**Unit 15 Outline**

**Real Estate Financing - Principles**

**Outline**

I. Mortgage Basics

A. A mortgage is a voluntary lien on real estate. The borrower (mortgagor) pledges the land to the lender (mortgagee) as security for the debt.

1. In title theory states, the mortgagor actually gives legal title to the mortgagee and retains equitable title.

2. In lien theory states, the mortgagor retains both legal and equitable title; the mortgagee simply has a lien on the property as security for the mortgage debt.

IN ILLINOIS . . . *Neither the title theory nor the lien theory is strictly followed. Illinois is often referred to as an intermediate theory state. Mortgages and deeds of trust in Illinois may convey a qualified title to be used as security for the debt during the existence of the debt. The mortgagor remains the owner of the mortgaged property for all beneficial purposes, subject to the lien created by the mortgage or deed of trust.* *Title is subject to the defeasance clause and must be reconveyed, or released back, to the mortgagor at the time the debt is repaid in full.*

II. Security and Debt

A. Mortgage Loan Instruments—There are two parts to a mortgage loan: the debt and the security for the debt. When a property is to be mortgaged, the owner must execute (sign) two instruments.

1. The *promissory note* is the borrower’s promise to repay the debt.

2. The *mortgage* (security instrument) creates the lien on the property.

B. Hypothecation: the pledging of property as security for payment of a loan without actually surrendering possession of the property.

III. Promissory Note—A promissory note executed by a borrower (known as the maker or payor) generally states the amount of the debt, the time and method of payment, and the rate of interest.

A. Interest—A charge for using money.

1. Usury—Charging interest on a loan in excess of the maximum legally allowable rate is called *usury*. To protect consumers from unscrupulous lenders, many states have enacted laws limiting the interest rate on loans.

IN ILLINOIS . . . *Technically there is currently no state limit on the rate of interest that a lender may charge a borrower when the loan is secured by real estate.*

2. Loan origination fee—The processing of a mortgage application is known as loan origination. A loan origination fee is usually charged to cover the expenses involved in generating the loan.

3. Discount points—To make up the difference between the interest rate a lender charges the borrower and the rate of return demanded by an investor, the lender charges the borrower discount points.

a. One discount point equals one percent of the loan amount and is paid as prepaid interest at the closing.

B. Prepayment—If the borrower repays the loan before the end of the term, the lender collects less than the anticipated interest. For this reason, some mortgage notes contain a prepayment clause that requires the borrower to pay a penalty against the unearned portion of the interest for any payments made ahead of schedule.

IN ILLINOIS . . . *Lenders are prohibited from charging a borrower a prepayment penalty on any loan secured by residential real estate when the loan’s interest rate is greater than 8% per year.*

IV. Mortgage Document or Deed of Trust

A. Mortgage document or deed of trust establishes property as security for debt

B. Deed of trust

 1. Conveys legal title, without right of possession

C. Provisions for Default

D. Assignment of the Mortgage

E. Release of the Mortgage Lien

F. Duties of the Mortgagor or Trustor

1. Payment of the debt in accordance with the terms of the note

2. Payment of all real estate taxes on the property given as security

3. Maintenance of adequate insurance to protect the lender if the property is destroyed or damaged by fire, windstorm, or other hazard

4. Maintenance of the property in good repair at all times

5. Receipt of lender authorization before making any major alterations on the property

V. Mortgage Clause and Provisions

 A. Acceleration Clause

 1. Foreclosure

 B. Defeasance Clause

 1. Satisfaction of mortgage

 2. Release deed

 C. Alienation Clause

 1. Defeats assumption

 D. Assignment

 E. Tax and Insurance Reserves

 1. PITI

 2. Flood insurance reserves

 F. Assignment of Rents

 G. Buying “Subject to” or “Assuming” Existing Financing

 1. Novation

H. Recording - Mortgage or deed of trust recorded in county in which property is located

 I. Priority - Determined by the order of recording

 1. First lien

 2. Second or junior lien

 3. Subordination agreement

VI. Provisions of Land Contracts

A. Under a land contract, the buyer (vendee) agrees to make a down payment and a monthly loan payment that includes interest and principal (and may include real estate tax and insurance reserves). The seller (vendor) retains legal title to the property during the contract term, and the buyer is granted equitable title and possession. When the entire debt is paid, the seller delivers clear title.

B. Predatory Lending and Mortgage Fraud

 1. Unfair or abusive loan terms

 2. Subprime lending

 3. Mortgage fraud

 a. Fraud for profit

 b. Fraud for housing

C. Mortgage Law

 1. Title-theory states

 a. Mortgagee has title and mortgagor has equitable and possession.

 2. Lien-theory states

a. Mortgagor retains legal and equitable title; mortgagee has a lien on the property as security for the mortgage debt

 3. Intermediate-theory states

a. Mortgage and deeds of trust convey only qualified title to lender as security for loan during existence of the debt. Mortgagor holds legal title. (Illinois is referred to as intermediate-theory)

VII. Foreclosure—A legal procedure in which property pledged as security is sold to satisfy a debt is called foreclosure.

A. Methods of Foreclosure

IN ILLINOIS . . . *By statute, mortgage foreclosures may be brought about only through a court proceeding. As a result, Illinois is classified as a judicial foreclosure state.*

1. Nonjudicial foreclosure—In nonjudicial foreclosure states, no court action is required. In those states that recognize deed of trust loans, the trustee is generally given the power of sale.

2. Judicial foreclosure—Judicial foreclosure allows the property to be sold by court order after the mortgagee has given sufficient public notice.

IN ILLINOIS . . . *Power of Sale documents are not recognized in Illinois and any default on a deeds of trust financing arrangement must be handled through judicial foreclosure*.

3. Strict foreclosure—If, after receiving adequate notice, the borrower does not pay off the loan by a court-appointed date, the court simply awards full legal title to the lender without a sale.

B. Deed in Lieu of Foreclosure—A lender may accept a deed in lieu of foreclosure from the borrower, sometimes known as a *friendly foreclosure* because it is carried out by mutual agreement. The mortgagee takes the real estate subject to all junior liens.

C. Redemption

D. Reinstatement in Illinois

E. Deficiency judgment

F. Short sales

1. Borrower is unable to make mortgage payments and cannot sell for what is owed on the property
2. The lender agrees to accept less than the amount owed
3. Potential for several different types of fraud

G. Bankruptcy and Foreclosure

1. Advise consumer to seek legal advice
2. Chapter 13
3. Chapter 7