

Chapter 14

Mortgage Default Insurance,
Foreclosure, and Title
Insurance

Chapter 14

Learning Objectives

- *Understand how each of the three different default insurance plans -VA, FHA, and private mortgage insurance - operate*
- *Understand how state foreclosure laws differ*
- *Understand the risk that is insured by title insurance*

Mortgage Default Insurance

- Partial Coverage
- Full Coverage
- Self-Insurance
- FHA Insurance
- VA Insurance
- Private Mortgage Insurance (PMI)

VA Loans

- Started in 1944
- Provides mortgage loan guarantees for principal residences
- Guarantees only a portion of the loan
- No down payment may be required
- Funding fee varies with down payment
 - >95%- 100% Loan 2%
 - >90%- 95% Loan 1.50%
 - 90% or Less Loan 1.25%
- Fee is waived for service related disability

VA Loans

- Must have eligibility and entitlement
- Eligibility- Minimum active duty, 90 days for " Hot War"
- Maximum Entitlement- was \$60,000
- Ginnie Mae requires a 25% guaranty. Standard amount is \$417,000 maximum but now up to 729,750 in selected counties
- Since 1988 can only be assumed after qualification of new loan holder
- Release of liability versus entitlement restoration (letting someone assume the loan does not restore entitlement)

VA Loans

- Follows HUD/FHA foreclosure procedure
- Contract interest rate is not regulated
- Offers ARMs
 - TB Yield, 1/5 Caps, 2.00 Margin
- VA will finance mobile homes

FHA Loans

- Analyze Credit Risk to Minimize Foreclosure
- Factors Analyzed Include
 - Loan Amount
 - Settlement Costs
 - Credit History
 - Income
 - Housing Expense

FHA Loans

- U.S. citizenship not required. House must be in the U.S. and must be principal residence
- High-cost limit for one-family residence was \$290,319; fall 2008 increased to FHLMC limit of \$729,750
- For-non-high-cost areas, the limit is 48% of the FHLMC conforming loan limits (San Antonio now is \$322,500, which is less than 48% of the current FHLMC conforming limit.)

FHA Loans

- MIP
 - Up-front payment plus an annual premium paid monthly
 - Starting January 1, 2001 the up-front premium is 1.50% and the annual premium is 0.5% of the outstanding balance, (or higher with low credit scores)
 - Borrower can suspend the premium payment when the loan-to-value ratio reaches 78% of the original purchase price
 - Currently cost varies by Down Payment and Credit Score. 2.25% and 0.55% is the highest rate as of July 2008

FHA Loans

- HUD does not regulate the contract interest rate or the amount of discount points paid by the borrower
- A discharged veteran with a certificate of veteran status can finance 100% of the purchase price

FHA Loans: Determining The Loan Amount

- Currently 3% down payment that will increase to 3.5% on January 1, 2009
- **“Low Downpayment** - We have a low 3% downpayment, and that money can come from a family member, employer or charitable organization. Other loans don't allow this.” (Quoted from <http://www.hud.gov/fha/choosefha.cfm>)
- Other's (i.e. the seller or non profit, can assist with other closing costs)

FHA Loans

- No mortgage assumptions after December, 1989, without qualification of the new borrower
- Non-Qualifying assumptions before December 1986
- Will finance mobile homes
- Offers RAMs
 - 62 years old
 - Own home
 - Principal residence

FHA Loans

- Offers ARMs
 - TB Yield, 1/5 Caps, 2.00 Margin
- In foreclosure, get an appraisal then decide whether to take title
- Also offers graduated payment loans

FHA Loans

- “Less than Perfect Credit - Even if you have had credit problems, such as bankruptcy, its easier for you to qualify for an FHA loan than a conventional loan.” (Quoted from <http://www.hud.gov/fha/choosefha.cfm>)
- With Chapter 7 bankruptcy, borrower must wait two years
- With Chapter 13 bankruptcy, borrower must be paying for one year and be in good standing

FHA Loans

- FHA RAM
 - Age 62 or older
 - No repayment as long as you occupy the house
 - Borrower pays insurance premium
 - 2% MIP instead of 1.50%
 - Loan amount

Age	Borrow
■ 65	26% of Value
■ 75	39% of Value
■ 85	56% of Value

Private Mortgage Insurance (PMI)

- Private insurers
- Insures top portion of loan (which is the riskiest part)
- Pay claim and take title or just pay losses
- Homeowners Protection Act Of 1998 requires lenders to cancel PMI automatically when L/V is 78%
- After July 29, 1999 can be cancelled at 80% L/V of original property value

PMI

- Other requirements for cancellation:
 - No payment more than 30 days late in last 12 months
 - No payment more than 60 days late in last 24 months
 - Property value has not declined
- Protects conventional mortgages and cannot be required with 80% or less L/V ratio

PMI

- Some borrowers do “Piggyback” loans called 80-10-10s to avoid PMI
- 80% First Mortgage
- 10% Second Mortgage
- 10% Down Payment


Foreclosure Laws


- Judicial Foreclosure
 - Court judgment against borrower allowed in all states
- Power of Sale
 - Foreclosure proceeds without a court order Usually with the deed-of-trust
- Equitable Right of Redemption
 - Redeem the property before the sale
- Statutory Right of Redemption
 - Redeem the property after the sale
- Deficiency Judgment
 - Court ordered judgment against the borrower for the difference between the proceedings from foreclosure sale and amount owed.

Title Insurance (Insures the past)

- Insures Good Title
 - Owners Policy
 - Lenders Policy
- Title Search
 - Finds the current liens on a property that will be removed at or prior to closing
 - Most common lien is for mortgages, but may also be IRS or property tax liens, or mechanics or other liens.
 - May maintain a "title plant" which is the expensive part of a title business (claims are a small expense)

On the Courthouse Steps:
A preliminary investigation of mortgage foreclosure auctions in Bexar County, Texas





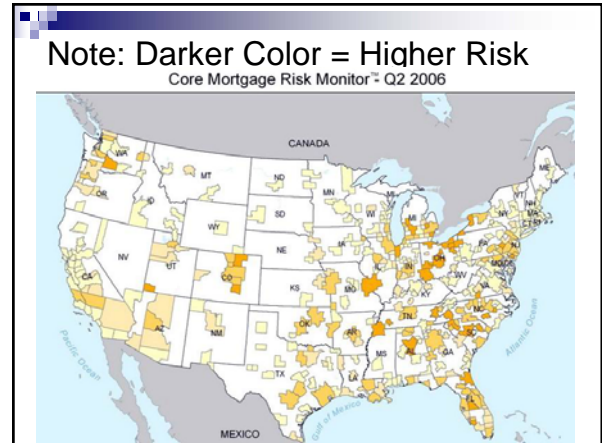
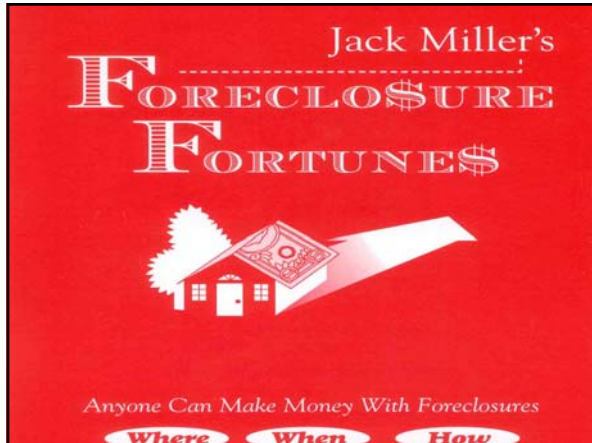
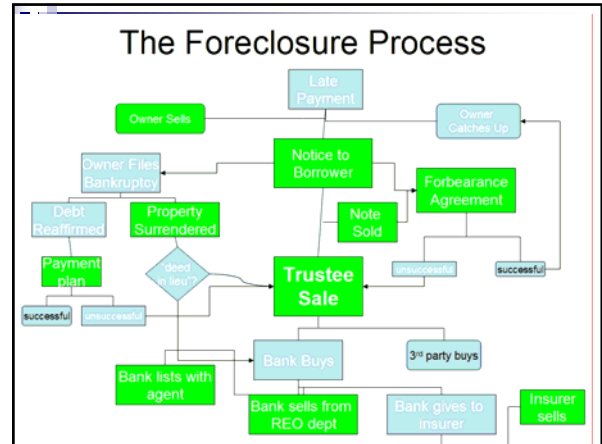
**Jose Gutierrez
Jennifer Larson
Thomas A. Thomson**

The American Dream



The American Nightmare?



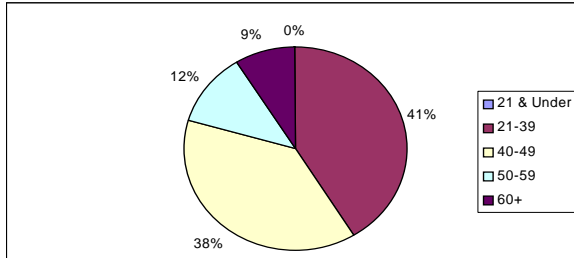
Objectives

- Some reporters questions (who, what, when, where, why)
- What can the data tell us about the bidding process?

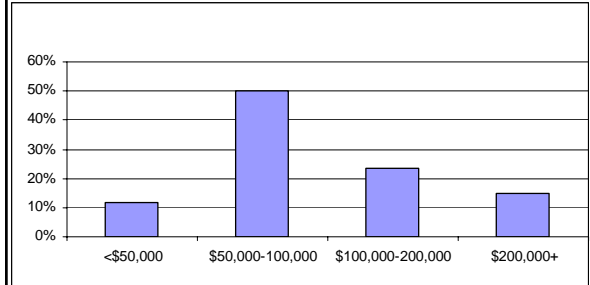
Bexar County Foreclosures

- First Tuesday of each month from 10 AM to 4 PM
- On the back steps of the County Courthouse
- Loud mostly disorganized
- Sheriff's sale on left – mortgage and homeowners associations sales on right. We only consider mortgage sales
- Administered a survey to those willing to participate, mostly before the auctions began and during the lunch break

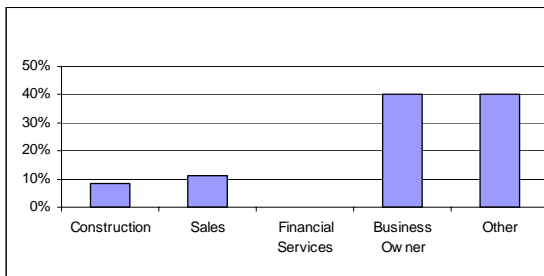
Respondents' age. N=34
 (Note: About 2/3 of respondents are male)



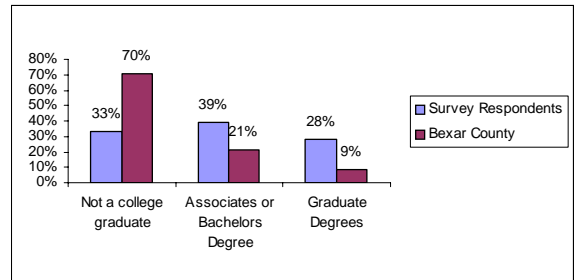
Respondents' annual household income. N=34



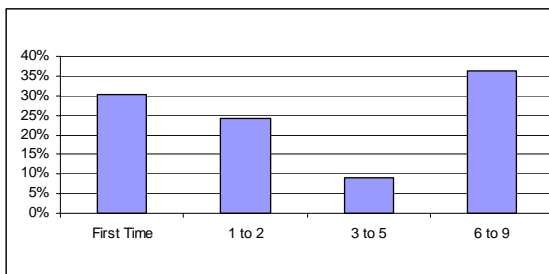
Respondents' occupation. N= 35



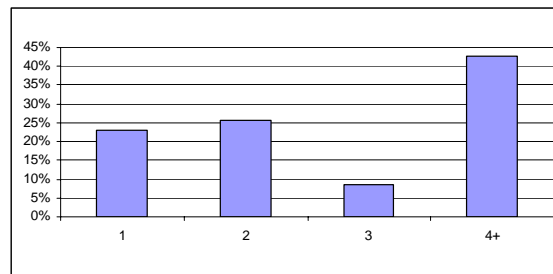
Respondents' education (and compared to county average). N=36



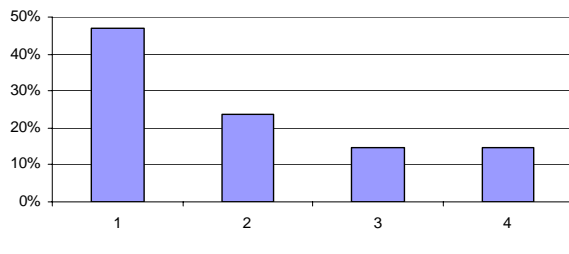
How many auctions have you attended in the past year? N=33



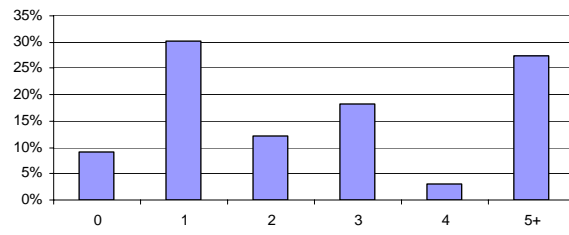
How many homes are you planning on bidding on today? N=35



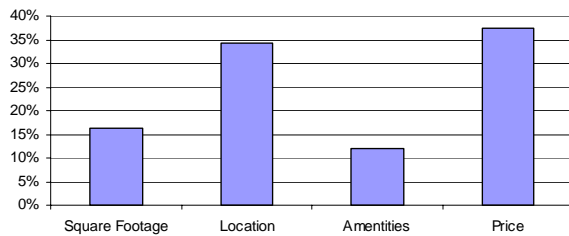
How many homes are you hoping to buy today? N=34 (total homes = 67)



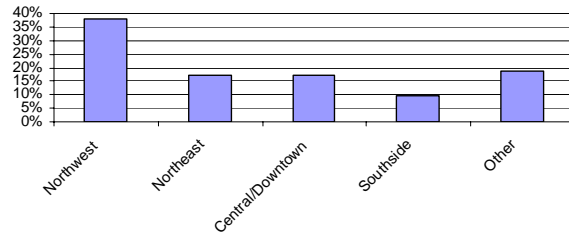
How many homes have you purchased at foreclosure? N=33 (total homes = 85+)



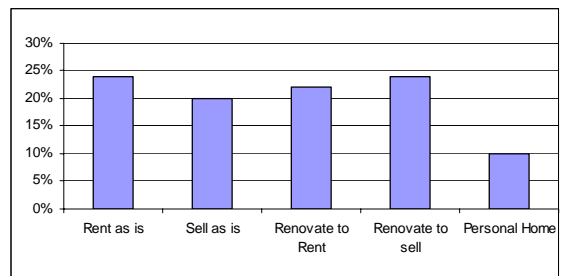
What do you consider on homes you bid on? N=67



In which areas are the homes you plan to bid on? N=53

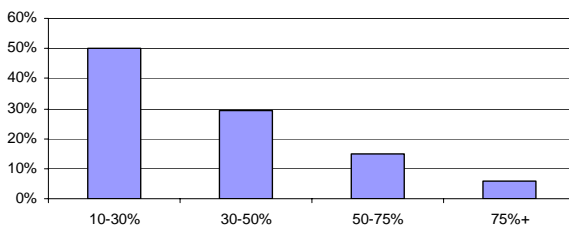


What are your reasons for purchasing auctioned homes? N=50



(Note 80% do not plan on using a loan)

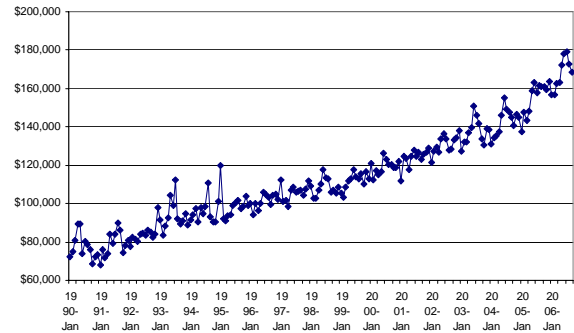
If you flip homes, about how much profit do you target?



Data Analysis

- We obtained auction data from RexReports
- We only use the mortgage part of the data. Must indicate conventional, FNMA, FHA or VA (we don't consider tax sales, home owners associations sales, 2nd mortgages, or home equity)
- We have data from 13 auctions
- About 700 mortgage notices per month
- About 250 sales per month
- About 15% are sold to third parties

San Antonio House Price



Descriptive Statistics N=2471

Variable	Mean	StdDev	Min	Max
Note Amount	98.882	62.616	13.53	760.00
Note Rate	6.379	0.773	5.23	9.17
Term	28.642	4.194	5.00	40.00
Loan Balance	97.828	63.549	2.56	779.12
Equity	8.415	25.984	-191.43	194.98
FHA	0.400	0.490	0.00	1.00
VA	0.076	0.265	0.00	1.00
Not Fannie	0.085	0.278	0.00	1.00
Fannie	0.440	0.496	0.00	1.00
Square Feet	1.672	0.697	0.38	6.00
Loan Age	3.639	2.468	0.10	14.44
First Bid	101.004	63.901	1.00	716.41
Winning Bid	102.244	64.146	1.05	716.41
Bid Premium	1.240	6.685	0.00	108.16
Thirdparty	0.144	0.351	0.00	1.00

OLS Regression: Opening Bid

Covariate	Opening Bid			
	Model A		Model B	
	Estimate	t stat	Estimate	t stat
Intercept	13.373	12.47	-13.712	-1.79
Loan Balance	0.896	97.43	0.788	57.28
Equity			0.120	4.86
FHA			7.805	5.96
VA			-7.958	-3.49
Not Fannie			-5.906	-2.63
Square Feet			14.111	11.24
Loan Age			-0.295	-0.73
Term			-0.178	-1.26
Note Rate			2.691	2.24
Adj R-squared	0.79		0.81	

Logistic Regression: Probability of a Third Party Sale

Covariate	Estimate	p-value	Estimate	p-value
Intercept	-2.295	<.0001	-2.361	0.0063
Loan Balance			-0.009	<.0001
Equity	0.035	<.0001	0.037	<.0001
FHA			-0.808	<.0001
VA			-0.338	0.1804
Not Fannie			-0.176	0.4399
Square Feet			0.217	0.1330
Loan Age			0.142	0.0006
Term			0.044	0.0171
Note Rate			-0.159	0.2082
Corr_Square		0.10		0.16

OLS Regression of Final Bid for sales going to a third party

Covariate	Model C		Model D	
	Estimate	t stat	Estimate	t stat
Intercept	-5.68	-3.48	-11.20	-1.10
Loan Balance	0.99	71.68	0.97	36.70
Equity	0.57	19.77	0.50	14.20
FHA			-0.31	-0.14
VA			-4.43	-1.42
Not Fannie			-2.43	-0.95
Square Feet			4.57	2.27
Loan Age			1.02	2.22
Term			-0.31	-1.53
Note Rate			0.85	0.55
Adj R-squared	0.94		0.95	

Note: Average Equity is about \$28,200 and average Bid Premium is about \$8,600

Summary

- It appears that lenders opening bid is about the amount they are owed
- Lenders bid about \$8000 higher on FHA loans, \$8000 lower on VA loans and 6000 lower on conventional loans compared to FNMA loans
- Third parties are most likely to bid when there is equity in the house (About 15% of sales)
- Third party bidders bid an average 31 cents on the dollar for equity (57 cents at the margin)

Investing In Distressed Properties

- Foreclosures are at record highs, indicating there may be some real estate bargains
- One alternative is to buy “pre foreclosure”
- Owner with equity may sell at a bargain to prevent foreclosure
- Lender may be willing to accept a “short sale” to avoid foreclosure

Investing In Distressed Properties

- Borrower unable to meet mortgage payments
- Market value of property below loan balance
- Delinquent in property taxes
- IRS liens
- Civil judgments/bankruptcy/divorce
- Mechanics and/or construction loan liens
- Personal debts
- Estate settlements

Investing In Distressed Properties

- Buyer must be aware of quality of title when investing in distressed properties
- To profit from investments in distressed properties, the investor must buy low and sell high
- The gain will be the selling price (less selling expenses), less the cost of improvements, less the financial holding costs, less the price the property was purchased for.

Robert Kohl Internship Report UTSA Fall 2007



Budget



- Foundation
- Doors/windows
- Siding
- Roof
- Water heater
- Cement cap
- Closet
- Drywall

Budget

- Fixtures
- Kitchen/Bath
- Paint: Interior/exterior
- Back porch
- Flooring
- A/C
- Staging
- Total – Approx
\$25,000




Project Repairs

- Re-leveled foundation
- New windows
- New doors throughout
- New siding
- New bath
- New kitchen
- Install A/C
- Drywall work
- New fixtures




Project Repairs

- Put cement cap on addition
- Build master bedroom closet
- Install water heater
- Pour new back patio
- New flooring throughout
- Paint interior/exterior
- New 30 year roof




Timeline

- 6 Weeks
- Before one project is completed another subcontractor has to be lined up
- Some projects can run at the same time
- Actually took 7 weeks




Timeline Extension

- Due to unforeseeable problems, the timeline had to be extended
- Extension was 1 week
- Due to subs taking longer than expected
- Also due to having to pour concrete cap



Unforeseeable Problems

- During leveling rain prolonged the job
- During leveling the addition could not be leveled due to no rebar in slab
- Concrete cap was poured to level the addition



Problems with sub contractors



- Took longer than agreed upon
- Walking off the job
- Not showing up on time or at all
- The quality of work was below average
- I had to fix a fan that was hung wrong

The Sale



- Listed for \$99,900
- For Sale by Owner
- Staged home with furniture for quicker sale
- 2 contracts were received after staging

Final Product



- Completed in 7 weeks
- \$25,000 budget was met
- Total investment approx 70,000
- Sold for approx 100,000
- 6 weeks to sell home
- From purchase to closing took 17 weeks

Finished Product

