FINANCE & ECONOMICS

Florida Post Licensing 15 Hour Course

SECTION 1

Introduction & Objectives

- Lesson 1: An Orientation to Your Online Learning Environment
- Lesson 2: About Your Florida Post-Licensing: Finance and Economics Course

SECTION 2:
REAL ESTATE FINANCE

Unit 1: The Big Picture on Real Estate Finance

Unit 2: Loan Applications and Options

Unit 3: Loan Terms and Details

FDIC & FSLIC

In 1933, President Franklin Roosevelt reformed the banking industry and established two federal agencies to protect consumers: the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC).

FHA

The Federal Housing Administration (FHA) was created in 1934 and expanded housing opportunity by ensuring certain types of loans against losses from default, and creating the 30-year fully amortized loan.

To solve some of the problems plaguing the mortgage financing industry, the government created the Federal Housing Administration (FHA) in 1934. This agency made mortgage financing more available by ensuring certain types of loans for lenders, protecting them against losses from default.

The Federal Housing Administration (FHA) made mortgage financing available and affordable for people who before would never have had that opportunity. The FHA insured certain types of loans against losses from default.

FNMA

Federal National Mortgage Association (FNMA or "Fannie Mae") was established in 1938.

Originally, Fannie Mae made money available by purchasing FHA loans from individual lenders, grouping them together and selling them as mortgage-backed securities to willing investors.

At the conclusion of World War II, the government instituted programs within the Veterans Administration (VA) to guarantee mortgage loans made by private lenders to veterans.

THE SPLIT AND FHLMC

In 1968, Fannie Mae split into two separate entities: the Government National Mortgage Association (GNMA or Ginnie Mae), who took over the sale of the government loan market, FHA, VA, and farm housing loans; and Fannie Mae, which became a private entity.

In 1970, the U.S. Congress chartered the Federal Home Loan Mortgage Corporation (FHLMC), better known as Freddie Mac.

ONLINE LENDING

Potential borrowers can now log on to the Internet and apply for loans online.

This allows for borrowers to have the convenience of completing the loan application in the privacy of their own home, without the stress of being in the lender's office.

Lenders also use the Internet to speed up the process.

Credit reports, appraisals, and title records can all be generated online, and easily accessed by the underwriters and loan processors.

Reports can be delivered electronically, and disclosures can be sent to the borrower through e-mail.

HMDA

The Home Mortgage Disclosure Act (HMDA) requires financial institutions to collect and publish loan data that will assist the government in determining if the institution is serving the needs of their local communities and identify possible discriminatory lending patterns.

USA PATRIOT ACT

One of the rules in the USA Patriot Act increased the responsibility of financial institutions to collect information about their borrowers' identities. The Gramm-Leach-Bliley Act requires financial institutions to secure all financial data and limits how that information can be shared.

SECONDARY MARKET INVESTING

In the 2000s global investors began investing in mortgage-backed securities, which fueled the mortgage finance industry.

Primary lenders had trouble keeping up with the demand for mortgage-backed securities, so documentation and underwriting standards were lowered, increasing the number and size of loans borrowers received.

Stated-income and no income no asset (NINA) documentation options increased the investment risk for the secondary mortgage market and those who purchased mortgage-backed securities.

THE 2000'S

- *Adjustable-rate mortgages also contributed to the mortgage crisis. During the early 2000s, introductory ARM interest rates were very low.*
- *Many people qualified for ARM loans with very high principal balances.*
- *Later, when the interest rates adjusted and the economy began crumbling, borrowers were unable to afford their monthly payments and began defaulting on their loans.*
- *Many people who purchased homes in the early 2000s, when property values were rising steadily, purchased their homes with loan products with adjustable rates and sticky terms.*
- *In the mid-to-late 2000s, when property values began depreciating, loan rates began adjusting upwardly, and the job market began struggling, many homeowners were caught in negative equity situations, unable to refinance or sell their properties.*

SELLING TO THE SECONDARY MARKET

It has become tougher for lenders to sell high-risk loans on the secondary market, so many lenders and underwriters have tightened their documentation and underwriting standards.

In the mid- to late 2000s, when property values began depreciating, loan rates began adjusting upwardly and the job market began to struggle.

Many homeowners were caught in negative equity situations, unable to refinance or sell their properties.

It became more difficult for lenders to sell high-risk loans on the secondary market, so many lenders and underwriters tightened their documentation and underwriting standards.

DODD-FRANK ACT

In 2014 the CFPB rolled out another iteration of the Dodd-Frank Act in 2014, which limited the availability of certain questionable loans, required verification of borrowers' ability to pay, and limited fees that lenders could charge to consumers.

MAKING HOME AFFORDABLE PROGRAM

The Making Home Affordable program is aimed at helping homeowners stay in their homes and avoid foreclosure.

Since the impact of millions of foreclosures on the global economy is so hazardous, the government passed Home Affordable Foreclosure Alternatives (HAFA), and thereby created the Making Home Affordable program in an attempt at helping homeowners stay in their homes and avoid foreclosure.

SHOPPING FOR THE HOME

In many local markets, you will want to encourage your buyers to obtain a pre-qualification and/or preapproval for the financing prior to shopping for properties.

Early in the buying process, you should ask your clients many questions in order to determine their needs, including the type of home they may want, desired features, location, etc.

Down payment assistance programs are offered by several non-profit organizations that work with traditional mortgage lenders.

STATUTE OF FRAUDS

The statute of frauds requires real estate loans to be in writing.

REAL ESTATE FINANCE INDUSTRY

Although recent statistics from the National Association of REALTORS® (NAR) show an uptick in the number of investment properties being purchased through all-cash transactions, more than 90% of home buyers still require some type of financing.

The real estate finance industry involves many key players, including the borrower, loan officer, loan processor, borrower's employer, borrower's bank, underwriter, property inspector, appraiser, title company, insurance companies, and others.

Federal, state, and local governments regulate the mortgage lending industry to protect consumer rights and ensure that lenders adhere to consistent standards.

LOAN MONITORING

Individual mortgage companies and secondary market investors monitor their loans for compliance with federal and state laws and regulations, as well as watch for employee and third-party fraud.

Most real estate loans are initiated through the borrower's lender or a mortgage broker. Collectively, lenders and mortgage brokers are known as loan originators.

MORTGAGE BROKERS & BANKERS

A mortgage broker is an intermediary loan originator who brings borrowers and lenders together.

A mortgage broker is not to be confused with a mortgage banker.

Mortgage bankers close and fund mortgages using their own funds and their own name, although shortly after closing, the loan may be sold to a commercial lender.

PRE-QUALIFICATION

In today's competitive environment, your buyers will want to come into the process from the very beginning with pre-qualification or pre-approval for a mortgage loan.

LOAN PACKAGES

To determine whether a borrower is a good risk for a loan, lenders look at three primary items: credit, capacity (income), and collateral.

Lenders require the submission of a loan package so they can properly assess the risks and the yields associated with the loan.

A standard loan submission package consists of the following main sections: cover letter, project overview, appraisal analysis, borrower analysis, rental analysis, and supporting exhibits.

A standard loan submission package consists of the following main sections: approved, approved with conditions, suspended, and denied.

TYPES OF LOANS

A bridge loan is a temporary loan that is used until permanent financing can be put in place. With a bridge loan, borrowers are able to tap the equity in their existing home for a down payment.

Conventional and adjustable-rate mortgages have pros and cons. FHA loans appeal to low- to moderate-income home buyers.

The advantage of a U.S. Department of Veterans Affairs loan (typically referred to as a VA loan) is that the borrower may get in with no down payment.

LOAN TYPES (CONT.)

"Soft second" mortgages, if available, can help buyers avoid paying for private mortgage insurance.

An assumable mortgage is one that is simply transferred to a qualified home buyer. This can help the buyer realize considerable savings because it may include no points, no interest rate change and lower closing costs.

A balloon mortgage will have a fixed rate for a certain period (often seven years), followed by a "balloon" payment that requires the borrower to repay the entire home loan balance.

A home equity line of credit (often called HELOC and pronounced HEE-lock) is a loan in which the lender agrees to lend a maximum amount within an agreed period (called a term) against the borrower's equity in their house.

LOAN TYPES (CONT.)

Blanket loans are loans that cover two or more properties.

There are also package loans, which bundle real estate and personal items (such as the furniture in a house) together.

There are construction loans, which many builders use when building a home on speculation.

THE UNIFORM RESIDENTIAL LOAN APPLICATION

The standard of modern conventional loans is the fixed rate mortgage loan with a term of 30 years.

When your client is ready to apply for a mortgage loan, they will be required to complete The Uniform Residential Loan Application, commonly referred to as the 1003 (ten-oh-three).

UP FRONT FEES

If a borrower is willing to pay an additional amount up front, they can buy down to a lower interest rate and realize a lower monthly payment. These up-front fees, called discount points, are actually pre-paid interest and as such they are tax deductible.

AMORTIZED LOANS

Fixed-rate loans are fully amortized, meaning the loan will pay off its entire principal by the end of the term.

A 15-year, fixed-rate loan is amortized over a shorter period, thus saving the borrower thousands of dollars in interest.

A bi-monthly payment plan involves a standard monthly payment, calculated for standard amortization.

MEETING EVERYONE'S NEEDS

To meet the needs of the consumer, as well as the return-on-investment requirements of the lender, loans are available in a variety of lengths (called terms) and come with a variety of provisions (which confusingly can also be described as the "terms" of the loan).

Adjustable-Rate Mortgages (ARMs) are home loans with rates that change over time. The amount of change is based on a specified indicator, or index.

PRIMARY MARKET

The primary lending market consists of lenders who provide financing for the purchase, or refinancing, of homes or other properties.

Buyers have almost as many options in selecting a lender as they do in selecting a loan. Lenders in the primary market include banks, savings associations, credit unions, and mortgage banks and brokers.

SECONDARY MARKET

The secondary market frees up cash for the primary market so it can make more loans.

Mortgage bankers pool a collection of loans with similar characteristics, such as loan type, loan term, and interest rate, and sell the pool to an investor in the secondary market.

Secondary market players determine underwriting standards.

END OF SECTION 2

Take this time to complete Section 2 of your online coursework.

SECTION 3: MORTGAGES

Unit 1: The Big Picture on Mortgages

Unit 2: The Application Process

Unit 3: Loan Processing

Unit 4: Underwriting

Unit 5: Closing

IMPORTANCE OF PRE-APPROVAL

The five basic steps of the mortgage process are pre-assessment, application, loan processing, underwriting, and closing.

By having loan pre-approval in place when presenting an offer, buyers will get the seller's attention and may be looked at more favorably compared to others who are lacking pre-approval.

PREFERRED LENDERS

Licensees should build a short list of lenders they can recommend that deliver exceptional service, competitive prices, and consistent delivery on their promises.

It's a good idea to periodically re-check the lenders on your short list, making sure they are still reputable.

Schedule an appointment to meet with each lender on your list one-on-one and ask them about the services they offer.

REFERRAL FEES FROM LENDERS

It's against federal law for a real estate professional to receive any type of commission, kickback, or reward from a mortgage lender for referring business.

Your recommendations must be based solely on your experience with that lender, and on the satisfaction of other clients.

PREDATORY LENDING

Predatory lending can be categorized as follows:

1) *Practices that strip borrowers of home equity.*
2) *Practices that require borrowers to pay inordinately large fees and costs, larger than the risk inherent in a sub-prime loan would warrant.*
3) *Practices that require the purchase of additional products not usually required.*

1003

The Uniform Residential Loan Application is used throughout the mortgage industry and is divided into several sections.

All persons included on the loan will be required to complete the mortgage application information and supply any required documentation.

An application is considered a true application only under certain conditions.

APPLYING BEFORE FINDING

If a borrower applies for a loan without a property address, this is considered a pre-qualification, and most clients will complete the 1003 as a pre-qualification, adding the property address later.

ECOA requires lenders and other creditors to make credit equally available without discrimination based on sex, race, skin color, religion, national origin, age, marital status, or receipt of public assistance.

RESPA & TILA

The Real Estate Settlement Procedures Act (RESPA) requires lenders to provide applicants with timely information on the nature and costs of the loan settlement process and to notify borrowers regarding the transfer of loan servicing.

The servicing transfer disclosure statement explains that the lender may transfer servicing of the loan to another lender. The statement must be presented to the borrower(s) at application or within three business days of application.

The Truth in Lending Act (TILA), implemented by Regulation Z (Reg Z), gives consumers the ability to compare different loan offers on an equal basis, helping them become more aware of the conditions and terms among various offers.

LOAN ESTIMATE

The Loan Estimate is designed to give your client information about the costs of the loan so that they can compare these costs with those of other loan programs or lenders.

The new "Loan Estimate" form integrates and replaces the existing RESPA Good Faith Estimate (GFE) and the initial Truth in Lending forms.

AFFILIATED BUSINESS ARRANGEMENT DISCLOSURE

An affiliated business arrangement involves a person or firm that refers business to a settlement service provider that is related to that person or firm.

LOAN ESCROWS & LOCK IN RATE

The Initial Escrow Account Statement is required for all loans that have an escrow account.

A lock-in, rate-lock, or rate commitment is a tool by which a lender commits to a specific rate and certain points and holds that commitment for a set period. If the loan closes before the lock expires, theborrowers get that rate on their loan. It doesn't matter if rates rise during that time, the borrowers are protected.

IN THE BEGINNING

Setting up a loan file requires collecting specific documents and information.

The loan processor will collect all the initial documents, including the 1003 application, and the disclosures, and place them into a single file.

Loan processing usually takes two to six weeks.

REVIEWING DOCUMENTATION

The major determining factors are documentation type (the less documentation needed, the faster the file moves), transaction type, loan type (VA loans take a bit longer because of the appraisal procedure, and FHA loans can be delayed due to mandatory repairs to the property), and loan complexity.

When reviewing the documentation in a loan file, the loan processor's primary objective is to ensure that the documentation answers all questions that an underwriter may have.

PURCHASE & SALE AGREEMENT

The Purchase and Sales Agreement is a binding contract.

The seller's obligations usually relate to the condition that the property must be in at the time of the closing.

Most lenders have limits to the amount the seller can contribute toward the buyer's closing costs.

INCOME & EMPLOYMENT

Income and employment documents include pay stubs, tax returns, and so on. CPA letters are used to verify a self-employed borrower's employment.

If a borrower is moving to a new area, but will remain with the same employer, the borrower will need to obtain a transfer letter from the employer to verify that his employment will continue after the move.

If a borrower is moving to a new area and will be starting a new job as a result of the move, the borrower can sometimes pre-qualify for a loan using a job offer letter.

ASSETS

Lease agreements are required if the borrower has investment property. Asset documents include bank statements, stock account statements, and so on.

The sources of those funds are important. Some sources of funds are generally acceptable, some are generally not acceptable, and some may be acceptable depending upon the loan program.

PROPERTY VALIDATION

Preliminary Title Commitments, or "prelims," are acquired to verify the current title information on the property and to state the requirements needed to insure the title, as required by the lender.

Appraisals consider the property condition, comparable sales, and more.

INCOME & DEPOSIT VERIFICATION

Income and employment verifications come in two forms, verbal and written.

A verbal verification is sometimes enough to satisfy requirements.

Written verifications of employment can highlight recent raises and bonus income.

A loan processor can order a verification of deposit (VOD) when traditional asset statements are unacceptable.

CREDIT VERIFICATION

Credit bureaus generate consumer credit reports.

Whenever a person acquires any type of consumer credit, whether it is a credit card, auto loan, mortgage, or other, the institution keeps detailed records of the account and the borrower's payment history.

Nationwide, there are three major consumer credit bureaus, Equifax, Experian, and TransUnion.

TYPES OF CREDIT REPORTS

There are three types of credit reports that can be obtained by the lender: single bureau reports, tribureau merged reports, and residential mortgage credit reports (RMCRs).

All credit reports now include fraud alerts, which alert lenders to potential fraudulent use of the person's credit.

Credit scores rank all the criteria based on risk factors and generate a numeric value.

FICO SCORES

A FICO score is based on five categories and can range from 300 to 850.

Payment histories show whether borrowers pay their bills on time.

Amounts owed looks at the borrower's debt and available credit.

Credit scoring greatly benefits borrowers with good credit histories.

Qualifying ratios actually bridge the gap to establish both credit and capacity.

SCORING FACTORS

A FICO score is based on five categories and can range from 300 to 850.

Payment histories show whether borrowers pay their bills on time.

Amounts owed looks at the borrower's debt and available credit.

CREDIT SCORING (CONT.)

Derogatory credit references are categorized based on severity and credit type.

Housing delinquencies are especially problematic, but consumer delinquencies are not as critical.

The public record section of the credit report will contain any information regarding judgments, liens, foreclosure proceedings in process, and bankruptcies.

THE UNDERWRITER

The underwriter's primary objective when underwriting a loan file is to prevent loss for the lender.

The underwriter will need to establish capacity by determining whether the borrower can repay the loan. The underwriter must be comfortable with the borrower's willingness to repay the loan.

Willingness to repay is established through the review of the borrower's current and past credit.

The underwriter must review the security for the loan to ensure that if the borrower defaults on the loan, despite their capacity and credit, the loan can be repaid through the sale of the property.

This process is referred to as review of the collateral.

METHODS OF UNDERWRITING

There are two basic methods used in the underwriting of a mortgage loan file: criteria-based and risk-based methods.

Criteria-based underwriting must follow strict guidelines and set standards.

The guidelines for risk-based underwriting will have general tolerances, as opposed to set standards for the underwriter to use in reviewing the file.

Blended-style underwriting combines aspects from risk-based and criteria-based. Fannie Mae, Freddie Mac, FHA, and VA use a blend of both criteria-based underwriting and risk-based underwriting.

AUTOMATED VS MANUAL UNDERWRITING

Currently, the mortgage loan underwriting process is mostly automated.

Manual underwriting is still used by non-conforming portfolio lenders.

ABILITY TO REPAY

The primary component to establishing the borrower's capacity, or ability, to repay the loan is the income used to qualify the borrower.

Calculating income based upon an hourly wage is one of the most common methods.

The greatest challenge in calculating a salaried borrower's income is establishing the frequency of the borrower's pay periods.

Self-employed borrowers who are providing documentation are typically required to use two years of tax returns for determining

EXCEPTIONS

If a borrower's income is slightly lower than the income needed to qualify for the loan, but the borrower has plenty of extra assets after closing the loan, the underwriter may approve the loan anyway.

Some loan programs have reserve requirements. Reserves are monies left over after closing.

The reserve requirements for most loans range between two and six months.

A co-borrower or co-signer is an additional person who is applying jointly for the primary borrower's loan. Co-signers and non-occupant co-borrowers are not as common as they used to be. Co-borrowers who will occupy the property with the primary borrower, such as a spouse or domestic partner, are still permitted and common.

LOAN COLLATERAL

The collateral for the loan can often supersede all other factors to encourage an underwriter to approve a loan.

Loan to value is calculated by dividing the loan amount by the purchase price or appraised value, whichever is less.

Since the collateral is the primary security for the lender, the appraisal is often the document that is most carefully reviewed by the underwriter.

The appraisal provides all the information that can be deemed relevant about the physical characteristics of the property, as well as the housing market of the surrounding area.

Hazard Insurance is the standard structural insurance on the property.

TITLE SEARCH

A title search is conducted to determine if there are any defects on the title. A title describes the possession rights of ownership in real property. A title search covers matters recorded in the county records during the period searched. A title defect is anything that might encumber or inhibit the owner's rights to the property. These could be liens, easements, or any other claim of ownership. A title defect may cause the owner to lose all or part of their land to the superior ownership interest or claim of another.

ETC.

If a title is unmarketable, there is question over who rightfully owns the property.

Construction of a new home can raise special title problems for both the lender and the owner.

A title search will uncover any existing liens, and a survey will determine the boundaries of the property; however, builders routinely fail to pay subcontractors and suppliers.

This may result in the subcontractor or supplier placing a lien on the property being purchased.

TITLE INSURANCE

There are two primary types of title insurance policies: the owner's policy and the lender's policy.

The owner's policy ensures that when the new owner takes over the title, the vesting is correct, and no liens exist aside from those created by the new mortgage.

The primary purpose for a lender's policy is to protect current and future lenders from losses.

This policy will carry over in the event the loan is sold on the secondary market.

TYPES OF CLOSINGS

There are two primary closing methods used by settlement agents when closing a loan: table closings and escrow closings.

A table closing, or wet closing, occurs when the funding is completed at the same time the loan documents are signed.

Escrow closings, or dry closings, require the borrower and seller to sign all loan documents in advance.

CLOSING DAY

The borrower should remember to bring a cashier's check and a photo ID.

In an escrow closing, the buyer and the seller attend separate meetings.

A table closing will have one appointment for both the buyer and seller.

DISCLOSURES AND DOCS

The Closing Disclosure identifies all parties to the transaction including the borrower or buyer, the seller, the lender, and the settlement agent.

The Deed of Trust or Mortgage is the security instrument that binds the loan to the property.

The Note establishes the borrower's promise to repay the loan.

The Truth in Lending Act (Reg Z) allows a borrower three business days following the date of signing in which they may cancel the transaction (right of rescission) with no financial repercussions other than third party fees that may have been paid in advance.

SIGNATURES

All signatures on closing documents must be signed with the borrower’s full legal name as typed in the documents and as it appears on the purchase agreement.

Many of the loan documents included in the closing package will need to be notarized by a public notary.

Photo identification is required at the signing appointment.

If the borrower fails to sign consistently throughout the closing documentation, the borrower will be required to return to the settlement agent's office to re-sign these disclosures.

CLOSING THE CLOSING

Attorneys preside over residential real estate closings in some states, such as Massachusetts.

Buyers need to bring a certified check to the closing appointment.

Although buyer and seller have agreed on the closing date in the purchase and sale agreement, this date often changes prior to closing. As soon as the borrower receives firm approval from their lender, you should confirm the actual date of loan closing.

Closing occurs when funds have been disbursed, and the transfer of ownership has been recorded.

END OF SECTION 3

Take this time to complete Section 3 of your online coursework.

SECTION 4:
FRAUD AND REAL ESTATE

Unit 1: Real Estate Fraud

Unit 2: Fraud for the Purpose of Obtaining Real Estate

Unit 3: Fraud for the Purpose of Obtaining a House for Profit

Unit 4: Steps You Can Take to Prevent Fraud

WHAT IS FRAUD?

Fraud is legally defined as the misrepresentation of a material fact made with the knowledge of its falsity and with the intent to deceive a party who relied on the misrepresentation to his or her detriment.

Typically, in a fraud-for-housing scheme, individuals fraudulently report their income, personal debt, or down payment resources to make their financial situation appear stronger than it is.

Real estate professionals who coach borrowers to commit fraudulent acts to qualify for home loans are equally guilty of fraud.

MOTIVATION

Money is the primary motivator in a fraud-for-profit scam. Insiders, such as appraisers, are frequently involved in fraud-for-profit schemes.

Fraud-for-profit scams often involves misrepresenting the condition of a property in order to sell it for a higher price.

PROPERTY DISCLOSURES

When working with sellers to complete property disclosures, you must ensure that the seller completes a thorough and honest disclosure—and when in doubt, you should always disclose, even at the risk of losing a sale.

The intent to commit fraud and the degree to which damages were caused are key elements that prosecutors use to construct a fraud case.

REGULATORY EFFORTS

Despite legislative and regulatory efforts to stop con artists, fraud remains a major problem in the real estate industry.

Licensees should monitor changes in real estate laws and advise their clients to err on the side of being conservative—in terms of acting within the law—when buying and selling properties.

FRAUD NOT MISREPRESENTATION

Buyers could misrepresent facts on the loan application, including income, assets, sources of down payment funds, length of employment, and more.

Buyers potentially could misrepresent facts on many of the documents involved in this process. When they do, this is fraud for housing.

IDENTITY THEFT & THE PATRIOT ACT

Identity theft is the misuse of another person's identifying information for fraudulent purposes.

The Patriot Act requires that financial institutions obtain the following customer information: name and home address, date of birth, tax ID/Social Security number, and a copy of a government-issued photo ID.

STRAW BUYERS & CREDIT DOCTORING

Straw buyers are individuals who receive money for the use of their identity and credit history on a mortgage loan application.

Credit doctoring occurs when credit repair services, legally or illegally, conceal and remove bad credit.

UNIFORM COLLATERAL DATA PORTAL

Fannie Mae and Freddie Mac developed the Uniform Collateral Data Portal to provide lenders with greater confidence in loan quality by improving and overseeing the appraisal process.

BUY AND BAIL

A buy-and-bail situation involves homeowners buying a new home and then disposing of their old home through a short sale or foreclosure.

In an effort to stop buy-and-bail transactions, lenders now require that individuals seeking to purchase a new home and to convert their current home to a rental property have significant equity in the rental property, as well as a lease agreement with a tenant and evidence of the receipt of a security deposit.

SILENT SECOND

In a silent second transaction, the buyer of a property borrows the down payment from the seller, or from a third party, through a non-disclosed second mortgage, causing the lender to be unaware of the additional debt.

MATERIAL AND LATENT ADVERSE FACTS

Sellers must report both material and latent adverse facts in a property so that any potential reductions in property value are identified prior to the sale.

A material adverse fact is something that has a significant negative impact on the value of a property or that poses an unreasonable risk to the tenant.

Latent facts, which may be minor or material, are concealed defects that are not obvious during a visual inspection.

Nondisclosure or misrepresentation can result in liability for the seller.

If you fail to report a known adverse fact regarding a property in a transaction, you can be held liable.

CHURNING & ILLEGAL PROPERTY FLIPPING

Churning involves inflating more than one property value in order to create comparable sales, resulting in honest appraisers using the inflated comps when pricing homes for sellers.

Illegal property flipping occurs when a con artist buys a property, makes minor improvements to it, and then resells it for a considerable profit to a straw buyer who never makes mortgage payments, causing the lender to incur significant losses.

MONEY LAUNDERING

Money laundering occurs when someone filters illegally gained money through a series of legal transactions, making it difficult to trace the money back to the illegal activity.

Money laundering involves three main processes in order to "clean" the funds: placement, layering, and integration.

The Financial Crimes Enforcement Network, a bureau of the U.S. Department of the Treasury, uses a variety of tools and tactics, including the monitoring of financial transactions data, to combat crimes such as money laundering.

FinCEN requires that all non-bank residential mortgage lenders and originators establish an anti-money laundering program and file suspicious activity reports in an effort to protect lenders and their customers from losses caused by illicit actors.

CASH BACK SCHEMES

Cash back schemes occur when the buyer applies for a mortgage amount that is higher than the value of the property and cashes out the difference.

PREDATORY LENDING

Historically, predatory lenders targeted susceptible neighborhoods where people were less informed and more vulnerable, especially the elderly, minorities, and women.

During the housing boom, predatory lenders expanded their aggressive marketing efforts to people of all backgrounds and income levels.

The Nationwide Mortgage Licensing System serves to protect consumers against mortgage fraud and predatory lending.

NMLS & SAFE ACT

NMLS makes the licensing of MLOs uniform and more efficient.

The SAFE Act requires that MLOs either be registered with the federal government or licensed by the states.

Under the SAFE Act, state-licensed MLOs need to register with NMLS.

CFPB

The Dodd-Frank Act includes numerous anti-predatory lending measures and created the Consumer Financial Protection Bureau (CFPB), an agency that protect consumers by carrying out federal consumer financial laws.

The CFPB possesses the authority to levy significant financial penalties against firms that violate consumer protection laws and regulations.

Newly enacted laws and regulations have reduced predatory lending activity, but it remains a problem to guard against.

WARNING SIGNS

Licensees should be aware of warning signs that someone is engaging in fraudulent activity during a real estate transaction.

Fraud is often detected through the identification of document irregularities, which serve as evidence of the suspect's intent.

Carefully review paperwork related to a property sale to ensure that all information is up-to-date and accurate and advise your clients to do so as well.

Fraud can appear in the mortgage application or supporting documentation.

REPORTING FRAUD

To report mortgage fraud to the FBI, contact the organization's field office nearest you.

Mortgage fraud also can be reported to the Consumer Financial Protection Bureau, which supervises financial institutions and enforces consumer financial laws, and to the state's attorney general.

If you or your clients suspect a mortgage broker is engaging in fraud, contact your state's regulator to either file a complaint or obtain information about the broker's license.

REPORTING FRAUD *(CONT.)*

The National Association of REALTORS® should be contacted to report suspicious unethical activity of one of its member agents or brokers.

Victims of identity theft should file a report online using the FTC's Complaint Assistant, and after doing so, all three major credit reporting agencies will be notified.

If you suspect someone is engaging in tax violations or money laundering, notify the Internal Revenue Service (IRS) by completing Form 3949-A.

SILENT FRAUD

Silent fraud occurs when a person who has the duty to be truthful fails to speak or disclose information where the buyer has expressed specific concerns about a property.

Omitting information—or "silent fraud"—is not a defense against fraud in the context of real estate.

Sellers have the duty to speak up—as do agents, brokers, appraisers, inspectors, and lenders—if they possess knowledge of omitted information.

END OF SECTION 4

Take this time to complete Section 4 of your online coursework.

SECTION 5: TAXES AND REAL ESTATE

Unit 1: Introduction to Residential Real Estate

Unit 2: Taxes Involved in Buying a Residence

Unit 3: Taxes Involved in Owning a Residence

Unit 4: Taxes Involved in Selling a Residence

Unit 5: 1031 Exchanges

Unit 6: Taxes Involved With an In-Home Office

PROPERTY TAX

In the 1600s, lawmakers in England began taxing individuals on their total assets. Finding a loophole in this system, citizens began hiding and moving assets to avoid the tax.

To close this loophole, lawmakers enacted the first tax on the only thing that could not be moved, the dwellings situated on the land. In 1913, the 16th Amendment was signed allowing for the federal taxation of an individual's income.

Because of the income tax burden precluding the ability of most Americans to purchase a home, the federal government passed a law which permitted an individual to deduct mortgage interest from income.

TAX VARIETIES

Taxes are paid through various sources including sales tax, income tax, and real estate property tax.

Sales tax is based primarily on the sale of goods. It's collected at the point of sale by the seller and paid to the state/local/city governments by the seller.

Some states collect gross receipts tax in lieu of sales tax, which is levied on businesses. The goods or services that are taxed depend upon the state, county, or municipality.

GROSS INCOME

According to the IRS, “gross income means all income from whatever source derived.” It can take the form of money, property, or services.

All gross income is taxable unless the law specifically excludes it.

Property tax is paid to governmental entities based on the value of real estate.

Real estate taxes may be paid by a taxpayer to an escrow account and then paid by the escrow service to the governmental entity or paid directly to the governmental agency.

Gross income is reported annually to the IRS. From gross income, there are expenses that can be deducted to determine taxable income, which is the income used to calculate the taxes owed for the year.

MORTGAGE INTEREST

Mortgage interest is interest paid to a mortgage lender on debt taken on to acquire, construct, or substantially improve a qualified residence, and secured by a qualified residence, and may be deducted from gross income to produce a lower taxable income.

In order to take advantage of the home mortgage interest deduction, your buyers must first determine if the home they're purchasing will serve as a qualified residence.

Qualified residences can include a principal residence and a secondary residence. A principal residence must meet qualifications: (1) the land must house living quarters with sleeping space, a toilet, and cooking facilities, and (2) it must be the principal residence where the taxpayer lives or resides for the taxable year.

SECOND HOMES

A second residence, also commonly known as a vacation home, may qualify for a home mortgage interest deduction if certain conditions are met.

Rental properties introduce new tax liabilities and deductions and should be considered carefully before the buyer chooses a second home.

Your buyers can deduct home mortgage interest only if the qualified residence is secured by a mortgage, deed, or land contract instrument.

COLLATERAL

With secured debt, if the taxpayer doesn't make the payment on the debt, the taxpayer could lose the qualified residence to satisfy the debt.

Collateral means the property that the taxpayer is purchasing would revert on default to the lender so that the lender could eventually sell it to satisfy the debt.

The good news about securing a loan with the qualified residence is that the interest paid on the loan may be deductible from the buyer's gross income for tax purposes. Not all buyers are aware of this benefit.

ITEMIZING

Due to the increase in the standard deduction ($12,200 if filing singly, $24,400 if filing as a couple), itemizing to take the mortgage deduction won't make sense for everyone.

Where it makes sense for the homeowner to itemize, any loan incurring interest that's secured by the qualified residence may qualify for a deduction.

According to the IRS, in most cases, buyers will be able to deduct all their home mortgage interest. However, there are limitations. These depend on the date the mortgage was taken, the mortgage, and how the proceeds from the mortgage are used.

FORM 1040

Most state and local governments charge an annual tax on the value of real property.

This tax can be deducted if it's based on the assessed value of the real property and the taxing authority charges a uniform rate on all property in its jurisdiction.

To deduct expenses of owning a home, your clients must file Form 1040 and itemize deductions on Schedule A (Form 1040) rather than take the standard deduction.

It's possible that the standard deduction provides a better tax position than the itemized deduction, particularly with the tax changes that took effect in 2018.

ALLOCATION OF TAXES

At closing, the seller and the buyer agree on how to allocate the real estate taxes for the year between them.

Generally, real estate taxes for a tax year are divided between the buyer and the seller based on the number of days the buyer and seller held the property.

Often the seller has already paid the taxes on the home for the year. From a tax perspective, this isn't important.

The IRS requires that the taxes be split based on the number of days of the year that the home was owned by the homeowner.

THE NEED FOR MORTGAGE LOANS

Most homebuyers take out a mortgage (loan) to buy their home. To be deductible, the interest must be on a loan secured by a main home or a second home.

The loan can be a first or second mortgage, a home improvement loan, or a home equity loan.

Consumers used to use home equity loans and home equity lines of credit like credit cards. No more.

Only the interest on home equity loans and home equity lines of credit that's used to improve or purchase a home may be deducted.

POINTS

Generally, interest paid in advance for a period that goes beyond the end of the tax year must be spread over the tax years to which it applies.

However, there is an exception that applies to points. The term "points" is used to describe certain charges paid, or treated as paid, by a borrower to obtain a home mortgage.

Points also may be called loan origination fees, maximum loan charges, loan discount, or discount points.

The seller can't deduct points. Any points paid by the seller as part of the sale will only decrease the total amount that the seller has received from the sale for purposes of determining a gain or loss from the sale.

Once the eligibility requirements are met, the buyer must follow the rules for each loan type to determine what points, if any, are deductible.

PMI & MIP

Requiring private mortgage insurance is a way for lenders and investors to reduce the risk of a mortgage loan, especially those that have a high loan-to-value ratio.

Premiums paid or accrued for qualified mortgage insurance in connection with home acquisition debt (debt used to purchase, build, or improve the home) are no longer deductible at this time.

DEDUCTIONS

Interest on home mortgage debt is deductible, subject to certain limitations, as explained earlier. This interest is deductible in the year that it is paid on Schedule A, Form 1040.

Homeowner's insurance is not deductible unless your client runs a business out of their home, or if the home is a rental property.

Real property taxes are deducted in full in the year they are paid.

Property taxes and state and local tax combined (the so-called SALT deduction) is capped at $10,000.

HEAD OF HOUSEHOLD

To file as head of household, you must meet the following criteria: (1) pay for more than half of the household expenses; (2) be considered unmarried for the tax year; and (3) have a qualifying child or dependent.

Standard deduction for Head of Household is $18,350.

Itemization allows a taxpayer to deduct housing related expenses, such as mortgage interest. With the increase in standardized deductions, some taxpayers who don't itemize will have a lower tax bill compared to those who do.

There are expenses paid by the homeowner that may not be deductible, including fire or homeowner's insurance premiums, the amount applied to reduce the principal of the mortgage, depreciation, utilities, most settlement costs, and forfeited deposits.

The seller cannot deduct points. Any points paid by the seller, with respect to the buyer's loan, are allowed to be deducted by the buyer.

REFINANCING

Refinancing has been a common approach to lowering mortgage payments through lower interest rates, as well as using the equity in a home to finance other expenses or debt.

Any secured debt used to refinance home acquisition debt is treated as home acquisition debt.

Points paid for refinancing aren't fully deductible in the year they are paid.

Points paid during refinancing are deducted over the life of the mortgage.

The remaining points are deducted when the mortgage is refinanced again or when the house is sold.

To figure the annual deduction amount, divide the total points paid by the number of payments to be made over the life of the loan. Usually, this information is available from the lender.

MORTGAGE INTEREST DEDUCTION

Before 2018, homeowners could deduct mortgage interest on up to $1,000,000 in debt. Those who owned a home with that debt level prior to Dec. 15, 2017, were grandfathered in.

For homes purchased after that date, interest may be deducted on up to $750,000. Only 6% of households have homes with $500,000 or more debt. Interest on home equity loans and HELOCs are deductible, but the funds must be used for home improvements and additions and no other purpose.

Mortgage interest paid on a second home is still deductible, but it's subject to the mortgage debt limit of $750,000 total (primary home + second home debt can't exceed $750,000).

HELOC

A home equity loan allows a homeowner to borrow against his home's value. A home equity line of credit (HELOC) is a revolving line that can be used as needed by the homeowner.

A homeowner can deduct interest on a home equity loan, HELOC, or second mortgage. However, the tax law changes of 2018 limit deductibility through 2026 to those funds used to pay for home improvement or addition.

Historically, taxpayers have been able to deduct 100% of their state and local income, sales, and property taxes from their federal tax liability.

SALT

SALT is an acronym that means "state and local taxes.

The 2018 tax law changes capped the SALT deductible amount at $10,000 through 2025.

For some states with high state and local income, sales, and property taxes, the SALT cap halves the deductions that taxpayers can claim.

Prior to 2018, there was no limit on the amount of personal SALT deductions taxpayers could take, if they itemized.

You could deduct 100% of: state and local income (or sales) taxes (not both) as well as state and local property taxes.

OPTIONS

Options allow the buyer to have an exclusive right to buy a property during the option period for a fee.

If the option is exercised, the option amount is generally added to the basis of the property.

If the option is not exercised and the option was not for business purposes or rental property, the option amount generally is not deductible for the optionee.

If the option is not exercised by the end of the option period, the seller must report the amount received for the option as ordinary income.

CAPITAL ASSETS

Whenever an asset transfers ownership, there's usually a gain or loss that may be calculated.

Almost everything you own and use for personal purposes, pleasure, or investment is a capital asset.

When you sell a capital asset, the difference between the amount for which you sell the asset and your adjusted basis, which is usually what you paid for the asset plus or minus some items, is a capital gain or a capital loss.

BASIS

It's also necessary to know the basis in a home to determine any gain or loss when it's sold.

The basis in the home is determined by how the owner obtained the home.

The basis is its cost when purchased or built, plus any improvements.

Throughout the ownership of a home, homeowners adjust the home's basis.

The result of these adjustments is the home's adjusted basis, which is used to calculate the gain or loss on the sale of the home.

ADJUSTED BASIS

The following can increase a home's adjusted basis: improvements to the home after purchase (not repairs), assessments for local improvements, amounts spent to restore damaged property, and some settlement fees and closing costs.

The following can decrease a home's adjusted basis: points paid on the loan by the seller, insurance or other reimbursement for casualty losses, deductible casualty loss not covered by insurance, payments received for easement, etc.

Once you identify the specific adjustments that can be made to the home's basis, you're ready to calculate its adjusted basis.

The adjusted basis formula is: Original Basis (Cost) + Increases to Basis - Decreases to Basis = Adjusted Basis.

NET GAIN OR LOSS

To calculate the net gain or loss on the sale of a capital asset, the net selling price must first be determined.

The net selling formula is Sales Price of Property - Selling Expenses (Settlement Costs) = Net Selling Price.

Once you’ve got your net selling price, subtract the adjusted basis to get the gain or loss on the sale of assets.

Gain or loss on sale of asset formula: Net Selling Price - Adjusted Basis = Gain or (Loss) on Sale of Assets.

DEPRECIATION

Depreciation is an income tax deduction that allows a taxpayer to recover the cost or other basis of certain property. It's an annual allowance for the wear and tear, deterioration, or obsolescence of the property.

To qualify for a depreciation deduction for a piece of property, the property must meet certain requirements. For instance, the taxpayer must own the property.

Taxpayers may also depreciate any capital improvements for property the taxpayer leases, but the taxpayer must use the property in business or in an income-producing activity.

Principle residences don't qualify.

PROPERTY BOTH BUSINESS AND PERSONAL

If a taxpayer uses a property for both business and personal purposes, the taxpayer can only deduct depreciation based on the business use of that property.

In such cases, the property must have a determinable useful life of more than one year. Even when a taxpayer meets the depreciation requirements for a property, a taxpayer can't depreciate property placed in service and disposed of in the same year.

For equipment used to build capital improvements, a taxpayer must add otherwise allowable depreciation on the equipment during the period of construction to the basis of the improvements.

REPAIRS & MAINTENANCE

Repairs and maintenance keep a home efficiently operating, but they don't increase the basis of a home.

Routine repairs include painting the home, fixing gutters or floors, remedying leaks or plastering, and replacing broken windowpanes.

Work done on a home is considered a capital improvement if the work materially adds to the value of a home, considerably prolongs the home's useful life, or adapts the home to new uses.

The costs of improvements (vs. repairs) are added to the basis. The amount added to the home's basis for improvements is the actual cost of the improvements.

This includes all costs for material and labor, except the homeowner's own labor, and all expenses related to the improvement.

SHORT- & LONG-TERM GAIN

Capital gains are divided between short-term capital gains/losses and long-term capital gains/losses.

The taxation of the gain is dependent on the length of the time the capital assets are held.

Short-term capital gain rules apply to those capital assets that weren't held for more than 12 months. Short-term capital gains are generally treated as ordinary income and are subject to ordinary taxation rates.

Long-term capital gain rules apply to those capital assets that have been held for more than 12 months. Generally, the tax rates that apply to net long-term capital gains are lower than the tax rates that apply to ordinary income.

WHEN CAPITAL LOSS EXCEEDS CAPITAL GAIN

If total capital losses exceed total capital gains, the excess is subtracted from other ordinary income on the income tax return, up to an annual limit of $3,000 ($1,500 if the taxpayers are married and filing separately).

Any unused capital loss can be carried over to the next tax years until the loss carry forward is completely used up.

An exception is a capital loss from the sale of a taxpayer's main home. A loss on the sale of a taxpayer's main home isn't deductible.

SECTION 121

A Section 121 exclusion occurs if sellers qualify to exclude from their income all or part of any gain from the sale of their main home. If qualified, they won't have to pay tax on the gain up to the limit described under the maximum exclusion.

To qualify for a Section 121 exclusion, the home and homeowner must meet specific tests. If the taxpayer meets all the qualifications, the taxpayer can exclude up to $250,000 of the gain on the sale of their main home. A married couple that meets all the qualifications of Section 121 may deduct up to $500,000 of the capital gain.

In addition to the home being the main home, the taxpayer must satisfy two other tests to qualify for the exclusion provided for in Section 121: the ownership test and the use test.

THE OWNERSHIP TEST

To pass the ownership test, the seller must have owned the home as a principal residence for at least two of the five preceding years.

To pass the use test, the seller must have used the home as their principal residence for at least two of the five preceding years.

1031 TAX-DEFERRED EXCHANGE

A tax-deferred exchange for properties used for investment or business purposes is also referred to as a like-kind or 1031 exchange.

The 1031 tax-deferred exchange is used to defer paying capital gains taxes on one investment property when there is an almost immediate repurchase of a "like-kind" property.

EXCHANGES

Income-producing residential, commercial, and industrial properties can qualify for a tax-deferred exchange as can hotels and motels. The exchange of real estate owned for a real estate lease that runs 30 years or longer is a like-kind exchange; however, not all exchanges of interests in real property qualify.

Real property located in the United States and real property located outside the United States are not considered like-kind property under the like-kind exchange rules. If foreign real property is exchanged for property located in the United States, the gain or loss on the exchange is recognized.

IDENTIFYING PROPERTIES

Generally, in an exchange of business or investment property solely for business or investment property of a like-kind, no gain or loss is recognized under Internal Revenue Code Section 1031.

Taxpayers may purchase and exchange any number of properties as long as they identify properties within 45 days, and purchase the properties within 180 days, or the due date of their tax return, whichever is earlier.

Although the Internal Revenue Code Section 1031 doesn't require it, it's a good idea to include language in a purchase and sale agreement that the property being sold or bought is being used as a 1031 exchange property.

TAX EXCHANGE AGREEMENT

In a like-kind exchange, there should be a tax exchange agreement, containing an agreement regarding the following: the establishment of the safe harbor account, fees, interest expectations, liability issues, and other like-kind issues.

Form 8824, Individual Taxpayer Tax Return, is the form the taxpayer uses to identify and explain any 1031 like-kind exchanges incurred in the tax year.

THE TAX CUTS & JOBS ACT

The Tax Cuts and Jobs Act states that only self-employed people may deduct home office expenses, for the tax years 2018 through 2025.

In order to qualify for the home office deduction, the office space must be dedicated to business use. The IRS requires that the home office be the principal place of business.

MORE THAN ONE MEETING PLACE

Self-employed people can have more than one place of business (meeting space to meet clients, for example) and still claim the home office deduction.

But they can only claim it if they do most of their work (or certain kinds of work) in their home office. To determine the business percentage, divide the size of the portion of the home that is used for business by size of the entire home.

Divide the area (length, in square feet, multiplied by the width, in square feet) used for the business by the total square feet of the home.

DETERMINING DEDUCTIONS

If the rooms in the home are all about the same size, your client can divide the number of rooms used for business by the total number of rooms in the home.

You can also multiply the square footage of your home office (if it's 300 square feet or smaller) by $5 and then claim that amount.

Direct expenses are deductible in full and include expenses such as painting or repairs only in the area used for business. In a daycare facility, however, these may be limited.

INDIRECT EXPENSES

Indirect expenses are deductible based on the business percentage and are for maintaining and operating the entire home.

These expenses include insurance, utilities, and general repairs to the home.

Home business deductions include a portion of several expenses, such as rent, mortgage interest, property taxes, casualty losses, utilities, services, improvements and repairs, security systems, and depreciation.

END OF SECTION 5

Take this time to complete Section 5 of your online coursework.

THE END.