SHIFT TACTIC 10: FINANCING SOLUTIONS

TWENTY-EIGHT LEGAL, PROVEN WAYS TO GET THE DEAL DONE IN A SHIFTED MARKET

Author: David Reed

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Table of Contents

OVERVIEW **7**

GETTING THE MOST OUT OF THIS EXPERIENCE **13**

WHAT SELLERS CAN DO IN A CHANGING MARKET **15**

1. Seller Contributions: What, When, and How 16
2. Seller-Funded Permanent Buydowns 22
3. Seller-Funded Temporary Buydowns 28
4. Owner Financing 35
5. Contract for Deed 44
6. Seller Seconds 47
7. Lease with Option and Lease Purchase 54
8. Selling to Relatives 60
9. Wraparound Mortgages 64

WHAT BUYERS CAN DO IN A CHANGING MARKET **69**

10. Using a 401(k) 70
11. Temporary IRA Transfers 75
12. Appraisable Assets for Down Payment and Closing Costs 78
13. Pledged Asset Mortgages (PAMs) 83
14. Equity Transfers and Bridge Loans 87
15. Down Payment Sources and Gift Funds 92
16. Nonoccupant Coborrowers 96
17. Employer Assisted Mortgages (EAMs) 101

WHAT LENDERS CAN DO IN A CHANGING MARKET **107**

18. Lender-Funded Buydowns 109
19. The "MyCommunityMortgage" 113
20. Leveraging Automated Underwriting Systems 116

21. Adjusting Amortization Periods..123

22. Adjusting Interest Rates to Cover Closing Costs 126

23. State, Province, and Local Government Grant and Bond Programs 132

24. Mortgage Credit Certificates—MCC 137

25. Expanded Alternative Lending..142

26. Subprime Lending 147

27. Private Lending...152

28. No Documentation Programs 156

....161

THE BOTTOM LINE **162**

From Aha's to Achievement 165

RESOURCES **166**

GLOSSARY..**167**

About the Author 172

Don't Forget Your Evaluation!...173

Overview

In 2006, the real estate market began to shift dramatically. Houses took longer to sell, values fell, and new home construction slowed almost to a standstill. Inventories were at levels that perhaps would have been unheard of just a few years before. The situation had changed from a seller's market to a buyers' market.

Many of us have experienced a shift. Depending on how long you've been in the business, you've experienced your fair share of market swings. You also understand that during the slow times you need to hunker down and wait for the good times to roll again. Or do you?

Actually, real estate markets are in a constant state of change. Regardless of whether your market is white-hot, freezing cold, or somewhat more temperate, your market is changing—but the opportunity for you and your business doesn't go away. There are still enough transactions available for you to have a great year. But you will have to adapt to the current market to do that. This book is designed to give you the tools you need to close more transactions in a shifted market. Used properly it will not just help you survive a shift but also thrive in it.

What You'll Find

The next twenty-eight chapters are tried-and-true methods that will help sellers in a soft market and help buyers who are facing challenges. Some of these methods have been around for years; some are brand-new programs, while some are simply new ways to look at traditional lending. But whichever method works best for you from Montreal to Miami, welcome to the ever-evolving world of finance!

Parts

This book is divided into three parts:

- Part I: What Sellers Can Do in a Changing Market
- Part II: What Buyers Can Do in a Changing Market
- Part III: What Lenders Can Do in a Changing Market

Part I explores different things your sellers can do to help sell their home. Part II opens the door to your buyers who may have problems getting qualified. Part III explains how mortgage companies and lending programs can help buyers who might otherwise not be able to buy.

Each part is further divided into chapters that explore a different method, and contain each of the following elements:

- The Challenge
- The Solution
- Watch Out!
- Snapshot

The Challenge describes the current market condition or a problem that's been identified, keeping someone from buying or keeping a house on the market too long.

The Solution provides an answer to the Challenge, explains it, and gives examples on how it applies to the Challenge.

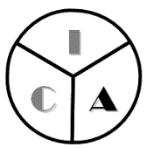
Watch Out! describes potential pitfalls and problems different challenges present. Getting "creative" with finance does not mean doing things that are against the law.

Finally, each chapter has a **Snapshot**—a short story taken from real, life situations—that tells how a buyer or a seller overcame their own situation.

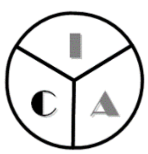
The "IAC"

You'll notice some chapters are headed with an icon containing one or more of the letters, **I**, **A**, and **C**. When buyers are having difficulty qualifying for a mortgage it's due to one or more of these three things.

Income. Maybe the buyers are just shy of qualifying due to income, or they have income but the lender won't recognize it.



Assets. Perhaps the problem lies with assets, or money for down payment and closing costs.



Credit. The buyers may currently or have recently experienced some negative credit.

Some chapters will address one of the three issues, and some will address two or all three. This is an easy way for you to look through the different ideas presented in this book and quickly identify relevant answers to your buying or selling situation.

Geographic Considerations

It's also important to remember that all real estate is local. There may be programs presented in this book that can't work in your area. For instance, a state or province might have a statute that prohibits, limits, or regulates a "Lease Purchase" transaction.

There are simply too many local and state guidelines for us to place in this book, and even if we did, by the time we put all relevant laws in this book, it would be far too impractical to publish.

Some loan programs won't be available in all areas, or down payment assistance is administered by a city government instead of a state or national government.

Canada and the United States will have their differences as well. In this book, the loan amounts and interest rates used in the examples are similar. Yet most loans in Canada are "hybrids" instead of longer-term fixed rates as found in the United States.

A hybrid is an adjustable rate mortgage that is fixed for a predetermined period, say five years, and then resets into an annual adjustable rate mortgage. There can be literally hundreds of mortgage loan programs offered around the world, but in this book we use one program to keep the examples uniform. Instead of providing a hybrid example and a thirty-year fixed example, we simply keep the amortization period constant: thirty years.

Comparing a 5/1 hybrid in Canada amortized over thirty years with a thirty-year fixed rate in the United States will yield the same results. If you're in Canada, the mortgage program might indeed be a short-term loan, but the amortization period is the same as a thirty-year fixed rate in the United States.

Getting the Team Together

You will need to assemble your team if you haven't already done so. Your team is your host of affiliate providers that can act as your own referral source when needed.

You need a trusted loan officer (or two) that can review buyers' approval letters or help your sellers navigate the terms of a Seller-Funded Permanent Buydown.

You can consult your loan officer for prevailing rates and terms when considering Seller Seconds, Owner Financing, or Expanded Alternatives programs. Your loan officer is someone you will use to make sure your sellers and buyers are getting a fair shake and do not become victims of a shady loan officer's "shell game."

Attorneys should be available to review contracts or to determine the feasibility of a particular program in your area. Find a closer who can help you guide your buyers and sellers through the closing process.

Let's Get Started!

You would never build a house without a blueprint. The same holds true when putting together a mortgage plan. This guide is your blueprint for helping your buyers and sellers throughout the mortgage process. So read through, and keep your blueprint handy for reference whenever mortgage questions arise—you'll soon be ready to implement some of the most powerful and proven financing methods that will help your buyers and sellers in any market.

Notes

Getting the Most Out of This Experience

There are often three types of people in a typical training class. Which one are you?

The Prisoner *Has to be there, doesn't want to be there, and doesn't know why they're there.*	The Vacationer *A day in training is better than a day on the job.*	The Explorer *Excited and curious about the new knowledge, skills, and tools they will discover in class.*
Doesn't engage	Spends as much time chatting as listening	Listens attentively, then participates fully in discussions and exercises
Spends class time catching up on their emails	There to have fun—distracts the class with irrelevant comments	Asks meaningful questions and contributes compelling aha's
Escapes by spending time in the hall on their phone	Returns late from break and lunch	Arrives to class on time and returns promptly from breaks
Holds on to limiting beliefs	Not purposeful in their learning goals	Adopts a posture of acceptance
Multi-tasks on their computer by working on side projects	OMG! Spends the day on their smartphone, texting and checking Facebook	Takes notes in their manual for future reference
Picks fights with trainer or other participants if they don't agree	Isn't paying attention	Respects the different learning styles and opinions of others

Notes

What Sellers Can Do in a Changing Market

There are three distinct players in a real estate transaction: the seller, the buyer, and if financing is involved then the lender plays a key role.

When markets shift, the tide shifts as well. In a sellers' market, the seller holds most of the cards. When real estate is soft, then the buyer typically has the upper hand. The lenders, with all of their resources, are constantly trying to adjust to market moves and tighten credit, loosen lending guidelines, or invent new loan programs to serve a new market.

Sellers are in a unique situation in that the main asset in the transaction belongs to them. Nothing happens unless the seller decides to move that property. They own the equity in the property as well as the home itself.

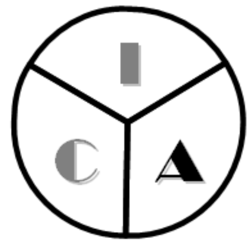
Sometimes your asset can also be a liability. If the current real estate market is stacked with inventory and a seller wants or needs to move a property soon, then the seller needs to be aware of every tool that's available.

Occasionally interest rates are too high and sellers need to help offset those high rates. Sometimes buyers don't have enough money for a down payment or they are having problems qualifying for a loan.

Sellers can help themselves by assisting buyers facing income, asset or credit barriers by funding different types of buydowns to lower rates, providing down payment assistance, or by carrying all or part of a newly created mortgage note.

Too often, sellers who are trying to move a property in a slower market make the mistake of simply slashing their asking price, regardless of the advice given to them by their real estate agent. Instead of giving away their equity in the form of a "fire sale," they can implement the various techniques described in this book, save money, and provide you with more listings.

1. Seller Contributions: What, When, and How



A seller contribution—often called a concession—implies that the seller is giving in to some demand the buyer makes. "Throw in the appliances!" or "I want two years of home warranty" and the seller concedes. Technically that's a seller contribution.

But a seller contribution doesn't necessarily have to mean conceding anything. Sometimes a contribution is simply a listing enhancement and a part of the package that is nonnegotiable.

A seller contribution could be, "I'll throw in an extra garage door opener," or "I'll pay to have the locks changed." Or it can be more complex depending on the situation. Contributions can create a win-win situation. It saves buyers money and makes the entire deal more attractive.

Contributions can be offered in any market, but they have to be constructed in a way that addresses current market conditions while at the same time meeting requirements set by lenders. This chapter will address contribution basics and how to properly construct a seller contribution.

The Challenge

The seller is being transferred and needs to sell his home within sixty days at $250,000. The seller has agreed to pay for the buyer's closing costs to help move the home in such a short time frame.

There are similar listings in the area and most comparable sales are similarly priced. To sweeten the listing the seller has agreed to pay $5,000 of the buyer's closing costs and, if push came to shove, the seller would even pay for as much as $10,000 in closing costs to cover things such as discount points and origination fees.

The reality is lenders will allow sellers to pay for typical buyers' closing costs as long as it's in the contract and is shown on the final settlement statement. However, lenders do have rules as to how much the seller can provide. Not knowing those rules can kill a deal, and the deal won't die until you're about two to three weeks into the process. That's about the time the lender would find out that the seller's contributions are out of compliance and you have to start all over again.

Lenders base seller contributions as a percentage of the sales price compared to the amount of down payment the buyer will be using. The more down payment the buyer has, the more the seller can contribute toward closing costs.

Seller contribution limitations for conventional loans start at 3 percent of the sales price and can go up to 9 percent of the sales price of the home. Anything above that will most likely affect the appraisal.

Typical Seller Contribution Limits	
Down Payment	**Maximum Contribution**
Less than 10%	3%
10% to less than 25%	6%
25% +	9%

The Federal Housing Administration (FHA) limits seller contributions to the buyer's closing costs at 6 percent. The minimum down payment required is 3.5 percent of the sales price. Seller concessions do not vary regardless of the down payment amount.

For veterans using their VA eligibility, the maximum seller contribution is 4 percent of the sales price.

The seller can only contribute to closing costs, not the down payment.

The Solution

When trying to move a property quickly, one of the first considerations is going to be the price and the second might be a seller contribution. But why not price in the "contribution" with the listing price and forego the contribution altogether? It saves the buyer money and nets the seller the same amount of money.

Say that you list at $250,000, but the seller will go no lower than $245,000. It's a fair price and you've determined that at the $250,000 sales price you'll have tons of offers. But instead of lowering the price, offer a $5,000 buyer's closing cost credit at closing. Why? Let's look at the numbers. This technique works well with those who have 5 percent or less to put down because they're the ones trying to scrape up money to buy their next home.

Compare Buyers' Closing Cost Credit to Lowering the Price		
	Buyers' Closing Cost Credit of $5,000	Lower the Price by $5,000
Sales Price	$250,000	$245,000
Down Payment 5%	$12,500	$12,250
Closing Costs	$0 ($5,000 credit)	$5,000
Total Out of Pocket	$12,500	$17,250
Net to Seller	$245,000	$245,000

See how the seller nets the same amount yet the buyer has to come in with an additional $5,000? What's that you say? That makes for a higher loan amount and the buyer pays more? That's correct but it's a marginal difference. The down payment is made as a percentage of the loan amount.

Loan Amount	5% Down Payment	Loan Amount
$250,000	$12,500	$237,500
$245,000	$12,250	$232,750

Now let's compare the monthly payments using a loan amortized over thirty years at 6.5 percent.

Loan Amount	Monthly Payment
$232,750	$1,471
$237,500	$1,501

That's only a difference of $30 a month, and with mortgage interest deductions come tax time, it's a lot less than that. Heck, that's a large pizza and a round of sodas!You've just saved the buyers $5,000 and walked away from the closing table with the exact same amount of money as if you'd reduced the price instead! Properly constructed, a seller contribution is a true win-win.

Watch Out!

Certain loan programs may limit the types of closing costs a seller can pay and they're broken down into two types: recurring and nonrecurring.

Recurring closing costs are also called "prepaid" closing costs. Prepaids are items the buyers will pay up front at closing that they'll also have to pay again and again (recurring), such as mortgage interest, property taxes, and insurance. A buyer will make interest payments each month, pay taxes when due, and keep the property insured.

Nonrecurring closing costs are those encountered once: at the closing table. Nonrecurring closing costs include such items as attorney fees, title insurance, discount points, or origination charges. Every loan program will allow the seller to pay nonrecurring closing costs, but some loan programs limit seller contributions to nonrecurring costs and won't let the seller pay for an insurance policy. Most loans that are in the market today do allow the sellers to pay for both recurring and nonrecurring, so you'll rarely run into this problem.

A common seller contribution that doesn't work is sometimes written into a contract called an "allowance," and is an amount deducted from the sales price that allots funds from the seller to be applied to future repairs. Don't do it and don't do it for two reasons. First, sellers are absolutely forbidden to give buyers cash at the closing table. Pay for $5,000 of buyers' closing costs? Sure. Hand over a $5,000 check? No way.

When the contract states something like, "$2,000 allowance to repair deck," it won't be acceptable to a lender. Cash buyer? Sure. But if there's a loan involved, allowances aren't, well, allowed.

Second, when the lender sees "repair deck" in the contract, they will want to make sure the deck is repaired before the loan can close. In fact, the lender will even send an appraiser or inspector to inspect the property to make sure the deck has been fixed. After all, the property is collateral for the lender and the lender wants to make sure it's in good shape.

Finally, don't go overboard with seller contributions and stay within acceptable contribution guidelines. If you really want to move a $250,000 property, don't offer $25,000 in contributions as it could affect the value.

All appraisals have a section on the very first page that addresses current market conditions and if seller contributions are common. Appraisers understand that seller contributions are a common item as long as they're within standard limits and conform to lending guidelines. But even if the contribution does meet the guidelines, too much of a contribution can backfire.

Say you wanted to give a $15,000 credit to closing costs by paying all of the buyers' costs plus more discount points to lower the buyers' rate. If that $15,000 is unusual for your market, the appraiser might just reduce the value of the home from the sales price of $250,000 to $240,000!

The appraiser could make a case for saying, "Yes, your contract did say a $250,000 sales price, but you also had to give the buyer $15,000 in order to make the deal work. That tells me your house would not have sold at $250,000 but closer to $240,000."

When the appraisal comes in lower than the sales price, the buyer must come in with the difference as loans are made on the lower of the sales price or appraised value. So be judicious with contributions.

Some agents have tried to circumvent these checks by negotiating higher commissions with the promise of returning a portion of their commission after the sale. Others might inflate the price with the promise of money being returned to the buyer. In both cases, they are committing loan fraud. If assets (cash or property) are being moved from buyer to seller or vice versa (even through a third party), it must be disclosed!

Finally, any personal property transferred to the buyers (often called "chattels") as a contribution must be disclosed. For example, if the boat comes with the lake house or the snowmobiles come with the resort home, the lender needs to know.

Snapshot

Jill wants to move closer to her family back in Oklahoma, so she puts her home on the market for $200,000. Jill needs to sell her current home before she can close on a new one. That's where all of her down payment and closing cost money will be coming from when she finds a house in Oklahoma. Jill owes $125,000 on her current mortgage and wants the house to move fast so she can start shopping for her new place and wants to walk away from the closing table with about $60,000.

Her real estate agent Diana tells Jill that her home is perfect for first-time home buyers (just like Jill when she first bought the home), and she is going to market it that way. Since first-time home buyers typically struggle to find money for down payments and closing costs, Dianna suggests offering to pay for all of the buyers closing costs, as well as a 1 percent origination fee.

After adding all potential closing costs a buyer would incur, including funds for prepaid items, Diana figures Jill needs to offer a $5,000 credit. $5,000 in closing cost credit equals 2.5 percent of the sales price, well within allowable lender guidelines.

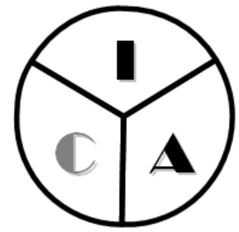
By offering a no closing cost deal to first-time home buyers, Diana figures they'll get plenty of offers while at the same time holding firm on the sales price, netting Jill the $60,000 she needs to take with her.

Sure enough, within a few days of listing the home begins to show and offers come in. Diana has all the numbers that show how much the buyers will save by buying Jill's house instead of others.

Another real estate agent submits an offer that matches his buyers' requirements. While there were other homes on the market that appealed to his buyers—even some that were listed for slightly less than Jill's—Diana gets an offer within five days of the original listing at full price. The buyers were more concerned with how much money they'd need to bring to closing and less about a monthly payment that might only be $15 a month higher.

Jill paid $5,000 of the buyers' fees, successfully closed on her home sale, and walked away from the closing table with $68,000.

2. Seller-Funded Permanent Buydowns



We have identified what seller contributions are, how to apply them, and reviewed current limits on how much a seller can offer during a transaction if the buyer is financing the home.

Paying for closing costs, however, is just one financial incentive for moving the property. You can pay for the attorney fee or the title insurance policy or both. You can pay for all these nonrecurring costs or just some of them. But paying for recurring costs can have a lasting impact that is far greater than any individual fee such as an escrow or document fee.

The seller-funded permanent buydown is one way to reduce those recurring costs and make your property more attractive to buyers. That's a mouthful, but it's really a long-winded way of paying down the interest rate (discount points) on the buyers' behalf and turning a $2,500 seller contribution into buyer savings of almost $15,000 and a $5,000 seller contribution into nearly $30,000 in savings for a buyer.

The seller-funded permanent buydown is a creative way to highlight how much money the buyer will save on their new mortgage. Properly marketed, discount points are a great selling point.

The Challenge

The seller has agreed to pay up to 2 percent of the sales price in closing costs in order to help sell the home. Often, when one property owner offers to pay closing costs for the buyer and that property sells more quickly than similar properties, other agents will take notice and begin to make the same offer on their new listings.

After a while, though, all the homes on the market are also offering to pay some or all of the buyers' closing costs and the closing cost credit becomes too common and less of an incentive.

How can the seller provide a financial incentive to buyers that will set itself apart from other listings, while at the same time costing the seller no more than any other seller concession?

Solution

A seller-funded buydown can take the amount used to pay for closing costs and instead of paying for one-time (nonrecurring) closing costs, the sellers' funds are directed at one thing: buying down the interest rate with discount points.

A discount point is a form of prepaid interest and is represented as 1 percent of a loan amount. One point on a $200,000 loan is $2,000. One point on a $350,000 loan is $3,500 and so on. A discount point is so-called because the point is used to lower, or "discount," the interest rate for the entire term of the loan.

But you don't have to stop there: you can pay more in points to get an even lower rate. You can pay 1½ points. Or you can pay 2 points. It's entirely up to you given allowable seller concession guidelines described in the previously.

In general, 1 point will reduce a thirty-year mortgage by ¼ percent. If the prevailing rate at par (no points) is 6 percent on a $250,000 loan, then the cost to reduce the rate to 5.75 percent, or ¼ percent lower, is one discount point, or $2,500.

If you wanted to decrease the rate by another ¼ percent it will cost another point for a total of $5,000 on a $250,000 loan. Mortgage rates are also offered in ⅛percent increments and that ⅛percent difference is usually had for half the price of a point.

Here's a chart that shows a typical point structure on a thirty-year rate on a $250,000 mortgage.

Typical Point Structure on 30 Year Rate on $250,000			
Rate	Point(s)	Point(s) in Dollars	Monthly Payment
6.00%	-0-	$0	$1,498
5.875%	½	$1,250	$1,478
5.75%	1	$2,500	$1,458
5.625%	1½	$3,750	$1,440
5.50%	2	$5,000	$1,419

Okay, so you pay a couple of points and drop the monthly payment from $1,498 to $1,419. That's about $79 per month. Big deal, right? Saving $79 might not make a powerful impact, but look at what you save over the lifetime of the loan.

Savings Over Lifetime of Loan					
Rate	Point(s)	Point(s) in Dollars	Monthly Payment	Interest Paid	Interest Saved
6.00%	-0-	$0	$1,498	$289,595	-0-
5.875%	½	$1,250	$1,478	$282,671	**$6,924**
5.75%	1	$2,500	$1,458	$275,215	**$14,380**
5.625%	1½	$3,750	$1,439	$268,375	**$21,220**
5.50%	2	$5,000	$1,419	$261,010	**$28,595**

In each case, the amount of interest paid over the life of the loan is actually more than the original loan itself. And that is where the secret of marketing the permanent buydown lies: in the true dollars saved over the course of the loan!

Two points may only save $80 per month in payments, but over the life of the loan it will save almost $30,000 in interest!

The sign reads:

Seller-Funded Permanent Buydown
Saves You $28,595!

For instance, you decide you want to buydown the sellers' rate by ¼ percent—it would cost you one discount point at closing and the difference in monthly payments is $40 per month. Over the course of that thirty-year mortgage, the buyer now saves $14,400 in interest.

In this example, that one discount point, or $2,500, results in a $14,400 savings!

Take it one step further and pay two points to get a monthly savings of $79 per month. The savings add up to $28,440 … a $5,000 investment is guaranteed to yield an interest savings of $28,440 over the term of a thirty-year note.

This is a true savings of interest. No shell game. It's easily explained and can be much more effective when simply paying buyers' closing costs just isn't doing all that much in your market.

One note, however. These numbers reflect long-term interest and may not appeal to someone who is thinking "short term" with their property. That buyer could be a first-timer or someone who gets transferred frequently with their job.

If someone is only going to own the house for three to five years, then the math won't work. Five years of saving $79 per month only equates to $4,740; less than the $5,000 in points paid and much less than the $28,440 in long-term interest. In this instance it's better for the seller to pay for closing costs and not use their funds to buydown a rate for the buyer. In this case, the buyer's agent would ask the sellers to apply that same money to closing costs or a temporary buydown explained in the next chapter.

Watch Out!

Interest rate advertisements can be a real shell game. You can probably attest to that yourself after getting mortgage rate quotes over the phone. Discount points should be for one thing and one thing only: discounting the interest rate! If the buyers are using a lender that you're not familiar with, then you need to have a lender that you are familiar with examine the buyers' rate lock from their lender or mortgage broker. At a minimum, get the terms the buyer is getting from the lender or broker and find out the exact rate your buyers are getting. You want the points to go toward buying down the interest rate, not eaten up by loan fees.

The same can be said with origination fees. Origination fees are typically fees mortgage brokers charge as income and not as a vehicle to buydown an interest rate. While there can certainly be an origination fee on the settlement statement, your two points must be listed separately. Points and origination fees are not the same even though the Internal Revenue Service can treat them as such.

It's important to make sure your seller's contract clearly states that the buyer is paying two discount points and not 2 percent of the sales price and not to be used to pay origination fees.

Finally, you'll need to comply with local advertising regulations. Since the "$20,000 seller- funded buydown" you're marketing is based on a presumed offer, you'll likely need to show your math ("… based on a full price offer with 10 percent down on a thirty-year mortgage bought down from 6 percent to 5.5 percent …). Check with your broker to ensure your ad is within area guidelines and disclose, disclose, disclose.

Snapshot

Houses had been moving in the area, so John and Terry decided to cash in on their home and move with the equity they'd built up over the years. They called their real estate agent and put their home on the market, expecting the home to be sold within about three to four months, tops.

Apparently, John and Terry weren't the only ones thinking about doing the very same thing as more and more listings began hitting the market. After a couple of months, the home was still sitting. It got plenty of showings, but there was simply too much competition on the market. John and Terry had their eye on a property but couldn't buy the new one without selling the current house.

Across the market, buyers began to lowball their offers and sellers prepared to reduce prices at the initial offer. Still other sellers were either reducing their asking price or offering to pay for title insurance policies and other buyer closing costs.

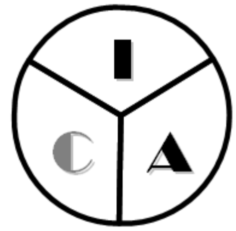
John and Terry's agent sat down with the couple and suggested they hold onto their sales price, but offer something other than paying for closing costs.

"Instead of paying for closing costs, let's take the same amount of money and apply it to the buyer's interest rate. I can show how we can save the buyers more than $28,000 in mortgage interest," their agent told them.

Sure enough, the agent did the math and showed how lowering the interest rate on the buyers' behalf would save more than $28,000 in interest. Once they agreed this would appeal to buyers, the agent put a rider on their yard sign that said, "$20,000 Seller- Funded Buydown Available!" and listed the same numbers in the MLS asking other agents to call for details.

That did the trick. No other sellers were offering permanent buydown. It even elicited phone calls from buyers and other agents simply wanting to know what the seller-funded buydown actually was. Other sellers weren't able to offer a seller-funded buydown, quite frankly, because they didn't know how to properly construct such a rare concession. $5,000 can indeed equal $28,400!

3. Seller-Funded Temporary Buydowns



Many things can motivate a buyer to make an offer. And it's part of your job to discover that motivation during the selling process. You need to have absolutely everything at your disposal and use it when needed. Sometimes people aren't motivated by saving interest over an extended period as we discussed in the last previously.

The Challenge

The market has been stagnant with more and more homes coming up in the marketplace and inventory is getting a bit out of control. Homes are certainly selling—it's just that it can be difficult to entice a buyer when there are so many other similar homes on the market.

A weakening economy also has the newspapers and news reports speculating on interest rates dropping. Now people are talking about interest rates going down and how much further they might dip. As interest rate talk becomes more and more frequent, buyers are become focused on one thing: the interest rate.

This makes a lot of sense when you think about it. Lenders spend millions of dollars on various advertising and marketing campaigns. But ultimately lenders really only have one product and that product is no different from the product other lenders are also spending millions of dollars to advertise each and every day.

As people begin to search for homes, they also begin to select their lender. They can use their bank or credit union or perhaps a mortgage broker they know, but how do they compare one lender to another? That's right: the interest rate.

Suddenly, a buyer begins to pay more attention to radio ads touting this rate or that rate. Those annoying newspaper ads showing different mortgage rates somehow become relevant. The buyers are shopping and shopping hard. But they find that, in the end, one lender can't be at 5 percent while all the other lenders are at 6 percent. All things being equal, of course.

Solution

But what if you could tap into that? What if the buyer sees only 6 percent everywhere, when in fact you could offer not just 5 percent but 4 percent? You can. Such a rate will surely get the buyer's attention, and you get that 4 percent by utilizing the seller-funded temporary buydown!

We have showed how to calculate a permanent buydown and how much just a ¼ percent difference in the interest rate could add up to so much money. But the permanent buydown is just that … permanent. The rate never changes because you "bought" the rate down by ¼ percent. With a temporary buydown you're now appealing to those buyers who are fixated on rates. Your sign would read, "Seller offering 4 percent start rate on thirty-year fixed rate loan!" or "Seller offering 2-1 buydown!"

Temporary buydown loans work with fixed rate mortgages and are merely a method of paying mortgage interest to the lender up front in return for temporary lower rates. If a prevailing thirty-year rate on a $250,000 loan amount is 6 percent with no additional points to the lender, then a temporary buydown would start in year 1 at 4 percent, year 2 at 5 percent, and beyond that at the note rate of 6 percent.

This is called a 2-1 buydown. Because a temporary buydown can be calculated, you can theoretically make up just about any buydown period you want. That is if lenders would accept it. A 4-3-2-1 buydown would start at 2 percent, then 3 percent, then 4 percent, then 5 percent, then finally at 6 percent. But that's as far as lenders will generally go.

More typically, lenders will accept either a 2-1 or 3-2-1 buydown, and most lenders will offer a buydown on any of their fixed rate mortgage loans. Many loan officers are not even aware of its existence. Buydowns work on fixed rate loans and may not be available in Canada.

Buydowns aren't free. Lenders don't like "free," but they can be accommodating. Here's how they work.

First, calculate the monthly payment for 6 percent on $250,000, which is $1,498 per month, principal and interest. Next, calculate the monthly payment on that same $250,000 at 5 percent and at 4 percent for a 2-1 buydown. Monthly payments are $1,342 and $1,193, respectively. Then, add up the payments for one year at 4 percent, or $14,316, and add the payments for one year at 5 percent, or $16,104. The total is $30,420.

The third step is to add up what the payments would have been for those two years using instead the current market rate of 6 percent. Two years of $1,498 per month is $35,952. Subtract $30,420 from $35,952 and the difference is $5,532 … the interest the lender "lost" during the temporary buydown period.

Finally, divide the $5,532 difference by the original loan amount. The difference is how many "discount points" will be required to fund the temporary buydown ($5,532 / $250,000 = .022, or 2.2 points). The lender will require approximately 2.2 points to fund the buydown. This is still well within range of allowable seller concessions yet powerful in its impact.

You are now able to offer mortgage interest rates well below the market rate, while at the same time reducing the buyer's payments by hundreds of dollars each month. For buyers who might "just qualify" for a regular mortgage, a temporary buydown gives them a little breathing room when taking on a brand-new mortgage.

30 Year Rate of 6.00% on $250,000				
Year	Rate	Monthly Payment	Monthly Savings	Annual Savings
1	4%	$1,193	$305	$3,660
2	5%	$1,342	$156	$1,872
3+	6%	$1,498	-0-	-0-

Buydowns can also offer a huge benefit to the buyer from a qualification standpoint. When lenders use a temporary buydown to qualify a buyer, the lender uses the start rate plus 1 percent and not the note rate. In this example, the buyer qualifies at 4 percent plus 1 percent, which equals 5 percent, and not the higher note rate of 6 percent! We'll discuss how buydowns can enhance buying power in more detail in part II, and show how a buydown can increase the buyer's borrowing power as well.

Qualifying a buyer at 5 percent means the buyer only needs to have a gross income of $4,915 per month to qualify, whereas using a 6 percent rate on the very same loan amount causes the minimum income to qualify to shoot up to $5,387 per month! The seller-funded temporary buydown packs a double wallop.

As discussed in the previously, you'll need to work with your loan officer to make certain the buydown funds your seller is providing are in fact going to the buydown and not, by error, into the lender's pockets.

You can easily ensure the integrity of your buydown by having your own loan officer review the terms of the financing, the buydown rates, and the lender. You might include this stipulation along with the requirement that the buyer must be prequalified by your own lender or loan officer. As with the permanent buydown, you'll also have to make sure your marketing meets local guidelines. If you advertise monthly savings, you'll likely have to "show your math." Check with your broker to be sure.

A seller-funded temporary buydown is a seldom-used yet effective marketing tool that is truly a win-win and can be used in any selling situation.

Watch Out!

While buydowns can lower a buyer's monthly payments for the first few years, payments will eventually increase and the buyer should completely understand that the first few years will be artificially low. A temporary buydown should not be used to get someone to qualify at 4 percent when they can't qualify at 6 percent.

The buyer's lender will have the terms of their mortgage spelled out for them and there are various disclosures that the buyer will sign. Take a little caution here and make sure that the buyers thoroughly understand the process.

If the buyers are using their own lender and not someone from your team, be sure to have one of your mortgage professionals review the temporary buydown to check its accuracy and to compare it to current buydown programs on the market.

Snapshot

Kenya's home just came on the market. She was informed that she was going to be transferred out of state soon, and she needed to prepare for that move. One thing she had to do was decide what she was going to do with her house.

Her company didn't have any sort of relocation department that would help her move out of state, so she was really on her own to get everything in order. So she first called her agent, Malcolm.

"Malcolm, I'm getting transferred and soon. I have to sell and sell quickly, can you help?"

Malcolm put together a presentation for Kenya and showed her the other homes listed in her area. He thought she could probably sell between $250,000 and $265,000. Kenya's home was in a relatively new development, so all the comparables Malcolm used were nearly identical to Kenya's home. To attract more buyers, Malcolm suggested she differentiate her listing and pay for a temporary buydown.

When Malcolm explained how paying for a temporary buydown would give her buyers a starting interest rate of 3.5 percent on a $200,000 loan for a full year and 4.5 percent for the second and would save the buyers more than $4,000 in interest, she was intrigued. She was sold when she saw how the buyers could more easily qualify for the mortgage!

Malcolm put out a yard sign that had a rider attached reading, "Seller providing special financing incentives!" The phone began to ring and the home began to show.

Kenya soon entertained several offers and sold her home long before she had to transfer.

4. Owner Financing

So far, the selling strategies we've discussed involve buyers obtaining a mortgage loan from a lender. What if the buyer can't get a conventional loan?

Do you simply turn them away? Not necessarily. Perhaps it's a time when lenders have severely tightened their lending guidelines, and someone who could have qualified for a mortgage a few months ago now cannot. Maybe the buyer is an independent contractor, successful but without a financial track record of income.

Lenders providing free and easy money in good economic times might tighten qualification guidelines with a vengeance when times turn for the worse.

During slow markets the seller can offer owner financing as an incentive to move a property. Owner financing can provide a solid rate of return when other investment vehicles aren't performing. Owner financing can help keep the asking price intact during a soft market.

But owner financing carries an inherent risk—if the buyer doesn't pay the seller back, the seller (not the "bank") will have to foreclose on the property. That means sellers need to know how to qualify buyers.

The Challenge

Phillip owns his home free and clear. The property, a single-family residence, right at 2,000 square feet, has been in the owner's hands for decades through an inheritance. The owner is considering selling the property.

But the market's not very good now. It used to be better, but right now it's definitely a buyer's market. The property which could have sold for $125 per square foot is now estimated at closer to $100 per square foot. Homes haven't stopped selling; they just take longer to sell and sell for much less.

Phillip put the home on the market for $250,000, the price he would have originally listed it for a few years ago. After all, there were some upgrades and he just finished a new bathroom in the master bedroom, so why not start there? He thought he could save some money if he sold it himself. So he put up a sign, placed some ads, and waited.

Other homes in his area were selling for much lower than his asking price, and they were also knee-deep in seller concessions. Paying closing costs and reducing prices and putting on new roofs and new carpeting throughout was the norm. Every property seemed to have some sort of concession built in. Buyers could almost name their asking price, or at least it seemed that way.

Lenders have also tightened their credit standards. Again. That means the pool of potential buyers continues to dwindle. Subprime lending has dried up completely and even FHA loans won't work in this case since the sales price is higher than the maximum FHA limits.

A real estate agent called and said he had an idea that could sell the home quickly and asked for the listing.

Solution

Owner financing. Since the property is owned free and clear, the seller can sell to anyone and deed the property over to the buyer. The seller effectively becomes a lender and originates their own mortgage through a contract. If the property is not owned free and clear and the seller is willing to finance a new note, that sale will trigger a "due on sale" clause meaning the entire note will become due. Yet properly constructed, owner financing can widen the pool of potential buyers and realize a higher return on the property by commanding a higher sales price.

Buyers who require owner financing come in three types: no credit, bad credit, and good credit.

There are a lot of buyers looking to buy a home with owner financing because they can't qualify for a conventional loan due to their credit history or lack thereof. They have bad credit or no credit at all. They look for owners who advertise that owner financing might be considered.

There are also other buyers who have good credit, yet still can't get conventional credit because their profile simply doesn't match up with current lending guidelines and most often those guidelines pertain to income. More specifically, income which is available but which can't be used as qualifying income for a conventional loan.

Examples of nonqualifying income without a two-year history are:

1. Part-Time Income
2. Bonus Income
3. Royalties
4. Dividends and Interest
5. Newly Self-Employed

Each of these income types typically require both "seasoning" and a "likelihood to continue." Seasoning means the income must have been received and verified as such for at least two years and must also indicate the likelihood of continuing. But for someone who has only gotten one bonus at his job for only one year won't be able to have it counted by a lender. The same can be said for part-time, royalty, dividends, and interest income and someone who hasn't owned their business for more than two years.

When a buyer approaches a seller and inquires about owner financing, the seller knows there must be a reason why—most likely the buyer has been turned down by a conventional lender. If the primary reason is that there is income but it can't be used, then this buyer just might be an ideal candidate for owner financing.

When suggesting owner financing for a seller, it's important that you provide similar guidelines that lenders typically use for a "regular" borrower. The first question you need to ask of the buyer is "Why do you want owner financing?"

If the answer is bad credit, you might want to wait for an offer from someone who has good credit. Or if you want to consider the offer, find out what happened to cause the bad credit. Was it a medical situation where someone was out of work or got sick and couldn't work? Perhaps a catastrophic event such as a divorce or a death in the family caused the bad credit. Isolated credit blemishes should be viewed under a different light than repetitive ones.

Owner financing also should require a substantial down payment from the buyer, something similar to conventional loans requiring 20 percent down.

If you get an offer from someone who has good credit, a down payment and income to pay back the loan, you can help your sellers evaluate these three criteria.

1. Down Payment
2. Credit
3. Ability

Down Payment

This is the amount the buyer puts into the transaction at closing. It can be whatever you wish, but owner financing with a zero down payment is your last choice and probably a mistake. Twenty percent is most advisable.

Someone who is willing to put down 20 percent knows that if they default on the mortgage you can foreclose on them and they will lose those funds. Ten percent might be something to consider; just remember that the more the buyer is willing to put down, the less risk you're going to have as a financier.

Credit

A buyer should provide you with a credit report that is no more than thirty days old. Credit reports that are older may not show newly purchased items on credit that could affect their ability to repay the mortgage.

It can take up to thirty days for a finance company to report a new automobile payment, a boat payment, and a new balance on a bunch of credit cards. The newer the better.

Consumers can get their own credit reports, free of charge, by logging on to www.annualcreditreport.com. This website was formed by the three main credit repositories and allows consumers to pull their own credit.

What Are You Looking for in a Credit Report?	
1. Balances	Total amount outstanding versus the consumer's credit lines
2. Monthly Payment	Minimum amount due on each outstanding balance
3. On Time Payments	Report of how many, if any, late payments there have been over the past two years
4. Derogatory Credit	Report of any collection accounts, judgments, or bankruptcies

You want to look for low balances when compared to their credit limits, no late payments and no derogatory credit. If they have a credit card account with a $10,000 credit line, ideally you want to see the outstanding balance or below $3,333, or 1/3 of the available balance.

Ability

"Ability" to pay is often determined by the buyer's "debt ratios." A debt ratio is the total minimum monthly payments divided by their gross income. There are two debt ratios to consider: the "front" and "back" ratio.

The front ratio is the monthly principal, interest, taxes, and insurance (PITI) on the home and the back ratio is the PITI payment plus outstanding monthly credit obligations such as automobile loans, credit cards, and student loans. An ideal front ratio is typically 33 percent or less of the borrowers' gross income and an ideal back ratio is 44 percent or less of the borrowers' gross income. These ratios can be moving targets sometimes but are typical acceptable ratios for conventional and government lending.

For example, if the loan amount is $200,000, using a thirty-year rate of 8 percent, the principal and interest payment is $1,467 per month. The property taxes work out to $1,800 per year, or $150 per month and the monthly hazard insurance bill is $50.

Principal and Interest	$1,467
Property Taxes	$150
Insurance	$50
PITI	$1,667

If you divide the $1,667 PITI by the front ratio of 0.33, the answer is $5,051. Expressed as a gross monthly income, the borrower would qualify if she made at least $5,051 per month.

Here's how you figure the back ratio: In this example if the buyer only had one car payment of $350 and one credit card payment of $85, her total monthly debt would be:

PITI	$1,667
Car Payment	$350
Credit Card	$85
Total	$2,102

Divide the $2,102 by the front ratio of 0.44. The answer is 4,777, or $4,777 gross monthly income needed to qualify.

Your buyer can provide evidence of her monthly income by giving you her most recent pay stub or having an employer provide you with an earnings statement.

With technology the way it is today, it's not all that difficult for people to forge documents. Basic software can put together some very impressive looking pay check stubs, W-2s, and income taxes.

When you review pay stubs or income tax returns to verify income, independently verify the existence of the company simply by dialing "411" and ask for the phone number of the company listed on the documentation.

You can also "Google" search the company name as well. Verify employment by calling the Human Resources Department. You may be asked for a "Borrowers Authorization" form, which is a signed statement from your potential buyer that gives you the permission to check on their credit, assets, and employment.

If your buyers have a down payment, if you have reviewed their credit and their debt ratios are similar to those used by lenders, then it's likely the buyers can afford the home. You've just sold the property and done so in a prudent fashion.

Did you see in this example that the interest rate was 8 percent and not 6 percent as used in previous examples? Owner financing can command higher rates. If the buyer can't get conventional financing, you can offset that potential risk with a higher rate of return.

An even higher rate and perhaps even more down payment would be required for someone with damaged credit. Bad things can happen to good people. Often, damaged credit is associated with a life-changing event such as an illness, divorce, or a loss of job. Sometimes the only way to rebuild a credit profile is by owner financing.

It's also important that you have a proper sale under procedures common for your area. Make sure both parties are represented by their own attorney, preferably one with experience in owner financing. Spell out every possible outcome. What happens if the buyer pays late? If they default? The sellers should act on these clauses without hesitation. If they fail to enforce the contract one time, they may lose that right altogether! If an escrow or title agency handles closings, then be certain that the closing is held just the same as with any other closing.

You'll need to have a proper note drawn, have the proper deeds signed and recorded, and make sure there are no previous title issues with a title insurance policy.

You'll also need to be aware of foreclosure procedures that govern your state or province. Unfortunately, people can get behind on their mortgage and you'll need to recover your home through foreclosure proceedings should the buyers be unable to continue making payments.

Make it clear that you, as their real estate agent, are NOT the one who is "approving" any loan nor guaranteeing any sort of timely payment whatsoever. You don't want it implied that you approved someone on the seller's behalf. Simply provide the seller with these qualifying guidelines and consult your team to help walk them through the process.

One final note: it's critical that the property be adequately insured and property taxes are always paid on time. As part of your contract, require that the buyers provide proof of payment for one full year of hazard insurance at the beginning of each year, and verify coverage by placing a phone call to their insurance agent. Do the same with property taxes, and have a drop-dead date for payment of property taxes and for when the buyers must provide you with a paid receipt.

Owner financing works best when it is for a limited period of time, typically a two to five year balloon note. This effectively sets a date in the near future for the buyers to refinance conventionally and pay the note in full. Most credit and income problems can be overcome in two to five years, but make sure there is a contingency built into the agreement in case the buyers are still unable to qualify.

Many localities offer escrow or impound accounts that are paid directly to the county or parish, and you can always check the status of paid or unpaid property taxes anytime you choose as most areas now allow consumers to research taxes online.

Snapshot

Jim and Glenda wanted to sell their current home and move to a lakefront retirement home, which their son found in Arkansas. Unfortunately, home sales were in the doldrums and their retirement plans hinged on home prices being higher.

The home sat for a few months, and Jim and Glenda wanted to move to their retirement home by winter. Since they owned their home free and clear, their real estate agent suggested they offer to finance the home to those who qualified.

Immediately thereafter, their real estate agent announced on the MLS that the owners were willing to finance and placed a sign in their yard, "Owner Financing." Very soon, the phone began to ring.

Most calls were from those who had some serious issues such as bad credit, a lack of a job, or a combination of the two. But one caller's unique situation got Jim and Glenda's attention.

The potential buyer had been an automobile mechanic for nearly twenty years when he had the opportunity to buy the shop where he worked. He did just that, but then found out he couldn't qualify for a home loan from a mortgage company until he had been self- employed for at least two years.

He had money for the down payment and provided a copy of his credit report along with copies of his bank statements showing regular deposits and a healthy savings account.

Jim and Glenda accepted the offer and agreed to finance the property with 20 percent down and an interest rate of 8.5 percent. They also constructed a "balloon" note where the buyer would have to refinance the loan and pay Jim and Glenda the entire amount at the end of five years. Jim and Glenda worked with a local real estate attorney and their agent to have the purchase contract and note drawn. Their closing agent helped guide the buyers and sellers along the way through the closing process.

It worked out perfectly for both parties. The buyer got the house he wanted under good terms and Jim and Glenda sold their house that gave them an 8.5 percent return, much better than the current return from their retirement accounts!

In fact, Jim and Glenda were a little sad when the buyer actually refinanced two years down the road and not five … they were enjoying their nice little 8.5 percent guaranteed return!

5. Contract for Deed

Previously, we discussed how owner financing can help move a property and how to properly structure an owner-financed sale.

When the seller acts as the lender in an owner-financed transaction and executes a mortgage, the seller not only sells the property but deeds the property to the buyers and retains a lien on title. If the buyers fail to pay their mortgage, the sellers would proceed with foreclosure proceedings according to state and provincial laws just as any lender might.

A contract for deed, sometimes called a "land contract," is similar to an owner-financed transaction, yet there is no mortgage. Ownership doesn't change hands until the entire sales price has been paid in full. Think of it as an automobile loan—once all the payments have been made, the car belongs to the buyer. If the buyer doesn't make the payments, they'll soon find their car repossessed.

A contract for deed is advantageous for the buyer and seller under the right circumstances, but those … and pitfalls … need to be examined.

The Challenge

Some markets are just plain slow and properties are not moving like they used to. Concessions work, but it's really a buyers market. Many of the buyers still in the market are ones who have had trouble qualifying for financing from conventional or government lenders either because of credit or income concerns.

A different challenge can also exist with regards to the property itself. Lenders like to make loans on properties that have shown to have marketable value. Marketable value means there are other homes in the area that have sold that are similar to the one being listed. For example, a four-bedroom, brick home near local schools would have a proven marketable value because there are several other four-bedroom, brick homes similar in size that have recently sold.

Sometimes, however, a two-bedroom home not anywhere near schools and sitting on five acres with a barn may not be as marketable as others! There simply aren't many homes that have sold of that nature. Probably none in many markets. The property could be a geodesic dome, or a log cabin where there are no others. Or it could be any property that appears unique compared to others sold in the area.

The Solution

Much the way owner financing can help move a property while retaining value, so too can a contract for deed. And just as with owner financing, the property must be owned free and clear by the seller with no current loans on the property.

The main difference between an owner-financed mortgage and a contract for deed is that with a contract for deed, ownership does not fully change hands until the entire sales price has been paid to the seller.

If the sales price on a home is $250,000, with a contract for deed, the seller and buyer can come to almost any terms they mutually decide upon under state and local laws.

The buyer makes monthly payments to the seller, and when the $250,000 is paid in full, the buyer gets complete ownership of the property.

The buyer and seller agree to terms such as monthly payments, down payment, and duration of the contract. In most cases, the contract term is set to give the buyer the time they need to qualify for a conventional loan to pay off the seller's loan.

A contract for deed can also be used to finance a property without comparable sales because of the lack of appraisal or property qualification guidelines. If the seller and the buyer agree to a price, then the deal is done. Sign the contract and move in.

Another benefit of a contract for deed is in the infusion of some income on a property that's either not rented or sold. To attract buyers, a landlord could opt for a contract for deed in lieu of renting the property. This makes it more attractive to buyers as they see this as a way to buy a property instead of renting.

Watch Out!

A contract for deed can move a property quickly, but really should be a last resort if you're wanting to cash out some or all of your equity. There may also be restrictions on contracts for deed where you live that either restrict how they're executed or deem them illegal altogether.

Consult an attorney when considering a contract for deed. Because ownership does not change hands until the entire sales price has been paid, it is easier to take the property back from the buyer without going through the foreclosure process. Just like automobiles that get repossessed when payments aren't made, the house can be "repossessed." Most laws that do govern such contracts allow the buyer to make up for the past due payments and retain the contract for deed. In areas where contracts for deed are unrestricted, it can be a huge advantage for a seller.

As with owner financing, both parties should be represented by a qualified attorney. The contract should be clear on penalties for late payments, defaults, etc. Most importantly, the seller should enforce the contract at all times.

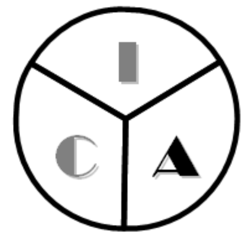
Snapshot

Jimmy owns several rental properties, most acquired through various 1031 exchange transactions. He does have some properties he'd like to sell, but they are difficult to finance. They are HUD-approved manufactured housing sitting on some acreage. When he gets an offer on one of his homes, the buyers either don't have enough for a down payment or their credit is damaged. Still, he'd rather have some income on the homes instead of nothing at all.

Instead of trying to find a buyer with an approved mortgage, he advertises that the home is available as a "rent to own" using a contract for deed. He begins to get some phone calls and finds that he has more phone calls than he does houses. This helps to weed out the less creditworthy buyers.

Jimmy's and the buyer's attorney draw up a contract for deed, record it, and the buyers move in and begin renting the property! The buyers begin to repair their credit under terms they can afford and Jimmy gets newfound cash flow. After a few years, the buyers are able to get conventional financing, and a second closing allows them to purchase the property outright.

6. Seller Seconds



A “seller second” is so-called because it is a mortgage issued by the seller to the buyer, placed in a subordinate, or second, position behind the first mortgage issued by a conventional lender. It’s also called a seller carryback, because the seller “carries back” a second mortgage on the property.

Seller seconds can help buyers leverage their assets by borrowing more and putting down less when buying a home. Buyers can use seller seconds for a variety of reasons while providing an extra financial incentive to sell a property.

Buyers who explore seller seconds can have excellent credit to not-so-good credit, and can have little money for the down payment and closing costs or have tons of money for either but would rather not use their own assets to buy real estate.

Second mortgages typically carry higher interest rates than a first mortgage and help buyers, as well as sellers who want a solid return on an investment (their equity in the home being sold). Not getting 10 percent year in and year out from your mutual fund? You could with a seller second.

The Challenge

Lenders make loans based upon, among other things, a concept known as “loan to value,” or “LTV.” If the sales price of a home is $250,000 and the loan amount is $200,000, then the LTV is said to be 80 percent because the loan equals 80 percent of the value, or sales price.

The less equity there is in a transaction, such as down payment from the buyer, the riskier a loan is said to be. As credit guidelines move around, at some point, lenders tighten their lending guidelines. One of the things they can tighten the most is the LTV.

As things get a tad more “dicey” in the real estate lending business, lenders will typically decrease their exposure, reducing their risk. This means loaning less money when compared to the sales price of the property.

For instance, a lender might have in its lending portfolio a loan program that offers 100 percent financing for those who have credit scores above 700. Then the economy begins to sour or more than their fair share of loans go into default, so the lender decides to tighten their credit standards and lend less money on each transaction.

When a lender lowers the LTV, it helps to ensure that they will still get their original mortgage amount if they have to foreclose. The lower LTV allows them to breathe a bit easier when approving a home loan.

That doesn't mean a lender won't allow for a purchase with 100 percent financing. It only means that the lender won't be exposed to more than 90 percent of the value. Another lender can provide a second mortgage to cover the other 10 percent, but they do so at their own risk. Also, the lender must be told of the second.

This is called "combined loan to value" or "CLTV." Certain mortgage programs might have lending guidelines that read: "Maximum LTV 90 percent - Maximum CLTV 100 percent," which means the lender is willing to issue a mortgage at 90 percent of the sales price and someone else, not the first mortgage lender, can offer a second to finance 100 percent of the sales price of the home!

There is another issue with LTVs that involves private mortgage insurance, or PMI. PMI is an insurance policy, payable to the lender, should the borrower default on roughly the difference between 20 percent down and what the buyers actually put down. PMI is typically required on all mortgage loans whose LTV is above 80 percent.

If a lender makes a loan at 90 percent LTV, there will likely be PMI. A typical PMI monthly premium is about ½ percent of the loan amount. On a $250,000 mortgage, a monthly PMI payment would be about $100 per month.

While guidelines have allowed for PMI payments to be tax deductible in the past, it's not a guarantee that will be the case in the future. Also, not everyone can qualify for the tax deduction. On the other hand, mortgage interest in the United States is always tax deductible for those who itemize their deductions on their tax returns.

Additionally, seller seconds can help with jumbo purchases. Jumbo mortgage rates can be as high as 1 percent above the conforming loan limit.

If a thirty-year rate for a conforming loan is at 6.5 percent, then a jumbo loan amount above $417,000 could be as high as 7.5 percent.

Loan Amount	Rate/Term	Monthly Payment
$417,000 Conforming	6.5% thirty year	$2,635
$418,000 Jumbo	7.5% thirty year	$2,922

By using a seller second, the buyers can have one first mortgage at the maximum conforming limit of $417,000 and the seller could carry a second note for the balance.

The Solution

One of the biggest challenges for some home buyers is saving for a down payment. While there are certainly zero-down loan programs available, most are more difficult to qualify for and they carry much higher interest rates than loan programs with a down payment.

Although saving for the down payment is important, it can be a challenge to save 20 percent of the sales price to avoid PMI. But, what if the buyers don't have 20 percent down and want to buy immediately? Sellers can provide the remainder of the 20 percent in the form of a seller second.

For instance, a home is listed for $400,000 and the buyers only have $20,000 saved for a down payment. With 5 percent down, this would leave them with a loan amount of $380,000 and a PMI payment of about $160 per month.

With a seller second in the amount of $60,000, the buyers get both lower total monthly payments and avoid paying PMI. Let's compare the following two scenarios.

Scenario One	
5% Down and No Seller Second	
Sales Price	$400,000
5% Down	$20,000
Loan	$380,000
Thirty-Year Loan at 6.5%	$2,401
PMI Payment	$160
Total Payment	$2,561 per month

Scenario Two	
5% Down and 15% Seller Second	
Sales Price	$400,000
5% Down	$20,000
Loan (80% of $400,000)	$320,000
Seller Second Loan	$60,000
1st Thirty-Year Loan at 6.5%	$2,022
2nd Thirty-Year Loan at 7.5%	$419
Total Payment	$2,441 per month

With a seller second, the payments are $120 lower per month, the buyers avoid PMI, and the sellers get a 7.5 percent return on their money!

This scenario is called an 80-15-5 because the buyers put down 5 percent of their own money, the sellers provided a second at 15 percent of the sales price and the lender made a loan at 80 percent of the sales price.

Another common seller carryback structure is called an 80-10-10 where the buyers put down 10 percent, the sellers carry a second at 10 percent of the sales price, and the lenders again provide a mortgage at 80 percent of the sales price.

Just Barely Jumbo" Seller Seconds

Seller seconds can also be an attractive offer for homes priced in the "just barely jumbo" category. It is also applicable for homes priced from $500,000, when the seller carries a second to keep the larger first mortgage at the conforming limit. Let's look at an example with a home listed for $550,000 and the buyers only have 10 percent down, or $55,000.

$550,000 – $55,000 = $495,000

If conforming rates are at 6.5 percent, a jumbo rate might be 7.5 percent, yielding a monthly payment of $3,461 plus a PMI payment of $200, or $3,661.

Now let's rework this structure with an accommodating seller and keep the loan amount at the conforming limit of $417,000.

Conforming Loan of $417,000		Monthly Payment
Sales Price	$550,000	
10 % down	$55,000	
1st Loan at 6.5%	$417,000	$2,635
Seller Second at 7.5%	$78,000	$545
	Total Monthly Payment	$3,180

Compare the $3,180 total monthly payment with the first scenario with no seller carryback of $3,661 and the total monthly savings is $481!

Because the total monthly payments are so much lower, the seller is also increasing the buyer's buying power by $481. This means your pool of buyers is increased because more people can qualify.

Assuming a monthly tax and insurance payment of $600 for a $550,000 home and a 33 percent debt ratio, a buyer would have to make $12,912 per month to qualify.

But with a seller second, suddenly the home becomes more affordable with just $11,450 per month needed to qualify, or a decrease in required income of more than 12 percent!

Put another way, an 80-10-10 with a seller second increases the borrowing power by more than $75,000 using a 6.5 percent thirty-year first mortgage and a 7.5 percent thirty-year second!

Watch Out!

Lenders evaluate loan risk and calculate debt ratios using monthly payments the buyers will make after the loan closes. Many loans prohibit second mortgages, especially at higher LTVs, and plainly tell the buyer, "this loan prohibits subordinate or secondary financing."

You may have heard the term "silent second," where the seller does indeed carry a second mortgage for a cash-strapped buyer but doesn't disclose that fact to anyone, including the lender issuing the original mortgage. This is illegal. You must disclose the seller second.

One of the many documents buyers and sellers sign at closing essentially asks that you claim there are no other outside agreements other than what's in the sales contract. Hiding a second mortgage will skew the debt ratio, and if the buyers ultimately default, the lender will do a little research and find that the sellers were a party to loan fraud.

As with any owner financing, make sure you have a proper note drawn for the buyers to sign and have your lien recorded just as the first mortgage is recorded by the state. Also remember to exercise prudence when evaluating a buyer's credit worthiness.

Snapshot

Bill and Charlotte have recently retired and want to downsize a bit while cashing out all the equity they've accumulated over the years. They almost own their house free and clear with a $65,000 balance yet remaining.

The market is slowing and although they haven't completely ruled out owner financing, if they did finance the entire sales price it would leave them with less of a nest egg than they had been planning on.

Since financing some but not all the home seemed practical, they offered a seller carryback for a zero down loan.

The zero down loan option was intriguing to Laura and Luke, some buyers who inquired about the zero-money-down terms. The listing agent explained that the sellers were willing to finance up to 20 percent of the sales price of the home, which was a dent that could be used with a lender that offers 80/20 financing.

The buyers did some research and found a lender that did allow for a seller second to 100 percent of the sales price of the home. They moved in with no money down and the sellers still got the lion's share of their nest egg from the sale of their home. Plus they had a monthly annuity paying 8.5 percent per month, every month … more than most of their retirement accounts were doing!

7. Lease with Option and Lease Purchase

A lease with option and a lease purchase are often interchanged and can mean the same thing, but technically they're a bit different.

A lease with option to purchase is an agreement where renters have an exclusive right to lease a property for a certain period of time, and when that period ends, the renters can exercise their "option" to buy the property or not buy it. Purchasing is optional.

A lease purchase stipulates that renters *will* purchase the property at the end of their lease period and in the meantime must arrange for financing. Purchasing is mandatory.

A lease purchase allows landlords to set aside part of their renter's monthly payments for a down payment and/or closing costs at the end of the lease period. A lease purchase works well for buyers who haven't saved up for a down payment or who are having a hard time doing so.

Lease purchase agreements can work in any market condition, and are often a solution for someone having trouble selling their property outright and would consider a lease purchase arrangement to increase their cash flow or offset the mortgage payment on the house.

The Challenge

In a sellers' market, a lease purchase won't be your best bet. There's no reason not to sell when you've got willing buyers lining up at your doorstep.

As markets slow or even come to a dead stop, sometimes an outright purchase isn't going to happen. At least on the seller's time frame. Sometimes it's best just to take it off the market and wait for conditions to improve. This means, however, that a property is sitting with no prospects of selling and there's no income to offset the property taxes, insurance, and maintenance.

A market can also have a small pool of buyers, and if the quality of those buyers is less than stellar, no amount of seller concessions would have any impact.

Offering a seller-funded buydown or paying for closing costs matters little if the buyer can't qualify. And as credit begins to tighten, suddenly loans that were available a few months ago are no longer around.

The Solution

A lease purchase is a perfect way to sell a house at an agreed-upon price, take on a tenant to pay for the current overhead, and help someone save up money to buy your property.

A lease purchase agreement will establish how much the rent will be each month along with how much will be paid each month to fund a buyer's account that will be used at the end of a predetermined period, say one to two years, for a down payment and/or closing costs.

A lease purchase can work with or without an initial "down payment" paid to the seller and can work with or without an agreed-upon price to sell the home at the end of the lease period.

The seller and buyer work up a lease purchase contract as well as what the monthly rent and buyer's fund amounts will be. First, however, the seller needs to determine the market rent for their property.

Whatever the monthly rental agreement comes out to be, it must be in line with other rents in the area. If the home being rented is a three-bedroom, two-bath brick home, then the monthly rent must be similar with other homes in the neighborhood of similar size, condition, and amenities.

The best way to determine market rent is to hire an appraiser to perform a rent survey for the neighborhood, but market rent may also be determined by using the MLS or craigslist to search for other similar rentals.

However you do it, it's critical to document how you arrived at the monthly rent and keep that documentation with you throughout the term of the lease all the way through the closing of the house.

Let's say $1,500 per month is the market rent for your property. The next step is to decide how much the buyers pay into their buyer's account every month. Let's say the buyers can pay $2,000 per month. After subtracting $1,500 per month for the market rent, $500 is left per month to fund their buyer's account.

If the market rent is $1,500 and the monthly payments are also $1,500, no matter what arrangement you make with the buyers regarding how much to put in the buyer's account each month, only the amount above and beyond market rent can be used for buyer's funds.

In this example, if rents were going for $1,500 per month and the owner took out $500 per month to go into the buyer's account, the tenants would in effect only be paying $1,000 per month, well below market.

While this might sound like a great deal on a lease, a lender won't count the $500 monthly savings account in this scenario because the $500 is not above and beyond market rents for the area. Instead, the $500 turns out to be a "gift" from the seller.

Sellers aren't allowed to give buyers money for their down payment or closing costs; it has to come from the buyers' own funds. That's one of the main reasons to document market rents for the area, so the lender can be assured the extra money being paid each month is in fact the buyers' very own.

If the buyers want $500 to go toward a down payment fund and the market rent is $1,500, then the buyers must pay $2,000 to the owner who then sets aside the $500 as it comes in. At the end of twelve months, the buyers have saved up $6,000 that they had given to their landlord in addition to the funds they had saved on their own.

In the meantime, the buyers have lined up a lender and are preapproved for a new mortgage, using their $6,000 buyer's account to help qualify for the new home loan.

A lease purchase buyer should be treated like any other buyer who makes an offer on your home. It is possible then for sellers to help pay for closing costs if they want or even take on a second mortgage to help them qualify.

The seller should use this period to help the buyers establish a payment history if the buyers have impaired credit. Sellers should be able to terminate the agreement if the buyers don't pay their rent as agreed.

A lease with option can work just as a lease purchase, except that at the end of the lease period there is no requirement that the buyers buy the property as the contract would state in straight lease purchase. Lease option contracts typically allow for the buyers to get back all the extra funds they paid should they decide not to exercise their purchase option during their option period.

Watch Out!

As mentioned earlier, it's important to document current market rent by using information pulled from the MLS or pay for a rent survey to be performed by a licensed appraiser.

There are even market rents determined by looking in the classifieds for rentals and saving the advertisement that has the date on it.

A lease purchase needs to be handled as carefully as any other contract and having attorneys for both parties review the agreement is a good idea. Do potential buyers default if they fall behind on their rent and, if they do, are they entitled to any of their buyers' funds? What happens if the buyers can't qualify at the end of the lease term? These questions need to be addressed in advance and answers should be spelled out precisely in case problems arise.

Problems can occur if property values are deteriorating. If the lease purchase agreement spells out that the buyer will buy a property for $200,000 at the end of eighteen months and property values have fallen since then, it's possible and quite likely that when the buyers' lender orders an appraisal, the market value will be lower than the original sales price.

The appraisal could come in at $180,000 instead of $200,000. Because lenders establish loan amounts on the lower of the sales price or appraised value, if the appraisal comes in lower than the sales price, the lender will use $180,000 as the sales basis and the buyers must come in with the $20,000 difference in addition to their down payment!

It's also important to keep the buyers' rent and buyers' fund payments in separate accounts and not commingle them with the seller's personal or business bank accounts. Lenders will always scrutinize lease option funds, and if there is ever any notion that some of the funds actually belong to the seller, it can cause problems. Keeping rent payments and buyers funds in separate accounts will alleviate any question as to what money belongs to whom.

Snapshot

Blanche graduated from college a couple of years ago and was one year away from getting her master's degree. Several times during her college career, she wondered if it might be better to buy a condo instead of renting, but every time she thought it might be a good idea, she realized she didn't have enough money or enough income to qualify. It simply remained a dream.

A real estate agent friend of hers told her about a lease purchase program that would provide her a nice place to live during graduate school while at the same time help her to save up money for down payment and associated closing costs.

Blanche's agent knew a seller who had a condo close to campus who was willing to write up a lease purchase with the right person, so Blanche's agent arranged a meeting.

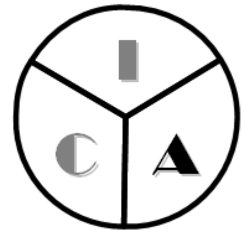
The seller agreed to a lease purchase and the lease period of eighteen months, after which Blanche would apply for, and obtain, financing. Eighteen months was perfect because that would give her plenty of time to finish school and secure a good job.

Rents for a two-bedroom condo were around $1,100 per month, and Blanche agreed to pay the seller $1,800 per month leaving $700 each month to go into her own buyers' fund. At the end of 18 months, Blanche had accumulated $12,600. Blanche's parents had also agreed to help Blanche pay the extra $700 if she ever got a little short.

Two months before her lease option was up, she got a job and applied for a conventional mortgage with her local bank and closed before her eighteen months had expired.

The seller cash flowed on the condo from day one, sold the property at his asking price, and Blanche was a homeowner just two months out of college!

8. Selling to Relatives



Among real estate professionals, the term "arms length transaction" is not uncommon. This means that both the buyer and the seller are independent and are buying or selling the property in their own individual interest and not in the interest of each other.

Lenders make loans partly on the value of the property being sold and use appraisers to fairly assess properties, making sure they're not being sold too high or too low compared to similar homes in the area.

When a family member sells to another family member, the "arms length transaction" notion is difficult to establish. Would parents selling to their son decide to give the son a better deal than what they would give to any other willing and able buyer? One would think so.

Sometimes selling to relatives is a prudent choice when a family wants to sell a property that's not moving or simply wants to keep the property in the family.

Family members can buy and sell from one another, but there are certain precautions that must be met before a buyer can get financing from a lender.

The Challenge

When family members sell to one another and the buyer needs financing, one of the first things a lender looks at is the appraisal on the property along with the sales contract. If the lender determines the value of the home is skewed, then there'll be no loan. Especially so if the buyers have little or no down payment money.

When buyers have little or no down payment money, they run up against a challenge: lenders won't have a firm grip on their collateral's value (the property), hence no mortgage.

Even though parents might want to sell the property to their son, if they have a mortgage on the home, that old mortgage will have to be paid off. If the house is owned free and clear, then the parents can do mostly anything they want with the house. But if they want some money out of the transaction as well as paying off the old note, then the buyers need to get financing.

The Solution

Parents can give money to their kids in the form of a gift to help them buy a home. In fact, relatives are one of the few allowable sources for cash gifts to buy real estate and secure a home loan.

But in the case of parents selling to their son, they don't have to give the child any cash whatsoever. The parents will give a gift of "equity" in the property.

If a home sells for $200,000, then the parents can give a gift of some of the equity in the property and the lender can make a mortgage based upon the difference between the gift and the sales price. But there's sometimes the rub. It's a non-arms length transaction and the value can be hard to pin down. But not if the seller gets an appraisal before the contract is written up.

The parents can contact an appraiser, pay the $350 or so and ask, "If we sold this house today, what do you think it would sell for?" The appraiser would do his job, find comparable sales in the area, and come up with an appraised value.

If the parents use the appraised value as the sales price then a lender will breathe a little easier and consider making the loan as the appraisal was performed independently and prior to the official sale.

How much does a parent need to give in the form of equity? If it's an FHA loan the buyer is getting, then the only equity the parent needs to give is enough for the minimum investment required on the buyers' behalf (3 percent of the sales price).

If a home is appraised at then sells for $100,000, then an FHA lender can place a mortgage loan simply by transferring equity from the parent to the child in lieu of a cash down payment, or $3,000.

If the sales price and loan amount are higher than the maximum FHA lending limits, then a conventional loan will work, but only if a minimum of 20 percent of the equity is gifted.

If a home is appraised for then sells at $300,000, then the amount of equity transfer needs to be at least 20 percent of $300,000, or $60,000 in order for a lender to place a conventional mortgage loan.

Instead of the buyer showing up with a $60,000 cashier's check to buy the property, the parent constructs an equity gift letter showing how much of the equity will be given at the closing table.

A gift of equity is an excellent vehicle to transfer a property from one family member to another.

There is yet another method to transfer a property from one family member to another and that involves adding the relative to the title on the property in the form of a recorded deed.

The lucky family member must occupy the property as their primary residence and declare it as their homestead. After one year, lenders will consider the new resident a seasoned owner who can then refinance the old mortgage and pay off the original relative with proceeds from a cash-out refinance.

Watch Out!

Gifts of any sort can have income tax ramifications, so it's important to receive professional tax advice with regards to transferring equity or property from one family member to another.

There are specific IRS guidelines that can impact how much a family member can give per year and over a lifetime without being taxed, and there are certainly state and provincial statutes that must be explored.

Family members who receive gifts of equity to purchase a property will still have to be creditworthy for a lender to make a mortgage loan. Equity gifts don't automatically mean someone can get a mortgage; it's just that the down payment is in the form of equity that already exists in the property being sold and doesn't directly affect whether or not someone qualifies for financing.

Finally, everything must be disclosed. There can be no private "side arrangements." The parents can't forgive a loan which is in fact a gift in the eyes of the IRS.

Snapshot

A couple owned a home for several years and decided to put the house on the market to see if they could sell it for a reasonable amount After two months on the market, they received a few offers, but the ones they did receive were way below what they were willing to accept. The house was listed at $175,000.

Their real estate agent asked if they had any relatives such as a son or daughter who might be interested in purchasing the home. The couple could help out on the down payment with a gift of equity and also contribute to the buyers' closing costs.

The couple in fact did have a son and a daughter-in-law that were newly married and renting an apartment. The father called his son and asked if he and his wife would like to buy their home from them.

The son said, "Sure," but they didn't have any money for the down payment and it might be a while before they could acquire enough money. They were newlyweds!

The father explained how they could give both the son and the daughter-in-law gifts in the form of equity in the property instead of a down payment if they qualified for a regular mortgage for the difference.

The son contacted a lender and explained the situation. The lender said they qualified.

Surprised but happy, the young couple applied for a mortgage using their equity gift as their down payment and the parents helped with closing costs.

Instead of throwing away rent every month, the couple owned their own home and the parents were able to sell for what they wanted, paying off their old mortgage in the process.

9. Wraparound Mortgages

Wraparound mortgages or "wraps" have existed and been written about in various books, magazines, and seminars for years. The problem with wraps is that they're almost always illegal.

A wraparound mortgage is so-called because the buyer's mortgage is "wrapped" around the original mortgage that still remains on the property. A wrap is part of a sale and the property is deeded to the buyer.

Almost every mortgage loan has as part of the original note a "due on sale" clause that means quite literally the entire mortgage amount due to the lender shall become immediately due. Since a wrap includes a sale and ownership is being transferred, the lender can call the note in.

There are in fact two notes: the original note made by the original owner and a new note made by the buyer to the seller.

The buyer makes payments to the seller, and the seller in turn makes payments directly to the original lender. Wraparounds are not owner financing, which can only occur when there are no other liens on the property being sold.

As a selling or listing agent, it's important that you know the ins and outs of a wrap and counsel your buyers and sellers accordingly. In rare instances you can indeed inform the current lender of your intention to do a wrap and let the lender decide if they'll waive the due on sale clause. For our purposes, this chapter is primarily intended to inform.

DO NOT UNDER ANY CIRCUMSTANCES PARTICIPATE IN AN UNDISCLOSED WRAP. IN THE UNUSUAL INSTANCE THAT A LENDER CONSENTS TO A FULLY DISCLOSED WRAP, YOU SHOULD ALWAYS INVOLVE YOUR OFFICE'S LEADERSHIP AND LEGAL COUCEL TO MAKE SURE YOU, YOUR CLIENTS, AND YOUR OFFICE ARE ON THE RIGHT SIDE OF THE LAW.

The Challenge

A seller has a home listed for $200,000 and has a home loan balance of $100,000 at his bank. The current market isn't all that favorable and homes haven't been moving. The seller does have some "wiggle room" due to his favorable equity position in the home.

He also has another attractive feature that's not advertised—his current mortgage rate is at 5 percent while the market rates are closer to 8 percent.

He's got a house he wants to sell to cash in on his equity, and he's got an interest rate far below market. He knows he has an asset, but he's not quite sure how to best use it in a slow market.

He is soon approached by a buyer, but the buyer hasn't been able to secure financing and would like the seller to consider financing the sale.

The buyer asks about the possibility of a wraparound mortgage where the buyer would make monthly payments to the seller and the seller would then make the monthly payments to the lender.

The Solution

At first glance this sounds like owner financing.

But owner financing can't work because there's a current note on the property. Yes, the buyer could take a second from the seller and keep the current mortgage in the first position, but in doing so, the seller would trigger the due on sale clause and the first mortgage note would become due.

The buyer, or somebody, would have to pony up a bunch of money fast … and if the buyer couldn't secure conventional financing in the first place, he certainly can't qualify for a new one to pay off the lender whose terms have just been violated.

There are two possibilities with a wrap. First, a wrap may not necessarily trigger a due on sale clause *if the lender has granted permission for the sale to be made.* If a wrap is indeed being considered, the owner needs to make a formal request to the lender asking for permission for a wraparound mortgage to take place.

In all likelihood, the lender won't allow it, but some lenders, particularly local mortgage lenders, might make an exception. It doesn't hurt to ask.

Most loan programs are not as easy to transfer as they were 20 years ago. For instance, it wasn't up until 1988 that the VA stopped issuing those "nonqualified assumable" mortgages.

These loans were designed to be easily transferred to a buyer without qualification. The buyer's income, credit, or the ability to repay whatsoever wasn't checked.

Part of the VA philosophy was that if a veteran was having problems paying the mortgage, then why not take that burden from the veteran and sell it to someone who would take over the mortgage? The VA loan had an assumption feature that did not qualify the buyers … anyone who could legally enter into a contract and would occupy the property could qualify.

Nowadays, however, if loans carry an assumption clause, meaning the loan itself can be assumed by a new buyer, the loan doesn't have the "nonqualifying" feature. Those loans went away about twenty years ago. Even if you could find a "nonqualified assumable" mortgage, because it was made so long ago, the seller of the property has likely built up a considerable amount of equity.

Let's look at a home that sold under a nonqualified assumable loan in 1987 for $150,000. There's at least $100,000 in equity for the buyer and that only assumes natural amortization and doesn't include any home price appreciation over the past two decades.

Let's say home prices doubled since 1987, and the home was valued at $300,000 and not $150,000 and had a current loan balance of $50,000. The seller's equity would be $250,000.

Even if a buyer could walk into a nonqualified assumable mortgage, no seller in his right mind would give away that equity. For all intents, nonqualified assumable mortgages are gone.

For loans that are assumable, they are "qualified" assumptions meaning that the lender will consider transferring the mortgage to the buyer, but the buyer must go through a standard qualification process as with any other mortgage.

If the buyer had trouble qualifying for a new mortgage, the buyer will have trouble qualifying for the assumption. Those are the two answers to wraps: getting permission from the lender and qualifying for the assumption.

Watch Out!

There will be times when the buyers and sellers keep their wrap "under wraps." After all, if the original lender keeps getting the same monthly payment every month from the original owner, how would the lender know that the house was even sold? As long as the money comes in on time each and every month, the lender would never notice. Or so the thinking goes.

As attractive as this might sound between a willing buyer and seller, there are pitfalls that can affect both parties. Lenders routinely pay research companies that peruse various public records reviewing real estate and look to see if any other liens have been attached to the property. If a lien is discovered, the lender would inquire a bit further and find out that the home had indeed sold and ownership had been transferred. Early in Mary Tennant's career, she witnessed a prominent attorney sentenced to seventeen years in prison for wrapping homes. Don't risk it! Always check with an attorney to ensure legal compliance with local, state, and federal law.

On the opposite side there is another worry. The buyer could be making payments to the seller each and every month on time, every time. But what if the seller got into some serious financial difficulties and suddenly stopped making the mortgage payments to the lender, yet instead kept the money himself?

Bad things can happen. The lender forecloses on the original seller and the buyer who made wrap payments to the seller loses everything, including any down payment given to the seller. The lender won't recognize the illegal transfer, and will take ownership of the home leaving the "buyer" unwrapped and out in the cold.

Snapshot

Carl had been trying to sell his house for a few months when he was approached by a buyer who explained that, even though his credit was currently in a bad way, it was completely due to an accident that kept him out of work for several months.

The buyer's credit had gotten better and was on its way to being completely repaired. "Could you finance the property for the first few years while I get back on my feet?" the buyer asked. "I've got about 10 percent down that I can give you."

Carl had a mortgage on the house so he couldn't finance it entirely, but if he did carry a note for the buyer, he would actually make some decent money on it every month as the new payment would be much higher than his current mortgage payment.

Carl explained that he couldn't finance the property because there was still a mortgage balance on the home. But Carl did contact the lender and described his situation. "I've got someone that wants to buy my house, is my note assumable?" he asked. The lender responded that "Yes, the buyer can assume the mortgage, but he'll have to qualify for it first." Carl contacted the buyer and explained what the lender had told him, so the buyer made an application to assume the note.

The property's loan-to-value ratio was right at 70 percent, comparing the appraisal and the current loan balance. By adding the buyer's 10 percent down the loan-to-value ratio was lowered even further.

Even though the buyer's credit had been bad, the lender could see that while it was not "excellent," it was improving, and the buyer had provided any and all documentation that the lender needed to prove that the buyer had been in an accident and unable to work but now he was back on the job.

The lender approved the assumption based upon a lower loan-to-value ratio, credit improved and a documented reason for the negative credit.

What Buyers Can Do in a Changing Market

If the market has changed directions and sales are at a standstill, buyers can still help themselves in a variety of ways. All too often buyers never enter the real estate game because they incorrectly assume they wouldn't qualify. This is your opportunity to educate them on available financing solutions.

Perhaps they think that they can't buy without 20 percent down. Maybe they believe the collection procedures last year sunk their credit rating too far for them to buy. Or the layoff, divorce, accident, etc., has put home buying out of reach.

Too often buyers can research their own situation and determine that there's no reason to apply for a mortgage because their credit score is 679. Or that they had a bankruptcy five years ago. Perhaps they "discover" that the FHA debt ratio requirement is 41 and they're a 43.

Buyers need your help to bust these myths. The following chapters will reveal ways buyers can overcome income, asset, or credit concerns on their own. And you'll be there to guide them.

RESOURCE

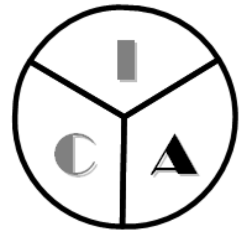
To help your buyers through the mortgage process, check out the "7 Critical Points in the Mortgage Process for Realtors" by Robert Griffith, CEO of Primero Home Loans, in *Ignite Power Session 7: Win the Buyer*, available on www.KWConnect.com.

Sharing your agent-branded KW App?

1. Get the Keller Williams Real Estate app from Apple App Store or Google Play Store.
2. In the app, use "Agent Search" to find and select your name.
3. Toggle "Make this my agent" button to "Yes"
4. Use "Share App" to share with your contacts!

Find More on KWConnect.com

10. Using a 401(k)



The immense popularity of 401(k) plans stems not only from their proven ability to help people invest for their retirement, but also from employers looking to avoid the sizeable costs of pension plans. The net result, according to the Investment Company Institute, is a 401(k) retirement system holding more than $2.7 trillion in assets for over 50 million participants.

There will be those that say "never touch your retirement account," and while I'm not going to get into any debate with a certified financial planner, I will say that, used properly, a 401(k) account is an excellent source to help a buyer secure funds to buy a house. It's perhaps the easiest method to find down payment money because almost everyone qualifies to use a 401(k) to help buy a house.

There are two ways a home buyer can use their 401(k)—cashing in a portion of their account tax- and penalty-free if they're first-time home buyers or borrowing from their 401(k) regardless of first time home owner status.

Similarly Canadians may also tap into their registered retirement savings plan (RRSP) to borrow money and buy a home. This special program is called the Home Buyers' Plan (HBP). A person can borrow up to $20,000 from their RRSP and a couple can borrow up to $40,000.

The Canadian HBP is designed for first-time home buyers only (cannot have owned a house as your primary residence for the past five years), but allows for monthly repayments similar to the 401(k) loan program.

The Challenge

Saving money can be difficult. It's hard to put money away each and every paycheck when there are other bills to pay and other things to buy. After all, the modern consumer isn't known for their savings ability.

In fact, the savings rate in the United States has even been "negative" at some stages since the third quarter of 2005, according the U.S. Bureau of Economic Analysis. A negative savings rate means Americans spent more than their personal disposable income. Even with low down payment loans such as FHA loans or zero-down alternative loans, there are also closing costs to deal with. And depending on market conditions, sellers may not be eager to help with down payment assistance programs or contribute anything toward closing costs.

Having a down payment helps the buyer's borrowing profile significantly. If someone has impaired credit or their debt ratios are stretched a bit thin, then a down payment is something the lender looks for when making a credit decision. Tapping into these retirement accounts can be a sound solution for a prospective home buyer short on cash.

The Solution

A 401(k) account may be used to help buy a house and can be used in two ways:

1. Withdrawing up to $10,000 penalty-free
2. Borrowing from the account

IRAs and 401(k) accounts have a provision that allows first-time home buyers to permanently withdraw up to $10,000 for the sole purpose of buying a home. The $10,000 can be used for down payment or closing costs or any combination thereof and does not have to be paid back.

A first-time homebuyer is defined as someone who has not owned a home in the last three years. That also means someone who owned a home as early as four years ago would still qualify as a first-timer under these guidelines. In Canada the guideline ranges from three years to five years of not having owned a home.

Another way to use a 401(k) to help buy a home is arguably the most common—borrowing against the retirement account. Most 401(k) programs allow the buyer to borrow against the account regardless of whether or not the buyer has ever owned a home.

Typical Guidelines for Borrowing Against a 401(k)
Loan amount is limited to the employee's *vested* balance
Loan must be paid back in less than five years (or fifteen in Canada)
Loan has a maximum loan amount of $50,000 regardless of the vested balance (or $20,000 for individuals, and $40,000 for couples with Canada's HBP)
Interest rates are based on the prime plus 1 or 2 percent
If the employee leaves the company, the remaining note becomes immediately due and payable

Certain major employers may also let buyers borrow from their 401(k) plan as part of that company's employee benefits package.

For example, if an employee borrowed $20,000 and paid it back over five years with a prime rate of 7.5 percent plus 1 percent, the monthly payment would be $401 per month. Even though a new debt is created by borrowing against the 401(k) account, it is not counted against debt ratios when underwriting a loan application. Borrowers are simply transferring assets and "paying themselves back" into the 401(k).

There are a couple of considerations when borrowing against a 401(k). First, when employees borrow those funds they are in fact taking funds out of their retirement account then paying back into that account over time. This means the amount borrowed will not be working for them in the retirement account; it's being transferred as equity in a home purchase. That can be a bad thing, but it can sometimes be a good thing depending on how the retirement account performs compared to housing for the duration of the loan.

Either way, moving money from a 401(k) or an RRSP is simply a transfer of equity from one asset to a new one, while at the same time enjoying the financial benefits home ownership offers such as stable appreciation in home values.

Watch Out!

Waiting until the last minute to see if the employer's 401(k) plan allows for loans is a no-no. Even if the buyer is certain that he can borrow from his retirement plan, the 401(k) loan application process can take weeks. If there is the possibility that the buyer will be using his 401(k), the application needs to be processed well before a home search has begun.

A buyer can never borrow more than 50 percent of the balance. The other 50 percent goes to pay back the loan in case the employee leaves the company before the 401(k) loan is paid off. Also, if some of the remaining 401(k) funds are used to pay off an outstanding loan, that means there's an early disbursement of retirement funds. A 10 percent penalty will be assessed for early withdrawal of the 401(k) funds and income taxes will be paid on the disbursement. Always advise your buyers to consult with a CPA before withdrawing or borrowing against a retirement account.

Snapshot

David and Cindy had been looking for their first home in a desirable school district. They had been saving, or at least had been trying to save, enough money for a down payment that would get them the best rate available and make their monthly payments more affordable with a lower loan amount.

After several months of various family "emergencies," their savings account was depleted. They were thinking they weren't going to be able to buy very soon as the houses they were looking at kept getting snatched up.

Their agent Mark, sat down with them, reviewed their finances, and saw that while David and Cindy didn't have much money, Cindy had amassed nearly $80,000 in her 401(k) at work. Each paycheck, Cindy would put back 10 percent of her pre-tax earnings in her 401(k).

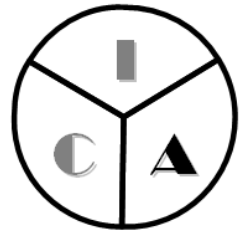
Mark said, "Did you know that you might be able to borrow from your 401(k) account to help with your down payment and pay it back as a withholding from your regular paycheck?"

Cindy said she didn't know if she could or not but would check with her employer. She logged on to her company's website that evening and found that indeed she could withdraw some funds from her 401(k) account as a loan.

The next day David called their friend who was a CPA and asked if it was a good idea or not to tap into that 401(k) account. The CPA knew that David and Cindy were currently renting and that reinvesting the money in home ownership would be a good financial move. They could also benefit from a mortgage interest deduction as well.

The CPA told David that as long as they paid back the money as soon as they could, borrowing from Cindy's 401(k) would be a great idea to help buy their new home. Cindy applied for her 401(k) loan, and together, the couple applied for a mortgage at their bank and began shopping. Two months later they found their perfect home.

11. Temporary IRA Transfers



Like the 401(k), millions of individuals have socked away money for retirement in their individual retirement account (IRA). IRA funds can be withdrawn at any time. But there is a price for pulling it out prematurely—a 10 percent penalty in addition to the income tax due on the withdrawal. That's expensive money! But there is a way to temporarily use IRA funds and avoid the 10 percent penalty.

The Challenge

The buyers found the right house for them. Even though they're highly motivated to buy, they simply don't have the cash savings for a down payment. The buyers have money in their IRA but don't want to pay the penalty for early withdrawal, and don't want to take money out of their retirement savings. The IRA is there, but it's just costly to tap into.

The Solution

One quirk in IRA withdrawals is that the funds can be replaced within sixty days without penalty. Withdraw the money, go to Tahiti or wherever, then put the money back and avoid the income tax and early withdrawal penalties. Easy enough to say, but how does someone who is having difficulty finding down payment money replace withdrawn IRA funds so easily after the house is bought? This can be done by taking out an equity loan on the house simultaneously with the home purchase!

This approach takes some timing but can be done. It works this way:

1. Buyer determines the IRA is sufficient to use as a down payment.
2. Buyer applies for a mortgage and gets approved on the condition that the IRA is the source of funds to make the purchase.
3. Buyer simultaneously applies for a home equity line of credit to be funded at the initial closing or immediately thereafter.
4. Buyer uses IRA funds as down payment and successfully closes on the home.
5. The new homeowner taps the equity line of credit and replenishes the IRA within sixty days to avoid the early withdrawal penalty.

Here's how it might play out. A buyer puts an offer on a house listed at $200,000. The buyer applies for a mortgage with 20 percent down ($40,000) and at the same time applies for a home equity line of credit for that same $40,000.

The lender underwrites the loan as if it were a zero-down loan, approving the borrower based upon a first mortgage loan at 80 percent of the sales price, which avoids PMI, while also hitting the borrower with the full payment of a second home equity loan at 20 percent of the sales price of the home to properly calculate final debt ratios.

The borrower withdraws money from his IRA account ($40,000 in this example) and places it in his bank account, all the while documenting the transfer the lender will want to review.

In essence, this is a zero-down loan with no PMI and nothing more than a temporary equity transfer.

Watch Out!

The sixty day rule needs to be foremost in this scenario. That means a delayed closing for any reason could jeopardize the penalty-free transfer. Any property inspection or pricing issues need to be resolved well in advance. Going beyond that sixty day period on a $40,000 withdrawal costs $4,000—an expensive proposition. There's not much wiggle room for error. The buyer simply needs to know that the IRA funds are available and how long it would take to receive those funds once requested to coincide with the closing.

In addition, some IRA withdrawals also require an immediate 20 percent withholding set aside to pay for income taxes that would be payable upon a standard withdrawal. Even though the IRA withdrawal would be refunded upon the closing of the equity loan, it's possible the 20 percent would still be withheld by the IRA custodian.

In this case, if a buyer needs $40,000 for a down payment and the custodian will keep 20 percent of any withdrawal, then the buyer needs to withdraw $50,000 in order to have $40,000 available to close the deal (80 percent of $50,000 = $40,000). When the buyer replaces the IRA funds with the equity loan, any excess withholdings will only be replaced at income tax time the following year via a refund or be applied to income taxes due for the year the property was purchased.

Be absolutely sure the buyers consult their tax adviser, financial planner, or CPA about such a transaction!

And last but not least, never, ever give advice to your clients regarding retirement, investing, or income taxes. Leave that to the *other* professionals!

Snapshot

Steve found a house he really wanted but wasn't ready to buy. At least he hadn't saved up enough money for a down payment in order to buy. But he did have some money in an IRA.

He asked his agent, Andrea, about cashing in his IRA because he was desperate to buy this "perfect" house.

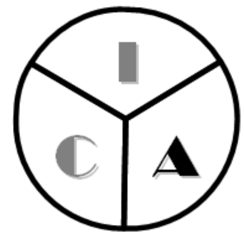
Andrea said, "Absolutely, but if you want to avoid taking a big tax hit we'll have to do a little preparation first. If you have a financial planner or a CPA, then call them so we can work out the details. If you don't, I have a couple you can call."

Steve called his CPA who agreed that, yes, he could pull some money from his IRA and replace it within sixty days to avoid penalties.

He called his mortgage broker and told her his plan. She verified the IRA, tracked the withdrawal from the IRA account as well as the deposit into his bank account. The broker also arranged for the home equity line of credit at the buyers credit union.

Steve pulled money from his IRA, bought his dream home, and replaced that IRA withdrawal with his new equity line. This was accomplished with no money down and no PMI, and at competitive rates.

12. Appraisable Assets for Down Payment and Closing Costs



It's a common joke that buyers need to look everywhere including their sofa cushions for down payment and closing costs. Checking accounts, savings accounts, retirement accounts, and absolutely every other possible resource needs to be explored. But there are times when non liquid assets that might simply be collecting dust can be turned into cold, hard down payment money.

The Challenge

Buyers want to buy but are plagued with no cash for a down payment or for closing costs. They've collected "stuff" over the years and even inherited some rather nice home furnishings from their grandparents, which included a couple of relatively expensive paintings in addition to some very fine furniture. Unfortunately they're not familiar with any lenders who will take an antique recliner as a down payment!

They also have visited websites that "prequalify" buyers based upon their income and current interest rates. As a result, they erroneously believe they qualify for a lot less than what they're paying to their landlord as rent. It's frustrating to them because they know they could afford a monthly mortgage payment.

They'd like to put some money down and perhaps take back a second mortgage to help with the down payment, but they're still short on closing cost funds and they're afraid that, if they wait too much longer, interest rates will keep climbing and keep them out of the home buying market altogether. The couple figures they'll need about $40,000 but only have $10,000. The buyers do have an extensive coin collection, can they use that as collateral?

The Solution

Yes, they can. But they can't walk into closing with a fistful of doubloons! The fact is that anything that can be appraised by an independent third party can be used to help with down payment and closing costs. And depending upon the asset, it could pay for the entire transaction!

Assets used to buy a house could include baseball card collections, artwork, rare books, stamps, an automobile, an airplane, anything that has a price in the public domain is eligible.

In our example, the buyers need to have the coin collection appraised, sell the collection and then deposit the funds into their bank account.

Lenders need to know where cash to close is coming from to make sure the buyers aren't borrowing it from a third party (such as a silent second) and that the funds indeed belong to the buyers and not someone else. That's why it's absolutely necessary to establish a paper trail under such transactions. What is considered "appraisable?" If there's a market for anything that is bought and sold in the open marketplace, then it can be appraised. If there are no buyers of an item, then no value can be determined.

Your client's grandma might have the neatest collection of vintage oven mitts you ever saw but, if she's the only one who thinks so highly of them, there are no buyers. Therefore, no value can be assigned to that lovely mitt collection.

On the other hand, her 1953 Mickey Mantle rookie card does have value. Baseball cards are bought and sold every day and even magazines publish the going prices for baseball cards. If they wanted to, they could sell that rookie card, show a sales receipt, deposit that money in their bank account, and use it to help buy real estate. As long as the asset can be valued by an independent third party, the sale is documented, and the funds are deposited, then non liquid assets can be used.

Watch Out!

Even if the buyer gets an appraisal on the asset, the loan underwriter will try to independently verify the value of the asset, especially if the underwriter isn't familiar with the type of asset being sold. Make sure to keep a paper trail of the appraisal.

Another misperception about assets is that they can be used as collateral to borrow money. While anyone can borrow money from any other party under agreed-upon terms, lenders want cash, not loans, in order to buy a home. But if, the asset is appraisable, one may borrow money against that asset, mortgaging the coin collection for instance while not selling the assets off entirely. Remember that if your clients do obtain a loan against an appraisable asset, then the lender will need to review the terms of the new loan and count those terms in the buyer's debt calculations.

Snapshot

A buyer wanted to buy the house next door to his own home, but was having problems coming up with enough money for both the down payment and closing costs. His lender needed at least 10 percent down.

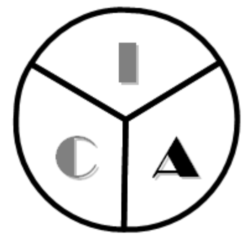
As a professional editor, he was a fan of rare books and had quite a collection. First editions, out-of-print books and such. He arranged to have two of his prized books sold to another book collector to get enough money to buy the property.

He obtained an appraisal and provided a copy of the sales slip. He sold the books, deposited the check into his bank account, and documented the transfer.

The loan officer who helped with the transaction logged onto eBay and typed in the titles of the books to verify the prices obtained. The loan officer printed the page that listed those same books along with their prices and placed it in the buyers loan application file.

The underwriter, certainly not a book collector, now had the asset, its appraised value, the sale, the deposit, and third-party verification of the approximate value of the books that were sold. The loan was approved.

13. Pledged Asset Mortgages (PAMs)



There are times when buyers have assets but don't want to use them for the purchase of real estate. Buyers could have cash retirement accounts or stocks or bonds. The use of Pledged Asset Mortgages (or PAMs) is a common way to collateralize, or pledge, that asset against the property being purchased. Instead of making a down payment, the buyer can pledge those assets to the lender instead.

The Challenge

A buyer has been trying to buy a place for some time and has been having trouble saving the money for a down payment. It's not that the buyer can't afford the monthly payments; it's just that the money needed for a down payment and closing costs is hard to come by.

Even though there are no down payment loans available, the interest rates plus mortgage insurance cost make the monthly payment too high. In the Buyer's preferred neighborhood, affordability is the issue. To live where the buyer wants to live simply costs too much. If a down payment were available, the buyer could borrow less and have lower monthly payments.

The current market isn't helping much because there aren't many seller concessions available and home prices keep rising due to demand. The buyer does have some certificates of deposit (CDs), but he would have to pay a penalty to withdraw those funds and he would lose any income on those CDs if he cashed them in.

Another typical situation involves higher income buyers interested in investing in real estate but unwilling to cash in stocks, CDs, or other investments and risk getting hit with any taxes and penalties that might occur.

The Solution

A PAM is a perfect solution. It's not as exotic as one might think. Fannie Mae, for instance, has a PAM program; but it's just not used very often. Other investment banks offer PAMs, but again they're not at the top of the popularity list. But for those who do qualify, the PAM makes more sense than any other loan out there.

Most financial assets can be used, such as a mutual fund, CD, or other publicly traded stocks, but with the Fannie Mae loan those funds are held as a CD only. A conventional PAM asks that the buyer pledge 30 percent of the sales price of the home in lieu of a down payment or as little as a 10 percent pledge with mortgage insurance.

For instance, on a $200,000 home, the buyer pledges 30 percent, or $60,000 of an asset. The asset typically remains where it is and doesn't have to be transferred to an investment company or custodian. A CD at a bank will simply stay at the bank, yet now that CD has a claim against it payable to the lender in the amount of the pledge. If the house were to end up in foreclosure, the buyer loses both the house and the pledge portion of the asset.

PAMs also allow for family members to pledge their own assets in lieu of the buyer pledging their own. An example would be a grandparent pledging some of their CDs on behalf of their grandchildren.

Investment banks and other lenders also offer their own version of a PAM. More PAMs issued through these investment banks, rather than through Fannie Mae because of the nature of the typical PAM client.

PAM buyers are typically in a higher income bracket and have various investment accounts managed by a professional investment adviser. When a high income earner is thinking of buying a house, they may not want to pull money out of their investment accounts and lose potential earnings on those funds and also be liable for any capital gains tax.

Instead of pulling money out of an account, the investment account is simply pledged as an asset and tied to the property being purchased. There is no restriction on these types of PAMs, so the asset doesn't have to be a CD, although it certainly can be.

If a buyer wants to buy a house without any money down using 10,000 shares of ACME Stock trading for $25 a share, the buyer merely "pledges" those shares in lieu of a down payment and obtains a mortgage for the balance. This avoids paying any capital gains tax or any commissions on selling a stock, while also putting zero money down and simply transferring equity.

Pledge amounts can vary based upon the investor, but a typical pledge is 140 percent of the required down payment for the mortgage applied for. This transfer typically takes place at the closing table, but the asset needs to be verified before the closing can take place. Let's look at a home selling for $800,000.

Sales Price	Typical 20% Down	140% of Down
$800,000	$160,000	$224,400 pledge

If the buyer has 10,000 shares of ACME stock and that stock was trading at $25 per share, the buyer would pledge 8,976 shares (8,976 X $25 = $224,000).

Watch Out!

When pledging equities it's important to remember that a stock price can change throughout the day. If a share of stock is selling for $25 per share and the stock price falls to $15 per share then no longer is that asset equal to 140 percent of the sales price, is it? If the shares fall to $15 a piece then those same 8,976 shares are now worth $134,000 and not $224,000.

When this happens, the investor contacts the homeowner and asks for more pledge. Essentially this is a margin call on a house. Lenders realize that asset valuations can change daily, but they don't check stock prices every hour. They do set a minimum value that asset must be worth. There may also be a cap that the investor will keep as a maximum in times when stocks are increasing in value, and not going down. When stock prices go up, the stock can stay in the PAM or be traded as with any other investment. This minimum is typically 120 percent of the initial down payment. If the valuation drops below the 120 percent, the investor could ask for additional stock to replenish the value.

PAMs should be used only after consulting a financial adviser, planner, or CPA and are not available in all areas.

Snapshot

Ed had not been planning on buying a house, at least not right away. But a particular piece of property which had always appealed to him as a possible retirement home came on the market before he retired.. He didn't want to buy a house that large just yet because some investments he was counting on wouldn't mature for another five years.

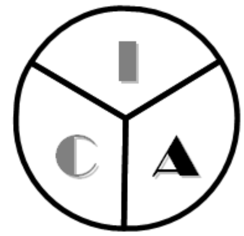
Besides, even if he did cash in his stocks, they were worth much less than when he bought them and he'd take a huge loss. He had resigned himself to losing his retirement home.

His agent told him to contact his stockbroker and ask about a Pledged Asset Mortgage instead of selling stock.

Ed called his stockbroker as well as his CPA and discussed how a PAM would work. Instead of putting enough money down so that he would comfortably be able to pay the mortgage upon retirement, he learned how he could pledge some stock in lieu of a down payment and get a comfortable mortgage loan. He made arrangements to pledge a part of this stock portfolio, got approved for a mortgage loan and closed within thirty days.

Soon thereafter, the stock that had been trading at a low price began to recover and its value soon exceeded his original purchase price. Had he cashed in that stock, he would never have recovered those gains.

14. Equity Transfers and Bridge Loans



Sometimes a buyer has equity but it's not "liquid," meaning they can't exactly run to their ATM machine and pull out $50,000. A liquid account is an account where the buyer has ready access to funds from sources such as checking accounts or CDs. The most common non liquid asset for homeowners is the equity in property they own, be it in their primary residence or investment properties. In this fashion, property owners can transfer equity from one property in order to purchase another. This type of transaction can be a temporary transfer or it can be permanent.

Another type of temporary loan is a bridge loan. A bridge loan creates a "bridge" to buying another property either with equity in a current property or a loan placed on the property to be purchased. A bridge loan, regardless of where the lien is placed, is paid off when the old property sells.

The Challenge

The market is holding steady, not really a buyers' nor a sellers' market. Asking prices are mostly holding, but at the same time seller concessions aren't that uncommon either.

A buyer calls his agent and lets him know that he will soon be in the market for a bigger house. His 3 bedroom house will soon be too small for him. He has a wife and two boys—and now his wife is pregnant with twins!

The buyer doesn't have a lot in his savings accounts nor are there other assets he can tap to help buy a new home. He would have to sell his current property in order to buy a new one.

The agent takes note and begins a search for their perfect home. And guess what happened? The agent found the perfect house, recently listed. But there is no money for down payment.

The Solution

The buyers have a current loan balance on their primary residence of about $85,000 and the house is valued at $185,000. By using the equity in their primary residence, they can buy their new home.

Equity in a property, be it a primary residence or a rental, can be tapped in two easy ways:

1. Equity Loan
2. Bridge Loan

In essence they perform the very same function it's just that they operate a little differently. The money drawn from either of these loans is used in lieu of a down payment and the buyer then secures a traditional mortgage.

An equity loan is the easier of the two because the buyer simply calls his bank or credit union and applies either for a home equity line of credit (HELOC) or an equity loan for the amount needed.

The difference between an equity line and an equity loan is that the line is simply a "line of credit" using the home as collateral. An equity loan is one big loan again using the home as collateral. Most times an appraisal isn't necessary for either. The bank will make a reasonable determination of value using a variety of online and automated property valuation models, or AVM.

HELOCs and equity loans aren't very expensive. Fees for them are typically around $400. They can be free if you actually use a HELOC during the course of a twelve month period. Using a HELOC means tapping into the equity of the home immediately to buy a new property, so the fee won't apply. But some HELOCs will charge a 1 percent origination fee when the property with the HELOC attached is sold.

Another way to use equity in a property is with a bridge loan. A bridge loan uses equity in either the primary or the property being purchased. When the primary residence is sold, the bridge loan is paid off with proceeds from the sale, just as a HELOC is retired. Sometimes there may not be enough equity for a HELOC. In this instance, although a bridge loan will be slightly more expensive, it can work where there is little equity in the primary residence yet enough to pay off a bridge.

Equity loans and bridge loans are issued by lenders and banks, are often tied to the Prime lending rate. How does your client decide between these two alternatives?

Equity loans and bridge loans are very close cousins so there's not a whole lot of difference between them. But before selecting either one, your client needs to get at least two good faith estimates for each loan type from different lenders and compare them side by side. The single biggest deciding factor is the cost of the money actually borrowed. Any short-term note must have the lowest fees possible, because the money borrowed isn't going to be around for very long and will be paid off when the old property sells.

Because these loans are typically based upon the very same index, the choice comes down to fees. In the case of equity and bridge loans, the cheaper the better.

Watch Out!

Sometimes a home will already have an equity line, way before any notion of buying another home has come about. When there is a prior equity line, it's likely that the buyer can tap into that line and pay it off when the home sells without paying any penalty or origination charges when the HELOC is paid off. Homeowners with a HELOC can use that line as needed and pay it off as needed with no fees.

Note, when a buyer applies for an equity line or an equity loan, the lender, as part of the appraisal review process, will look to see if the home is listed. If it is listed, be prepared to pay the 1percent origination fee or not get the equity line at all. Some banks won't make an equity loan of any kind if the property is listed. This makes sense. Lenders make money on interest and if they don't see the loan lasting long, they'll probably not be very keen on going through the motions.

Equity lines are included in debt ratios when a lender determines affordability. That means the lender on the new mortgage will qualify the buyers based on not just two mortgage payments (the current primary residence and the new purchase) but also the payments on the equity line. After all, it might take a few months for a property to sell and the new lender wants to feel comfortable in issuing a new mortgage in that light.

Even though these programs help buyers avoid a contingency clause (e.g., offer is contingent on sale of another home), they must be disclosed in the contract. The seller has the right to know.

Traditional bridge loans normally do not take debt ratios so seriously and do not count the new debt incurred with a bridge. Sometimes a bridge loan doesn't even require monthly payments, so a lender wouldn't count that against their debt ratios.

The payments to the bridge lender would be the accrued interest from the time the loan was placed until the time the loan was paid off. A bridge loan will be a bit more lenient than an equity loan in this regard. It's wise to get a letter of prequalification to make sure this is a real option for your buyer.

Carrying two mortgages can be hard so be sure your buyer understands the implications, not only between the two types of equity lending, but also from lender to lender as internal guidelines can vary from one mortgage company to the next.

Snapshot

Jody had lived in her house for nearly twenty years and had dutifully paid her mortgage down with extra payments when she could. She had five years left on it. She also had an equity line that her late husband had put on the home which she had never used. "Only for emergencies," she always thought.

Her husband had passed away just a few years earlier, and although the mortgage payments were a little high, she knew she would soon pay off that note entirely.

Her agent was visiting her that day and simply said, "You know, this house is kind of big. Have you ever thought of downsizing?"

Jody had never considered it. She thought she would live there for the rest of her life. But now she thought about a smaller house a lot.

A few weeks passed and she called her agent and said, "I've been thinking about what you said, and I really wouldn't mind living in a smaller place with a smaller house payment. But I guess I would have to sell my house first."

"Not necessarily," her agent responded. "I think a bridge loan might be a good idea. Here's the name of a good loan officer I know who can help explain how bridge loans work. I'll bet you're a good candidate."

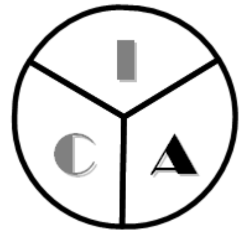
Jody took her agent's advice and called the loan officer who explained the process: how she could get a large bridge loan on her current property and not have to pay anything on it until the old home sold.

Having a large bridge loan meant when she found her "last" home she would also have a very small mortgage that was more affordable. She did have an equity line on her property, but the loan officer told her that she would have to qualify for both mortgages plus the new equity line and that could be a problem.

She took the loan officer's advice and applied for a bridge loan, which closed in a matter of days. Because the terms of the bridge loan allowed her interest payments to accrue rather than be paid each month, it suited her better than paying on an equity line. Her agent thought her current house would sell quickly in the current market, but still asked Judy to discuss the bridge loan with her financial planner. If the market slowed down, her agent insisted she be prepared.

After a few weeks, she found her perfect home. She was able to pay cash using the loan on her old home which closed in just three months.

15. Down Payment Sources and Gift Funds



Gifts are a wonderful thing, especially when it's money and can be used to buy real estate! Lenders follow guidelines covering who can and who cannot give a gift to help people buy real estate. One of the issues of "giving" is to make certain the money given to the lucky home buyers is indeed a gift and not a loan to be repaid.

The Challenge

A newlywed couple has just returned from their honey moon, and they begin to look into buying their own home. They both have read about the benefits of home ownership and how buying young can start them on a path of personal wealth.

They're fresh out of college with jobs, but like most who start their life together, their financial cupboard is bare.

Where they live and work, rents are actually a bit higher than if they had a mortgage payment. Yes, there are other amenities with renting that they enjoy; their apartment complex has a swimming pool (two of them), a top-of-the-line workout facility and a nice social life with lots of friends close by. But they also realize that rent is money thrown away. More importantly, they're ready to buy. They just can't come up with the down payment and funds for closing costs.

Fortunately, both have parents and grandparents who have said they would be willing to help them financially.

The Solution

The couple asks their relatives to help them buy their first home and they say yes!

There are requirements that gifts must meet and those requirements are aimed at verifying the source of the gift funds. Why is that important? It makes complete sense for a family member to give a financial gift. But a stranger wouldn't give money away without wanting it back. From the lender's standpoint, this must be a gift and not an undocumented loan.

Approved Sources for Financial Gifts to Buy Real Estate	
1.	Family Members (specifically parents, siblings and grandparents)
2.	Non-Profit Agencies
3.	Local and State Agencies
4.	Churches
5.	Domestic Partners
6.	Trade Unions

How does a lender know that gift funds are coming from one of these sources and not the seller or another interested party? First, the Gift Affidavit Form identifies the donor, where the money is coming from, and that the funds are not to be repaid. Second, there's typically an "ability to give" requirement that shows where the money is in fact coming from. For instance, if Grandpa is giving $20,000 to his granddaughter and her new husband, the lender can ask for a bank statement, with Grandpa's name on it, that shows at least $20,000 in the account.

Nonprofit agencies and local and state agencies, established to help with down payment money, also have traceable methods to give a gift to a deserving home buyer. Churches and synagogues can also give a gift to help their members buy their home. Those funds are typically tracked by a donor letter or a copy of the gift check made out to the buyers or to the settlement agent who is handling the closing. Finally, domestic partners and trade unions are also allowed to give a financial gift.

How much is enough? Anyone can give as much as they can stand, keeping tax laws in mind. There is no requirement from a lending perspective on how much to give.

Buyers Who Receive Gift Funds Must:	
1.	Verify the source (have a signed gift affidavit provided by the lender).
2.	Show the "ability to give" (the donor has the funds available).
3.	Track receipt of the funds (typically from a wire or a copy of the cashier's check).
4.	Show the deposit into the buyer's account (the gift funds and deposit must match).
5.	Provide a final bank statement showing the funds (statement must match with gift).
6.	Be grateful (okay, that was thrown in there, but really!)

Watch Out!

Lenders as well as the IRS scrutinize nonprofit organizations. In fact, so-called non-profit organizations specializing in providing down payment assistance have, in the past, been exposed as "for profit" organizations.

Another detail which is often overlooked when receiving gift funds is the confirmation of the funds. This is normally a problem when the buyer gets a gift in the form of a check and not an electronic wire or cashier's check. Lenders who verify gift funds will verify the receipt of those funds by making sure the funds have cleared the donor's account. With a wire or cashier's check this isn't a problem, but when Grandpa writes a personal check to his grandson, the lender will want to see a copy of both the front and back of the canceled check. Sometimes this can add ten days to the closing time.

Snapshot

A few years ago, Paul's parents told him that when he was ready to buy his own home they would help him out. He also had savings of his own.

But he hadn't really been all that serious about it until a friend told him about the very cool condo that he was buying with the help his Mom's real estate agent. That got Paul a little jealous, but curious at the same time. His buddy also told him that his mom helped him buy his condo. That also jogged his memory.

He called the agent, Becky, that same day.

The agent explained how much the condos were selling for and how much the payments would be. She said if he didn't have any down payment money there were several sources available that could provide the down payment for him.

To say the least he was excited, and called his parents to tell them the good news, "Mom, I'm going to buy my first place. A real estate agent knows of a nonprofit agency that helps home buyers with the down payment money for closing costs. I already spoke to a lender and I'm qualified. I'm going to own my first home!"

Mom said, "That's wonderful news son. But guess what? We've already been saving up for your down payment money. It's ready when you are."

Paul used his parents' gift funds to buy the condo and moved in within 30 days.

16. Nonoccupant Coborrowers

A nonoccupant coborrower is a person who agrees to cosign on the buyers' mortgage yet not live in the property. Such coborrowers are normally relatives although they don't have to be. A nonoccupant coborrower is usually added to the loan application to strengthen the occupying buyers' overall credit profile.

Perhaps the buyers have shaky credit or their income just isn't enough to qualify due to debt ratio concerns. Whatever the reason, nonoccupant coborrowers have been helping buyers qualify for many years.

While a coborrower can be a great solution for a buyer who is short on income or down payment funds, it will not help when the buyer has truly poor credit.

The Challenge

A young lady knows that she should quit renting and find something to buy. In fact, it seems like she hears it from her father every other day. But the fact remains that until she completes her internship and starts making some "real" money, real estate will have to wait.

The rental market where she lives is tight, with rents easily outpacing a monthly mortgage payment. It's also another reason why the real estate market itself is hot: everyone's buying because rates are so low and rental properties usually produce cash flow. But the demand is starting to push prices up even further. Too much of that would cause first-timers to be shut out of the market. In order to qualify right now, the buyer needs income and down payment help from her father.

Several years ago, "cosigners" were more common than they are today since many loan programs required more money down than they do now. In addition, some banks wouldn't lend to a first-time home buyer without someone else also being responsible for the note.

The Solution

With an FHA loan, she can have her father cosign on the mortgage to help her to qualify. But with a conventional loan, a nonoccupant coborrower won't help at all.

A nonoccupant coborrower completes a separate loan application just like the occupying borrower will do. Both will provide all pertinent information that would apply on any application such as pay stubs, W-2s and bank statements.

The nonoccupying coborrower's income will be added to the buyer occupant's income to help the buyer qualify. At the same time, debts from both nonoccupant and occupant will be counted together to get one debt ratio.

Let's say that a $200,000 home is on the market and the buyer wants to put 3 percent down and use an FHA loan at 6 percent on a thirty year fixed rate. Let's also assume property taxes are $2,000 per year and hazard insurance is $700 per year.

$200,000 Home with 6% FHA for 30 Years	
Loan Amount	**$194,000**
Principal and Interest	**$1,163**
Taxes and Insurance	**$225**
PMI	**$81**
Total Payment	**$1,469**

Now let's add a monthly car payment of $300 and a student loan payment of $100 to the $1,469 house payment and the total debt is $1,869.

The buyer makes $2,600 per month. That means if she bought it by herself her debt ratio would be $1,869 / $2,600 = 71.9. Her debt ratio is much too high and she would never qualify for a mortgage, much less be able to make the payments.

But here comes Dad to help. Dad makes $9,000 per month and has no debt other than his mortgage payment which is $2,180 per month.

The lender will add both the debt and the income together to arrive at a new ratio.

	Buyer + Dad	New Total
Income	**$2,600 + $9,000 =**	**$11,600**
Debt	**$1,869 + $2,180 =**	**$4,049**

The new debt ratio is $4,049 / $11,600 = 34.9, well below FHA's maximum ratio of 41. When the buyer and her dad go to the closing table they will be on the mortgage and the title together.

Nonoccupying coborrowers were used to be more common, but a couple of years ago conventional lenders placed debt ratio restrictions on the occupying borrower.

These debt ratios require the buyer to qualify as if she didn't have a nonoccupant coborrower whatsoever. In other words, the nonoccupying coborrower, even with additional income, no longer helps an occupying borrower. This is a major change and can surprise some when they find out that, although mom and dad are willing to co-sign, the lender will still approve the loan using only the occupying buyer's income.

The only time nonoccupying coborrowers or cosigners can be used is in FHA financing, since FHA does not have this debt ratio qualification.

Watch Out !

Coborrowers do not help when the occupying borrower has bad credit. Lenders no longer allow coborrowers' good credit to overcome the bad credit of the occupying borrowers. Credit scores aren't averaged together nor do they help convince a lender to "go ahead and make the loan." FHA is somewhat more forgiving. If the occupying borrower has yet to establish a credit score, they will work with you. Also, when someone cosigns for someone else, on any debt, that debt will appear on the cosigner's credit report and will affect the cosigners' debt ratio in future credit applications.

In this case, "Dad" now has two mortgages: his and his daughter's. Lenders don't look at co-signed debt as "50 percent his and 50 percent hers" but 100 percent to both. In addition, any late payments on a cosigned account will negatively affect the credit of both parties, regardless of who was responsible for making the payments.

Snapshot

Karen was heading into her second year in college, having lived in the dorms her freshman year. She had thought about buying a condo close to campus like some of her friends, but since she only worked part time she certainly couldn't afford a mortgage. Or could she?

One Sunday when she was just snooping around some listings, she talked to an agent named Teresa who was showing a condo that was perfect for her. It was close to campus, close to stores, and relatively quiet.

Karen explained she was "just looking" and couldn't afford to buy a condo right now. Teresa and Karen got to talking and Karen asked, "How do these other people buy a condo when they make as much or even less than I do?"

Teresa explained that, in most cases, their parents had cosigned with them on the note. Karen didn't realize that was even possible.

"How much are monthly payments?" asked Karen.

"This is a two-bedroom unit and lists for $120,000, so monthly payments would be about $950 per month. I'll bet your rent payments are about that much!" said the agent.

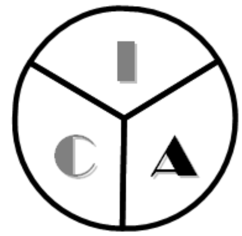
"That's almost exactly how much I pay in rent."

Karen called her parents back home and explained to them what she wanted to do. She did some math and explained that the mortgage payment was the same as her rent now, and she could take in a roommate who could pay rent each month to further offset the mortgage payment.

"Have the agent call me," her mom said.

Teresa did call, and Karen was soon the proud owner of her first piece of real estate as a sophomore in college. Six years later she sold the condo and made about $40,000 which she used to buy her first house. And she made sure she again called Teresa, the agent who had helped her into her very first "home."

17. Employer Assisted Mortgages (EAMs)



An employer assisted mortgage, or EAM, isn't necessarily a mortgage (although it can be) but mortgage *assistance* that helps employees buy their own homes. Employers know that employees that own their own homes can be more stable. People who own their own homes are less likely to move, are concerned about their credit and income, and have a sense of pride that comes with ownership.

Employers are one of the few legal sources for financial gifts that can also act as a lending source. While most EAMs are found at larger companies, there are opportunities to construct a similar program at any size company.

The Challenge

The white hot market has finally cooled off, providing an opportunity for many first-time homeowners to get into home ownership.

A buyer has been left out of the market for a couple of years which allowed him to save some money to buy a home and he's begun to look. He's got about 5 percent saved up, but he would like to get more to have at least 20 percent down to avoid PMI.

He calls his agent and begins his search. He's still dreading putting only 5 percent down but thinks that if he doesn't buy now, home prices will soon start to move back up again.

The Solution

He explains his situation to his agent, and while they are reviewing sources of down payment assistance, his agent mentions that many employers have programs that are designed to help their employees buy a home. He calls his Human Resources department and is told there are three different ways the company can help.

7. Direct Lending
8. Down Payment Assistance
9. 401(k) Loans

Often, EAMs require that the employee live close to the employer and may designate a certain geographical area for them to be eligible. Employers might want their employees who take advantage of this program to live close to their work. His employer has a similar policy, but the areas in which he wants to buy easily meet the requirements.

Direct Lending

This program is a loan made directly to the employee for the sole purposes of buying a house, and is a smaller, second mortgage and not a first mortgage. The employer will issue the loan, collect the monthly payments, and will be recorded on the title report as a lien holder. The employee makes payments every month to their employer, typically by having the payment withheld from their paycheck.

Down Payment Assistance

More common, down payment assistance is typically in the form of a second mortgage that can be used for down payment and closing costs, just like many other down payment assistance programs. These programs are a recorded lien. Many times they do not have to be repaid on a monthly basis, but must be repaid if the home is ever sold. This is a "forgivable" loan and most of them also carry zero interest. The original balance will never grow over time.

401(k)

There is another type of 401(k) loan that employers can issue using their vested balance as collateral. Unlike the program discussed previously, employers amortize this loan over fifteen years with a lower interest rate than a typical three to five year 401(k) loan with variable interest. This type of loan dramatically reduces the monthly payments due to the longer amortization period and rate.

Borrowing $25,000 from 401(k) Loan Payments	
Regular 401(k) at Prime plus 1% over 5 Years	**$501 Per Month**
Employer Assisted Housing over 15 Years	**$224 Per Month**

EAMs can be issued by most any company, but can also be issued by any employer that's large enough to handle them, such as a college or university.

Make Your Own Employee Benefit

If a company isn't large enough or simply doesn't have an EAM, then why not help construct a company's very own employee benefit that can help your clients buy a home?

Every employer is always on the lookout for additional employee benefits that can not only keep their staff healthy and happy, especially if that benefit doesn't cost them anything.

Create your own team, negotiate a discount, and provide those discounts as a package benefit to the company's Human Resources Department, or any other decision maker, for that matter. Contact your team and have them discount their services.

	Standard Amount	Discount
Loan Officer	$400 processing	$400
Attorney	$300 review fee	$200
Closer	$250 closing fee	$100
Appraiser	$350 appraisal	$100
Surveyor	$450 survey	$100

And don't forget your contribution. Perhaps you can contribute a percentage of your commission to the buyers' funds for closing. Who else could offer a discount to add to your service plan? In return for discounted services, they will get all the business from Company X's employees.

Gather your team, put your savings together in a presentation. Make a sales call to the company, and present this as an employee benefit package. "If your employees use me to help sell or find a home to buy, they will save $2,900 on a $200,000 home." What employer would turn that down? And the employee benefit package can work on both the listing side and the selling side.

It's best to use this approach when you've already worked with one of their employees, so you have a ready reference. You also need to make sure your affiliates are indeed giving true discounts and not waiving or inflating imaginary fees.

Done properly, helping an employer help their employee at no cost to the employer is a surefire way to win more business!

Watch Out!

With any direct or 401(k) loan, make sure the client knows the terms of the note and what happens if the employee leaves the company for any reason. In the case of a fifteen year loan, that's really a long time to stay in one place, especially in today's employment market. These loans are secured by the 401(k) and can be paid off by their remaining vested balance or the ex-employee can pay it back directly.

If the loan is paid off early the buyer might have some unintended tax consequences. The remaining 401(k) loan balance could be issued as an early disbursement and could be taxable as well as subject to a 10percent early withdrawal penalty. Be certain to consult with a CPA if you are unsure.

When creating your own EAM program, it's critical that your affiliates are truly giving discounts and not inflating their fees only to issue a "discount."

Snapshot

Ronaldo was transferring from Washington DC to Austin, Texas. He hadn't bought anything in DC because the prices were too high. Where he could afford to buy was way out in the suburbs and he worked downtown. He was soon offered the opportunity to transfer, and he chose Austin where he could still work for his employer while also taking advantage of lower home prices. His company referred him to their relocation company and he began his search.

He also contacted his employer to take advantage of their down payment assistance program that could be used to buy a property in a designated area, close to the employer's Austin facilities. The program was a loan amount, up to $15,000, to use for down payment or closing costs on his new home. The loan was forgivable and interest free, yet still recorded as a lien.

For each year Ronaldo owned the home and remained with his employer, 20 percent of the $15,000 balance was forgiven. In five years the original $15,000 balance was entirely waived.

What Lenders Can Do in a Changing Market

When lenders face large numbers of defaults and foreclosures, they are more open than ever to helping struggling homeowners with their existing mortgages. They may adjust the terms, roll back late payments to the back of the mortgage, or even work with an agent on a short sale. They want to avoid the costly process of taking the home back and the potential liability of owning it (an REO) themselves if it doesn't sell at auction.

What's not immediately evident is that many are still eager to lend money to good buyers. After all, they are in the lending business and they have to maintain a pipeline of business. With buyers challenged to meet conventional requirements, lenders are still offering a wide array of programs to help those buyers safely purchase their home.

These last chapters identify different things lenders can do to help buyers get approved for a mortgage.

Mortgage loans come from different sources. They can come from a bank, a credit union, a mortgage banker, or a mortgage broker. All but the mortgage broker make home loans directly; the mortgage broker only arranges the financing between a lender and a consumer.

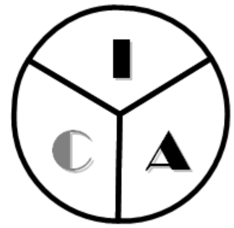
Regardless of the source, mortgage loans are virtually identical from one lender to the next. There are certain exceptions to this rule, commonly called "portfolio" loans where the lender makes their own determination of credit risk with no intention of selling the loan, but all in all a mortgage is a mortgage and lenders price their various loan offerings from the very same indexes.

In Canada buyers will talk to a mortgage specialist, while in the United States it might be a loan officer, mortgage consultant, or a certified mortgage planner. But again, that same person provides typically the same function regardless of their title. They attempt to find the best financing for their buyers needs while walking their buyers through the home loan process.

Lenders are constantly figuring out new ways to lend money. It's a competitive business as each lender tries to outdo the other using mostly the same resources.

These chapters will offer ideas that can help get your buyers the ideal loan amount at the ideal terms. Use one of them or use them all. When you become more familiar with these ideas, you'll soon become the expert … and buyers will seek you out.

18. Lender-Funded Buydowns



Lender funded buydowns work in much the same way as the seller-funded buydowns we discussed previously. The obvious difference between the two is that the lender makes the adjustment for the buydown and not the seller.

A lender funded temporary buydown can be of the 2-1 or 3-2-1 type. The goal is to help buyers stretch their debt ratios in order to qualify for a mortgage, temporarily help offset a drop in income, or help when income is anticipated in the near future.

Lender funded is a slight misnomer in that buydown funds aren't given to the buyer outright in the form of cash at closing, but the interest rate is adjusted to cover the buydown.

The Challenge

The market is tight, inventory low, and homes are selling quickly. New condos are being built but real condo inventory won't hit the market for at least another year. Sellers are holding firm with their prices, and seller concessions are scarce.

Buyers that are ready to buy are acting quickly and getting approved by a lender before they start shopping. Contingencies are few and far between.

The buyer is ready to buy but because of the way he is paid, he won't be fully vested in his pay structure for another two years. He also has a fiancée and in a year he'll have another income to help qualify. But ideally, he wants to buy now to take advantage of current interest rates as well as get two years of equity buildup in a rapidly appreciating market.

Unfortunately, his income is just out of reach for the house he wants, a $200,000 bungalow near downtown. His ratios are pushing fifty and he can't qualify. He's got just over $20,000 for a down payment and closing costs but no more.

The Solution

To qualify for a $200,000 house with 10 percent down, he would get a 2-1 buydown and qualify at the lower rate. The lender will subsidize the buydown since the sellers would be unlikely to pay for it and the buyer doesn't have enough available cash for closing costs and a buydown. Divide the difference in interest the lender would have received using a standard thirty-year fixed rate in to the loan amount to arrive at the funds needed to buy down the rate.

Sales price	$200,000
Down payment amount	$20,000
Loan amount	$180,000
Current thirty-year fixed rate	6.5%

The rate for year 1 would be 4.5 percent and year 2 at 5.5 percent. First calculate the monthly payment at the note rate of 6.5 percent.

Monthly payment at 6.5% =	$1,137	x 12 months =	$13,644
Monthly payment at 5.5% =	$1,022	x 12 months =	$12,264
Monthly payment at 4.5% =	$912	x 12 months =	$10,944

Now figure the amount of interest "lost" to the lender over the first twenty-four months: $27,288 payments at 6.5 percent for two years versus $23,208 in payments at 4.5 percent year 1 and 5.5 percent at year 2. Difference in interest is $4,080.

Okay, we're almost done. Divide $4,080 by the loan amount of $180,000 and you get the difference expressed in "points" as a percentage. So, $4,080 divided by $180,000 equals .023, (2.3 percent) or 2.3 points. Since the buyer doesn't have the extra $4,080 to help him qualify and the seller won't pay for it, the lender can.

The buyer now has $20,000 for the down payment plus a little more for closing costs. The buyer needs another $4,080 to qualify. No charge? Of course not, we're talking about a lender here. But what can happen is the lender can adjust the note rate upward to cover those 2.3 points. Generally speaking, for each discount point a buyer pays for a loan, the rate adjusts ¼ percent. In this example we've got approximately two points, so the lender would adjust the initial note rate upward by two points to 7 percent. Now the note rate is at 7 percent and the 2-1 buydown starts at 5 percent, then 6 percent, then 7 percent for the remaining twenty-eight years.

Yes, the note rate is higher, albeit slightly, but the buyer also didn't have to come up with $4,080 on his own in order to help him qualify, and the difference between 6.5 percent and 7 percent on a loan of $180,000 is only $54 a month.

Another option is a partial lender-funded buydown. This temporary buydown can be funded with some of the buyers' funds and by adjusting the interest rate at the same time. In this example if the buyer had half of the $4,080, say $2,040, he could fund part of the buydown and the lender would only have to adjust the rate ¼ percent instead of ½ percent. The rates when both the buyer and lender construct a buydown would then be 4.75 percent, 5.75, percent and finally 6.75 percent.

Watch Out!

Don't suggest a buydown if the buyer doesn't anticipate increased income in the near future or the buyer feels uncomfortable at the higher rate. Although the difference in monthly payments is slight, it's still a difference.

You'll also want to run down the buydown calculation with one of your mortgage team members if your client is securing financing on his own. You'll want to make certain the loan officer is truly using all the lender's funds for the buydown and not for other lender charges.

Lenders can have different qualification requirements regarding buydowns. Some lenders will qualify the client at the start rate and some at 1 percent below the note (final) rate. A buydown with one lender may not mean exactly the same thing with another lender in regards to qualifying rates.

Snapshot

Sara was on an "upwardly mobile" career path. She had recently graduated from law school and took her first job at a legal firm in town. Sara had explored buying some real estate when she was studying for her law degree, but looking for a home to buy while at the same time going to law school proved difficult. Now that school was over and she had her first job, she decided to call a real estate agent her professor had recommended.

Heather, the agent, began a search and couldn't quite find a sales price in Sara's price range. Homes seemed to be "just out of reach," at least in Sara's eyes. The fact was that her debt ratios were in line with the homes Heather was bringing her, yet she still wasn't ready.

Heather asked her how her income might change in the near future. Would she soon be making more money?

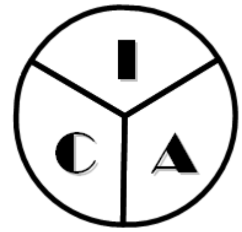
Sara said that she would get a raise after her first year, a big one when she made full attorney … almost a 25 percent increase in income. But Sara still felt uncomfortable making a mortgage payment with her current income.

Heather asked if she knew what a temporary buydown was. Sara said, "No," so she explained how they worked and how they're calculated and suggested Sara call a lender Heather knew.

When Sara asked about a buydown, the loan officer told her how much a buydown would cost and that the buydown could be paid for monthly in terms of interest rate or Sara could pay for the buydown. Sara chose both. She paid for part of the buydown and the lender adjusted her monthly payment down.

Sara found a house and moved in with a lower monthly payment that she felt comfortable with. One year later she got her raise, making her new payment even more affordable.

19. The "MyCommunityMortgage"



Fannie Mae's MyCommunityMortgage is designed to help first-time home buyers overcome common problems: specifically down payment money, debt ratio, andsometimes credit issues. Although this program isn't limited to first-timers, it's structure is designed around such a buyer. The MyCommunityMortgage (called the MCM by mortgage companies) has been around for several years but has been recently fine-tuned to match the needs of today's first-timers and current market trends.

MCM is Fannie Mae's alternative to FHA loans but it has some unique advantages— MCM only requires 3% down, does not have a minimum investment requirement so all funds can come from a gift, and although it does carry a mortgage insurance premium, it may be less expensive than the mortgage insurance found on FHA loans. MCM has a higher interest rate than other conventional and government products but not by much.

While there are no maximum loan amounts for the MCM, there is a restriction on "household" income. Household income is the combined income from everyone who is occupying the property. Income must not exceed 100 percent of the Department of Housing and Urban Development's (HUD) median income for the area where the property is located. Also, it can't be used for rentals or investment property.

The Challenge

The buyers want to buy their first home, but they have no money for closing costs. Having been at their jobs for only a couple of years, they have yet to establish a strong credit profile. Not that their credit is bad, it's just that there isn't enough information in their credit files to produce a credit score for all three credit bureaus.

They do have other forms of credit history, just not the type that will show up on a credit report. They have always paid their telephone bills, cable bills, and utilities on time since they moved into their first apartment two years ago. If the buyers bought, their mortgage payments would actually be less than what they're paying in rent. But no money and little credit have kept them renting.

The Solution

Fannie Mae's MyCommunityMortgage is the answer. Every lender that underwrites loans to Fannie Mae standards can also underwrite and approve MCM loans. Fannie Mae doesn't make the loan, the lender does. It's just that if a lender approves and funds an MCM mortgage, that lender can sell that loan on the secondary market to get more money to lend just as with any conventional loan.

There are no minimum investment requirements. Because every mortgage loan is going to have some closing costs, the MCM mortgage also allows for seller contributions, as much as 6 percent of the sales price.

For a home that's listed for $150,000, the buyers would have 3 percent down and would also have approximately $3,000 in closing costs. The seller could contribute up to $9,000 in closing costs and still be within lending guidelines. The seller could contribute less, say $2,000, and the buyers could adjust their interest rate to cover the remaining $1,000. The MCM is flexible with available sources of funds as long as they're documented.

With regard to credit, the buyers can provide what lenders call "alternative" credit. Alternative credit means providing copies of payment records to telephone companies or utility companies showing twelve months' worth of on-time payments. This will satisfy the credit requirements as long as there are no payments made thirty days past the due date.

The MCM also allows for a 2-1 temporary buydown, which can help buyers "ease into" mortgage payments for the first couple of years. And, similar to other conventional and government loan programs, the MCM has no prepayment penalties.

As long as the buyers meet the income and credit qualifications for a MCM, it's hard to beat, especially for first-timers struggling to find funds and even for those who have some slight credit issues.

Watch Out!

There is no leeway regarding income limitations. It also needs to be clear that the income levels are set by gross income and not income after taxes or "take-home" pay.

Often a singular mistaken collection account can show up in a credit report, damaging a credit score. If an underwriter can determine the collection account is in dispute and can also provide other compensating factors that mitigate the negative credit, the underwriter can issue an approval.

Snapshot

Cindy has wanted to buy a property for quite some time and get out of the area she currently lives in. She'd like to be closer to both work and the lake where she runs. But her paycheck seems to only be taking care of her bills, her rent, and her everyday necessities. She has a car payment that is nearly paid off, only six months left, but no credit cards or other credit accounts. Because of her perceived lack of credit, she's afraid to see what does or doesn't show up. She's never even checked her credit and she's a little intimidated to do so.

One of her friends, Ben, is a loan officer at a mortgage company and he told her about a program called the MyCommunityMortgage® which he thought she should check out.

It was a normal conventional mortgage that didn't have any down payment requirements. There would still be closing costs, but Ben explained that she could find down payment money from a variety of places and he'd help her find them. What could she lose?

Cindy agreed, went to Ben's website, and applied for a thirty-year mortgage with no money down. Ben ran her application through Fannie Mae's automated underwriting system and got her an approval. She would still need to procure money for closing costs and in the meantime she could start looking for a new home.

Ben printed up her approval letter and gave her the name of a good real estate agent, Karen, to get her started.

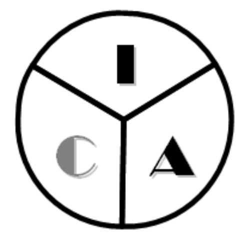
"Have Karen call me after you talk to her, but remember to tell her you're going to need some help with your closing costs," said Ben. Cindy did exactly as he said and later that afternoon Karen called Ben.

Ben explained to Karen, "Cindy is going to need some down payment help. If we can't find a seller that's willing to help with closing costs, let me know and I can see about a housing grant from the city."

Karen said that probably wouldn't be necessary because she's got another client with similar needs and there are several sellers who have recently accommodated that request in a counteroffer.

After about three months, with Ben and Karen's help, she put in an offer on a home. The sellers agreed to cover her closing costs and, about a month later, Cindy moved into her brand-new home. Now, she doesn't even have to drive to the lake—she can walk there!

20. Leveraging Automated Underwriting Systems



Automated underwriting systems (commonly referred to as an AUS by lenders) have replaced manual underwriting. First developed by Freddie Mac in the mid-1990s, they are the source of all those "instant approvals" you hear about. The two main AUS applications are Freddie Mac's Loan Prospector (called LP) and Fannie Mae's Desktop Underwriter (or DU) which direct lenders use and Fannie's Desktop Originator (or DO) for mortgage brokers.

A borrower's loan application is entered into a loan processing software on the lender's computer or website and then uploaded directly to DU, LP, or DO. The application simultaneously evaluates credit scores, income, debt ratios, assets, and other information then provides a written approval to the person who inputs the data. This loan approval can be issued within minutes.

The approval comes with a laundry list of items the lender needs to collect in order to both fund the loan as well as make it "saleable" in the secondary market. When a loan is saleable, it conforms to conventional guidelines and may be bought and sold between lenders.

In the past, loan applications were documented first and then sent to an underwriter who would manually calculate debt ratios, review credit histories, and assure there was enough money in the borrower's accounts to close the deal. This meant that upon application, a borrower would provide his W-2 forms, his paycheck stubs, all his bank and investment statements, tax returns … most everything that a lender might ask for during a loan approval.

Not anymore. Now a loan is submitted to the AUS first and only the documentation requested by the AUS decision is asked for. The better the entire loan file, the less documentation needed to close the loan. This is true of both conventional loans and government loans such as VA and FHA mortgages.

Seasoned loan officers can review a loan application and credit report and have a pretty good feel about the chances of a loan approval before a loan gets submitted. Sometimes minor adjustments in a loan application can change a loan from being rejected to approved with these automated systems.

An AUS evaluates the entire application and isn't restricted to historical lending guidelines, such as cash for reserves or specific debt ratios.

The Challenge

The real estate market is hot. People are buying at a faster clip and new developments are being sold before dirt is broken on many new projects.

As prices escalate, fewer and fewer people qualify. Many buyers have to choose between putting more money down than they had anticipated or buying a less expensive home. Thankfully, rates have been stable during this period, but some home buyers are getting a bit anxious.

There are also stories in the newspaper and on television about how lending guidelines are being tightened and people who might have qualified a year ago might not be able to qualify for the exact same loan today. Many decide to wait on the sidelines after hearing such news. Home prices are rising and it's more difficult to qualify for a mortgage than it used to be.

There are many potential buyers who have resorted to "underwriting themselves" and not bothering to apply for a mortgage, because they've gone online to check their debt ratios and found out that their ratios are higher than standard lending guidelines.

The Solution

Submit the loan using an AUS and see what happens. While an underwriter might decline a loan because a debt ratio is above guidelines, an AUS may not. If the loans were very low compared to the value of the home, the credit was excellent, and there was a fair amount of money in the bank, then they may get AUS approval.

Leveraging an AUS is a way to take the results of an AUS and massage the data then resubmit for an approval. I don't know of an official name for the process but I call it "tweaking."

After a loan officer enters a borrower's data into the loan software and submits it to an AUS, the AUS returns a decision. The decision is either "approve" or "refer" in the case of Fannie Mae, or "accept plus", "accept" or "caution" in the case of Freddie Mac. Note that in either, "refer" and "caution" equate to "declined." When these two terms are used in the case of an AUS decision, that means the loan is declined by the AUS but is still eligible for a manual underwrite. An underwriter will need to make a determination that the loan does deserve approval based on extenuating factors. When a loan doesn't get an AUS approval on the first try, an experienced loan officer will evaluate the results and see what might be changed in order to get an approval. The loan officer will adjust certain aspects of the loan application and resubmit for an approval. There is no limit as to how many times a loan can be tweaked then resubmitted.

Certain lenders may have an agreement that a loan can be submitted as many as fifteen times before Freddie Mac begins charging additional fees (automated decisions aren't free for the lender but the borrower doesn't pay for them). Resubmitting also doesn't "hit" a new credit report each time, yet references the initial credit report as the loan application is being adjusted.

A common tweak is simply lowering the amount of the loan. A loan officer might see a debt ratio at 50, well above standard ratios of around 38 and suggest a lower loan amount. For example, a buyer has a $250,000 house in sight and wants to put down $50,000 and borrow $200,000. Because of his high debt ratios and marginal credit score of 650, he gets a "refer." But the loan officer resubmits the application, this time with a loan amount of $180,000. After a few seconds, the decision comes back, "accept!"

Historically, tweaking wasn't possible because an underwriter wouldn't be on the other end of the telephone with the loan officer evaluating various scenarios—an underwriter would either approve or deny the loan. The loan would have to be repackaged under the new terms and resubmitted. This would take days, not minutes.

Back to the guy who could borrow $180,000 and not $200,000. What if he doesn't have the extra $20,000? Well, he has to find it if wants to get approved for that loan. He could tweak other things on his application. Does he have other financial assets he didn't disclose on his application? Sometimes a buyer doesn't include his 401(k) or other retirement account. Sometimes having additional assets can offset higher debt ratios. Maybe this same buyer did have a retirement fund of $50,000 he didn't tell his loan officer about and now the AUS comes back with an "approve" for the higher loan amount.

Perhaps changing the terms of the loan from a shorter term to a longer term will get the approval. If the buyer wanted a fifteen-year fixed rate and got a "refer," the experienced loan rep would automatically resubmit the loan using a thirty-year fixed rate to get lower payments and a lower debt ratio. That same client could instead opt to keep the fifteen-year fixed rate loan yet pay a couple of points and buy the interest rate down another ½ percent. If a buyer gets a "refer" at 6 percent, he might be approved at 5 ½ percent by paying a couple of points or asking the seller to pay them as part of the offer.

Tweaking is an art form for the seasoned loan officer and, with all the variables that can go into a loan, the secret is to identify which one or two minor changes can be made to get the desired approval.

Another benefit for those who sit on the sidelines because they've "declined" themselves? An AUS only needs a street address in order to issue a decision. A buyer can apply for a loan and the loan officer enters "123 Main Street" as the hypothetical address during the approval process.

Now the buyer who thought they were marginal is walking around with a bona fide approval letter. All they needed was a new address!

Watch Out !

Tweaking and lying are not the same thing. Lying is loan fraud. Inflating income in order to qualify doesn't count for tweaking unless the buyer can in fact find more income. Get a raise, a new job, an inheritance, or get married? Sure. That's fine. Lying is not.

Everything that is on the loan application will eventually be verified by the underwriter. If a buyer needs to sell a vehicle in order to get his debt ratios in line to receive an approval, the underwriter will want verification that the vehicle has in fact been sold and the debt removed from the credit report.

Tweaking will not work with a loan officer who doesn't entirely understand the approval process—knowing the difference between what makes for an approval and what causes a decline. Most loan officers who have been in the business for less than five years, are only familiar with the automated underwriting systems. Sometimes a rookie loan officer would not know to tweak or how to tweak. For those that did tweak, it would be nothing more than blindly throwing the loan against the wall to see if it stuck or not. This is where a savvy, experienced loan professional can be invaluable.

Finally, a real estate agent should never, under any condition, give advice on this. This can unlock a Pandora's box of liability. Work with great lenders and let them do the tweaking.

Snapshot

Kent and Peg put in an offer to buy a second home in order to live closer to their grandkids. This would be their fourth property, and they have lots of equity in other real estate, as well as funds in various checking, savings, and retirement accounts.

The accepted offer came in at $180,000, and they wanted to put down $50,000 for a final loan of $130,000. They were partial to fifteen-year fixed rate loans, so that's what they applied for at their loan officer's website. "Caution" was the result.

The loan officer reviewed the application and saw a couple of things he could do right away. The first would be to put more money down. The buyers certainly had the assets as well as a propensity to pay off mortgages way beyond their shelf life.

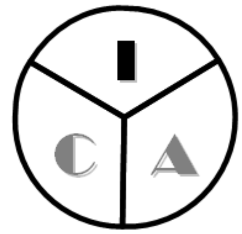
He also noticed the coborrower's credit score was much lower than the borrower's. He was at 630 while she was at 785. This was entirely due to a paid foreclosure five years ago that was still on his report, plus a recent late payment on one of his personal credit cards. Ratios were a little high, but not by much, in the mid-forty range.

The loan officer first submitted the loan at $125,000 and got another caution. He lowered it again to $115,000 and received the same result. The last try at $100,000 got the desired approval. He got another approval with the original loan amount, by taking the coborrower off the note and removing his negative credit from the transaction.

He also noticed that one of their current mortgages only had a $10,000 balance on it. He then reran yet another approval with the original loan amount and both borrowers on the new mortgage but instead he took just $10,000 and paid off a mortgage.

Getting rid of that one mortgage payment dramatically reduced their debt ratios, helping them obtain the approval.

21. Adjusting Amortization Periods



An amortization period is the time frame that loans automatically go away after a borrower has been paying on the loan, typically ten, fifteen, or thirty years. Amortization periods can be any length that the borrower and lender agree upon, but lenders will typically amortize a loan in five year increments with the shortest period being ten years and the longest fifty years.

Some lenders offer five year loans but not many. Nor do many lenders offer fifty year loans. Most believe that there are just two types of amortization periods, fifteen and thirty, but that's not true. Loans can amortize over any period in between including twenty-, twenty-five- and forty-year terms. The reason that's important is that the shorter the term, the higher the monthly payment. The longer the term, the lower the payment. The lower the payment, the more affordable the property.

The Challenge

A couple is deciding whether or not to buy right now. They have been waiting for two years for a series of raises to kick in while at the same time saving up what they could. They saw rates at different lenders and on the Internet for either fifteen-year or thirty-year fixed rates.

They have enough for a 5 percent down payment on a $250,000 home, but rates also began to move up over the past twelve months. Home prices, as well as rates, were on the move, and they didn't like it. They kept their fingers crossed that rates would either stay the same for a couple of years or home prices would stabilize, but neither had happened. It was getting to the point where they were thinking of waiting until their next annual raises came up, but were confused and disappointed.

They could take adjustable rate mortgages, or even hybrids, which offered lower rates, but had promised each other they would take a fixed rate mortgage and stay away from anything that could adjust later on.

Their parents had also told them, as well as a host of websites, that paying mortgage interest, while tax deductible, should be held to a minimum, and to take a shorter length mortgage rather than a longer one.

The Solution

Adjust the length of the mortgage term to change the payments and improve their debt ratios.

Using this scenario of a $250,000 sales price with 5 percent down, the loan amount comes to $237,500. Using a fifteen-year fixed rate loan at 5.5 percent the principal and interest payment would be $1,940 per month. Add on taxes, insurance, and PMI, and the total monthly payment would be approximately $2,370. If a loan program asks for a housing debt ratio of 28 percent, that would mean the gross monthly income in order to qualify would be $8,464 ($2,370 / .28 = $8,464 per month). But the couple doesn't make that much per month. Their combined income is just over $6,000.

Let's look at the difference in monthly payments using the same loan amount and taxes, insurance, and PMI totaling $430 per month but with different amortization periods.

Impact of Varying Terms for Loan of $237,500			
Term	Rate	Payment	Income to Qualify
10 years	5.25%	$2,978	$10,635
15 years	5.50%	$2,370	$ 8,464
20 years	6.00%	$ 2,131	$ 7,610
25 years	6.00%	$1,960	$ 7,000
30 years	6.00%	$1,853	$ 6,617

You can see the dramatic differences in monthly payments and you can also see how lengthening loan terms can reduce the amount of income needed to qualify. In this instance changing the loan term from ten years to thirty years reduced the amount of income needed to qualify by $4,018.

Lenders typically don't advertise interest rates with such varying terms. In fact, you're most likely to see only a thirty-year fixed rate and sometimes a fifteen-year. Consumers may incorrectly assume that's their only choice. It's also possible a loan officer doesn't know that lenders offer terms in five year increments because they're not always on their rate sheets.

It's a fairly common dilemma. Consumers want to save on interest so they gravitate toward a fifteen-year loan then find out that their payments are nearly a third higher so they get a thirty year, then calculate the difference in interest paid over thirty years, and they're shocked at the amount of interest a thirty-year loan collects. Of course, that's over the life of the loan, and few loans ever get near that. Yet consumers do look at that number, and few know there are "in betweens."

Longer amortization periods do have more interest, but that shouldn't stop consumers from paying extra on their loan to offset that effect. Prepayment penalties have all but disappeared, especially on conventional and government products. Making one extra payment each year toward the principal on a thirty-year mortgage will knock off about six years worth of interest. This is a simple, prudent way to pay down the loan, avoid paying extra interest, and accelerate the accumulation of equity.

Snapshot

Rosa was ready to buy and had done all her homework beforehand. She attended some free home buying classes in her community and read all the right books about buying real estate.

It's just that she couldn't decide on which loan to take: the fifteen-year fixed or the thirty- year fixed. She had already been preapproved by her lender, but if she took the fifteen-year loan, she could only qualify for about $300,000. But with a thirty-year loan she could get approved for a $400,000 mortgage because she made just over $10,000 per month. The trouble was, nothing in the $300,000 did anything for her. To buy a home she liked, she either had to increase her income to qualify for $400,000 or save up more money for a larger down payment.

She showed her agent, Maria, her preapproval letters, one using a fifteen-year loan and one using a thirty-year loan.

"Did you look into twenty- and twenty-five-year terms?" Maria asked.

Rosa replied that she didn't know lenders had them, asking, "What good would that do?"

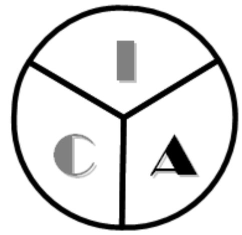
Maria said that a twenty-year might be a better alternative, and with her good credit and down payment it's possible she could get approved that way.

Rosa called her loan officer and asked her to run her approval again, but this time with a twenty-year term and a twenty-five-year term, both with the $400,000 loan amount.

The loan officer did as she requested and sure enough both approvals came through. Even though the twenty-year loan was just five years longer than the fifteen-year term, she discovered that her good credit, along with her down payment, got her approved with the AUS.

She got the $400,000 loan amount she wanted and, with her approval letter in hand, went house hunting!

22. Adjusting Interest Rates to Cover Closing Costs



Lenders not only offer a variety of loan programs, but they also offer a variety of interest rates. Loans, after all, are nothing more than a commodity. They're the same from one lender to the next. So to differentiate themselves they have to present as many loan offerings as possible in order to appear to have a loan for every circumstance. The fact is that those multiple loan programs are nothing more than variations of the same few ingredients.

Consumers get the wrong impression that a lender can offer only one rate and that rate is, well, "just what the lender offers" right now. Lenders can't advertise every single interest rate just like they can't advertise the fifty or so loan programs they offer. It would take up too much space.

Mortgage rates from lender to lender are tied to the very same index. A thirty-year fixed rate mortgage at Lender A is tied to the very same index as Lender B. That's why, all things being equal, a thirty-year fixed rate can't be 5 percent at Lender A and 6 percent at Lender B.

The same is said for any hybrid or adjustable mortgage rate. If a mortgage is based upon the London Inter-Bank Offered Rate, (LIBOR), lenders peg their loans on the very same index. They can't differ. A 5/1 hybrid with LIBOR as its index is the very same index from Lender A to Lender Z. The difference is in the marketing—not the loan. Rates within loan programs can also vary, depending on whether or not points are paid.

All this variety means that an experienced loan officer can adjust the interest rate on a loan to help a buyer qualify with less money down. In some circumstances, this can even offset all of the closing costs, recurring, and nonrecurring ones.

The Challenge

Sometimes buyers have little or no problem putting money down to buy real estate because that money is still theirs in the form of equity in the home. But paying closing costs is an expense. It's equity out the window. If there are $5,000 in closing costs for a home purchase, there might be buyers who would rather spend or invest that same money elsewhere. In their home, in a stock or bond, in a retirement account.

Closing costs can't be avoided. The attorney, appraiser, title insurance, tax services, flood certificates, closing and escrow fees all must be paid. That can add up. Sometimes people have the money for such fees but don't want to spend it, and sometimes people don't have the money and can't spend it.

In different markets seller concessions may be common and uncommon in others. If a buyer wants a seller to pay for some or all of the closing costs in a transaction, and it's purely a sellers' market then the buyer is out of luck.

If the seller won't pay for the closing costs and the buyer doesn't want to or can't, then who will?

The Solution

The lender can pay for closing costs. Sort of. Remember how paying one discount point will reduce an interest rate by about ¼ percent? And by paying two points the rate will drop ½ percent? Let's turn the tables. Let's raise the interest rate by ¼ percent. Guess what happens? Instead of the buyer paying one point at closing he is now paying zero points. Rates can move up or down on the very same loan program depending on how many, or lack of, points the buyer will pay.

A lender might offer a loan program at 6 percent with one point or 6.25 percent at zero points. The lender gets more money up front with a point being paid, but now the loan is worth less because the interest rate is at 6 percent compared to higher rates. Interest is collected upfront in the form of points or long term in the form of interest. Either way, the lender expects a similar amount of return regardless of the interest rate selected.

Now let's take it one step further. By increasing that very same loan from 6.25 percent and zero points to 6.5 percent, what happens? Suddenly that 6.5 percent interest rate is now "paying" the borrower one point, which can be used to offset the borrower's closing costs.

Let's look at the following example: Sales price is $250,000, the down payment is $50,000 and there are $3,000 in closing costs to the buyer's side. The buyer selects a thirty-year fixed rate at 6.5 percent with no points on a loan amount of $200,000. That makes the monthly principal and interest payment $1,264. Plus $3,000 in closing costs. Now the buyer either chooses not to pay for closing costs or doesn't have it after the 20 percent down payment of $50,000.

By dividing the $3,000 in closing costs by the loan amount of $200,000 you get a decimal of 0.015, or 1 ½ points. As we explained in previously, if the buyer wanted to buydown the loan by one point, they would pay $2,000 ($200,000 x 0.01). But if an interest rate can be reduced by paying one point, then an interest rate can be increased by ¼ percent and the buyer will get one point credited back to them. So what would it take to erase the closing costs? 1 ½ points on a $200,000 loan is $3,000. So by increasing the interest rate by ⅜ percent, the buyer has the lender "pay" for his closing costs. More precisely, the borrower got rid of their closing costs by accepting a higher rate.

The lender just accommodated the buyer's request and received a similar yield if the buyer got a 6 percent loan with one point with the buyer paying $3,000 out of his own pocket. The interest rate is higher, but the difference in monthly payments is marginal compared to the cash outlay of $3,000.

A $200,000 loan at 6.25 percent at zero points is $1,231 with $3,000 in additional closing costs, while a $200,000 loan at 6.25 percent at zero points is $1,281 with no additional closing costs. The monthly payment is higher by $50, but the buyer saved $3,000 in cash. The buyer can take that same $3,000 and immediately put it into his principal balance after closing and save over $17,000 in interest over the term of the loan, or knock off one full year of monthly payments. It's simply a matter of leverage and is an option on most every loan product offered.

Watch Out!

Some closing costs are fixed and some are in relation to the size of the loan. An appraisal might cost $350 for a $50,000 house, as well as a $500,000 house. An attorney and an escrow company could charge $300 for a closing on that same transaction regardless of the sales price or loan amount of the home. Other costs are relative to the loan amount such as title, hazard insurance, and property taxes.

This method is more effective on larger loan amounts rather than smaller ones. Fixed costs in relation to a smaller loan means the increase in interest rate will be much higher to cover those fixed fees.

For instance, compare a $50,000 sale and a $500,000 sale. Fixed costs might be

Fixed Costs	
Appraisal	$350
Attorney	$300
Escrow	$300
Survey	$400
Total	$1,350

That totals $1,350. Now divide $1,350 by $50,000 and the result is .027, or 2.7 points. To increase the interest rate by 2.7 points, the rate on a thirty-year fixed rate loan would go from 6 percent to 6.75 percent.

Take those same fixed costs of $1,350 for a $500,000 loan and the result is .0027, or about 2 .7 points. That would change the rate barely, if at all, from 6 percent to maybe 6.125 percent.

Snapshot

Carlton saved diligently. His job was going very well and, or the past three years he had gotten both a promotion and a couple of raises to go along with it. He was ready to buy.

Carlton applied for preapproval on a mortgage loan and received it. He had enough for a small down payment but he didn't have any money for closing costs.

Without warning his dream home right down the street had a brand-new "for sale" sign firmly planted. Jay, his agent, made an offer on the home asking the seller to pay for closing costs. The seller declined. Jay told Carlton that he thought there were others making offers and he needed to make a decision fast or else the house might be lost.

Jay asked him why he was so firm with not paying any closing costs. Carlton replied that he didn't have the money right now. He wasn't expecting this to happen so quickly. Jay asked if he'd talked to his lender about a "no closing cost" loan.

"I haven't," said Carlton. "But I will."

Carlton called his loan officer that night and asked about a no closing cost loan. His loan officer ran the numbers and told him that he could get a no closing cost loan by increasing his rate by ¼ percent. All he would need to pay for was his down payment and his first year's insurance policy for the home. The loan officer calculated that his monthly payment would go up by about $19 per month with the higher rate.

Carlton signed the closing papers on his dream home thirty days later.

23. State, Province, and Local Government Grant and Bond Programs

Lenders work in conjunction with various government agencies that provide financial assistance in the form of loans, grants, and loan subsidies to those who want to buy homes. A grant is a gift that doesn't have to be repaid and a loan subsidy is similar in that there are no monthly payments, yet it has to be repaid if the owner ever sells the property.

Bond programs are also issued to help subsidize an interest rate, making mortgage rates lower for a select group of people. Those could be first-time home buyers, those with incomes less than the area median, or perhaps public servants such as police or firefighters.

The Challenge

The home affordability index is still slowly on the rise, meaning fewer and fewer people can afford the median home price in their area. Interest rates are also going up. There is no shortage of potential home buyers, but as the median price begins to rise, many are left out. Or, at least, they think they're left out.

Down payment money is also hard to come by, with many households having trouble simply making ends meet, much less saving to buy a home. Zero-money-down loans are available, but the interest rates that typically go along with them are a bit higher than what can be found at area banks.

At the same time, local governments would like to have some of their first responders live closer to their work. However, many government employees don't make enough money to live where the city wants and needs them to live.

The Solution

Buyers having trouble finding money for down payment and closing costs can look for local city or state agencies offering down payment assistance in the form of outright grants or interest-free, forgivable loans.

The trouble with such programs is that they are invariably launched with little fanfare—few know about them. The government agency that is charged with disbursing down payment assistance funds is rarely left with any extra money to promote the program. That's a shame because such programs are a great way to help those who are desperately trying to find money to buy a home in a location where they'd like to live. And there are more housing assistance agencies than you can imagine.

The first place to check on the availability of government financial assistance is with your local government. Local governments often are the issuers of down payment assistance and can have specific qualifications, but most are similar from city to city.

Common Qualifications for Down Payment Assistance
Must be a first-time home buyer (not owned a home in the previous three years)
Income must not exceed 80%–120% of the median family income for the area
Property must reside within the city's jurisdiction
Lender approval for down payment assistance (most do)
Take a HUD-approved home buyer education class
Typical amounts for down payment assistance range from $5,000–$10,000

Common terms for down payment assistance are either in the form of a flat-out grant, or an interest-free loan. If the flat-out grant is chosen, the money is disbursed at closing with no expectation of being repaid. With the interest-free loan, it wouldn't have to be repaid to the city unless the owner sells the property. Many times the city would not have to be repaid if the owner keeps the property for a minimum period, say seven to ten years. If the city does not offer such a program, the state or province likely does and will have similar qualifications.

Bond programs can also be issued with a specific audience in mind, and can be limited to first-time home buyers as well, but can also be directed to other groups. For example, in Texas, bond programs are issued to fund a program called "TexVet" which is only for qualified veterans who live in the state of Texas. The qualified veteran will apply for a mortgage at any mortgage company that participates in the program—most large mortgage companies do participate. At the same time, the veteran would make an application for the TexVet program. Interest rates for such programs can be as low as ½ to 2 percent below market rates! This allows a veteran to get qualified for more home than he would without the subsidy.

If a veteran qualified for a $150,000 home at 6 percent then with a 4 percent rate he could qualify to borrow nearly $190,000. California has a similar program called CalVet.

Other groups that have their own bond funds are teachers, police, and firefighters. This program is national in scope but administered by the states, and also offers below-market rates to those who qualify. It is renewed annually. If you are working with a buyer who is a public servant, government employee, first-time home buyer or who earns an annual income below the median of your area, you would be wise to encourage them to ask their lender about these programs. Good loan officers are usually in the know, but it's better to ask than assume your buyer doesn't qualify.

Watch Out!

Bond programs are typically issued on a first-come, first-served basis every year. A teacher's fund could have $20 million available, and with each loan that is funded, it is deducted from that $20 million amount. It's possible your clients would qualify for a special teacher program at the first of the year, but the funds would run out before they actually found a home.

Such programs have a preset interest rate and sometimes that rate isn't as attractive as what's available on the open market. When that's the case, those funds aren't used up. But when the rate is lower than what the current market can offer, then those funds will be taken rather quickly. Grants and other government programs aren't a permanent fixture, and they can change as political winds blow and funds become available.

Sometimes bond programs and grants have a special provision that may require the buyer to repay a portion of that grant or loan should the property be sold or refinanced in the future. If the program taxpayers' money funded the special initiative, it could trigger a recapture tax penalty. We discuss recapture tax in more detail in the next chapter.

Snapshot

Carrie, a single mother, began looking into buying her first home. She didn't want to raise her baby in an apartment building but wanted to have a fenced backyard, with a swing and trees. She soon found out that mortgage loans required more money than she could ever have, so she gave up.

After working with a city-sponsored job search agency, she soon found a better paying job. One day, someone at the agency told her about the city's First-time Home buyer Assistance program. She contacted the agency and they told her all about the program and how she could get enough money for the down payment and closing costs. She could also get a list of local real estate agents and lenders who participated in the program.

She didn't believe it at first but her contact at the housing assistance agency assured her that it was a great program. Several hundred families had already participated in the program and were now living in their own homes. She got the agent list and called Diane, the first agent on the list.

"Diane," she said, "My name is Carrie and the city gave me your contact information to help me find a home."

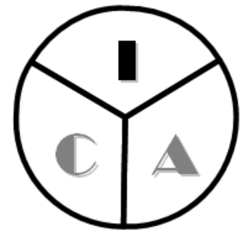
"I'd love to. Have you talked to a lender?"

"Yes. I'm already qualified according to one lender, but I'm also going to call a couple more." Carrie said.

As Carrie went through the homebuyer education class she learned about budgeting for emergencies. She also learned how to establish and keep a good credit record and about all the other things needed to successfully buy and own her very own home.

Diane found her a home after just a couple of weeks and Carrie made an offer with an approval letter in hand. The city wired $7,900 to the closing table, enough to cover her down payment and closing costs. She is now a homeowner and watches her daughter play in the backyard of her dreams.

24. Mortgage Credit Certificates—MCC



Designed for first-time home buyers, a mortgage credit certificate (or MCC) lets buyers exchange part of their annual mortgage-interest deduction and apply it to their monthly mortgage payment, effectively increasing their borrowing power. The MCC is designed to help first-time home buyers stretch their qualifying income by allowing borrowers to take a tax credit equal to 15 percent of the annual mortgage interest paid each year. The lender applies that additional credit to a buyer's monthly income when qualifying them.

An MCC can be used with any conventional or government loan but is restricted to first-timers who make no more than 100 percent of the area median income and who must occupy the property. The MCC benefit lasts throughout the life of the mortgage loan.

The Challenge

The local economy has been going strong for the past few years and has been putting the squeeze on home buyers. In a relatively strong market, current homeowners are able to sell their home and move up to larger homes with the accumulated equity. That's one reason median home prices are still on the rise—people are buying their second and third homes.

In this sellers' market, there are few concessions. Contingency offers are being rejected. There is no need in a seller's mind to help buyers with closing costs or seller carrybacks when another offer will likely come in with no such request.

There are willing buyers in the market but it's the first-time home buyer who is being shut out. More and more, the buyers are being forced to look at homes much further away from their jobs and their schools in order to find an affordable home.

The Solution

First-time home buyers should apply and use an MCC to increase their buying power.

The process is simple but needs to be performed with a team familiar with MCCs and how they work. The buyer need only contact a lender who participates in the MCC program and apply for a mortgage loan. The lender will underwrite the mortgage loan with the MCC in place. How much is the mortgage credit? It depends on the interest rate secured by the buyer and the loan amount. Say the loan amount is $200,000 and current thirty-year fixed rates are at 6.5 percent. To calculate the interest paid over the first year, simply multiply $200,000 by 0.065 which equals $13,000. This $13,000 is the amount of mortgage interest that will be available to the buyer as an income tax deduction. Next multiply that $13,000 by the MCC credit amount of 15 percent, ($13,000 x .15 = $1,950.) Finally divide that by 12 (months) to get the monthly tax credit amount. In this example that credit is $162.50 ($1,950 / 12 = $162.50.) This $162.50 can be used to simply reduce the overall monthly payment or added to the buyers' gross income to help qualify. The remaining interest from the original $13,000 would still be available to the buyers as a mortgage interest deduction come income tax time.

$200,000 Loan Without and With MCC		
	Without	With
Loan Amount	$200,000	$200,000
Thirty-Year Fixed Rate	6.5%	6.5%
PITI	$1,454	$1,454
MCC Credit/Month	-0-	15% ($162.50)
Effective Payment	$1,454	$1,291.50
Qualifying Income	$54,171/year	$48,120/year

In this example, with a $200,000 mortgage, the buyer would only need $48,120to qualify for the home loan versus $54,171without the benefit of the MCC.

Once approved for the MCC and after the house is purchased, the buyer would contact his employer and have his W-4 form adjusted to reflect the amount of tax withheld to match the credit received each month. Note, there is usually an application fee that goes along with an MCC at around $500. An MCC should be considered for most every first-time home buyer that qualifies.

Watch Out!

As with certain bond programs that offer below market rates, the MCC has a recapture tax provision that is in effect for the first nine years. The current recapture tax amount that would be paid upon sale would be equal to the lower of 6.25 percent of the original loan amount or half the sellers' net proceeds from the sale of the property. If a buyer bought a home for $250,000, borrowed $237,500, and the home sold five years later for $275,000, then the buyer would repay the lower of 6.25 percent of $237,500 = $14,844 or 50 percent of $275,000–$250,000–$10,000 closing costs = $7,500.

Rarely triggered, the recapture tax is the amount the homeowner must pay upon the sale of the house back to the IRS, but only under three distinct circumstances that must ALL be present:

1. The home is sold before nine years is up; and
2. There is a profit on the sale; and
3. The borrower makes more money than when he first bought the home, with a 5 percent annual income increase allowed each year.

Recapture tax disclosure forms are provided to the buyer at loan application. It needs to be made very clear to the buyer that there is a recapture tax provision and have it explained to him/her. The buyer will sign a form that says he/she has reviewed and understood the recapture tax possibility, but buyers also sign a lot of forms both at loan application and at closing that they may not understand, either.

If buyers don't fully understand the recapture, regardless of any signature on a disclosure form, you can bet they'll let you know their displeasure at the closing table when they sign a recapture form!

Snapshot

Betty and Carl were expecting and decided it was time to buy a home. They had been reading some books on first-time home buying and came across a section called the Mortgage Credit Certificate. The way it was explained in the book was that it was a way to transfer some of their annual mortgage interest deduction benefit into a monthly benefit that would let them buy a home with lower monthly payments. Or the MCC could be used to increase their monthly income to help buy a bigger house.

They went online and did a search for "Mortgage Credit Certificates in Wichita, Kansas" and up came several lenders that offered information on the MCC.

While they knew they could buy their first home using the MCC, they didn't really look at the benefit as helping them buy a bigger home; they had already found some areas they were interested in living in that suited them just fine. They ran some numbers and figured it was time to call an agent some friends had referred them to some time back. Mona, the agent, said, "Yes, I'm familiar with the program. Have you already been approved by a lender?"

"Yes," they said, "We've already applied for both the loan and the MCC. In fact, we know of a couple of areas we want to move to."

Mona began a search and quickly found eight houses that met their requirements. Four of them really stood out, so Mona scheduled a tour. The made an offer on the home which was accepted and closed soon thereafter.

Their tax credit was $187 per month. They also had their first child one month after moving into their first home. Instead of spending that $187 on a bigger mortgage, they took that money and began a college fund. After ten years that college fund grew to $33,946.

25. Expanded Alternative Lending

Expanded Alternative (or EA) loans are offered via Fannie Mae and are designed for those who have had some credit bumps in the past but can still qualify from a debt ratio, or income standpoint.

EA loans allow for relaxed credit scores with as little as nothing down. Interest rates are a tad higher than conventional fare, but also offer the opportunity to have those higher rates come down after the buyers make their payments on time. After twenty-four months of on-time payments, the higher interest rate may be reduced from one half to one percentage point, depending upon the approval level.

EA loans are only offered after an automated approval is requested but is not approved; instead an alternative is offered under expanded credit criteria. These loans are not considered subprime or necessarily "bad credit" loans, but simply do not fit the current conventional environment.

Often an EA is offered when a lower credit score is combined with little or no down payment. Fannie Mae's MyCommunityMortgage, which offers zero down and relaxed credit guidelines, is sometimes not enough and the automated decision will instead suggest an EA. EA comes in three levels, EA-I, EA-II and EA-III, with I being the best level of credit among EA approvals and III being the worst. EA-II permits a ½ percent reduction in rate after twenty-four months of timely payment, while EA-III has a 1 percent drop in rate after that same twenty-four month period of on-time payments.

Compared to a $250,000 conventional approval, typical rate spreads would be:

Rate Spreads			
Term	Rate	Payment	Payment after Reduction
Conventional	6.00%	$1,498	-
EA-1	7.25%	$1,705	-
EA-1I	7.75%	$1,791	$1,705
EA-1II	8.125%	$1,856	$1,684

Fannie Mae offers this program, which has only been available for just a few years, to help those with credit and down payment issues join the world of home ownership. What is different with such marginal credit loans compared with loans offered to those with bad credit is that income is verified, assets are verified, and ability to pay is required for each EA approval.

The Challenge

A buyer has had some rough times and experienced some credit bruises. Still, there are plenty of opportunities to buy a home, but both credit and lack of down payment are holding her back. Fortunately, interest rates have remained stable while she attempts to repair her credit. That process can take some time, typically up to two years before any significant credit score improvement takes hold.

In the meantime she will just sit back and continue renting while saving up money for a down payment, which can be difficult to do while she's also paying off old debt and some outstanding collection accounts.

FHA lending, a government-backed loan program with relaxed credit standards when compared to conventional fare, was also out of the question. She had talked to a mortgage company recently and couldn't qualify for FHA financing, and all that she could qualify for was a subprime mortgage with higher rates and more down payment.

The Solution

Until recently, someone with damaged credit either had the choice of trying to make an FHA loan work with its lower loan limits or mistakenly go straight to subprime.

Too often borrowers "diagnose" their own credit ills and assume they have bad credit when a lender might think otherwise. Borrowers don't even try for the best loan at first, a conventional mortgage, yet go straight to the second and third choices. Big mistake.

With the introduction of the EA program, borrowers can apply for a conventional mortgage first using an automated underwriting system and see what happens. Sometimes the borrower is surprised that in fact she did get an approval with the best conventional rates. But with the EA program, even if she didn't get the approval, the AUS will come back with alternative offerings based upon her income, credit, and down payment. The

AUS decision could be returned not with the best rate, but one slightly higher. The decision would read something like:

THE DECISION

"Approve/Eligible EA-II"
meaning the loan is approved under the EA-II rate program.

The approval will then list all the items the borrower needs to provide in order to receive the loan. The AUS will attempt to provide the highest level of approval rather than giving the borrower an option of which EA to pick.

It's also one of the loan venues left that allow for as little down payment as possible, zero down for EA-I, 3 percent down for EA-II, and 5 percent down for EA-III. Credit scores can be as low as 580, even lower in some instances, so this is truly a subprime alternative while giving the borrower a chance to repair credit through making timely mortgage payments.

Watch Out!

There really aren't any items to be careful with under this program. It's a program designed to be "in between" a subprime and a prime mortgage loan. The only problem would be that many consumers aren't aware of its existence and make the mistake of going right to a subprime loan or not applying at all.

One note on credit scores: consumers can go to www.annualcreditreport.com for a free credit report. www.annualcreditreport.com is the official consumer site comprised by the three main credit repositories; Equifax, TransUnion, and Experian; set up under the Fair and Accurate Credit Transactions Act (FACTA) of 2003. Don't have them go to any other similarly named site, as those sites are retail websites designed to sell credit reporting services after they view their "free" report.

Lenders use credit scores derived from the three credit bureaus, throwing out the highest score and the lowest score and using the middle score as the benchmark for the borrower.

Consumer sites issue credit scores but may not be the same ones lenders use. That could mean your borrower would get the false impression that their score is too low or better than it really is. The only way to find out is to apply directly with a conventional lender for a preapproval.

Snapshot

Durbin was watching TV with his friend Claire when one of those online mortgage company ads came on. "Apply now! Rates are at historic lows!" yelled the ad.

Claire said, "Hey Durbin, I thought you were going to buy a house last year. What happened?"

"I was laid off from my job for a few months, remember? I got behind on some bills.

One of them even went to a collection agency and I still haven't paid it all off yet," he said.

"My dad said he read that you don't have to have perfect credit anymore," Claire said.

"Yeah, maybe, but I still have to wait seven years until that collection account comes off my credit report."

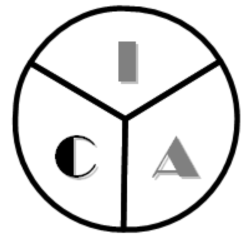
"Sorry, dude. You're wrong. Call my dad."

So Durbin did just that. Claire's dad was a real estate agent. He explained to Durbin how automated underwriting systems work and that it sounded to him like he might be approved after all … collection account or not. Durbin thought about it for a few days then called one of the lenders.

The lender explained how automated underwriting systems work, and if he was really ready to stop renting he could apply. And no, he didn't have to wait seven years!

Sure enough, although Durbin didn't get the best rate, the one he got was only about 1.5 percent higher than the best ones…much better than he thought! His lender sent him his approval letter and Durbin went looking for a house with Claire's dad.

26. Subprime Lending



Subprime lending is exactly what it says: lending to those with less than "prime" credit. Subprime lending has been around for years and years and fills a needed void in home lending.

It used to be that if someone had bad credit they would be tarnished forever, or at least it would seem so due to negative information remaining on credit reports for seven to ten years, depending upon the type of blemish. Subprime lending had become such a force in the early 2000s that most every lender had some sort of subprime division. Other lenders established their very own subprime mortgage company that went after the subprime business exclusively.

Subprime lending is not a permanent lending solution for a consumer but rather a temporary mortgage placed to help someone buy a home while in the meantime reestablishing damaged credit.

The typical subprime borrower is someone who had good credit up to a certain point when something catastrophic happened such as a death in the family, a divorce, a loss of job, or illness and injury. Due to any of those circumstances, and often some combination of the same, credit was damaged. Severely so.

In such cases a lender can see that a client had good credit up to a certain point and actually see a time line established on a credit report. Late payments suddenly begin to show up at the same time when none appeared earlier. Collection accounts are recorded at around the same time as well. It's easy to see when something bad happens to someone and their credit is hurt. The results of the event are recorded at the credit bureaus.

Subprime lending should only be used when conventional and government offerings fail. And then only when the buyer completely understands the nature and utility of subprime offerings.

The Challenge

A guy had been working at his job for about ten years when he was told that his company would be downsizing soon, and he had the choice of retiring now and taking some severance pay or staying on and taking the chance of being laid off.

He elected to leave. He couldn't find a job right away and he discovered that private insurance was more expensive than he thought. So he decided not to get insurance right away.

A few weeks later he was riding his bicycle when a car hit him, and he was sent to the hospital. His leg was broken and required two surgeries to repair. He went back home after a couple of weeks in the hospital. But now he was unemployed with no insurance and a backlog of medical bills he couldn't afford to pay. He had a job lined up, he just couldn't start for a few more weeks until his leg was fully healed.

His credit began to deteriorate. Soon he had plenty of medical bills he didn't want to pay because he was involved in a lawsuit with the driver that hit him. Soon those late payments turned into collection accounts.

He had been renting after his divorce a couple of years ago and was actually in the middle of shopping for a home when he was laid off and then subsequently injured. His credit was destroyed, so he abandoned his home shopping efforts. Especially when he found out his credit score was below 620.

The Solution

This is a classic example of a good subprime fit. Someone had excellent credit, had some money available for a down payment, and appreciated credit and how it works. Then something bad happened and credit scores went down hill.

A subprime loan will have interest rates anywhere from 3 to 5 percent above what a conventional loan would be. Subprime loans offer fixed rates, adjustable rates, and hybrids just like conventional and government loans.

There is a plan and a place for subprime loans and that is to acquire the real estate and then refinance out of that loan as soon as possible. If credit has been damaged to the point where the only offering is a subprime loan, then it might take up to two years of timely payment history to get the credit scores back up to a level that a conventional refinance would accept. A good mortgage payment history is one of the most efficient ways to improve a credit score.

The most important item a subprime lender reviews is timely payment history on their rent. Lenders appreciate someone, even under difficult circumstances, that will always, no matter what, pay their rent before they pay anyone else. That lets subprime lenders breathe a little easier when approving a subprime loan knowing that the buyer's first loyalty is to his housing. A borrower can have collection accounts, previous foreclosures, bankruptcies, and other negative credit, but having rent payments being paid on time does wonders. Subprime lenders will most often ask for copies of canceled rent checks or money orders showing a one- to two- year history of timely payment.

Because subprime rates are higher than conventional loans, the most popular subprime loan is the hybrid. So called because a hybrid is a cross between a fixed rate and an adjustable rate mortgage. Technically, a hybrid is an adjustable rate mortgage, but the first few years are fixed before it turns into an adjustable.

If a thirty-year fixed rate subprime mortgage rate is at 9.5 percent then a two year hybrid start rate might be 7.5 percent for the first two years before turning into an adjustable rate mortgage for the remaining twenty-eight years of the mortgage term.

The strategy with a subprime loan is to make certain that credit is being repaired during that initial two-year period after which the owners will refinance. This is crucial with subprime hybrids because most subprime adjustable rate mortgages can have some fairly onerous terms, such as at their first interest rate adjustment the rate can go 5, 6, even 7 percent higher than their previous interest rate. Someone who is paying 7.5 percent can see their rate jump as high as 14.5 percent at the end of the first two years. On a $250,000 loan amount at 7.5 percent, the monthly payment is $1,748 and on a $250,000 loan amount at 14.5 percent the monthly payment is $3,061.

Now you can appreciate the strategy necessary with a subprime loan. In fact, it's probably safer to look at a 3 year or even a 5 year hybrid as a safety net to avoid such a payment change. Rates are a little higher on 3 year and 5 year a hybrid when compared to a two year but just the peace of mind in having a little extra time to repair credit is worth it.

Watch Out!

Subprime loans and zero or little down don't go together. If a buyer can qualify for a subprime loan, but only has 5 percent or less to put down, then it might be better to wait.

Refinance loans must have some equity in them. If someone puts little or nothing down then expects to refinance in twenty-four months they're likely to find their property hasn't appreciated enough nor paid down enough in order to refinance into a conventional mortgage. If a buyer's monthly payments nearly double and they can't refinance the note, bad things like foreclosure happen and the buyer is worse off credit wise than before buying the home with a subprime mortgage.

Subprime lending has taken some hits and has contracted significantly. Foreclosures mounted when people couldn't refinance out of their hybrid subprime loan due to property values decreasing or their credit hadn't been repaired enough during the initial hybrid term. Subprime loans have a place in the mortgage industry, but borrowers must completely understand the consequences if certain chips don't fall where they're supposed to.

Snapshot

Sonja had a nasty divorce. With kids no less. She had owned a home with her "ex" for several years when they split up. They sold the home; she got her share of the equity and was now looking for a place to live. She called her real estate agent Julie, who was also a close friend, and asked if she should buy right now or wait a bit.

"You have at least 20 percent to put down, right? I mean you have at least that much from your settlement, don't you?" her friend asked.

"Yeah, I have plenty of money, I just don't know if I can qualify with all the credit stuff that happened during the divorce," Sonja replied.

Her friend gave her the number of a mortgage broker who specialized in helping people with damaged credit get a home loan. Sonja called the loan officer that night.

"I have a copy of my credit report. It doesn't look good but I do have at least 20 percent down and, if you'll notice, we've never been late on our mortgage," Sonja explained.

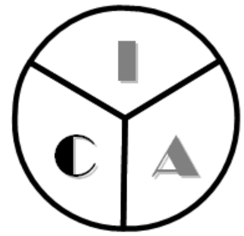
The loan officer reviewed her credit report, noted her scores, and ran the scenario by his best subprime lender. The next day, the loan officer called …

"Hi, Sonja. I have a loan approval for you based on your requirements. I suggest either a three year hybrid at 7.75 percent or a five year hybrid at 8 percent. You don't have to decide right now, just to let you know those rates are available to you.

"I've also sent your preapproval letter as an attachment to your email address … happy hunting!"

Julie reviewed the terms and made it very clear that Sonja needed to commit to two things. First, she needed to focus on repairing her credit and second she had to refinance the loan as soon as she could. Sonja happily agreed. She had thought any subprime rate would be higher than that. She would buy now, reestablish credit, and start building equity again.

27. Private Lending



Private money. Who is it and where does it come from? Private money is sometimes called "hard" money because it comes when conventional financing sources can't help. But private money doesn't mean loans for people with absolutely dreadful credit. No one wants to make a loan thinking they'll never see their money again.

Private lenders are either individuals or groups of individuals who form a company that provides financing under their very own guidelines. Private lenders must adhere to various lending guidelines when it comes to interest rates and terms offered, but private money loans are typically of shorter terms, higher rates, and higher fees.

Private lenders are more concerned with both their initial equity position and their exit strategy. Their equity position is the amount the buyer puts down on the property, and the exit strategy is how they will make money if they have to foreclose on the property.

Private loans are normally interest only and don't require as much documentation. Private lenders are not in the foreclosure business but in the high rate of return business. They want a high yield. They don't want to own real estate.

A private lender's forte is helping out those who are about to lose their real estate holdings with emergency funding to halt foreclosure proceedings or allow a property owner to pull equity out of real estate they own for other purposes. Private lending can also be a resource for purchase transactions as well.

The profile for a private money deal might be someone who has just come out of a bankruptcy (or some catastrophic event that a conventional nor subprime lender wouldn't touch) but has plenty of both liquid and nonliquid assets.

The Challenge

Sam has just won a nasty lawsuit, but it cost him his credit. He has plenty of money, but because of his credit profile, it appears he has to wait to buy a house.

Sam applied for a mortgage loan to buy a house he had his eyes on, but his bank politely said "no." He then contacted some mortgage brokers he found, some from the newspaper and some online, but they all said the same thing: that until his credit score got back above sea level, they couldn't do anything for him.

He had 30 percent down, at least, plus closing costs. And he could have paid cash for a house if he wanted to, but didn't want to. He wanted to buy but couldn't find the financing. He was told he would have to wait for at least two to three years.

The Solution

He searched online for "private lenders" and found several results, and they were all willing to listen to his scenario.

A typical private loan will require as much as 30 percent down and have loan terms based upon prime plus 3 percent or more, and loan terms from ninety days to three years. At the end of the loan term the mortgage balance becomes due in full.

Private loans then should be viewed as a Band-Aid and not a cure. Private loans can command not just higher rates but also ask for higher fees. Most of these loans are interest only as well, which helps to keep the payments lower, but never pays down the principal.

Let's look at a conventional mortgage at 6.5 percent over thirty years and a private money deal at 10 percent, interest only. The conventional mortgage would charge no points, and the private deal could charge two or more.

	Conventional	Private
Loan Amount	$250,000	$250,000
Rate	6.5% for 30 years	10% interest only
Term	360 months	12 months
Monthly Payment	$1,580	$2,500
Amount to Interest	$1,350	$2,500
Balance After one Year	$247,205	$250,000

After one year, although the conventional loan is lower, it's not lower by much. And yes, the monthly payments are higher with the private, but as you can tell, most of the payment goes toward interest with the conventional loan, with all of the payment being interest with a private deal. Plus, the $2,500 monthly payment is still mortgage interest which is tax deductible, whereas rent is certainly not.

There is no comparison regarding which is the better loan—the conventional loan wins hands down. But that's not the argument here. The argument is home ownership with all its tax benefits versus renting. And in a market with home prices on the rise, the private money loan lets the owner accrue that equity as well.

The owner needs to be prepared to refinance when the loan comes due, refinance with yet another private money loan, or perhaps move up a notch with a subprime mortgage. Just as the private money lender wants to see an exit strategy from their perspective, the buyer also needs to establish their own exit strategy from the private loan as well.

Where do you find private lenders? Private lenders can be individuals who market their services to local real estate agents, but they are most likely a group of individuals who pool their money to make private loans. Most any search engine will pull up a list of private lenders in your area, but your best bet is to get a referral from someone you know.

Watch Out!

Private funds are a legitimate way to acquire real estate when other methods have failed. If your buyer is using private money, make certain they fully understand how they're going to refinance out of the private money deal into either a subprime or conventional mortgage.

Lending laws can vary by state, and private lenders who provide mortgages held by residential real estate must also adhere to predatory lending guidelines. Private money deals can't be predatory in that they're designed to either strip equity or foreclose. If a private lender has to foreclose on a property, that lender made a terrible mistake, or the buyer's situation deteriorated unexpectedly. Private money is a short-term solution for those who are determined to buy.

Snapshot

Sharon's condo on the lake was just sold at auction after being foreclosed on. She had been involved in a very nasty lawsuit with her old lender over past property taxes. During the appeal process, the lender foreclosed. Simply put, she got some very, very bad advice from both her attorney and the old lender, and she was now out of a house and living with some friends.

Not that she was poor. She owned a successful manufacturing company with facilities in both Texas and California that was nearly ten years old. She just bet the wrong way on her house and lost. She was determined to buy a new house and contacted a mortgage broker for a loan. Sharon had some down payment money and was ready to buy.

The mortgage broker ran her credit report, and her credit scores were all in the 400s. She had excellent credit before the lawsuit, but now her credit was in ruins.

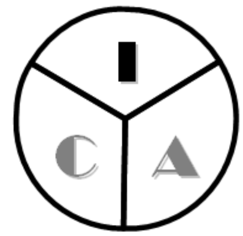
"I'm sorry," informed the broker, "but I can't do anything with this."

The broker had access to lenders that placed subprime loans. He also gave her another name. "This is a hard money guy. If you want this house and are ready to refinance in a year or two then this is another option."

She called the private lender who gave her the terms of the loan as long as the property checked out and she could put down 30 percent. The private lender did an appraisal on the property, it appraised at $450,000, and the contract was for $420,000 (it too was a bank-owned property!)

Sharon put down 30 percent, got an interest only loan for 24 months and moved in. At the eighteenth month of ownership, her credit scores had begun to improve, and she was able to refinance out of the private loan into one with lower rates and better terms.

28. No Documentation Programs



One of the many things lenders do when approving the loan is document the evidence in a loan file. This documentation typically requires third-party verification. Third-party verification means that if a buyer says he has a job at XYZ Motors and makes $5,000 per month, then the lender will contact XYZ Motors and have them verify how much money the buyer makes. If a buyer tells a lender he has $50,000 to put down in order to buy a house, the lender may also want to see evidence of that from the bank or investment account that holds those funds. The lender needs documentation from independent parties to help process a loan file.

Throughout the past few years there have been alternative loan programs popping up from different lenders that offered various levels of documentation. Originally meant to help streamline the loan application for the more affluent and credit worthy buyer, lenders would accept certain things to be true on a loan application. If the buyer stated he had $50,000 in a bank account and he had excellent credit and his job was verified, then the lender would take it easy on the buyer and not require third party verification of these assets.

Soon the same convenience crept into other loan programs, and not just for those with excellent credit, but for everyone, even those with subprime credit. So called “stated” loans soon became more and more popular, and what started out as a convenience to a certain group of borrowers soon evolved into a standard loan documentation process. Now these types of loans exist on a case-by-case basis with specialized lenders or banks that don’t sell their loans.

Lenders have various levels of documentation, from “fully documented,” meaning everything is verified via third party, to “stated documentation,” where the lender uses whatever the buyer puts on the application as gospel, to “No documentation,” where nothing is verified. No income, no assets, no employment. Just credit and a good down payment.

The Challenge

Loans have certain requirements, too many to mention here. Sometimes those requirements mean the property has to appraise at a certain amount, or the buyers must occupy the property, or that there are no previous claims on a property showing up on a title report.

When it comes to documenting the buyer's financial situation, sometimes the situation doesn't meet the criteria the loan requires. A borrower might not have enough money for down payment or doesn't make enough on his job to qualify. Those are some serious requirements that can't be overcome.

A buyer could have a new business that is making good money, but most lenders require a two-year history for income from the-self employed borrower. Regardless of the credit standing or how much money the new business is pulling in every month, the two-year history can't be overcome.

There are other times when income can't be used because it doesn't have a track record. If a buyer has recently inherited some money and is pulling in a monthly dividend from those investments, a lender won't use that either, because income from interest and dividends must have not only a history, but have a "likelihood of continuance" that would make the underwriter comfortable that the interest and dividend income will be available from this point forward to help make house payments. Sometimes the income or employment exists, but it just doesn't meet lending guidelines and can't be used.

The Solution

When income, assets, or employment exists, yet doesn't meet lending guidelines, then a No Documentation loan can help.

No Documentation, or "No Doc" programs are perhaps the easiest of all loans to approve because there really is no documentation, other than running a credit report on the borrower.

No Doc loans are reserved for those with excellent credit, and typically anything above a 700 credit score can qualify. No Doc loans used to be more prevalent than they are today, but with recent credit guidelines tightening, No Doc loans are again reserved only for those with good credit.

The loan application, when completed, looks odd when compared to a regular home mortgage application. Even though the application is exactly the same for a fully documented loan, when compared to a No Doc loan, there are so many blank spaces! There is no employer entered, no income entered, and no bank or asset information entered. The lender simply approves the loan based on credit and a down payment. No Doc loans usually require a minimum of 20 percent down. Even though the down payment isn't verified, the buyer will still come to the closing table with a cashier's check in the amount of 20y percent down plus money for closing costs.

No Doc loans will not only have a minimum down payment requirement, but will command a higher rate, but not as high as one might think when a loan has no income, asset, or employment documentation. Most will have an interest rate about ½ percent higher than a loan that is fully documented. How do lenders make such loans? First, not many of them do. But when they do, they look primarily at the credit score.

A lender can make a determination that someone with stellar credit didn't get that by accident, but only by paying attention to both establishing and maintaining a stellar credit profile.

Watch Out!

No Doc loans are not to be used when income is simply not there. That's loan fraud! After all, who would put down 20 percent into a transaction not knowing how they're going to be able to pay back the note?

Other "stated" documentation loans have often been called "liar's loans" because why would someone not want to document their income or assets if they weren't telling the truth? Fair enough. And there has certainly been a good amount of loan fraud that can back up that claim. But reduced documentation loans are there as a convenience not as a vehicle to commit loan fraud. When someone "fudges" their income in order to qualify, the lender might in fact never know about it. That is unless the file gets randomly audited (it happens), or the buyers find out they can't afford the payments after all and go into foreclosure.

During foreclosure proceedings, one of the things lawyers do first is uncover the facts. Lawyers will review tax returns filed by the buyers, then compare that amount to what they "stated" on their loan application.

There won't be any problem if the tax returns show $50,000 per year and the loan application shows $52,000 per year. But if the application shows $100,000 per year, then worse things than a foreclosure happen. Loan fraud is serious business, and people go to prison for it.

Snapshot

A couple had moved from Hawaii to Georgia. The husband had been a mechanical engineer for more than ten years and was an expert on fire suppression equipment for large warehouses and office buildings.

When they moved to Georgia, his wife went back to work as a nurse, just as she was in Hawaii. The husband, however, started his own business of selling, and installing fire suppression equipment for large warehouses and office buildings.

He was an instant hit. Within a few months he hired staff and moved into a new office.

They wanted to buy a new home, so they started shopping. They did some research online and found some houses they were interested in, and thought it would be a good time to go to their bank for a home loan.

"Sorry," said the bank loan officer, "but we need to see at least two year's worth of tax returns for your new business, and you have less than one year."

The couple needed both incomes to qualify. The income from the hospital was okay but was nothing near what was needed. They needed the husband's new income, which was more than $25,000 per month.

"But I make more than$25,000 per month, I have great credit, and I'll put 25 percent down!" said the husband.

"Sorry."

They did some research that night on the Internet and learned about No Documentation loans, so they made a few phone calls the following day and met with one company that sounded really nice.

The loan officer told them that with their good credit and 20 percent down they could get a No Documentation loan immediately. Even though rates were higher, they could always refinance down the road should they so choose when his business had two years worth of tax returns.

But as low as rates were at the time, it was possible that after two years had passed, their No Doc rate would be lower than what rates soon became. Rates in fact did go up. And the couple did buy their home with a No Doc loan.

The Bottom Line

You now know more than most mortgage loan officers will ever learn. You also found more than one way to help your buyers and sellers and to build your business. When word gets out that you were the agent that sold the home that couldn't sell, or that you helped someone get financing that had been previously turned down…well, you know what happens. You get more listings. You get more buyers. You make more money. And all with nothing more than using techniques described in this book.

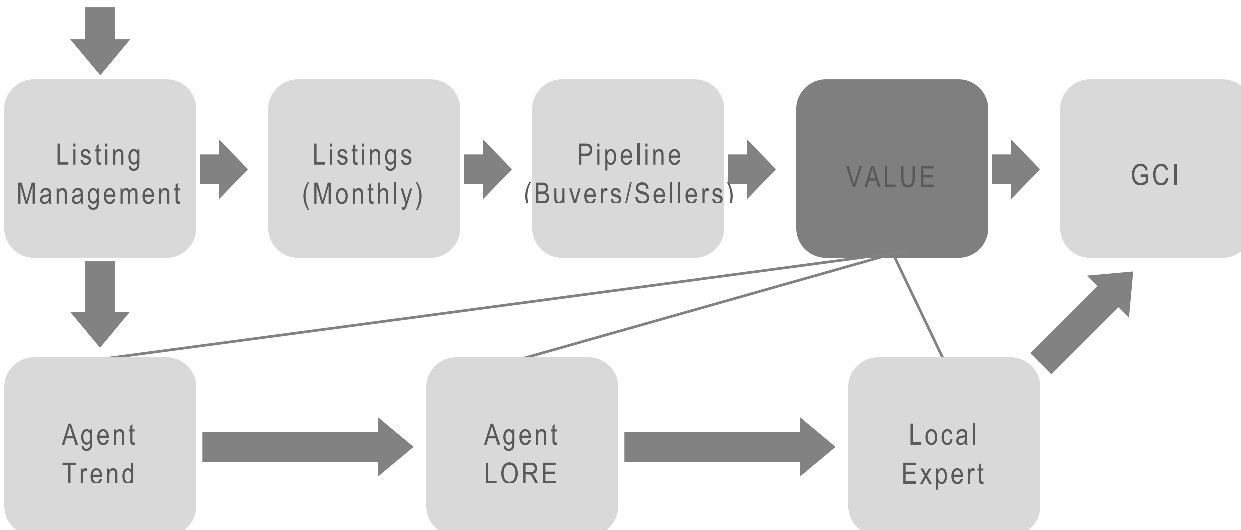
You probably noted that not all of the chapters applied to you. That's okay. Every single chapter won't apply to every single agent. Hopefully, you also realized that the techniques described don't have to work alone—you can apply more than one idea to the very same transaction.

For instance, an Expanded Alternative Loan can also be calculated as a seller-funded temporary buydown to help offset a slightly higher initial rate. You might also locate a down payment assistance program and combine that with a seller carry back and lengthen the amortization period to keep the payments lower and help sell the house and qualify the buyer.

And if you looked very closely, you likely came up with some ideas on your own. This book is intended to not only provide real world solutions to everyday situations, but to also help spark new ideas in your market. When you do get the creative "light bulb," consult with your team (your lender, attorney, CPA, etc.) to make sure your program conforms to area norms and laws.

Career Growth Initiative Power Tools:

The tools of the Career Growth Initiative are a synergistic system that fuel the Four Conversations with evidence.



Vision Tools

- **Listing Management:** A yearly plan for profitability through growth in market share.
- **Listings (Monthly):** Monthly tracking with adjustments to help you achieve your yearly goal.
- **Pipeline (Buyers/Sellers):** Identify on a daily basis whether your activities will turn your goals into reality.

Value and Validity Tools

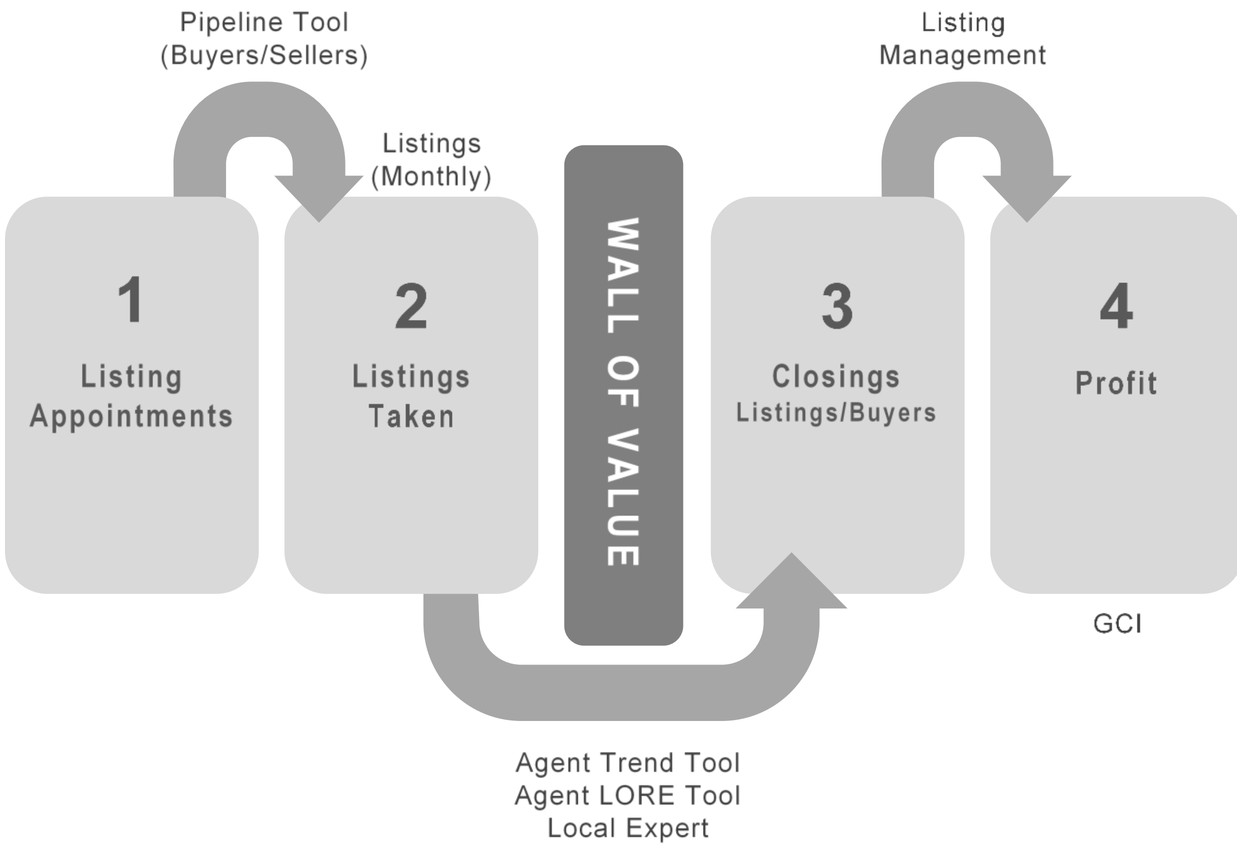
- **Agent Trend:** Report that tracks your growth in market share and critical levers in your business to assess performance and opportunities.
- **Agent Language of Real Estate (LORE):** Provides evidence of your value by comparing the growth of your business to that of your board, your subdivision, your Market Center, your Region, etc.
- **Local Expert:** The story of your expertise to underscore your validity to clients.

Thriving Tools

- GCI: Track your GCI against your expenses to identify your Break-even Day.

The Wall of Value

When you are able to quantify and communicate the benefits of the value you deliver, you will create a **Wall of Value** in your business that attracts listings and creates closings.



Communicate Value

Look for ways to share your Wall of Value to grow your business:

- Listing and Pre-Listing Presentations
- Buyer Consultations
- Marketing materials
- Conversations

For more, go to the Career Growth Initiative page on KWConnect.com

From Aha's to Achievement

AHA's *What are your Aha's?*
BEHAVIORS *What behaviors do you intend to change?*
TOOLS *What tools will you use?*
ACCOUNTABILITY *What does accountability for this look like?*
ACHIEVEMENT *What will you achieve?*

Resources

There are several resources you should keep bookmarked, with the most important one likely to be your local board. If you're looking for a particular form or have a question about a local guideline oftentimes you'll find that your local real estate association has a database that can help.

Other sites include www.realtor.com, the official website for the National Association of Realtors, and www.realtytimes.com, which has been noted throughout the years as one of the best online real estate news sources anywhere, and the only one with both a United States and a Canadian flair.

If you're looking for interest rate information, especially if you're looking at statistics and historical trends, look no further than www.hsh.com. You'll find interest rate data for every major index going all the way back to 1983, as well as statistical information for every major adjustable rate mortgage index. Lots of consumer information can be found there too, such as monthly payment calculators, amortization tools, and prepayment "what if" scenarios.

A competitive site (although with more advertising) is www.bankrate.com. Bankrate.com has evolved over the years from an interest rate survey company, which provided newspapers with current mortgage rate information, into a full-fledged consumer site filled with a smorgasbord of information for buyers and sellers everywhere.

The official website of the Mortgage Bankers Association of America is www.mbaa.org. It's a destination for updated lending guidelines, pending and passed legislation, and numerous consumer protection articles and tips.

If you want to further explore credit scores and visit the inventor of the mortgage credit score, then look up Fair, Isaac Corporation (FICO) at www.fico.com.

FHA loan information can be located at www.fha.gov, and VA information is at www.va.gov. Fannie Mae is at www.efannie.com, and Freddie Mac can be found at www.freddiemac.com.

Finally, Canadian agents can visit (in either language) the website for the Canada Mortgage and Housing Corporation at www.cmhc-schl.gc.ca, which is chock-full of consumer advice and has different areas for agents and other real estate professionals, consumers, and mortgage lenders and mortgage brokersNotes.

GLOSSARY

AUS (Automated Underwriting System) First developed by Freddie Mac in the mid-90s, it is an electronic application that evaluates a borrower's loan application for approval.

AVM (Automated Valuation Model) An electronic method of determining property value.

Alternative In real estate finance, it is a loan type that does not conform to conventional or government guidelines.

Amortization On a mortgage loan, the amount of time set aside for the note to be paid. Typical amortization periods are fifteen, twenty-five and thirty years, but lenders may adjust to any five-year period from five to fifty years.

Appraisal An independent third party determination of an item or a property's current market value.

Arms Length When a transaction involves those with no official relationship who are trying to independently get the best deal possible.

Buydown (Permanent or Temporary) A permanent buydown is a mortgage where the interest rate has been reduced permanently by paying additional fees, called discount points. A temporary buydown is a mortgage where the initial interest rates are reduced for the first two or three years.

Back Ratio The result of dividing all household debt by gross monthly income. See also Front Ratio.

Borrower Authorization A written, signed document that allows a third party to authenticate information about a borrower.

Balloon A mortgage loan that requires the balance be paid in full at a predetermined time, before the mortgage loan's normal amortization period.

CLTV (Combined Loan to Value) Expressed as a percentage, the comparison of all mortgages against a property compared to the appraised value. See also Loan to Value.

Carry Back A seller-owned note made out to the buyer.

Comparable In appraisals, a property used when making value comparisons with the subject property.

Conforming A mortgage loan that meets conventional lending guidelines and does not exceed predetermined mortgage loan amounts.

Conventional Mortgage loans that are issued and guaranteed by a mortgage company.

Credit Scores A three digit number from 350 to 850 that attempts to determine the likelihood of default on a mortgage loan. The lower the number, the greater the likelihood of default. A score of 680 is generally thought to be the middle ground, with those below getting less favorable terms, and those above enjoying more favorable terms.

Debt Ratios Expressed as a percentage, it is the result of dividing debt by gross monthly income.

Deed A legal document used to transfer ownership in a property.

Discount Points Also referred to as "points." This is a form of prepaid interest paid to a lender to get a lower, or discounted, interest rate. One point equals one percent of a loan amount and typically translates to a ¼ percent reduction in the interest rate.

Document Fee A fee charged to produce mortgage loan papers for closing.

Down Payment The amount of money a buyer places in a real estate transaction.

EAM (Employer Assisted Mortgage) An employer helps a buyer with either down payment money or a direct loan to buy real estate.

Escrow This term can have two meanings. In certain parts of the United States, an "escrow" is a closing. In other areas, an escrow is a third party account where monthly property taxes and insurance are placed, then paid when due, on behalf of the owner.

Equity The portion of the value of the home not secured by a note.

FACTA (Fair and Accurate Credit Transaction Act of 2003) An act added to the United States' Fair Credit Reporting Act that added stronger consumer protections against fraud and identity theft.

FHA (Federal Housing Administration) A unit of the United States government's Department of Housing and Urban Development (HUD).

Formed in 1934 to help foster home ownership by providing loan guarantees to banks when FHA loans went into default.

Fannie Mae The nickname of the Federal National Mortgage Association, or FNMA. A federal government-sponsored enterprise, it was established to provide liquidity in the mortgage marketplace by buying mortgage loans made by mortgage companies.

Freddie Mac The nickname of the Federal Home Loan Mortgage Corporation, or FHLMC. A federal government-sponsored enterprise, it was established to provide liquidity in the mortgage marketplace by buying mortgage loans made by mortgage companies.

Front Ratio The result of dividing PITI by gross monthly income. See also Back Ratio.

HELOC (Home Equity Line of Credit) An amount of money available to a homeowner that is equivalent to the equity, or non-obligated portion, of the value of the property.

Hard Money Money available from private investors to purchase real estate. Typified by higher rates and shorter terms for those with unique borrowing circumstances.

HUD (Department of Housing and Urban Development) A United States government agency that, among other things, oversees the FHA home loan program.

Jumbo A mortgage loan amount that exceeds conventional conforming loan limits.

LTV (Loan-to-value) Expressed as a percentage, the comparison of a first mortgage balance compared to the appraised value.

Land Contract A property sale where ownership does not change hands until all of the installment payments have been made.

MCC (Mortgage Credit Certificate) An allowance where borrowers can exchange part of their annual mortgage interest deduction into additional monthly income to help them qualify for a mortgage loan.

MCM (MyCommunityMortgage) A zero to little down loan program designed for first-time home buyers backed by Fannie Mae.

Mortgage Banker An individual or company that originates its own mortgage financing. Brokers typically work with numerous lenders to offer a variety of programs.

Mortgage Broker An individual or company that arranges mortgage financing between a borrower and a lender.

Nonoccupant A borrower who does not reside in the property being purchased.

Nonrecurring A type of closing cost that will only happen at the closing. An appraisal or an attorney fee are nonrecurring closing costs.

Note A legal security instrument that obligates the borrower to pay back the lender in full over time and establishes proof of debt.

No Documentation Often called a "No Doc," this is a level of loan documentation that does not require a lender to verify anything about a borrower except a credit report.

Origination Fees Typically charged by mortgage brokers as an income source, fees are represented as a percent of the loan amount being borrowed. One origination fee equals one percent of a loan amount.

PAM (Pledged Asset Mortgage) In lieu of a down payment, appraisable assets can be collateralized and pledged to the lender.

PITI (Principal, interest, taxes and insurance) Shorthand for the total monthly housing payment, which includes not only the principal and interest, but also property taxes and insurance. In Canada, insurance is typically not rolled into a monthly payment.

PMI (Private Mortgage Insurance) An insurance policy in favor of a lender, that insures the approximate difference between a 20 percent down payment and the lesser amount the buyer places into a transaction. If a buyer puts 5 percent down, the PMI policy would pay the lender approximately 15 percent of the sales price in case of default.

Par When an interest rate is offered with no points or origination fees.

Prepaids Nonrecurring closing costs that are paid up front at the closing, such as an insurance policy or prepaid interest.

Prime The interest rate surveyed by the Wall Street Journal of the thirty largest banks as to the rate these banks charge their best clients.

Recapture Tax A federal tax buyers may have to pay if they sell their home before nine years has passed if the home was financed with tax exempt bond money or with the use of a Mortgage Credit Certificate (MCC).

Recurring A type of closing cost that will happen over and over after the closing has taken place. Hazard insurance and property taxes are recurring closing costs.

Rent Survey Research performed by a licensed appraiser that determines market rental rates.

Seasoning A preestablished period of time to establish a value or legitimacy.

Secondary Market A financial market where mortgages are bought and sold between lenders, investors, and Fannie Mae/Freddie Mac.

SubPrime Mortgage loans made to individuals with marginal or poor credit.

Subordinate To take a secondary position behind a first. A second mortgage will subordinate to a first mortgage.

Stated A level of loan documentation that does not require a lender to verify certain parts of a loan application yet still allows use of the information to qualify the borrower.

Term The amortization period of a mortgage loan.

Terms The specific requirements of a loan program, including the interest rate and the amortization period, and any other rate specific rules, such as interest rate adjustment periods.

Title Insurance An insurance policy designed to protect buyers, sellers and lenders against previously unfiled claims, fraud, or other imperfections that can occur on previous transfers of real estate ownership.

VA The Department of Veterans Affairs. One of the benefits of being a veteran of the US Armed Forces is home buying assistance. VA-backed loans offer no down payment loans to those who qualify.

Wraparound Sometimes called a "Wrap," this is a method of private financing where the buyer pays the seller, who in turn continues to pay the original mortgage.

About the Author

In 1990, David Reed began his career in mortgage lending as a mortgage broker in San Diego, California, where he soon worked his way to vice president of Mortgage Production for his company.

In 1994, he was asked by syndicated columnist and author Peter Miller, the founder of America Online's Real Estate Center, to be a columnist, contribute articles, and answer real estate finance questions posted online by America Online subscribers.

That same year he published his first column, which appeared in the trade publication *Mortgage Originator Magazine,* where he penned a monthly column on mortgage finance and technology trends, and ultimately became a contributing editor for the magazine as well.

In 1995 he moved his family to Austin, Texas, where he is now president of CD REED Mortgage, and since 1990 has personally placed over 1,000 mortgage loans from Florida to California.

He is a columnist with *Realty Times,* where he writes a consumer column about mortgage finance, and is the author of five books on the topic of real estate; *Mortgages 101* (Amacom 2004), *Who Says You Can't Buy a Home!* (Amacom 2005), *Mortgage Confidential* (Amacom 2006), *Your Successful Career As a Mortgage Broker* (Amacom 2007), and *Your Guide to VA Loans* (Amacom 2007).

He has appeared on CNN, CNBC, Fox & Friends, *Today in New York,* and various newspapers and magazines across the United States and Canada.

He lives in Austin with his wife Cindy and three children.

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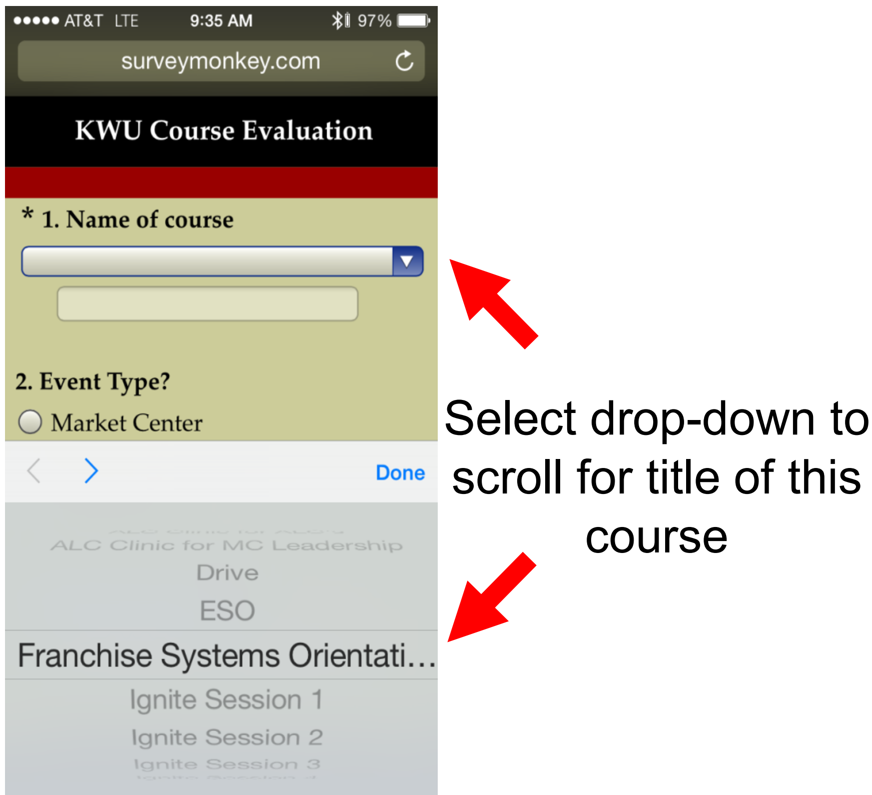

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