UNIT

12

RESIDENTIAL MORTGAGES

LEARNING OBJECTIVES

When you have completed this unit, you will be able to accomplish the following.

- Describe the mortgage instrument and the promissory note.
- Distinguish between title theory and lien theory.
- Describe the essential elements of the mortgage instrument.
- Describe the various features of a mortgage, including down payment, loan-to-value ratio, equity, interest, loan servicing, escrow account, PITI, discount points, and loan origination fee.
- Calculate the loan-to-value ratio, explain the use of discount points, and calculate the approximate yield on a loan.
- Explain assignment of mortgage and the purpose of an estoppel certificate.
- Distinguish among the various methods of purchasing mortgaged property.
- Explain the foreclosure process, distinguish between judicial and nonjudicial foreclosure, and describe the mortgagor's and mortgagee's rights in a foreclosure.

KEY TERMS

acceleration clause
assignment of mortgage
assumption
blanket mortgage
buydown
contract for deed (land contract)
deed in lieu of foreclosure
default
defeasance clause
discount points
due-on-sale clause
equity
equity of redemption
escrow
estoppel certificate
first mortgage
foreclosure
hypothecation
interest
land development loan
lien theory
lis pendens
loan origination fee
loan servicing
loan-to-value ratio (LTV)
mortgage
mortgagee
mortgagor
note
novation agreement
partial release clause
PITI
prepayment clause
prepayment penalty
receivership clause
right to reinstate
satisfaction of mortgage
short sale
subject to
subordination agreement
takeout commitment
title theory

INTRODUCTION

This unit is an introduction to residential mortgages. Because most real property transactions involve some type of financing, real estate licensees must understand this aspect of the business.

12.1 LOAN INSTRUMENTS

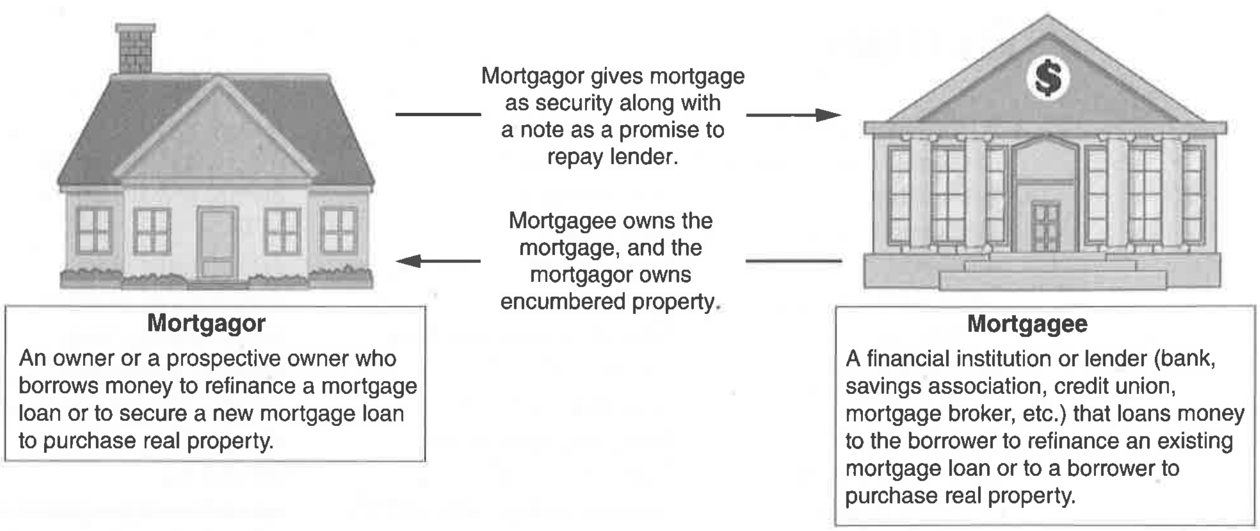
An important part of purchasing a home is to find a lender that will finance the purchase. Some buyers are fortunate enough to pay cash for their purchase; however, the typical buyer must secure financing for the purchase. The lender will require the borrower to sign two legal documents: (1) a mortgage and (2) a promissory note.

Mortgage

A **mortgage** is an instrument that pledges the property as security (collateral) for the debt. It is the legal document that, when recorded, creates a lien on the real estate that secures the debt. A mortgage specifies the procedure that will be followed if the borrower doesn't repay the loan. For the lender, the property becomes security to ensure recovery of the loan. **Hypothecation** refers to the pledging of property as security for repayment of a loan without surrendering possession of the property. Mortgages identify the property being used to secure a loan and contain the borrower's promises to fulfill certain other obligations to the lender. A mortgage instrument must be in writing to be enforceable. The mortgage is recorded to establish constructive notice of the lien and to establish priority ahead of subsequent liens (see "Notice of Legal Title," Unit 9).

Parties to a Mortgage. There are two parties to a mortgage: (1) the **mortgagor**, or borrower (debtor), and (2) the **mortgagee**, or lender (creditor). The mortgagor owns the property, and the mortgagee owns the mortgage. A mortgage is regarded as an investment or chattel (personal property) by the mortgagee and, like other such investments, may be sold to another investor if desired (see Figure 12.1).

FIGURE 12.1 ■ Mortgage Financing



TO REMEMBER: MORTGAGOR VS. MORTGAGEE

Borrower (mortgagor) **receives** the money to finance the property.

Hint: There are two Os in borrower and mortgagor.

Lender (mortgagee) **provides the money**; the mortgage instrument, when recorded, creates a lien on the property.

Hint: There are two Es in lender and mortgagee.

Promissory Note

673.1041, F.S.

The second part of the home loan process involves the promissory note. A **note** is a legal instrument that serves as evidence of a debt. A note is a promise to repay the debt, and it makes the borrower personally liable for repayment of the obligation. Think of the note as an IOU for the money borrowed to purchase the home. Recall that the borrower has signed a mortgage instrument that is recorded by the lender to create a lien on the property. Because the buyer also signs a promissory note, if the collateral pledged in the mortgage is sold in foreclosure and the proceeds are not sufficient to cover all that is due from the borrower, the lender can sue the borrower for the remaining unpaid balance. The note is usually a separate legal instrument and must be signed by the borrower. The note is not witnessed nor is it usually recorded. A promissory note (or simply note) must accompany all mortgages in Florida.

Download the Fannie Mae/Freddie Mac Uniform Florida Fixed-Rate Note for single-family property at https://sf.freddiemac.com/tools-learning/uniform-instruments/2021-updated-instruments (scan QR code).

16

The note provides the financial details of the loan's repayment:

- **Amount of debt.** In return for the loan, the borrower promises to pay to the lender the amount of the loan, called the principal, plus interest.
- **Interest rate.** Interest is charged on the unpaid principal until the full amount of the principal has been repaid. Interest rates are stated as yearly (annual) rates.
- **Repayment method.** The amount of the monthly payment and the due date are indicated. The monthly payment consists of principal and interest (also called debt service). The payment is applied to interest before principal.
- **Term or time period to repay.** The date that the loan ends (has been fully repaid) is called the maturity date.
- **Borrower's failure to pay as required.** The borrower agrees to pay a late charge if the monthly payments are paid late. The lender also warns the borrower that if the payments are not paid in full each month on the due date, then the borrower will be in default. If the borrower defaults (violates the terms of the mortgage), the lender can *call* the loan (demand repayment of the entire loan before the end of the term).

Mortgage Lien Priority

When a mortgage loan is recorded in the public records, it becomes a lien on the real property. A lien is a right to have property sold to satisfy a debt. The mortgage lien is a *voluntary lien* created by the property owner in exchange for financing. Generally, the priority of a lien is determined by its recording date; however, there are a few exceptions. Property tax liens, for example, have automatic superiority over prior liens (see "Liens," Unit 9).

The first mortgage to be recorded is the **first mortgage**. The first mortgage is usually the loan used to purchase the property. If the property owner later executes another mortgage without paying off the first mortgage, the mortgage for the new financing becomes a second mortgage when it is recorded. The date and the time of day establishes the priority. Whether a recorded mortgage lien is a first mortgage, second mortgage, or third mortgage, and so on, it has priority over all subsequently recorded mortgages (mortgage instruments recorded at a later date).

When there is more than one lien on a property, the priority of liens determines the order in which the liens will be paid if the property is sold in a foreclosure sale, unless a higher priority lien is subordinated to subsequent liens. A separate **subordination agreement** (or subordination clause in a mortgage) is used when a mortgage that has been recorded earlier takes a lower lien priority to a mortgage that is recorded later.

EXAMPLE: Homeowners have a first mortgage on their home for $350,000 at 5% interest. The homeowners would like to refinance with a lower interest rate loan. They also have a second mortgage on their home for $50,000 that they used to remodel their kitchen. The homeowners would like to pay off the existing first mortgage of $350,000 with a new mortgage at 3% interest. Without a subordination agreement, the $50,000 second mortgage would now be in first position (a first mortgage). In the event of foreclosure, because the $50,000 loan was recorded at an earlier date than the new lower rate $350,000 mortgage loan, the $50,000 lien would take priority over the larger $350,000 mortgage lien. The lender that is refinancing the $350,000 loan would never agree to this arrangement. The only way to arrange refinancing is for the second mortgage holder to agree to *subordinate* the priority and allow the new lender to be in the first position. Because refinancing is common practice in the lending industry, most second mortgages (junior mortgages) will contain a *subordination clause*.

Satisfaction of Mortgage

701.04(2), F.S.

85

On that joyous occasion when the mortgagor pays the debt in full, the mortgagee executes a **satisfaction of mortgage** (or a *release of mortgage*). Florida statute requires that the mortgagee cancel the mortgage and send the recorded satisfaction to the mortgagor within 60 days. This document returns to the mortgagor all interest in the real property that had been conveyed to the mortgagee. Recording the satisfaction of mortgage in the public records shows that the mortgage lien has been removed.

Practice Questions

1. List the two parties to a mortgage, along with their common names.

   1. ______________________________

   2. ______________________________

2. The legal instrument that contains the amount of the debt, interest rate, and repayment provisions is called a ______________.

3. A mortgage is the instrument that pledges the property as ______________ for the debt.

4. The mortgagor gives a mortgage as security to the ______________.

12.2 MORTGAGE LAW

Lien Theory

697.02, F.S.

Today, most states, including Florida, are **lien theory** states. The *borrower* retains title to the property. The lender is protected with a lien on the real property to secure the payment of the mortgage debt. If the borrower defaults on the mortgage debt, the lender will foreclose to recover the money owed.

Title Theory

4

43

In some states, title to the mortgaged property is conveyed to the *lender* through a mortgage deed or to a trustee through a deed of trust. This mortgage theory is called **title theory**. If the borrower defaults, the lender may take possession of the property. The borrower retains equitable title to the property. Once the debt is paid in full, the lender conveys legal title to the borrower (see "Legal vs. Equitable Title to Real Property," Unit 9).

Practice Questions

5. In a ___________ theory state, the borrower or ______________ retains title to the property.

12.3 ESSENTIAL ELEMENTS OF THE MORTGAGE INSTRUMENT

Borrower's Covenants and Agreements

A mortgage is a contract between the mortgagor (borrower) and the mortgagee (lender). Because the mortgage instrument is a contract, it must contain the essential elements of a contract to be valid (see "Essential Elements of a Contract," Unit 11). Conventional mortgage lenders in Florida commonly use the Fannie Mae-Freddie Mac Single-Family Uniform Mortgage Instrument.

The first section of the Uniform Mortgage Instrument defines mortgage-related terms and indicates the date, name of the mortgagor, name of the mortgagee, mortgagee's address, and the property address. The mortgage instrument also references the promissory note and indicates the date the note was executed and the dollar amount of the note. The instrument provides for the borrower's signature and place for notarizing the instrument.

The next section of the uniform instrument contains *uniform covenants*. In this section, the borrower and the lender covenant (promise) and agree to certain conditions. An explanation of the most important covenants follows.

To download a copy of the mortgage instrument, go to https://sf.freddiemac.com/content/_assets/resources/doc/uniform-instruments/3010-floridamortgage.doc (scan QR code).

Promise to Repay. The borrower (mortgagor) promises to pay principal and interest according to the terms of the note. The mortgagor also agrees to pay escrowed items, prepayment charges, and late fees, if applicable.

Taxes and Liens. The borrower agrees to pay all taxes, assessments, and fines that could create a lien with superior priority over the mortgage (security) instrument. This clause also stipulates that the mortgagor will pay community association dues, if applicable.

Property Insurance. The mortgagor promises to keep the property insured against loss by fire and hazards included in an *extended coverage* policy. The lender may require the mortgagor to pay a one-time charge for flood zone determination and, if applicable, flood insurance coverage. If the borrower fails to maintain hazard insurance, the lender may obtain insurance coverage, at the lender's option, and charge the borrower for the expense.

Occupancy. The borrowers agree to use the property as their principal residence within 60 days after the execution of the mortgage instrument and shall continue to occupy the property as the borrower's principal residence for at least one year after the date of occupancy, unless the lender otherwise agrees in writing.

Maintenance and Covenant of Good Repair. The mortgagor promises to keep the property in good condition, maintain the property, and prevent waste. The lender is authorized to make reasonable inspections of the property.

Important Mortgage Provisions

Prepayment Clause. A **prepayment clause** allows the borrower to pay off part or all of the debt, without penalty or other fees, before maturity. In Florida, a borrower has the right to prepay a mortgage loan unless the mortgage instrument states otherwise. A prepayment clause typically stipulates conditions and terms under which the mortgage loan may be prepaid.

Prepayment Penalty Clause. The lender may choose to charge a **prepayment penalty** for early payment, if provided for in the mortgage instrument.

39

Acceleration Clause. The **acceleration clause** authorizes the lender (mortgagee) to accelerate or advance the due date of the entire unpaid balance if the mortgagor fails to fulfill any promises stated in the mortgage instrument. The acceleration clause gives the lender the power to declare the entire unpaid mortgage loan due and payable and to foreclose on the property if the mortgagor does not remedy the default. The foreclosure process cannot begin unless the entire debt is delinquent. Without the acceleration clause, the mortgagee could sue a delinquent mortgagor for only the monthly payments that are in arrears. The borrower is given 30 days from the date of the *notice of acceleration* to pay all sums secured by the mortgage instrument. If the borrower fails to pay the debt within the specified time period, the borrower is considered to be in default. The Fannie Mae-Freddie Mac Uniform Single-Family Mortgage Instrument includes in the acceleration clause the remedies for curing defaults.

Right to Reinstate. This clause provides for the mortgagor's **right to reinstate** the original repayment terms in the note after the mortgagee has initiated the acceleration clause. It gives the mortgagor the right to have foreclosure proceedings stopped before the foreclosure sale, provided the mortgagor pays all sums that would be due if no acceleration had occurred plus all expenses incurred by the mortgagee in enforcing the mortgage.

Due-on-Sale Clause. The **due-on-sale clause** allows the mortgagee (lender) to demand the outstanding loan balance plus accrued interest. If the property or any interest in the property is sold or transferred without the lender's prior written consent, the lender may require immediate payment in full.

Defeasance Clause. The **defeasance clause** is so named because it "defeats" the prior action when the borrower-mortgagor has made the final payment on the loan. Recall that in title theory states, the mortgaged property is conveyed to the lender through a mortgage deed. Therefore, in title theory states, the defeasance clause defeats the conveyance of legal title and returns the legal title to the borrower-mortgagor. In lien theory states, the lender is protected with a lien on the property that pledges the property as collateral until the debt is paid in full. Once the debt is repaid, the defeasance clause defeats the mortgage lien and the property is no longer pledged as collateral. Constructive notice that the mortgage is defeated is accomplished when the lender-mortgagee executes and records a satisfaction of mortgage (see "Mortgage Law" and "Satisfaction of Mortgage," earlier in this unit).

IMPORTANT MORTGAGE PROVISIONS

Acceleration	Upon default, accelerates the entire debt due and payable
Defeasance	In title theory states, requires the lender to convey legal title to the borrower once the debt is repaid; in lien theory states, requires the lender to release the mortgage lien when the debt is repaid
Due-on-sale	Upon sale (alienation), loan is due and payable
Prepayment	Conditions to repay debt in advance of due date
Prepayment penalty	Allows extra charge if any amount of the loan is paid off early
Right to reinstate	Mortgagor's right to reinstate the original repayment terms in the note after lender initiated acceleration clause

Practice Questions

6. If a borrower is in default, the _______________ clause allows the lender to call the entire loan balance due and payable.

7. The _____________ clause in a mortgage in Florida releases the mortgage lien once debt is paid in full.

12.4 MORTGAGE FEATURES

Down Payment. The down payment is the amount of cash a purchaser will pay at the time of purchase. Any earnest money pledged when the original offer to purchase was made is applied toward the total amount of cash down payment due at closing.

Loan-to-Value Ratio (LTV). The **loan-to-value ratio (LTV)** is the relationship between the amount borrowed and the appraised value (or purchase price) of a property. Lenders use this ratio as the measure of financial risk associated with lending and borrowing money. The higher the LTV (or the greater the loan compared with the property's value), the lower the lender's safety cushion should the borrower default.

Equity. An owner's **equity** in property is the monetary interest the owner has in property over and above the mortgage indebtedness. When purchasing a property, the owner's initial equity is the down payment. The greater an owner's equity, the less risk for the mortgagee.

Formula: Equity

current market value – mortgage debt = equity

EXAMPLE: The current market value of a home is $350,000. The owners have a mortgage loan with a principal balance of $280,900. How much equity do the homeowners have in their home?

$350,000 market value – $280,900 loan = $69,100 equity

Interest. **Interest** is the cost (rent paid) for the use of borrowed funds. A lender charges interest on the remaining principal balance (amount borrowed) over the life of the loan. Interest may be due at either the end of the payment period or at the beginning of each payment period. Payments made at the end of a payment period are called payments *in arrears*. This payment method is the general practice, and mortgages often call for end-of-period payments due on the first of the following month. Payments may also be made at the beginning of each period and are called payments *in advance*.

Loan Servicing. Some lenders handle the loan payment collection and recordkeeping for the mortgages they originate. **Loan servicing** is an additional source of income for lenders. *Servicing fees* typically range from ⅜ to ¾ of 1% of the unpaid balance of loans serviced. Lenders are generally willing to retain servicing of any loans sold to institutional investors.

Escrow (Impound) Account. Most lenders require borrowers to pay, in advance, monthly installments for property taxes and hazard insurance. The monthly escrow payment is one-twelfth of the estimated annual expense for property taxes and the hazard insurance premium. These payments are held in an **escrow** (impound) account for the borrower. When the taxes and insurance premiums become due, the lender pays the expenses out of the escrow account. Federal regulations limit the total amount of reserves that lenders may require. Holding funds in an escrow account to cover ongoing expenses associated with the property protects lenders from defaults, tax liens, and catastrophe.

PITI. The monthly mortgage payment paid by the borrower consists of principal and interest on the loan and the monthly reserve for property taxes and hazard insurance. The monthly principal, interest, taxes, and insurance payment is called **PITI**.

EXAMPLE: A mortgage loan calls for monthly principal and interest payments of $2,186.25. The lender requires the borrowers to pay property taxes and hazard insurance in advance. Calculate the borrower's PITI based on estimated annual property taxes of $2,850 and annual hazard insurance of $1,680.

The monthly escrow payment for is one-twelfth of the annual expense for property taxes and the hazard insurance premium. These payments are added to the monthly principal and interest payment to determine the monthly PITI.

$2,850 annual property taxes ÷ 12 months = $237.50 monthly reserve property tax
$1,680 annual hazard insurance ÷ 12 months = $140.00 monthly reserve insurance
$2,186.25 monthly principal and interest + $237.50 + $140.00 = $2,563.75 PITI

Discount Points. **Discount points** are an added loan fee often charged by lenders to increase the yield on a lower-than-market-interest loan and to make the loan more competitive with higher-interest loans. Borrowers often pay discount points up front in order to gain a long-term, lower interest rate. The lower interest rate loan is advantageous to a homebuyer who plans to keep the loan for several years. This extra up-front fee is prepaid interest that increases the real yield, or annual percentage rate (APR), to the lender, making discount points advantageous for the lender (see "Discount Point Calculations" in this unit).

Loan Origination Fee. The processing of a mortgage application is called *loan origination*. Lenders typically charge the borrower a **loan origination fee**. Amounts vary, but the fee is typically 1% or 2% of the loan amount. The lender also charges the borrower all expenses encountered in obtaining credit reports, preparing loan documents, and processing a mortgage loan application.

EXAMPLE: The lender is charging an origination fee of 1.5% on a new mortgage loan of $250,000. What is the cost of the fee?

$250,000 × .015 (1.5%) = $3,750 cost of loan origination fee

Practice Questions

8. Discount points are charged by the lender to ______________ the ______________ on a mortgage loan.

9. Prepaid property taxes and hazard insurance costs are held by the lender in an ______________ ______________.

12.5 LOAN-TO-VALUE RATIO CALCULATION

The loan-to-value ratio (LTV) is calculated by dividing the mortgage loan amount by the property's sale price or appraised value (see the formula that follows).

Formula: Loan-to-Value Ratio (LTV)

loan amount ÷ sale price (or value) = loan-to-value ratio (LTV)

EXAMPLE 1: A purchaser secured a mortgage loan for $180,000. The home was purchased for $200,000. What is the LTV?

$180,000 loan amount ÷ $200,000 purchase price = .90 or 90% LTV

64

100

EXAMPLE 2: A home was purchased with a down payment of $60,000 and a loan of $240,000. What is the LTV?

Notice that this time the loan amount and down payment are given. Before the LTV ratio can be calculated, the purchase price must be determined:

$240,000 loan + $60,000 down payment = $300,000 total purchase price

$240,000 loan ÷ $300,000 purchase price = .80 or 80% LTV

EXAMPLE 3: A home was purchased with a down payment of $36,000 and a loan of $200,000 at 6.5% for 30 years. Monthly payments are $1,264.14. What is the LTV?

Notice that this time the monthly payment and loan term are given. This is extra information that is not needed to solve the question; however, it can make things seem more complicated. When solving a math question, always look for the key information *before* starting to do the calculation.

$200,000 loan + $36,000 down payment = $236,000 total purchase price

$200,000 loan amount ÷ $236,000 purchase price = .84745 or 85% LTV

Discount Point Calculations

Discount points are based on the loan amount, not on the selling price. When calculating the actual borrower's cost in dollars added by the discount points, each point is equal to 1% of the loan amount (1 point equals 1%). Discount points are charged as prepaid interest at the closing.

Formula: Cost of Discount Points

loan amount × discount points charged = cost of points (1 pt = .01 or 1%)

EXAMPLE 1: A lender charges 3 points on a $200,000 loan. Each discount point is equal to 1% of the loan amount. Therefore, 3 points is 3% of the loan amount. How much will the buyer pay for the discount points?

$200,000 loan amount × .03 = $6,000 cost of points

When the lender receives the $6,000, only $194,000 is needed from the lender's funds to make up the total $200,000 that is loaned to the borrower. However, the lender will receive interest based on the entire $200,000 during the full term of the loan. The *real yield* to a lender includes not only this interest but also the $6,000 paid as a mortgage discount.

EXAMPLE 2: Buyers purchased their home for $350,000. The buyers financed the purchase with an 80% conventional loan. The mortgagee charged 2.5 points. Calculate the actual cost in dollars of the points.

Discount points are paid on the loan amount; therefore, begin by calculating the amount of the loan. Each point is equivalent to 1% of the loan amount, so multiply the loan amount by 2.5% or .025.

$350,000 purchase price × .80 LTV = $280,000 loan amount

$280,000 × .025 = $7,000 cost of points

Lender's Effective Yield

57

78

Lenders use computers or prepared tables to determine the number of discount points that must be paid. However, as a general rule of thumb, each discount point paid to the lender will increase the lender's yield (rate of return) by approximately $1/8$ of 1% (.00125). When calculating yield, it is recommended to first convert from fractions to decimals so that the math can easily be solved with a calculator:

$1/8$ is the same as taking 1 ÷ 8 = .125

Multiply the number of discount points by .125 to determine the increase in yield.

Formula: Lender's Effective Yield

discount points × .125 = increase in yield

stated interest rate + increase in yield = effective yield

EXAMPLE: A buyer obtains a mortgage of $180,000, and the lender agrees to make the loan at 6% interest plus 2 points. How much will the 2 discount points increase the lender's yield?

2 points × .125 = .25%

Charging 2 discount points increases the lender's yield by .25%.

The approximate yield is also called the **effective yield**. The effective yield is based on the borrower paying the loan over the entire term of the loan. To calculate the effective yield, add the increased yield from the discount points (.25% in this case) to the stated interest rate of the loan (6%).

6% stated interest rate + .25% increase in yield from the discount points = 6.25% approximate (effective) yield

Frequently, a lender will state that mortgages are "going at" 98 or 97, for example. This is a different way of quoting discount points. It means that the lender is willing to lend only 98% or 97% of the face value of a mortgage loan. If the seller, the buyer, or a third party is willing to come up with the remaining 2% or 3%, then the lender will make the loan. It means exactly the same thing as quoting 2 points or 3 points. Regardless of the method used, the real interest rate earned for the lender will be increased approximately $1/8$ of 1% for each point charged up front.

Practice Questions

10. What is the loan-to-value ratio (LTV) for a home purchased for $315,000 with a loan of $283,500?

11. A borrower is getting a loan for $225,000 at 5% interest, and the lender is charging 2 points.
    a. What will the borrower pay for the points?

b. How much has the lender's yield increased?

12. The loan-to-value ratio is 80%. A buyer wants to acquire a property with a purchase price of $136,000. Calculate the required down payment.

12.6 ASSIGNMENT OF MORTGAGE

701.01, F.S.

When a homebuyer borrows money to purchase a home, the borrower (mortgagor) signs a promissory note and mortgage instrument. The mortgage and promissory note are the property of the mortgagee (lender). The mortgagee may choose to sell the negotiable instruments rather than continue to receive the monthly payments from the mortgagor.

When ownership of a mortgage is transferred from one company or individual to another, it is called an *assignment*. This process is accomplished by executing an **assignment of mortgage**. The assignment of mortgage is a legal instrument stating that the mortgagee assigns (transfers) the mortgage and promissory note to the purchaser. The assignment of mortgage is signed by the assignor (mortgagee) and delivered to the assignee (investor). The assignee becomes the new owner of the debt and security instrument.

Purpose of an Estoppel Certificate

718-720, F.S.

The purpose of an **estoppel certificate** is to stop a claim that the amount owed is different from the actual unpaid balance or that the interest rate is an amount other than the contracted rate. Estoppel certificates are used when the sale of property involves a condominium association or a homeowner's association, a mortgage lien on property, or a tenant occupied property.

EXAMPLE 1: When a company executes an assignment of mortgage, the company purchasing the mortgage instrument will receive an estoppel certificate (or estoppel letter) verifying the amount of the unpaid balance, the rate of interest, and the date to which interest has been paid before the assignment.

EXAMPLE 2: A title company, in preparation for the title closing, will order an estoppel certificate from the seller's mortgage lienholders. The title company will also order an estoppel certificate from the association if the property that is being purchased or refinanced is in a condominium, cooperative, or homeowners association.

WEBLINK @

Download the Fannie Mae Assignment of Mortgage at https://singlefamily.fanniemae.com/media/6426/display. Note that this instrument indicates that the purchaser (assignee) is Fannie Mae.

Practice Questions

13. The parties to an assignment of mortgage are the seller/lender called the ______________ and the purchaser of the mortgage loan and promissory note called the ______________.

14. An ____________ ______________ verifies the unpaid loan balance, interest rate, and the date to which interest has been paid before the assignment of a mortgage instrument.

12.7 METHODS OF PURCHASING PROPERTY ENCUMBERED BY AN EXISTING MORTGAGE LOAN

A buyer may purchase mortgaged property in one of several ways. The most straightforward method is for the buyer to pay cash for the property. In this case, the seller's mortgage is paid in full from the sale proceeds, a satisfaction of mortgage is recorded by the mortgagee, and the property is delivered free and clear of the mortgage lien at the time of closing.

Often, the buyer either does not have sufficient funds to pay cash for the property or the buyer does not desire to use cash for the entire purchase. A buyer may choose to secure new financing to purchase the property. Any existing mortgage debt is paid off from the sale proceeds.

When purchasing property that is encumbered by an outstanding mortgage loan, a buyer may choose to purchase the property in one of two ways. The distinction between the two ways is important if the buyer defaults and the mortgage is foreclosed.

1. *Assumption of an existing mortgage*. When assuming an existing mortgage, the buyer is agreeing to assume the seller's debt. The **assumption** of the mortgage obligates the buyer to execute a promissory note and become primarily liable for the debt. However, unless there is an executed *novation agreement*, the seller is still liable for the debt on the original promissory note. In the event the buyer defaults, the lender can sue both the buyer and the seller for any deficiency outstanding from the foreclosure.

   If a seller wants to be completely free of the original mortgage loan obligation, the seller, the buyer, and the lender must execute a written **novation agreement**. The novation agreement makes the buyer solely responsible for any default on the mortgage loan. The original mortgagor (seller) is released as a party to the mortgage loan. In effect, an assumption with novation allows the buyer to assume the mortgage and assign personal liability for the balance of the loan to the buyer alone (see "Assignment and Novation," Unit 11).

   Lenders may want to prevent buyers from assuming an existing mortgage. Most lenders today include a *due-on-sale clause* in conventional mortgage loans. In effect, this clause prevents another party from assuming the mortgage and requires that the mortgage debt be paid in full when the property is sold.

2. *Subject to the mortgage*. When a property is sold **subject to** the mortgage, the buyer is not personally liable to the lender for payment of the mortgage debt. The buyer takes title to the property knowing that the seller is still legally responsible for the note even though the buyer will be making the mortgage payments. In the event of the buyer's default, the lender forecloses and the property is sold by court order to pay the debt. If the sale does not pay off the entire debt, the seller (not the purchaser) is liable for the difference. The mortgagee can sue the seller for the deficiency because the seller signed a promissory note at the time the mortgage was created.

Contract for Deed (Land Contract)

A **contract for deed** or **land contract**, is used to finance the sale of property when a buyer does not have sufficient cash to make a down payment large enough to secure traditional financing. The buyer agrees to the purchase price for the property, typically makes a small down payment, and pays monthly payments of principal and interest to the seller. The buyer takes possession of the property at closing, however, instead of receiving a deed, the purchaser receives a contract for deed, giving the buyer equitable title to the property. *Equitable title* entitles the buyer to homestead protection. The buyer is responsible for the expenses associated with ownership, including the real estate property taxes, property insurance, and upkeep. The seller retains *legal title* to the property until the debt is repaid. Once repaid, the seller delivers a deed and the legal title is conveyed to the buyer (see "Legal vs. Equitable Title," Unit 9).

This form of seller financing is advantageous to a buyer who has insufficient down payment or lacks credit history. There are also less closing costs compared with financing the purchase through a traditional lender. Because a contract for deed is seller financing, the parties to the agreement are referred to as vendor (seller) and vendee (buyer).

Only an attorney should prepare a contract for deed. In case of buyer default, regular foreclosure proceedings are required, just as though it were a seller-held mortgage.

LAND DEVELOPMENT LOANS AND CONSTRUCTION LOANS

Land Development Loans. Developers purchase raw land and use **land development loans** to finance the installation of the onsite and offsite improvements, including sewers, streets, and utilities.

Construction Loans. Developers secure construction loans to finance the construction of homes, apartments, office building, and so forth. The lender commits to the full amount of the loan but disburses the funds in payments called *draws* as the construction progresses. Construction loans are short-term financing. The borrower pays interest on the money as it is disbursed in draws on the loan.

Blanket Mortgage Loans. A **blanket mortgage** pledges several parcels, usually building lots, as security for the loan. The developer uses proceeds from the sale of individual lots to pay off the blanket mortgage loan. A **partial release clause**, commonly found in blanket mortgages, provides for the release of individual parcels from the blanket mortgage lien upon payment of a specified amount. The partial release clause stipulates the conditions under which the mortgagee will grant a release of lots, free and clear of the mortgage.

Takeout Commitment. The developer or contractor typically obtains a written commitment from a financial institution certifying that permanent financing will be provided when the project is completed. The financial institution is willing to become the permanent lender after construction is completed. The written commitment for permanent financing, called a **takeout commitment**, makes it easier to secure the construction loan. When the project is completed, the lender for the permanent loan advances the amount committed. The developer uses the funds to pay off the construction lender.

Buydown. In times of high interest rates, homebuyers may be reluctant to purchase or they may have difficulty qualifying for a mortgage loan. A **buydown** is a financing technique used to temporarily lower the interest rate on a mortgage loan. The developer or a seller pays an up-front fee to the lender. In exchange for the fee, the mortgagor's loan interest rate (and monthly mortgage payment) is reduced, generally for the first one to three years.

EXAMPLE: A builder agrees to buy down the interest rate for the first three years of a mortgage in a new subdivision. The borrower will pay 2% interest on the mortgage for the first year, 3% the second year, and 4% for the remaining years of the mortgage. The difference in the monthly payment in years 1 and 2 is made up by the buydown cash payment the builder gives the lender. If mortgage amount were $100,000 and the loan term 30 years, for the first year at 2%, the borrower's monthly principal and interest (PI) is \$369.62. In the second year, at 3%, the borrower's monthly PI is \$421.60. In years 3–30, the borrower's monthly PI is \$477.42.

\$477.42 – \$369.62 = \$107.80 (monthly differential year 1) × 12 monthly payments = \$1,293.60

\$477.42 – \$421.60 = \$55.82 (monthly differential year 2) × 12 months = \$669.84

\$1,293.60 + \$669.84 = \$1,963.44 amount of buydown

Each month the lender goes into the "buydown account" and takes out the amount necessary for the full monthly payment of 4%. A builder would rather make an additional cash payment to the lender than reduce the price on a home in a new development.

Practice Questions

15. When mortgaged property is sold ______________ to the mortgage, the buyer takes over the balance of the existing mortgage and the seller remains solely responsible for a deficiency judgment.

16. A seller who allows a purchaser to assume the existing mortgage should have the lender and the purchaser agree to execute a ______________ agreement.

17. The clause in a blanket mortgage that allows a parcel of property to be sold free and clear of the blanket mortgage upon payment of a specified amount is the __________ __________ clause.

12.8 DEFAULT

Foreclosure

The borrower is required to fulfill certain obligations agreed to in the promissory note. These obligations include repayment of the debt, payment of property taxes, maintenance and upkeep, and keeping the property insured. Failure to meet any of these obligations can result in a borrower's **default**. When default occurs, the lender has the right under the mortgage contract to pursue legal action against the borrower for payment of the debt.

In Florida, foreclosure is a judicial process that requires the mortgagee to file a foreclosure suit in court. **Foreclosure** is enforcement of the mortgage lien.

If default on the mortgage occurs, the mortgagee has two remedies:

1. *Initiate a suit on the promissory note.* The mortgagee may choose to sue on the note, obtain a judgment, and then execute the judgment against any real or personal property of the mortgagor. This judgment may be levied against any of the mortgagor's property except property that is specifically exempted (such as homestead property, unless it is the property on which the default is based).
2. *Initiate a foreclosure proceeding.* The mortgagee may foreclose on the property that is subject to the mortgage lien. The foreclosure process begins with the mortgagee accelerating the due date of all remaining payments and then filing a lawsuit to foreclose. On receiving final judgment, the sale is advertised (public notice of the sale), and the property is sold at public auction to the highest bidder.

Equity of redemption allows the mortgagor to prevent foreclosure from occurring by paying the mortgagee the principal and interest due plus any expenses the mortgagee has incurred in attempting to collect the debt and initiating foreclosure proceedings. In

Florida, the right of equity of redemption ends once the property has been sold at foreclosure sale.

Results of Foreclosure. If redemption is not made, on confirmation of the sale, the clerk files a certificate of title and title passes to the purchaser. There are no warranties; title passes "as is," although free of the former defaulted mortgage. The successful bidder obtains no better title than the mortgagor held. The doctrine of *caveat emptor* applies in foreclosure sales; that is, the purchaser is presumed to know that the purchase is subject to any prior liens of record or interests for which there is constructive notice.

The clerk then disburses the sale proceeds in accordance with the final decree. The difference between what is owed the mortgagee at foreclosure sale and the successful bid is called *surplus funds*. Any excess proceeds are paid to the mortgagor. If, however, the proceeds are not sufficient to satisfy the outstanding debt, the mortgagee may request that the court issue a *deficiency judgment* against the person(s) who signed the note. When granted, a deficiency decree can extend to include all real and personal property belonging to the maker of the note, except a homestead.

Short Sale

A **short sale** involves a real estate transaction where the net proceeds at closing will not satisfy the payoff amount of mortgages and other liens on the property. The deficiency in funds is because the seller is attempting to sell the home to the buyer for an amount less than the amount owed to the lender(s) and other lienholders (if any).

Sometimes, because of depressed market conditions, a mortgagee will allow a property secured by a mortgage loan to be sold for less money than what is owed the lender. The lender releases its mortgage so that the property can be sold free and clear to the new purchaser. The lender decides to cut its losses by agreeing to a negotiated sale rather than the delay and expense of a foreclosure action.

Deed in Lieu of Foreclosure

Sometimes the parties will agree to settle the default without going to court. This can be accomplished with a **deed in lieu of foreclosure**. The process is sometimes called a *friendly foreclosure* because it is a *nonjudicial* procedure (it does not involve a lawsuit). If the lender agrees, the borrower who is in default under the terms of the mortgage gives title (the deed) to the lender to avoid judicial foreclosure. The lender takes title to the property subject to existing liens.

Income Property

Mortgage loans on income-producing property typically include a receivership clause. If the borrower of income-producing property does not make timely payments on the mortgage loan, the lender wants the income from the property to be used to make the mortgage payments. A **receivership clause** allows a receiver to be appointed to collect income from the property and use the income to make mortgage payments in the event of default.

Lis Pendens

A **lis pendens** (Latin for *action pending*) is a notice recorded in the public records (constructive notice) of a pending legal action that involves real estate. The notice of pending legal action states the names of the parties, the object of the action, and a legal description of the property.

A lender initiating a lawsuit to foreclose on a mortgage will file a lis pendens in the county records where the property is located. The lis pendens informs the public that a legal action is pending against the property. If the owner attempts to sell the property and a title search is conducted by or on behalf of the prospective buyer, then the buyer will learn of the pending litigation.

Practice Questions

18. Any surplus funds remaining after all liens have been paid after a foreclosure sale belong to the ______________.

19. The right of a mortgagor in default to prevent foreclosure by paying all money owed, including principal, interest, and the expenses incurred in initiating a foreclosure proceeding, is called the ___________ of ______________.

20. A deed in lieu of foreclosure is a ______________ procedure because the defaulting mortgagor transfers the deed to the lender in lieu of a foreclosure process.

21. A ________ ________ involves a real estate transaction where the net proceeds at closing will not satisfy the payoff amount of mortgages and other liens on the property.

22. A _______ ____________ is constructive notice of pending legal action that involves a parcel of real estate.

12.9 SUMMARY OF IMPORTANT POINTS

- The two instruments created with a mortgage loan are (1) mortgage, which creates the lien interest and pledges the property as security for the debt; and (2) promissory note, the promise to repay and represents legal evidence of a debt.
- The two legal theories of mortgages are (1) title theory (title conveys to lender/mortgagee through a mortgage deed) and (2) lien theory (title remains with borrower/mortgagor and lender has a lien against property). Florida is a lien theory state.
- Once the borrower has repaid the mortgage loan in full, the mortgagee executes and records in the public record a satisfaction (release) of mortgage to remove the mortgage lien. Florida statute requires that the mortgagee send the recorded satisfaction to the mortgagor within 60 days.
- The priority of mortgage liens is determined by the recording date. The oldest recorded mortgage has the higher priority and is the first mortgage. Later recorded mortgages have lower priority and are called second mortgages or junior mortgages.
- The acceleration clause authorizes the mortgagee to accelerate the due date of the entire unpaid loan balance if the mortgagor fails to fulfill any promises stated in the mortgage instrument.
- The due-on-sale clause allows the mortgagee to call due the outstanding loan balance plus accrued interest. The clause prevents another party from assuming the mortgage.
- The defeasance clause, in title theory states, requires the lender to convey legal title to the borrower once the debt is repaid. In lien theory states, this clause requires the lender to release the mortgage lien when the debt is repaid.

- The amount of cash the buyer pays is called the down payment. The loan-to-value ratio is the percentage of the purchase price or the appraised value (whichever is lower) that the buyer has borrowed.
- The owner's equity is determined by subtracting the mortgage balance from the current market value of the property.
- Many lenders require the borrower to pay monthly installments of $\frac{1}{12}$ of the total estimated annual property taxes and hazard insurance premium. The lender holds the installments in an escrow account and pays the property taxes and insurance premium from the impound account.
- Discount points are an up-front charge paid at closing to increase the lender's yield. One discount point is equal to 1% of the loan amount. Each discount point increases the yield by about $\frac{1}{8}$ of 1%.
- Assignment of mortgage transfers ownership of a mortgage and note from one company or individual to another.
- A contract for deed is another type of financing arrangement. The buyer agrees to make payments to the seller over time, but unlike a mortgage, the seller retains legal title until all payments have been made.
- Equity of redemption allows the mortgagor to prevent foreclosure by paying the mortgagee the principal and interest due plus any expenses the mortgagee has incurred in attempting to collect the debt.
- A short sale occurs when the lienholders agree to allow the property to be sold for an amount less than what will satisfy the liens and agree to remove the liens from the property.
- A deed in lieu of foreclosure is a voluntary action when the mortgagor transfers title to the mortgagee to avoid a foreclosure proceeding.

UNIT 12 EXAM

1. In a mortgage transaction in Florida, the legal evidence of the personal debt is the
   a. property (collateral).
   b. note.
   c. mortgage instrument.
   d. borrower's credit history.
2. A type of seller financing in which the seller retains legal title until the buyer has repaid the debt is a
   a. balloon mortgage.
   b. purchase-money mortgage.
   c. contract for deed.
   d. blanket mortgage.
3. In title theory states, the mortgage clause that provides that the conveyance of title to the lender is defeated when all the terms of the agreement have been fulfilled is the
   a. penalty clause.
   b. release clause.
   c. defeasance clause.
   d. insurance clause.
4. A home was purchased with a down payment of $50,000 and a loan of $200,000 at 6% interest for 20 years. Monthly payments are $1,432.86. What is the loan-to-value ratio?
   a. 25%
   b. 70%
   c. 75%
   d. 80%
5. A borrower who is in default on a mortgage is allowed to prevent the lender from foreclosing on the property by paying the mortgagee the delinquent principal and interest, plus any expenses the mortgagee has incurred in attempting to collect the payments. This right is called
   a. novation.
   b. a satisfaction of mortgage.
   c. the equity of redemption.
   d. an acceleration clause.
6. A lender declares all the unpaid balance due and payable as a result of default. The lender is exercising the
   a. acceleration clause.
   b. due-on-sale clause.
   c. defeasance clause.
   d. right to reinstate clause.
7. The person who borrows money to help pay for the purchase of real property is called at various times the
   a. lender.
   b. mortgagee.
   c. lienor.
   d. mortgagor.
8. When a vendee buys "subject to the mortgage," the
   a. vendee becomes responsible for the note.
   b. original obligation is substituted with a new note by novation.
   c. vendor is relieved of the obligation for the promissory note.
   d. vendee is not responsible for the note.
9. A couple has just made the final mortgage payment on their home. What document must the mortgagee file on their behalf?
   a. Lis pendens
   b. Novation
   c. Satisfaction of mortgage
   d. Estoppel certificate
10. If a mortgagee does NOT want the mortgage to be paid ahead of schedule, the mortgage will normally contain
    a. a prepayment penalty clause.
    b. a redemption clause.
    c. a defeasance clause.
    d. an acceleration clause.

11. A buyer agrees to purchase a property with an existing mortgage lien. In which situation is the new buyer the only party responsible for the debt?
    a. Assumption of an existing mortgage
    b. Estoppel
    c. Assumption with novation
    d. Subject to the mortgage

12. The loan-to-value ratio is 80%. A buyer wants to acquire a property with a purchase price of $116,000. Calculate the required down payment.
    a. $20,000
    b. $23,200
    c. $32,800
    d. $92,800

13. The primary purpose of an estoppel certificate is to
    a. prevent foreclosure.
    b. relieve the mortgagor of personal liability for the debt.
    c. verify the loan balance.
    d. prevent transfer of title to the mortgagee.

14. When a lis pendens is filed properly with the county clerk, it becomes a type of
    a. attachment on the subject property.
    b. vendor's lien.
    c. constructive notice.
    d. easement by prescription.

15. A couple purchased their home for $125,000. They financed the purchase with an 80% conventional loan. The mortgagee charged 2.5 points. Calculate the actual cost of the points in dollars.
    a. $1,600
    b. $2,000
    c. $2,500
    d. $3,125

16. A mortgagor defaulted on a mortgage encumbering an apartment complex. Once the foreclosure proceedings were filed, the lender appealed to the courts to appoint
    a. a receiver.
    b. an onsite manager.
    c. an attorney to handle the case.
    d. an arbitrator.

17. The rule of thumb used to convert discount points to an annual percentage rate is that each discount point increases the yield by approximately
    a. ⅛ of 1%.
    b. ¼ of 1%.
    c. ½ of 1%.
    d. 1%.

18. A lender charged 7% plus 3 points. What is the approximate yield on this loan?
    a. 7.25%
    b. 7.375%
    c. 7.5%
    d. 7.75%

19. You have a loan with monthly principal and interest payments of $846.21. If the lender requires an impound account for taxes and insurance, what would the total payment amount be if your annual property taxes were $2,840 and your annual insurance cost was $1,570?
    a. $1,082.88
    b. $1,130.38
    c. $1,193.71
    d. $1,213.71

20. The market value of an apartment building is $350,000. The investor has mortgaged $300,000. What is the investor's equity in the property?
    a. $50,000
    b. $300,000
    c. $350,000
    d. $650,000