be the person(s), whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s) or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature

______________________________ (Seal)

SHORT FORM DEED OF TRUST CONTINUED ON NEXT PAGE

EXHIBIT "A"

SHORT FORM DEED OF TRUST AND ASSIGNMENT OF RENTS

ORDER NO.
ESCROW NO.

The following is a copy of provisions (1) to (14), inclusive, of the fictitious deed of trust, recorded in each county in California, as stated in the foregoing Deed of Trust and incorporated by reference in said Deed of Trust as being a part thereof as if set forth at length therein.

To Protect the Security of This Deed of Trust, Trustor Agrees:

(1) To keep said property in good condition and repair, not to remove or demolish any building thereon, to complete or restore promptly and in good and workmanlike manner any building which may be constructed, damaged or destroyed thereon and to pay when due all claims for labor performed and materials furnished therefor, to comply with all laws affecting said property or requiring any alterations or improvements to be made thereon, not to commit or permit waste thereof, not to commit, suffer or permit any act upon said property in violations of law to cultivate, irrigate, fertilize, fumigate, prune and do all other acts which from the character or use of said property may be reasonably necessary, the specific enumeration's herein not excluding the general.

(2) To provide maintain and deliver to Beneficiary fire insurance satisfactory to and with loss payable to Beneficiary. The amount collected under any fire or other insurance policy may be applied by Beneficiary upon indebtedness secured hereby and in such order as Beneficiary may determine, or at option of Beneficiary the entire amount so collected or any part thereof may be released to Trustor. Such application or release shall not cure or waive any default or notice of default hereunder or invalidate any act done pursuant to such notice.

(3) To appear in and defend any action or proceeding purporting to affect the security hereof or the rights or powers of Beneficiary or Trustee, and to pay all costs and expenses including cost of evidence of title and attorney's fees in a reasonable sum, in any such action or proceeding in which Beneficiary or Trustee may appear, and in any suite brought by Beneficiary to foreclose this Deed.

(4) To pay at least ten days before delinquency all taxes and assessments affecting said property, including assessments on appurtenant water stock, when due, all encumbrances, charges and liens, with interest, on said property or any part thereof, which appear to be prior of superior hereto, all costs, fees and expenses of this Trust.

Should Trustor fail to make any payment or to do any act as herein provided, then Beneficiary or Trustee, but without obligation so to do and without notice to or demand upon Trustor and without releasing Trustor from any obligation hereof, may make or do the same in such manner and to such extent as either may deem necessary to protect the security hereof Beneficiary or Trustee being authorized to enter upon said property for such purposes; appear in and defend any action or proceeding purporting to affect the security hereof or the rights or powers of Beneficiary or Trustee, pay, purchase, contest or compromise any encumbrance, charge or lien which in the judgment of either appears to be prior or superior hereto, and in exercising any such powers, pay necessary expenses, employ counsel and pay his reasonable fees.

(5) To pay immediately and without demand all sums so expended by Beneficiary or Trustee, with interest from date of expenditure at the amount allowed by law in effect at the date hereof, and to pay for any statement provided for by law in effect at the date hereof regarding the obligation secured hereby any amount demanded by the Beneficiary not to exceed the maximum allowed by law at the time when said statement is demanded.

(6) That any award of damages in connection with any condemnation for public use of or injury to said property or any part thereof is hereby assigned and shall be paid to Beneficiary who may apply or release such moneys received by him in the same manner and with the same effect as above provided for disposition of proceeds of fire or other insurance.

(7) That by accepting payment of any sum secured hereby after its due date, Beneficiary does not waive his rights either to require prompt payment when due of all other sums so secured or to declare default for failure so to pay.

(8) That at any time or from time to time, without liability therefor and without notice, upon written request of Beneficiary and presentation of this Deed and said note for endorsement, and without affecting the personal liability of any person for payment of the indebtedness secured hereby, Trustee may reconvey any part of said property, consent to the making of any map or plot thereof, join in granting any easement thereon; or join in any extension agreement or any agreement subordinating the lien or charge hereof.

(9) That upon written request of Beneficiary state that all sums secured hereby have been paid, and upon surrender of this Deed and said note to Trustee for cancellation and retention and upon payment of its fees, Trustee shall reconvey, without warranty, the property then held hereunder. The recitals in such reconveyance of any matters or facts shall be conclusive proof of the truthfulness thereof. The grantee in such reconveyance may be described as "The person or persons legally entitled thereto". Five years after issuance of such full reconveyance, Trustee may destroy said note and this Deed (unless directed in such request to retain them).

(10) That as additional security, Trustor hereby give to and confers upon Beneficiary the right, power and authority, during the continuance of these Trusts, to collect the rents, issues and profits of said property, reserving unto Trustor the right, prior to any default by Trustor in payment of any indebtedness secured hereby or in performance of any agreement hereunder, to collect the rents, issues and profits of said property, reserving unto Trustor the right, prior to any default by Trustor in payment of any indebtedness secured hereby or in performance of any agreement hereunder, to collect and retain such rents, issues and profits as they become due and payable. Upon any such default, Beneficiary may at any time without notice, either in person, by agent, or by a receiver to be appointed by a court, and without regard to the adequacy of any security for the indebtedness hereby secured, enter upon and take possession of said property or any part thereof, in his own name sue for or otherwise collect such rents, issues and profits including those past due and unpaid, and apply the same, less costs and expenses of operation and collection, including reasonable attorney's fees. Upon any indebtedness secured hereby, and in such order as Beneficiary may determine. The entering upon and taking possession of said property, the collection of such rents, issues and profits and the application thereof as aforesaid, shall not cure or waive any default or notice of default hereunder or invalidate any act done pursuant to such notice.

(11) That upon default by Trustor in payment of any indebtedness secured hereby or in performance of any agreement hereunder. Beneficiary may declare all sums secured hereby immediately due and payable by delivery to Trustee of written declaration of default and demand for sale and of written notice of default and of election to cause to be sold said property which notice Trustee shall cause to be filed for record. Beneficiary also shall deposit with Trustee this Deed, said note and all documents evidencing expenditures secured hereby.

After the lapse of such time as may then be required by law following the recordation of said notice of default, and notice of sale having been given as then required by law, Trustee, without demand on Trustor, shall sell said property at the time and place fixed by it in said notice of sale, either as a whole or in separate parcels, and in such order as it may determine, at public auction to the highest bidder for cash in lawful money of the United States, payable at time of sale. Trustee may postpone sale of all or any portion of said property by public announcement at such time and place of sale, and from time to time thereafter may postpone such sale by public announcement at such time and place of sale, and from time to time thereafter may postpone such sale by public announcement at the time fixed by the preceding postponement Trustee shall deliver to such purchaser its deed conveying the property so sold, but without any covenant or warranty, express or implied. The recitals in such deed of any matters or facts shall be conclusive proof of the truthfulness thereof. Any person, including Trustor, Trustee, or Beneficiary as hereinafter defined, may purchase at such sale.

After deducting all costs, fees and expenses of Trustee and of this Trust, including cost of evidence of title in connection with sale, Trustee shall apply the proceeds of sale to payment of all sums expended under the terms hereof, not then repaid, with accrued interest at the amount allowed by law in effect at the date hereof, all other sums then secured hereby, and the remainder, if any, to the person or persons legally entitled thereto.

(12) Beneficiary, or any successor in ownership of any indebtedness secured hereby, may from time to time, by instrument in writing, substitute a successor or successors to any Trustee named herein or acting hereunder, which instrument, executed by the Beneficiary and duly acknowledged and recorded in the office of the recorder of the county or counties where said property is situated, shall be conclusive proof of proper substitution of such successor Trustee or Trustees, who shall, without conveyance from the Trustee predecessor, succeed to all its title, estate, rights, powers and duties. Said instrument must contain the name of the original Trustor. Trustee and Beneficiary hereunder, the book and page where this Deed is recorded and the name and address of the new Trustee.

(13) That this Deed applies to, inures to the benefit of, and binds all parties hereto, their heirs, legatees, devisees, administrators, executors, successors and assigns. The term Beneficiary shall mean the owner and holder, including pledges, of the note secured hereby whether or not named as Beneficiary herein in this Deed, whenever the context so requires, the masculine gender includes the feminine and/or neuter, and the singular number includes the plural.

(14) That Trustee accepts this Trust when this Deed, duly executed and acknowledged and is made a public record as provided by law. Trustee is not obligated to notify any party hereto of pending sale under any other Deed of Trust or of any action or proceeding in which Trustor, Beneficiary of Trustee shall be a party unless brought by Trustee.

SHORT FORM DEED OF TRUST CONTINUED ON NEXT PAGE

SHORT FORM DEED OF TRUST AND ASSIGNMENT OF RENTS
DO NOT RECORD

ORDER NO.
ESCROW NO.

REQUEST FOR FULL RECONVEYANCE

To be used only when note has been paid:

To________________________, Trustee

Dated ________________________

The undersigned is the legal owner and holder of all indebtedness secured by the within Deed of Trust. All sums secured by said Deed of Trust have been fully paid and satisfied; and you are hereby requested and directed, on payment to you of any sums owing to you under the terms of said Deed of Trust, to cancel all evidences of indebtedness, secured by said Deed of Trust, delivered to you herewith together with said Deed of Trust, and to reconvey, without warranty, to the parties designated by the terms of said Deed of Trust, the estate now held by you under the same.

____

____

By ________________________

By ________________________

MAIL RECONVEYANCE TO:

____

____

____

____

ALL SIGNATURES TO THIS DOCUMENT MUST BE NOTARIZED

Do not lose or destroy this Deed of Trust OR THE NOTE which it secures. Both must be delivered to the Trustee for cancellation before reconveyance will be made.

Mortgages

Promissory Note

A **negotiable instrument** is a document that guarantees a borrower's payment of debt to a lender. A negotiable instrument provides legal proof of a borrower's debt and a promise to pay it back by a specific date.

The most common negotiable instrument is a promissory note.

A **promissory note** – also known simply as a "note" – is a document that contains a written record of the sum a borrower owes to a lender. In short, it is a "promise" to pay back a loan through monthly mortgage installments.

A note protects the interests of a lender by establishing a clear record of debt.

A promissory note must be made in writing and signed by both a borrower and a lender.

Generally, a note includes:

- Principal loan amount
- Payment terms, including the amount that must be paid to stay current on the note and options on how to pay it off
- The date by which a loan must be paid off

A promissory note holder has the right to sell or transfer a note at will. If a note is transferred, the new note holder is known as a **transferee**. A transferee does not have the right to alter the terms of the original note, however.

Example

Question: Jon and his wife Samantha buy a home. They paid the full purchase price of the home in cash. Jon and Samantha subsequently find a great investment property that they wish to purchase. Lacking the funds, Jon asks his mother for a loan of $200,000. His mother wants 5% interest on the money borrowed and wants to use Jon and Samantha's primary residence as collateral. John and Samantha agree and borrow the money.

Jon's mother later sells the loan's promissory note to her sister, Mary. Mary quickly discovers that current market interest rates are above 7%. She decides to increase Jon and Samantha's interest rate to 7.5%. Can Mary do this?

Answer: *No. When an investor buys a promissory note, they cannot change the original terms of the loan. Unless Jon's mother had indicated there would be future rate increases in the original agreement, Mary cannot raise the interest rates. Therefore, Jon and Samantha only have to pay the original 5% interest rate until the loan is paid off.*

Holder in Due Course

A **holder in due course** refers to a party who purchases mortgage debt through a negotiable instrument. In other words, a holder in due course is a party that purchases mortgage debt from another lender. As the holder in due course, the buyer of the mortgage debt has the right to collect interest on the loan and foreclose on the property if the borrower fails to make the agreed upon payments.

For example, assume Neena is a private lender that invests in mortgages. She currently is the lender of ten mortgages. She wishes to sell four mortgages to free up her capital to invest in new mortgages. Shaun agrees to purchase four of Neena's mortgages. As the buyer of the Neena's mortgages, Shaun becomes the holder in due course.

It is common for lenders to sell mortgage debt to interested buyers prior to a borrower's default on the debt. The debt is usually sold for less than the principal loan amount. A lender sells mortgage debt to recoup its losses and protect its financial interests.

A holder of due course who purchases a negotiable instrument is subsequently entitled to the defaulting borrower's future payments.

A holder in due course may purchase a negotiable instrument:

- For face value ("value of the day")
- In good faith (not likely)

A holder in due course must purchase debt in good faith and under the assumption that the negotiable instrument has no defects or negative claims.

Valid defenses against a holder in due course include:

- *Incapacity*: The seller of the debt lacked the capacity to sell the debt
- *Illegal*: The transfer of the debt was illegal
- *Forgery*: The transferee was forged and not the intent of the maker or payee
- *Alteration*: Alteration of the terms of the sale without the approval of either party is illegal and serves as a valid defense

Sample Promissory Note

For value received, the undersigned jointly and severally promise to pay to the order of ______________________________, the sum of $__________________, together with interest thereon at the rate of ______ % per annum on any unpaid balance.

Said sum, inclusive of interest, shall be paid in installments of $____________ each, with a first payment due __(Date)__, and the same amount on the same day of each (month/week) thereafter until the full principal amount of this note and accrued interest is fully paid. All payments shall be first applied to earned interest and the balance to principal. The undersigned may prepay this note in whole or in part without penalty.

This note shall be fully payable upon demand of any holder in the event the undersigned shall default in making any payments due under this note within __________ days of its due date. In the event of any default, the undersigned agree to pay all reasonable attorney's fees and costs of collection to the extent permitted by law.

This note shall take effect as a sealed instrument and be enforced per the laws of the payee's state. All parties to this note waive presentment, demand, protest, and all notices thereto, and agree to remain fully bound notwithstanding any extension, indulgence, modification or release or discharge of any party or collateral under this note.

Signed under seal this __(Date)__ By: ________________________

In the presence of:

____

____

ALL-INCLUSIVE PURCHASE MONEY PROMISSORY NOTE SECURED BY LONG FORM / ALL-INCLUSIVE PURCHASE MONEY DEED OF TRUST (STRAIGHT NOTE)

DO NOT DESTROY THIS ORIGINAL NOTE

When paid, this original Note, together with the Deed of Trust securing it, must be surrendered to Trustee for cancellation, before reconveyance will be made.

$____________ ________________ ____________________

On or before ____________________ for value received, I/We ("Maker") promise to pay to____("Payee") or order, at __________________________________, the principal sum of ________________________ Dollars ($______________) with interest on the unpaid principal amount from ____________________, at the rate of ____________ Percent (________%) per annum Monthly. Payments shall be applied first on the interest then due and the remainder on principal; and interest shall thereupon cease upon the principal so credited.

The total principal amount of this Note includes the unpaid principal balance of the promissory note(s) ("Underlying Note(s)") secured by Deed(s) of Trust, more particularly described as follows:

1. Promissory Note executed by ____________________________________
   as maker in favor of __________________________________ as
   payee,
   with an original amount of ________________________________ Dollars
   ($____________)
   secured by a deed of trust dated ______________ and recorded on ______________,
   as ______________________________________, in ____________
   County, State of California.

PREPAYMENT OF PRINCIPAL WITHOUT PENALTY: Payor shall have the privilege to prepay this note in full, or in part, at anytime without penalty. Payment(s) shall first apply to interest then due and the balance to principal. Interest shall cease to accrue on any principal paid as of date of payment thereof. Interest only payments, if applicable, shall thereafter adjust accordingly.

Payment shall be in lawful money of the United States, and when received by payee shall first be applied to accrued interest and then upon the principal balance of this note, and shall thereupon, be paid upon such included notes in the amount of such installments of the included notes due or becoming due prior to the next installment date hereon.

ALL-INCLUSIVE PURCHASE MONEY PROMISSORY NOTE SECURED BY LONG FORM ALL-INCLUSIVE PURCHASE MONEY DEED OF TRUST (STRAIGHT NOTE)

(continued)

Any prepayment of all or any portion of the unpaid balance permitted under the terms of this note may be made upon the written requirement by maker that payee prepay a proportionate amount of the unpaid balance of the included notes, if such included notes can be prepaid, provided however that any such obligation of payee shall be conditioned upon the payment by maker of any additional amount required by payee(s) of the included notes as a penalty or consideration for such prepayment.

Maker shall pay to payee in addition to the installments above set forth such additional amounts as may be required by payee(s) of the included notes for tax or insurance premium impound accounts. Such additional amounts received by the payee hereof shall be paid to the payee of the included note maintaining such impound account. Any refund to payee hereof or application of any amount from such impound account upon the principal balance or accrued interest of such included note, shall be refunded to maker or credited upon this note in like amount and manner.

Should payee fail to pay any installments when due upon any included notes as provided herein, maker may make such payments directly to payee of the included notes, any amount so paid shall be credited to the next following installment or installments due under this note. Any reduction in the unpaid principal balance or payment of accrued interest of the included notes, other than by payment thereupon by payee, such as by payment from an award in eminent domain, or of proceeds of insurance, shall be credited to the unpaid balance and interest hereon in like amount.

Should default be made in the payment by maker when due, the whole sum of principal and interest after first deducting therefrom all sums then due under the terms of the included note(s) shall become immediately due at the option of the payee of this note. Upon any such default by maker, any payment made by payee to prevent or cure a default in the included note(s) shall be added to the then unpaid balance of this note except such amount that is credited upon the principal balance of such included note.

At any time when the total of the unpaid balance of this note, accrued interest thereon, all other sums due pursuant to the terms hereof, and all sums advanced by payee pursuant to the terms of the deed of trust securing this note, is equal to or less than the unpaid principal balance of the included note(s) and accrued interest thereon, at the request of the maker of his successor in interest, this note shall be cancelled and delivered by payee to maker together with a request for full reconveyance of the deed of trust securing this note.

ALL-INCLUSIVE PURCHASE MONEY PROMISSORY NOTE
SECURED BY LONG FORM
ALL-INCLUSIVE PURCHASE MONEY DEED OF TRUST
(STRAIGHT NOTE)

(continued)

If action be instituted of this note, maker promises to pay such sums as the court may fix as attorneys' fees. This note is secured by an all-inclusive deed of trust to Fidelity National Title Company, a California corporation, as Trustee.

MAKER

____

The undersigned payee agrees that so long as there is no uncured default by the maker of this note in the payment of obligations set forth herein or in the obligations secured by the deed of trust securing this note:

1. To pay the installments of principal and interest as they become due on the included note or notes, and
2. To secure and cause to have recorded a reconveyance of the deed(s) of trust securing the included note(s) prior to or upon the payment in full of the principal balance and interest accrued upon this note.

PAYEE

____

NOTE: YOU ARE CAUTIONED THAT THIS DOCUMENT CREATES LEGAL RIGHTS AND DUTIES. IF YOU DESIRE LEGAL ADVICE, CONSULT YOUR ATTORNEY.

Calculating a Mortgage Payment

The **principal** loan amount refers to the underlying debt a borrower takes on. The interest rate is the percentage a lender charges on the principal amount.

In order to calculate mortgage payments, interest, and others begin by using the following equation:

Principal loan amount X interest rate = **Total Interest**

This equation is then used to find the mortgage payment.

Calculating Interest and Mortgage Payments

Explanation: Convert the interest rate into a decimal by dividing the interest rate by 100. Multiply this figure by the loan amount and multiply this by the number of years on the mortgage program and you get the total interest. Add the total interest plus the original loan amount and you have the total amount of money due at the end of term including principal and interest.

If you want to calculate the monthly mortgage payment divide the total principal plus interest and divide this by the number of total months on the mortgage.

Example

Loan Amount: $100,000 with an interest rate of 3.875% on a 30-year mortgage.

Equation:
$A = P(1 + rt)$

Calculation:
First, converting R percent to a decimal
$r = R/100 = 3.875\%/100 = 0.03875$ per year

Solving our equation:
$A = 100000(1 + (0.03875 \times 30 \text{ years})) = \$216,250$
$A = \$216,250.00$

The total amount accrued, principal plus interest, from simple interest on a principal of $100,000.00 at a rate of 3.875% per year for 30 years is $216,250.00. The interest on the loan is $116,250. The $216,250 number is derived from adding the original loan amount ($100,000) and multiplying it by $116,250 in interest accrued over a 30 year period.

Example

Say Bob has a principal loan amount of $200,000. The interest rate on the loan is 7%. In order to calculate his monthly interest payment, he would use the following equation:

$200,000 x 7% (0.07) = $14,000

$14,000 / 12 = $1,166 monthly interest

$14,000 / 365 = $38.36 daily interest

Say Bob wants to refinance that loan within 90 days when interest rates are lower. If he wanted to calculate how much he would pay in interest for the initial 90 days, he would use the following equation:

$38.36 x 90 = $3,452.06 for 90 days of interest

Types of Mortgage Payments

Amortization

Amortization refers to a borrower paying down the principal loan amount plus interest with fixed, equal payments on a specified schedule.

An amortization schedule determines how many installments are necessary to pay off the full loan amount, as well as how much of each payment goes towards the principal loan amount and how much goes towards the interest payment.

- *Fully Amortized:* Payment schedule that pays off the principal and interest at the same time.
- *Partially Amortized:* Payment schedule with periodic principal and interest payments in a shorter time period than is necessary to pay off the loan. Most of

the principal balance will be paid at the conclusion of the loan as a balloon payment.

- *Non-Amortized:* Pays only the interest while the principal balance remains the same.

Negative Amortization

Negative Amortization – also known as deferred interest – refers to when a borrower fails to pay interest due on the loan and the unpaid interest is added to the principal loan amount.

Balloon Payment

A **balloon payment** is a type of mortgage payment in which only a portion of the principal loan amount is amortized over the loan term, leaving the borrower with a large payment at the term's completion.

Borrowers who obtain mortgages with a balloon payment structure typically refinance prior to the loan's maturation to avoid the balloon payment.

Straight Note

A **straight note** payment structure only requires a borrower to pay interest on a loan. A borrower must pay the full principal loan amount as a lump sum at the end of the loan term, however.

Other Mortgage Provisions

Lock-In Clause

A **lock-in clause** is a mortgage provision that prevents a borrower from prepaying, refinancing, or paying off a loan for a specified period of time. Typically, lock-in clauses are for the initial seven years of a mortgage.

Lenders provide loans to borrowers with the expectation that they will make a certain amount of interest on those loans. No lender wants to put time and resources into approving a borrower, only to have that borrower refinance with another lender at a lower interest rate soon after.

A lock-in clause ensures that a loan will be kept active for a certain period of time and that a lender will make a minimum amount of interest during that period.

Prepayment Penalty

A **prepayment penalty** is a mortgage provision that triggers a lump sum charge in the event that a borrower chooses to refinance a loan or sell a property within the penalty period.

Acceleration Clause

An **acceleration clause** allows a lender to "accelerate" its debt collection when a borrower fails to meet his or her debt obligations.

These are typically used when a borrower sells or transfers his or her property. In this case, a seller's full loan amount is due upon the sale or transfer of the property.

Acceleration clauses do not trigger automatically; rather, they are a result of a borrower missing multiple mortgage payments, failing to pay property taxes or mortgage insurance, or using a property for an illegal purpose.

For example, James agrees to sell his property to Bill using seller financing with an acceleration clause. The conditions of the seller financing are that Bill pays $10,000 a month for 12 consecutive months. Bill agrees. Bill pays $10,000 a month for six straight months. At this point, however, he loses his job and he struggles to make the next two mortgage payments. This triggers the agreement's acceleration clause. The clause requires Bill to pay the entire principal amount within a 30-day period or be subject to losing the property and his already invested $60,000.

Subject To

Subject to refers to when a buyer purchases a seller's property "subject to" the existing mortgage already in place on the property. In this case, the original terms of a seller's mortgage stay the same, including the name in which the loan was purchased.

Consequently, a buyer assumes control of a property's title, including all previous mortgages, liens, and encumbrances on the property.

Joint and Severe Liability Clause

When more than one individual signs onto to a loan, a mortgage may include a joint and severe liability clause. A **joint and severe liability clause** – which uses the words "jointly" or "as joint borrowers" – indicates that both the primary signer and the co-signer are responsible for the financial obligation of the loan. This means that the mortgage loan will be recorded on both borrowers' credit reports.

A joint and severe liability clause allows lenders to go after a loan's co-signer in the event that the primary borrower defaults on mortgage payments.

Mortgage Types

Leveraging

Leveraging refers to when a borrower uses the equity in his or her current property to obtain a loan, typically in the form of a second mortgage. If the property is paid off, leveraging will be used to get a first mortgage. Oftentimes, leveraging is used by property owners to cash out on their equity to purchase another property.

Homeowners can leverage the equity in their property at any time. They can take out a loan against the property to fund a business, or sell and profit from the difference between the original loan amount and property's sale price.

Example

The Manson family buys a home in 1998 for $200,000 with a $40,000 down payment. The Manson family then remodels the home, leveraging the $40,000 in equity to do so. The renovations increase the home's value to $300,000. Over the course of ten years, market trends drive the home's value up further. By 2013, the home is worth $1 million. The Manson family's initial investment of $40,000 allowed them to generate over $800,000 in equity, while simultaneously giving them a place to live.

At this point, the Manson family decides to take out a $90,000 loan against their home's equity to start a new business. Without the initial loan in 1998, the Manson family would never have been able to buy the home, let alone accumulate equity and start a new business. This shows the benefits of being a homeowner and having property equity.

Fixed-Rate Mortgage

A **fixed-rate mortgage** is a loan in which the interest rate remains "fixed" for the entire life of the loan, even if the Federal Reserve raises the index rate. Consequently, fixed-rate mortgage payments never increase. This allows borrowers to make consistent monthly payments on a predetermined payment schedule.

Fixed-rate mortgages are the most common type of mortgage in the United States.

Fixed interest rates provide an attractive alternative to the fluctuations of adjustable-rate mortgages and produce security in an otherwise unpredictable mortgage market.

Adjustable-Rate Mortgage (ARM)

Unlike a fixed-rate mortgage, an **adjustable-rate mortgage (ARM)**'s interest rates adjust at predetermined periods during the life of the loan. Interest rates adjust based on the Federal Reserve's index rate or the agreed-upon conditions between a borrower and a lender.

If interest rates drop during an adjustment period, a borrower can refinance his or her loan at a lower interest rate and pay less on his or her monthly mortgage payment. If interest rates rise, however, a borrower must refinance at a higher interest rate and pay more.

Renegotiable-Rate Mortgage

A **renegotiable-rate mortgage** – also known as a rollover loan – offers fixed interest rates for a set period of time. Upon the expiration of the fixed term (typically 3-5 years), borrowers have the ability to refinance the loan directly with the lender or apply for a loan with another lender.

Reverse Annuity Mortgage (RAM)

A **reverse annuity mortgage (RAM)** – known simply as a reverse mortgage – is a program designed for seniors. It allows a homeowner to use the equity in his or her home to make monthly mortgage payments.

In this case, the lender is responsible for paying the mortgage. Upon the death of the borrower, the title of the property is transferred to the lender.

Interim Loan

An **interim loan** is a short-term loan that typically comes with a higher interest rate. A borrower may use an interim loan if he or she cannot qualify for a conventional loan or needs immediate access to a mortgage.

One example of an interim loan is a construction loan.

Construction Loan

A **construction loan** provides capital to a property owner for the purpose of developing land. Such loans are typically short-term, between one to three years.

Construction loan funds are typically paid out as a property is being built. A lender will impose a draw schedule that determines the stages at which more construction funds can be dispersed.

As an undeveloped property isn't worth much in terms of collateral, a lender will typically charge higher interest rates than standard mortgages in order to protects its interests.

After a borrower has developed a property with a construction loan, the property's value increases. This means that it is a better form of collateral for a lender. Therefore, a lender will allow a borrower to replace an interim loan with a long-term loan at a lower interest rate. This is known as a **take-out loan**.

Buyers of commercial properties can get a **standby commitment**, which is an agreement signifying a lender's intent to give a future loan. To get a standby commitment, a buyer will usually pay a **standby fee**.

Open-Ended Mortgage

An **open-ended mortgage** – also known as an open-end trust deed – allows a borrower to increase his or her loan amount at a future time if certain loan qualifications are met.

Such a loan permits a borrower to mortgage additional money from his or her equity without applying for another mortgage.

Seller Financing

In periods of slow economic growth, high interest rates, and difficult loan qualification standards, sellers may implement creative financing methods to incentivize buyers to purchase their property.

Purchase-Money Mortgage

A **purchase-money mortgage** – also known as a purchase-money trust deed – is a loan provided by a seller to a buyer to cover all or a portion of a property's purchase price.

A seller may offer a purchase-money mortgage with lower interest rates or a lower down payment requirement than standard lenders. This gives more buyers the ability to purchase the property.

Land Contract

In a **land contract** – also known as an installment sales contract – a seller provides financing to a buyer, but does not sign over the property deed until the buyer makes all agreed-upon payments.

Under this type of loan, a buyer agrees to pay back a seller in installments. This typically includes a balloon payment that reduces the length of the loan term. As a buyer pays down the principal loan amount, the buyer increases his or her equity and diminishes a seller's interest in the property.

A land contract is typically used to provide short-term seller financing for buyers who cannot qualify for a standard loan. Most times, once a loan is close to being paid off or when a buyer has improved his or her ability to meet a traditional lender's loan qualifications, the buyer will refinance with a conventional loan and terminate the land contract.

A land contract is written by a buyer and a seller. Consequently, they may feature any terms to which both parties agree, such as interest-only, PITI payments, negative amortization, or balloon payments.

Wraparound Mortgage

A **wraparound mortgage** – also known as an overriding trust deed, all-inclusive trust deed (AITD), or simply a "wrap" – is a type of creative seller financing whereby a seller grants a buyer the right to purchase a property with the existing mortgage on the property.

In other words, a seller maintains a property's current mortgage, but transfers mortgage liability to a buyer. A buyer makes mortgage payments directly to a seller and the seller subsequently pays them the lender.

A wraparound mortgage allows a buyer to take advantage of a seller's existing mortgage's terms, such as a low interest rate. However, a seller also has the right to charge his or her own interest rate for providing the wraparound mortgage.

A buyer must pay the difference between the existing loan amount and the final sale amount. This essentially acts as the buyer's down payment.

In the event that a buyer does not make the agreed-upon payments, a seller has the right to foreclose on the property.

A wrap is common for buyers who cannot obtain traditional financing. A buyer may use a wrap until he or she has the ability to qualify for the standard mortgage.

For example, the Meyers list their property for sale. However, interest rates increase dramatically over the next six months and make the cost of ownership substantially higher. The Meyers have little to no luck attracting buyers. The Meyers may agree to provide a buyer with a wraparound mortgage in order to give him or her the ability to purchase the property.

Mortgage Assumption

Mortgage assumption refers to when a seller transfers all mortgage loan terms and conditions to a buyer upon the buyer's purchase of the seller's property.

Put simply, the buyer "assumes" the seller's loan and the seller is released from further mortgage obligations.

A seller might offer mortgage assumption in order to avoid a buyer going through a lengthy loan approval process. A seller may also offer mortgage assumption when current interest rates are higher than the interest rate on the seller's original loan to entice wary buyers with a lower interest rate.

The state of California has determined that all loans are assumable, except when it increases a lender's financial risk. However, many lenders may prevent a seller from transferring a loan to a buyer by adding a due on sale clause to the mortgage.

Due on Sale Clause

A **due-on-sale clause** is a mortgage provision that requires a borrower to repay the full principal loan amount plus interest upon the sale or transfer of the property.

Such a clause prevents a seller from transferring his or her mortgage to a buyer via seller financing or a wraparound trust deed. A buyer who assumes a seller's mortgage is not pre-qualified using a lender's specific standards. Therefore, the borrower has a higher likelihood of defaulting on the loan. Lenders use due-on-sale clauses to protect their financial investment.