

Chapter 15

The Successful Mortgage Loan Closing

Chapter Objectives

- Identify the components and requirements of a successful loan closing
- Describe appropriate and effective methods of dealing with challenging scenarios in the MLO's daily routine

Real Estate Appraisals

- **An Appraisal**

- Is an estimate or opinion of value as of a certain date that is supported by objective data from the marketplace
- Not a guarantee of value; value is subject to change
- Must be supportable and based on facts

- **Industry**

- Regulated
- Must use an appraisal management company (AMC)

Real Estate Appraisal Approaches

- **Sales Comparison Approach**
 - Compares the property being appraised with other similar comparable properties that have sold recently in the same market area as the subject property
- **Cost Approach**
 - Calculates the cost of the land, site improvements, the building cost, and the cost of property depreciation to reproduce the property
- **Income Approach**
 - Analyzes the revenue, or income, the property currently generates or could generate, often comparing it to similar properties

Reconciliation and Recertifying

- **Reconciliation**

- To arrive at best estimate, give each method appropriate weight depending on type of property being analyzed and amount and accuracy of data available
- Value estimates from three approaches rarely equal

- **Recertification of Value (recert)**

- To obtain a more current value; verify that “subject to” conditions of original appraisal have been met and that original opinion of value is valid
- Does not change the effective date of the initial valuation
- Required if ≥ 120 days old; >180 days requires new appraisal

Insurance

• Homeowner's Property Insurance

– Borrower

- At minimum, must carry an amount sufficient to cover cost to replace structure
- Free to choose company; must meet lender requirements

– Lender

- Policy must have clause to cover lender's interest
- May require buyer to pay first year's insurance premium in full prior to closing; disclosed on LE
- May set up escrow account for monthly payment
- Force-placed insurance allowed if borrower does not comply

Insurance

- **Flood Insurance**

- National Flood Insurance Program

- Reduce cost of national emergencies
 - Required to be maintained until the loan obligation is satisfied

- Special Flood Hazard Area

- Zone A or V: 1% chance of flood occurring in any given year; flood insurance required
 - Zone B or X; 0.2% annual chance of flood; flood insurance optional
 - Zone C or X; <0.2% annual chance of flood; flood insurance not required

Insurance

- **Private Mortgage Insurance**

- About PMI

- Insures lender against default on loan by a borrower where there is loss of collateral value at time of default
- Insures portion of loan that exceeds 80% LTV
- Coverage typically 20% to 25% of loan amount

- HPA Lender PMI Cancellation Requirements

- Mortgage has been paid down to 78% of its original value, or
- Attained 22% equity based on the original value
- Borrower must not be delinquent

Title Insurance – Key Terms

- **Marketable Title**

- Title that is free and clear from undisclosed encumbrances or other defects that would expose a purchaser to litigation or impede a purchaser's ability to enjoy the property or to later sell the property easily

- **Title Search**

- Search of the public records to determine ownership and the quality of the title prior to conveyance; starts with the **chain of title** and results in the creation of an **abstract of title**

Title Insurance – Key Terms

- **Chain of Title**
 - Clear and unbroken chronological record of the ownership of a specific piece of property; lenders require a 24-month chain of title
- **Abstract of Title**
 - Complete historical summary of title to property
- **Cloud on the Title**
 - Gap or flaw in the chain of title

Title Insurance – Key Terms

- **Encumbrance**
 - Non-possessory interest in real property that encumber (or burden) real property owner's title
- **Easement**
 - Right to use another person's real property for a particular purpose
- **Lien (Voluntary/Involuntary)**
 - Security for a debt that gives the creditor, or lien holder, the right to foreclose on the debtor's property if the debt is not paid

Title Insurance

- **Lender's Use of Title Report**
 - Review preliminary title report for undisclosed liens and encumbrances or property flipping
 - Review the report for accuracy of all details, including the seller's and borrower's names, the address of the property, sale price, and loan amount
 - Identify property tax amount disclosed and any homeowner association or property assessments that need paid

Title Insurance

- **Lender's Use of Title Report**
 - Verify property type; financing options different for each property type
 - Lot 1234 = owned in fee simple
 - Unit 1234 = most likely a condominium
 - May use continuance to bring down title report from its preliminary issuance to current date of the settlement; account for any new defects or clouds

Title Insurance

- **Lender's Use of Title Report**
 - Identify items that will be covered by title insurance and the items that will be exempt from coverage
- **Title Insurance Protection**
 - May protect lender or homeowner
 - Insures against losses (up to the coverage amount specified in the policy) due to title defects other than those specifically excluded
 - Generally paid for with one-time premium

Title Insurance

- **Title Insurance Protection**
 - **Mortgagee's Policy**
 - Protects the lender's interests in the property
 - Covers loan amount outstanding at time claim is paid
 - Facilitates sale of mortgage to secondary market
 - **Owner's Policy**
 - Issued in name of property owner
 - Paid for by buyer or seller; indicated in sales contract
 - Covers losses and damages if title is unmarketable or if there is no right of access to the property

The Closing Process

- **Closing Results**
 - Completes the process of granting a loan, as funds are disbursed to the settlement agent in accordance with the Closing Disclosure
 - Involves transfer of ownership of real property from seller to buyer, according to the terms and conditions of the sales contract or escrow agreement
 - Also referred to as settlement or loan consummation

The Closing Process

- **Closing Procedures**
 - Responsibility of either settlement agent or attorney; follows instructions of both the borrower and seller
- **Settlement Agent Role**
 - Gathers all necessary documents
 - Calculates various prorations, adjustments, and fees charged to each party
 - Compares the LE of closing costs to CD to verify the proper tolerance with disclosed fees

The Closing Process

- **TILA Disclosure Requirements**
 - Creditor is responsible for providing CD to borrower 3 business days prior to closing and initial escrow statement within 45 days of closing
 - Settlement agent is responsible for providing CD to the seller in advance of closing
- **IRS Form 4506-T**
 - Must be obtained/signed by all borrowers
 - Gives lender permission to request electronic transcripts of federal tax returns from the IRS

The Closing Process

- **At Closing**
 - **Lender's Role**
 - Ensures that there are no unforeseen problems during closing
 - Ensures loan papers are signed
 - Makes one final check to ensure everything is in order
 - **Power of Attorney**
 - Person designated to execute legal documents for borrower when borrower is unable to attend

15.1 Apply Your Knowledge

Identify the sequence of mortgage loan origination steps

Step	Activity
1	Consult with the MLO
2	Complete an Application
3	Process an Application
4	Appraise the Property
5	Analyze Application Information
6	Loan Settlement
7	Disburse Funding
8	Record Legal Documents

The Closing Process

- **Closing Disclosure Reconciliation**
 - Borrower-Paid Items
 - Typically sums of money owed; shown as either paid at closing or before closing
 - Seller-Paid Items
 - Items that have been paid by the seller at closing or before closing

The Closing Process

- **Closing Disclosure Reconciliation**
 - Summary of Transactions
 - Includes borrower- and seller-paid items
 - Calculates cash to close for borrower
 - Calculates cash proceeds for the seller
 - Shows adjustments made
 - Mortgage Amount
 - Shows as credit to borrower; lender brings that money to closing
 - Acquisition Cost
 - Shows borrower total of the amount of money necessary to purchase property

The Closing Process

- **Closing Disclosure Reconciliation**
 - Proration
 - Division of expenses between buyer and seller
 - Accrued Expenses
 - Cost has been incurred but the expense has not yet been paid
 - Prepaid Expenses
 - Seller has already paid
 - Proration Calculation of Expenses
 - A 360-day year, 12 months of 30 days each
 - A 365-day year, counting the exact number of days in each month (taking leap years into account)

The Closing Process

- **Closing Disclosure Reconciliation**
 - Mortgage Interest Proration
 - First payment is not due until the first of the month after the next full month
 - Lender wants to collect the interest from the date of settlement
 - Mortgage Interest Payment Calculation
 1. Determine the annual interest (loan amount x interest rate)
 2. Annual interest / 360 = daily interest
 3. Daily interest x number of affected days = interest proration to be debited from the borrower

15.2 Apply Your Knowledge

Buyer Bill is obtaining a \$200,000 mortgage at 5% interest. The annual interest is \$10,000 ($\$200,000 \times 0.05$). Use the statutory year (360-day method for prorations).

1. What is the daily interest?

\$27.777

Divide \$10,000 by 360 to find the daily interest

15.2 Apply Your Knowledge

Buyer Bill is obtaining a \$200,000 mortgage at 5% interest. The annual interest is \$10,000 ($\$200,000 \times 0.05$). Use the statutory year (360-day method for prorations).

2. How much must Bill bring to closing to cover the required mortgage interest for May, if escrow closes on May 17?

\$388.89

He's closing on May 17,
so there are 14 affected days: $14 \times \$27.7777$

MLO Challenges

- **Providing Unsolicited Advice**
 - Exercise caution to avoid civil liability
 - Remember MLO is liable for the advice provided
 - Refer the consumer to an attorney, a tax advisor, or a professional
 - Never provide advice that exceeds education or qualifications

MLO Challenges

- **Communication Protocols**
 - Ask for preferred method of communication
 - Provide a minimum of 3 loan options
 - For each type of transaction in which the consumer has expressed an interest, present:
 - Lowest interest rate
 - Lowest interest rate without risky features
 - Lowest total dollar amount for origination fees and discount points

MLO Challenges

- **Communication Protocols**
 - Provide delivery options for discussing loan type options and terms
 - Must conduct thorough discussion of items on initial Loan Estimate
 - Ensure borrowers utilizing electronic signatures have thoroughly read the documents they are signing and have printed a copy of the disclosures for their records and review

MLO Challenges

- **Handling Conflicts of Interest**
 - RESPA requires that a borrower be informed of any ownership of a settlement service provider if a referral is made to that provider by the mortgage company or MLO
 - A written disclosure of any interest by the MLO or mortgage company is required

MLO Challenges

- **Fraud Definition Review**
 - **Fraud:** Intentional or negligent misrepresentation or concealment of material facts
 - **Negligence:** Unintentional breach of a legal duty
 - **Actual Fraud:** Intentional misrepresentation or concealment of a material fact
 - **Constructive Fraud:** Negligent misrepresentation or concealment of a material fact
 - **Mortgage Fraud:** Misrepresentation or concealment used in an attempt to obtain a mortgage loan

MLO Challenges

- **Mortgage Fraud Schemes**
 - Fraud for profit; usually perpetrated by industry insiders
 - Fraud for property; usually perpetrated by borrowers
- **Common Mortgage Fraud Methods**
 - Material misrepresentations: altered paycheck stubs
 - Material misstatements: intent to occupy home as primary residence when it really is intended to be used as rental
 - Omission: failing to mention the borrower is taking an early retirement in six weeks

MLO Challenges

- **Avoiding Borrower Info Fraud**
 - Do not falsify information for borrower's benefit or knowingly make loan to unqualified borrowers
 - When you suspect false information:
 - Understand honest mistakes are not fraud
 - Never confront consumer without checking all facts
 - Take application then complete verification of information before processing
 - Consult with the manager/owner about the loan file
 - Penalty for actual mortgage fraud maximum: 30 yrs in prison, \$1,000,000 fine, and ordered restitution

MLO Challenges

- **Addressing Suspicious Large Deposits**
 - Deposits on borrower's bank statement must be sourced and seasoned; typically 2 or 3 months
 - Large deposits must be explained and documented; verifiable and reasonable source
 - Review credit inquiries
 - New loan impacts ATR
 - No credit inquiries than borrower must provide source
 - Presence of large, undocumented deposits is a red flag; refer to be addressed by underwriting or management for further review

MLO Challenges

- **Addressing Undisclosed Income**
 - Income tax transcripts may show undisclosed income
 - If a borrower does not claim the income on his IRS Form 1040, do not use for qualifying purposes (unless child support or disability payment)
 - If the borrower fails to disclose income on the application, the income should be explained, including the source of the income and the reason for non-disclosure on the application

MLO Challenges

- **Addressing Receipt of Gift**
 - The entire required minimum investment for a mortgage can be a non-repayable gift
 - Can be from a relative, an employer or labor union, a charitable organization, or a close friend
 - Cannot be from person or entity with an interest in the sale of the property
 - Lender must document through a gift letter

MLO Challenges

- **Addressing Multiple Company Applications**
 - Discouraging a borrower from shopping for the best program or settlement service provider is prohibited
 - Borrower must make disclosure of actions
 - If known or suspected multiple applications
 - Obtain a second, up-to-date credit report (a single bureau will suffice)
 - Note additional inquiries that have occurred since the first credit report; must be addressed by borrower

MLO Challenges

- **Handling Changes to Application**
 - Application must be accurate and up-to-date
 - Bring any change to immediate attention of the person who has control of the loan file

MLO Challenges

- **Handling Third Party Inquiries**
 - Duty, per case law, to deal fairly with all parties
 - Respond to third party requests for information
 - Protect client's personal, non-public information
 - FCRA Requirement
 - Provide information to those individuals with a legitimate business need
 - Financial Privacy Rule
 - Restricts when and under what circumstances information may be disclosed to affiliates and to nonaffiliated third parties; prohibited disclosure of nonpublic personal information

MLO Challenges

- **Handling Disclosure of Personal Info**
 - Adhere to FCRA and Financial Privacy Rule
 - FACTA
 - Must take measures to responsibly secure and dispose of sensitive personal information found in a consumer's credit report
 - Exercise great caution when disposing of a consumer's information

MLO Challenges

- **Obtaining Property Appraisal**
 - Reg Z Allowable Actions
 - Ask appraiser to consider additional information about dwelling or comparable properties
 - Ask appraiser to correct factual errors
 - Obtain multiple appraisals of consumer's principal dwelling if creditor adheres to a policy of selecting most reliable appraisal rather than appraisal that states highest value
 - Withhold compensation from appraiser for breach of contract or substandard performance of services as provided by contract

MLO Challenges

- **Utilizing Power of Attorney**
 - Inform borrower of closing date and the need to be personally present for the closing
 - POA must be approved by the lender in advance
 - Lender may limit the person who can be the POA to only immediate family members
 - A POA may never be a party to the transaction

Chapter 15 Quiz

- 1. Which appraisal approach is BEST described as assessing the value of a property by determining the amount it would cost to replicate the structure in its existing condition on a similar parcel of land?**
 - A. cost approach
 - B. income approach
 - C. market data approach
 - D. sales comparison approach

Chapter 15 Quiz

- 2. Properties that have the highest risk potential for flooding are referred to as Flood Zone _____ properties.**
- A. A
 - B. B
 - C. O
 - D. X

Chapter 15 Quiz

3. A recert does NOT

- A. address issues in a “subject to” appraisal.
- B. change the effective date of the valuation.
- C. confirm the validity of the original opinion of value.
- D. verify that conditions stated in the original appraisal have been met.

Chapter 15 Quiz

- 4. An appraiser has been contracted to determine the value of a large apartment building for a potential investor. Which appraisal method is probably the most useful for this situation?**
- A. competitive market analysis
 - B. cost approach
 - C. income approach
 - D. sales comparison approach

Chapter 15 Quiz

- 5. What type of lien is voluntary?**
- A. judgment lien
 - B. mechanic's lien
 - C. mortgage lien
 - D. property tax lien

Chapter 15 Quiz

- 6. What should be brought to closing to itemize any changes in a property's title since the preliminary title report was issued?**
- A. abstract of title
 - B. chain of title
 - C. continuation
 - D. title policy