

California Real Estate Finance
Chapter 8
Loan Terms and Note Payments

Chapter Purpose

This chapter demonstrates how differing structures of financing instruments can solve specific financing problems. The mastery of finance will enable the student to understand the variety of payment and interest rate arrangements possible in real estate loans. This chapter also provides information about innovative payment plans as well as variations in loan formats.

Learning Objectives

Upon completion of this chapter, the student should be able to:

1. understand the variations of interest and payments in real estate loans;
2. recognize the differences among the various innovative payment plans;
3. discuss the use of the open-end loan for construction financing , including the interim lender's requirement of a prior commitment for a permanent take-out loan and a builder's completion bond;
4. understand the purpose and operation of release clauses under a blanket loan;
5. describe the provisions of a participation loan;
6. understand the leveraging possibilities in land leasing, as well as financing leasehold improvements;
7. describe subordination when leasing land for development;
8. understand the use of a package loan as a device for financing personal as well as real property;
9. define the requirements for buying mobile homes under real property or personal property financing;
10. define a purchase-money loan, a hard-money loan and a wraparound loan.

Presentation Outline

- I. Variations in Payments and Interest Rates
 - A. Graduated Payment Mortgage (GPM)
 1. Lower payments in early years of loan
 2. May result in negative amortization
 3. Gradually increasing payments until amortization kicks in

- B. Adjustable-Rate Mortgage (ARM)
 - 1. Adjustment periods
 - 2. Note rate
 - 3. Payment rate
 - 4. Qualifying rate
 - 5. Index
 - 6. Margin
 - 7. Interest rate caps
 - 8. Loan payment caps

- II. Innovative Payment Plans
 - A. Shared Appreciation Mortgage (SAM)
 - 1. Lender secures share of any appreciation of the collateral's value
 - 2. Also known as a Participation Loan
 - B. Pledged Account Mortgage (PAM)
 - 1. Graduated payments for borrower
 - 2. Fixed and level payments to the lender
 - 3. Full cash out to the seller
 - C. Buydown
 - 1. Anyone can pay buydown
 - 2. Acts to reduce interest rate on loan for few years
 - 3. Makes payments more affordable
 - D. Renegotiable Rate Mortgage (RRM)
 - 1. Rollover loan
 - 2. Bullet loan
 - 3. Long-term amortization with short-term call dates
 - 4. Allows lender to reexamine collateral and borrower's credit before renewing
 - E. Lease-option
 - 1. Lease on property with option to buy
 - 2. Some or all rent may apply to purchase price
 - F. Lease-purchase
 - 1. Fixed purchase price, not at option
 - 2. Portions of rent apply to purchase price
 - G. Zero Percent Financing (APF)
 - 1. No interest stipulated on contract
 - 2. Usually requires large down payment and short-term amortization
 - 3. IRS imputes a 10 percent rate to both parties
 - H. Growing Equity Mortgage (GEM)
 - 1. Graduated principal payments
 - 2. Loan matures more rapidly
 - I. Biweekly loan
 - 1. Develops faster payoff
 - 2. 26 payments equal one extra month principal amount

- J. Reverse Annuity Mortgage (RAM)
 - 1. Pays borrower monthly amounts
 - 2. The balance accumulates over time until it reaches 80 percent of the property's value
 - 3. Borrower then starts repayment or sell property
 - 4. Designed primarily for older people with free and clear home
 - 5. Current participants
 - a. HUD
 - b. Capital Holding Corporation of Louisville, KY
 - c. Providential Home Income Plan
 - K. Convertible loan
 - 1. Allows conversion to fixed-rate from adjustable
 - 2. Borrower makes decision when to convert
 - 3. Offsets fears of variable rate loans
 - L. Fannie Mae resale/refinance program
 - 1. Used when loan rate lower than market rate
 - 2. Fannie Mae offers a blended rate to entice refinancing
 - M. Fannie Mae senior housing opportunities program
 - 1. Available to persons over 62 years old
 - 2. Financing options
 - a. accessory apartment in single-family home
 - b. cottage on lot of existing home
 - c. single-family home converted up to four units
 - d. sale-leaseback of family home
 - N. Fannie Mae two-step mortgage
 - 1. New loan at less-than-market rates for seven years
 - 2. Adjusted once to market rate
 - 3. New rate based on 10-year Treasury bond
 - 4. 6 percent cap
 - O. Customized mortgages
 - 1. Individually priced mortgage loans
 - 2. Offers array of interest rates and fees for borrowers' acceptance
 - 3. Those denied loans may turn to subprime lenders
- III. Variations in Formats
- A. Open end loans
 - 1. Mortgage for future advances
 - 2. Saves time and expense of refinancing
 - 3. Often used by farmers and ranchers
 - B. Construction loan
 - 1. Application and requirements
 - 2. Sequential pattern of disbursements
 - a. draws
 - b. mechanic's and materialmen's liens

3. Lender protection
 - a. completion bond
 - b. take-out commitment
 - (1) break-even cash flows
 - (2) rent-up ratios
 - (3) hold-backs
 - (4) gap financing
 - c. standby commitments
 - (1) regular standby
 - (2) suicide standby
 - (3) purchase standby
4. Sources of funds
 - a. commercial banks
 - b. life insurance companies
 - c. real estate mortgage trusts
- C. Blanket loans
 1. Covers more than one property
 2. Release clause
 3. Recognition clause
- D. Participation loan
 1. Partnership of lenders
 2. Partnership of borrowers (coops and condos)
 3. Partnership of lenders and borrowers
 4. Convertible participating loans
- E. Leasehold lending
 1. Growth of leasehold loans
 2. Subordination
 3. Credit loans
 4. Commercial leasehold insurance
- F. Package loan
 1. Real estate loan that includes items of personal property
 2. Helps buyer of property pay for equipment over time
- G. Mobilehome loan
 1. Personal property vs. real property
 2. Larger units affixed to land eligible for real estate loans
- H. Purchase-money loan
 1. Created when borrowing to purchase property
 2. Creates highest lien priority
- I. Hard money loan
 1. Given in exchange for cash in hand
 2. Collateral is usually equity in real estate
- J. Bridge loan
 1. Short-term loan to solve specific problem
 2. Example is gap financing

- K. Wraparound encumbrance
 - 1. New loan wrapped around existing loan
 - 2. Can be used to raise lender's effective yield