Chapter 13
Loan Origination, Processing, and Closing

Chapter 13
Learning Objectives
- Understand the steps involved in processing a loan application and closing a mortgage
- Understand the operation of mortgage bankers

Valuing Property: Appraisals
- Market value is the probable price that would be paid in a competitive market
- Three common approaches
  - Market or sales comparison approach – compare to similar properties which sold recently
  - Cost approach – cost to reproduce
  - Income approach – PV of potential CF’s
- One generally cannot get a mortgage without some sort of appraisal – based on the minimum of purchase price and appraised value

Sales Comparison Approach
- Find similar properties that have sold recently (typically three) Adjustments for:
  - Time, Location View, Design appeal
  - Quality of construction, Age, Condition
  - Size, Features, Functional utility
  - Type and condition of systems, i.e., HVAC
  - Sale or financing concessions

Sales Comparison: Example

<table>
<thead>
<tr>
<th>Subject</th>
<th>Comp 1</th>
<th>Comp 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>$152,000</td>
<td>$150,000</td>
<td>$161,000</td>
</tr>
<tr>
<td>Size</td>
<td>1800 sqft</td>
<td>1700 sqft + 8000</td>
</tr>
<tr>
<td>Garage</td>
<td>2 car garage</td>
<td>3 car garage - 5000</td>
</tr>
<tr>
<td>Indicated Value of Subject</td>
<td>$153,000</td>
<td>$152,000</td>
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</tbody>
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Cost Approach
- Value of land plus cost of improvements
- Deduction for Depreciation
  - Physical depreciation
    - Houses “wear out” or age (roof wearing out)
  - Functional obsolescence
    - Old kitchen, low ceiling, old wiring, small closets
  - External obsolescence
    - Such as shifting land use
  - Curable vs. incurable
    - New paint, carpets, roof, etc. vs. ceiling height
**Income Approach**

- Gross rent multiplier
  - The ratio of house prices to monthly rents
- Example – could rent out for 775 per month. If the Gross rent multiplier is 137, then the indicated value of the house is $106,175
  - This is like the P/E ratio approach to value a stock
- Difficult to use for single family residential properties as most houses are not used as rentals

**Loan Processing**

- Applying for Mortgage Insurance
  - After all application information is verified the loan package can be submitted for insurance
  - FHA – Allows “Direct Endorsement” for approved underwriters

**Loan Closing**

- Transferring Title
  - A deed is typically used to transfer title and a title insurance policy insures the warranty made in the deed
- Signing Documents
  - E.G. Promissory Note
  - Mortgage Instruments
- HUD – 1 used to verify costs associated with closing
- Final amount due from buyer (purchase price plus fees and escrows less loan amount)

**Mortgage Banking**

- Non-Depository Institutions
- Do Not Hold Loans in Portfolio
- Retain Servicing Rights
- Sources of Funds Are Commercial Paper and Warehousing Loans
- Income Primarily From Origination and Servicing Fees