California Real Estate License Exam Prep:
Unlocking the DRE Salesperson and Broker Exam

ANSWER SHEET INSTRUCTIONS:
The exam consists of multiple choice questions. Multiple choice questions are answered by selecting A, B, C, or D. You may use pen or pencil.

Chapter 4: Financing

	A	B	C	D		A	B	C	D		A	B	C	D
1.	☐	☐	☐	☐	26.	☐	☐	☐	☐	51.	☐	☐	☐	☐
2.	☐	☐	☐	☐	27.	☐	☐	☐	☐	52.	☐	☐	☐	☐
3.	☐	☐	☐	☐	28.	☐	☐	☐	☐	53.	☐	☐	☐	☐
4.	☐	☐	☐	☐	29.	☐	☐	☐	☐	54.	☐	☐	☐	☐
5.	☐	☐	☐	☐	30.	☐	☐	☐	☐	55.	☐	☐	☐	☐
6.	☐	☐	☐	☐	31.	☐	☐	☐	☐	56.	☐	☐	☐	☐
7.	☐	☐	☐	☐	32.	☐	☐	☐	☐	57.	☐	☐	☐	☐
8.	☐	☐	☐	☐	33.	☐	☐	☐	☐	58.	☐	☐	☐	☐
9.	☐	☐	☐	☐	34.	☐	☐	☐	☐	59.	☐	☐	☐	☐
10.	☐	☐	☐	☐	35.	☐	☐	☐	☐	60.	☐	☐	☐	☐
11.	☐	☐	☐	☐	36.	☐	☐	☐	☐	61.	☐	☐	☐	☐
12.	☐	☐	☐	☐	37.	☐	☐	☐	☐	62.	☐	☐	☐	☐
13.	☐	☐	☐	☐	38.	☐	☐	☐	☐					
14.	☐	☐	☐	☐	39.	☐	☐	☐	☐					
15.	☐	☐	☐	☐	40.	☐	☐	☐	☐					
16.	☐	☐	☐	☐	41.	☐	☐	☐	☐					
17.	☐	☐	☐	☐	42.	☐	☐	☐	☐					
18.	☐	☐	☐	☐	43.	☐	☐	☐	☐					
19.	☐	☐	☐	☐	44.	☐	☐	☐	☐					
20.	☐	☐	☐	☐	45.	☐	☐	☐	☐					
21.	☐	☐	☐	☐	46.	☐	☐	☐	☐					
22.	☐	☐	☐	☐	47.	☐	☐	☐	☐					
23.	☐	☐	☐	☐	48.	☐	☐	☐	☐					
24.	☐	☐	☐	☐	49.	☐	☐	☐	☐					
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Chapter 4: Financing

Key Concepts

Critical real estate concepts equaling approximately 9% of the state licensing exam.

- General concepts
- Sources of financing
- Mortgages/deeds of trust/notes
- Types of loans
- Government programs
- Financing/credit laws
- Loan brokerage
- Types of loan originators
- Default and foreclosure

Key Terms

Fundamental real estate vocabulary likely to appear on the state exam with reference to the quiz questions illustrating its application. See the Real estate glossary on page 331 for the full definitions.

acceleration (q. 46)
adjustable rate mortgage (ARM) (q. 39)
amortization (q. 8)
annual percentage rate (APR) (q. 37)
assignment (q. 7)
assumption (q. 35)
balloon payment (q. 47)
beneficiary (q. 6)
beneficiary statement (q. 10)
blanket mortgage (q. 48)
CalHFA (q. 40)
CalVET (q. 11)
construction loan (q. 49)
conventional mortgage (q. 50)
debt-to-income (DTI) ratio (q. 51)
deed-in-lieu of foreclosure (q.15)
deficiency judgment (q. 16)
deflation (q. 13)
due-on clause (q. 46)
Federal Reserve (q. 14)
Federal National Mortgage Association (FNMA) (q. 23)
foreclosure (q. 5, 19, 30)
government loan programs (q. 22)
graduated payment mortgage (q. 41)
hard money loan (q. 42)
home equity line of credit (HELOC) (q. 52)
hypothecate (q. 3)
impound account (q. 24)
inflation (q. 25)
interest rate (q. 26, 27)
loan brokerage (q. 28)
mortgage insurance premium (MIP) (q. 53)
negative amortization (q. 54)
notice of default (NOD) (q. 7)
open-ended mortgage (q. 43)
points (q. 9)
prepayment penalty (q. 55)
private mortgage insurance (PMI) (q. 56)

Key Terms cont'd

Real Estate Settlement Procedures Act (RESPA) (q. 31)
reconveyance (q. 12)
redemption (q. 17)
Regulation Z (Reg Z) (q. 38)
reinstatement (q. 18)
release clause (q. 29)
sale and leaseback (q. 62)
seasoned loan (q. 57)
secondary mortgage market (q. 21, 33)
seller financing (q. 32)
shared appreciation mortgage (SAM) (q. 58)
short sale (q. 60)
straight note (q. 34)
subordination (q. 4, 36)
subprime mortgage (q. 59)
trust deed (q. 1)
Truth-in-Lending Act (TILA) (q. 37)
usury (q. 44)
warehousing (q. 28)
wraparound mortgage (q. 61)

✓ *Note: This section is designed to give you a broad understanding of the basic principles which relate to the subject matter of this chapter. However, it is not exhaustive. For further reading on this concept, see your Real Estate Finance licensing course materials.*

JUST THE FACTS

General concepts

Property owners and lenders have *conflicting demands*:

- **owners** invest in real estate for shelter and income; and
- **lenders** invest in mortgages based on the real estate's value as security.

The owner's objectives are *long-term capital growth* and an annual return on their **equity** in the property they own. Alternatively, lenders seek an interest income portfolio yield, payable either directly from the property's rental income or the value of the owner's use of the property, called **implicit rent**.

The **Federal Reserve (the Fed)** is the central bank in control of regulating the U.S. financial and monetary system. Thus, the Fed plays an integral role in the overall economic and financial health of the nation. The Fed's mandate is to keep the economy stable. It fulfills this task by maintaining sufficient dollars in circulation as our nation's medium of exchange, and in doing so, maintaining both job and price stability.

Purchasing power refers to a homebuyer's ability to purchase property funded by mortgage money based on 31% of their gross income for mortgage payments and current interest rates. A buyer's **debt-to-income ratio (DTI)** has two components: the *front-end DTI ratio* is the percentage of a buyer's monthly pre-tax gross income spent on housing costs; the *back-end DTI ratio* is the percentage of the buyer's income spent monthly on all debt payments. Together, lenders use a borrower's DTI to determine whether they qualify for a loan.

Sources of financing

Most real estate sales hinge on financing some portion of the purchase price. In these **purchase-assist** mortgage financing arrangements, a lender generally funds the buyer's purchase price.

In exchange for the mortgage, the buyer promises to pay a sum of money to the lender either in:

- installments; or
- a single payment at a future time.

Alternatively, **seller financing,** also known as an **installment sale**, **credit sale** or **carryback financing,** occurs when a seller carries back a note and trust deed executed by the buyer to evidence a debt owed for purchase of the seller's property. The amount of the debt is the remainder of the price due to the seller after deducting:

- the down payment; and
- the amount of any existing or new mortgage used by the buyer to pay part of the price.

A **senior mortgage**, also known as a **senior lien** or **first mortgage**, is the first loan against a property and has priority.

A **junior mortgage**, also known as a **junior lien** or **second mortgage**, is the second or subsequent loan on a property in a lesser, subordinate position. For example, a *home equity line of credit (HELOC)* is generally in a second position.

The **portfolio yield**, also known as the **mortgage yield**, is any earnings from fees or interest on a mortgage realized by a mortgage holder, such as lender or carryback seller.

An **impound account**, also called an **escrow account,** is a money reserve of a property owner's funds received and held by a mortgage holder to pay the owner's annual obligations owed for property taxes, hazard insurance premiums, assessment liens and improvement bonds.

Mortgages/deeds of trust/notes

The promise to pay the debt is set out in a written document called a **promissory note**. A *promissory note* is a document given as evidence of a debt owed by one person (the borrower/debtor/payor) to another (the lender/carryback seller/payee).

A *note* documents the terms for repayment of a mortgage, including:

- the amount of the principal to be paid;
- the interest rate charged on the remaining principal;
- the periodic payment schedule; and
- any due date.

A note may be **secured** or **unsecured**. A *secured note* is a note evidencing debt which is backed by an asset, known as the **security** or **collateral**. The note is attached to property as a lien on title through the use of a *security device*.

If the note is secured by real estate, the security device used is a **trust deed,** commonly called a **mortgage**. When secured, the debt evidenced by the note becomes a voluntary lien on real estate described in the *trust deed* that references the note.

Promissory notes are categorized by the method for repayment of the debt as either:

- **installment notes**; or
- **straight notes**.

An *installment note* calls for periodic payments of principal and interest (or interest only) until the principal is paid in full by **amortization** or a **balloon payment**.

Amortization refers to the constant periodic payment of principal until the principal has been fully repaid. A *balloon payment* is any final payment on a note which is greater than twice the amount of any one of the six regularly scheduled payments immediately preceding the date of the balloon payment.

To secure payment of the debt by a parcel of real estate, the *security device* used is a **trust deed**. The *trust deed* is always the preferential method used to impose a **lien** on real estate.

The *lien* gives the lender or carryback seller the right to foreclose on the real estate if the borrower defaults.

The trust deed identifies three parties, each of whom has distinctly separate roles in the mortgage transaction:

- the borrower/owner (**trustor**) who voluntarily encumbers their property with the trust deed lien;
- the middleman (**trustee**) who holds the power of sale to auction the property; and
- the lender or carryback seller (**beneficiary**) who benefits from the trust deed lien encumbering the property.

The trustor who signs and delivers a trust deed to a lender or carryback seller is the *owner* of the real estate interest encumbered. Delivery is accomplished by recording the trust deed with the **county recorder**, which *perfects* its priority on title.

Types of loans

An **installment note** produces a schedule of constant periodic payments which amortize the principal. In doing so, the constant amount of scheduled payments contains diametrically varying amounts of principal and interest from payment to payment. With each payment, the amount of principal reduction increases and the amount of interest paid decreases. The *installment note* is the standard type of loan for consumer mortgage financing.

A **straight note** calls for the entire amount of its principal together with accrued interest to be paid in a single lump sum when the principal is due. Unlike in the installment note variation, a *straight note* does not include periodic payments of principal.

A note with a fixed interest rate, commonly called a **fixed rate mortgage (FRM)**, provides the classic method for calculating interest that accrues on principal. With an *FRM,* the interest rate remains fixed for the life of the mortgage.

However, variations on the interest rate and repayment schedules contained in the installment and straight notes exist:

- **adjustable rate mortgage (ARM);**
- **graduated payment mortgage (GPM);**
- **all-inclusive trust deed (AITD) note;** and
- **shared appreciation mortgage (SAM)**.

The *ARM*, as opposed to an FRM, calls for periodic adjustments to the interest rate. In turn, the amount of the scheduled payments fluctuates with each interest rate adjustment based on movement in an agreed-to index.

With a *GPM*, payments increase periodically by predetermined amounts until the payment fully amortizes the principal over the remaining life of the mortgage without a further increase in payments, the interest rate on the note being fixed.

The *AITD* variation of a note is common in carryback transactions. The AITD note, also known as a **wraparound** or **overriding note**, typically calls for the buyer to pay the carryback seller constant monthly installments of principal and interest. The carryback seller then pays the installments as they become due on the underlying (senior) mortgage, generally out of the payments received on the AITD note.

The *SAM* repayment schedule variation calls for the buyer to periodically pay interim interest at a fixed rate, then when the principal balance is due, to further pay the mortgage holder additional interest calculated as a fraction of the property's increased net value since origination. In return, the carryback seller receives part of the property's appreciated value as additional interest, called **contingent interest**, when the property is sold or the carryback SAM is due.

When a debt secured by a trust deed lien on real estate has been fully paid, the lien is removed from title in a process called **reconveyance**.

Private mortgage insurance (PMI) is default mortgage insurance coverage provided to a mortgage holder by private insurers on conventional mortgages with **loan-to-value (LTV)** ratios higher than 80%. *LTV* is a ratio stating the outstanding mortgage balance as a percentage of the mortgaged property's fair market value (FMV). Thus, *PMI* indemnifies a mortgage holder against losses on their investment in a mortgage when a borrower defaults.

Generally, an acceptable *LTV* for conventional mortgages is 80% of the property's value. An LTV of 80% requires the buyer to make a minimum 20% down payment. A greater LTV compels the lender to require the buyer to obtain PMI.

Promissory notes typically contain a **late charge provision**. The *late charge provision* calls for an additional charge if payment is not received by the mortgage holder when due or within a **grace period** after which the payment is delinquent. Also, the **minimum grace period** before a mortgage encumbering an owner-occupied, one-to-four unit residential property is delinquent is *ten days* after the due date without receipt of the payment.

Related to the note and trust deed is the **land sales contract**, also known as a **conditional sales contract**, **installment sales contract** or **real property sales contract**. Under a *land sales contract*, a buyer and seller enter into a contract for the sale of property. The buyer takes possession of the property and makes payments according to the terms of the contract. Title does not formally pass to the buyer by grant deed until the buyer pays the seller in full.

On the sale of a parcel of real estate, existing financing encumbering the property sometimes remains of record and is taken over by a buyer. The buyer generally takes title to the property under one of two procedures:

- a **formal assumption** between the mortgage holder and the buyer; or
- a **subject-to assumption** between the seller and the buyer.

A *formal assumption* is a buyer's promise to perform all the terms of the mortgage, given to the mortgage holder on the buyer's takeover of an existing mortgage, typically involving a modification of the interest rate and payments and an assessment of points and fees.

A *subject-to assumption agreement* is a promise given by the buyer to the seller to perform all the terms of a mortgage taken over by the buyer on the property purchased.

Government programs

A variety of state and federal loan programs exist, offering down payment assistance for low- to moderate-income buyers and first-time buyers, mortgage refinance or modification programs to distressed owners, and special programs for veterans.

Federal programs

Federal Housing Administration (FHA)-insured mortgage: The FHA insures lenders against loss for the full amount of a mortgage. FHA-insured mortgages permit small cash down payments and higher **LTV** requirements than mortgages originated by conventional lenders.

U.S. Department of Veterans Affairs (VA) mortgage guarantee: The VA mortgage guarantee program assists qualified veterans or their surviving spouses to buy a home with zero down payment.

Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac) and **Government National Mortgage Association (Ginnie Mae):** *Fannie Mae*, *Freddie Mac* and **Ginnie Mae** are *government-sponsored enterprises (GSEs)* designed to help facilitate home purchases for low- to moderate-income buyers. Fannie Mae and Freddie Mac do not provide home mortgages directly. Instead, they purchase and package pools of qualifying mortgages originated by mortgage bankers, known as **conforming mortgages**, as *mortgage-backed bonds (MBBs).* They then sell the MBBs to Wall Street Bankers on the secondary mortgage market.

State programs

California Housing Finance Agency (CalHFA): *CalHFA* administers several first-time homebuyer assistance programs, offering 30-year FRMs with interest rates and fees typically lower than conventional financing.

California Department of Veterans Affairs (CalVet): *CalVet* provides a veteran with a mortgage at a rate generally below market, low monthly payments and flexible credit standards, as compared to conventional financing or mortgages insured by the FHA or guaranteed by the VA. A CalVET buyer finances the property with a contract of sale.

California Department of Housing and Community Development (HCD): HCD programs fund local public agencies and private entities which produce affordable housing for rental or ownership.

Financing/credit laws

The **Real Estate Settlement Procedures Act (RESPA)** is a federal law promoting lender transparency in their mortgage origination process to protect consumers from **kickbacks** and uncompetitive or **duplicated fees.** *RESPA* mandates lenders and mortgage holders disclose all mortgage related charges on mortgages used to purchase, refinance or improve one-to-four unit residential properties.

Mortgage related charges include:

- origination fees;
- credit report fees;
- insurance costs; and
- prepaid interest.

RESPA is administered and enforced by the **Consumer Financial Protection Bureau (CFPB).**

A RESPA-controlled lender provides the buyer with:

- a **Loan Estimate** of all mortgage terms quoted by the lender within three business days of the lender's receipt of the buyer's mortgage application;
- a **special information booklet** published by the CFPB to help the buyer understand the nature and scope of real estate settlement costs within three business days after the lender's receipt of the buyer's application;
- a **Closing Disclosure**, which summarizes the "final" mortgage terms and details, provided by the lender at least three days before the consumer closes on the mortgage; and
- a list of **homeownership counseling organizations**.

The *Loan Estimate* under the **TILA-RESPA Integrated Disclosure (TRID)** rules replaces the previously required **good faith estimate (GFE)** of settlement costs and **Truth-in-Lending Act (TILA)** disclosure.

Similarly, the *Closing Disclosure* replaces the **HUD-1 Settlement Statement** and the final Reg Z. disclosure. The Closing Disclosure contains the actual terms and costs incurred in the transaction, which is then compared by the borrower against the Loan Estimate form. If the amounts paid by the borrower at closing exceed the amounts disclosed in the Loan Estimate by more than the set tolerances, the excess is to be refunded to the borrower within 60 days of closing.

The **Equal Credit Opportunity Act** is a federal law enacted in 1974 prohibiting discrimination in lending based on race, color, religion, national origin, sex, marital status or age (provided an individual is of legal age). The anti-discrimination rules apply to institutional lenders, loan brokers, and others who *make or arrange loans.*

California's **usury law** limits the interest rate on *non-exempt* real estate loans to the greater of:

- 10%; or
- the discount rate charged by the Federal Reserve Bank of San Francisco, plus 5%.

Usury laws apply only to a **loan of money** or the **forbearance of payment** on a money loan. Thus, seller carryback notes are not covered by usury law.

Loan brokerage

The 2008 **Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act)** created a uniform national licensing scheme for **mortgage loan originators (MLOs)** and the **Nationwide Mortgage Licensing System and Registry (NMLS)** for registering MLOs.

The SAFE Act applies to **residential mortgages**.

To implement the SAFE Act, the Department of Real Estate (DRE) and the NMLS work together.

The DRE sets the minimum standards for DRE licensees who arrange consumer mortgages for a fee as MLO endorsees.

The NMLS:

- processes MLO applications;
- assigns unique NMLS ID numbers; and
- administers the national MLO registry.

DRE licensees are required to obtain an MLO endorsement and unique NMLS ID when they:

- take an application for or negotiate a residential mortgage loan, an activity called **arranging**; and
- they receive fees for arranging the residential mortgage loan.

Types of loan originators

When applying for a mortgage, a buyer has several types of lenders to choose from, including:

- **portfolio lenders**, such as banks, thrifts and credit unions;
- **institutional lenders**, such as insurance companies and trade association pensions; and
- **warehousing lenders**, such as mortgage bankers who resell the mortgage in the secondary mortgage market.

While *portfolio* and *institutional* lenders typically service their own mortgages, they often originate mortgages for immediate sale in a process called warehousing.

Warehoused mortgages are sold on the secondary mortgage market to investment pools, such as **Fannie Mae, Freddie Mac and Ginnie Mae.**

The business of servicing mortgages is also bought and sold. This causes the mortgage to appear to be changing hands. Typically, the originating lender continues to service the mortgage when they sell the mortgage to an investor.

Default and foreclosure

When a mortgage is in default, a mortgage holder may foreclose on a property in one of two ways:

- **judicial foreclosure**, under mortgage law, also called a **sheriff's sale**; or
- **nonjudicial foreclosure**, under the **power-of-sale provision** in the trust deed or other security device, also called a **trustee's sale**.

Judicial foreclosure is the court-ordered sale by public auction of the secured property. A judicial foreclosure allows the mortgage holder to obtain a money judgment against the property owner for any deficiency in the value of the mortgaged property to fully satisfy a **recourse debt**, as occurs on a **negative equity** property.

The public sale held by a court-appointed receiver or sheriff is conducted as an **auction**. A **certificate of sale** is issued to the successful bidder on the completion of a judicial foreclosure sale.

Although the bidder purchased the property at the public auction, they will not become the owner of the property or be able to take possession of it until the applicable **redemption period** expires.

On a judicial foreclosure, the property owner has **three months** after the judicial sale to redeem the property by paying off the entire debt and costs.

However, if the owner is liable on a recourse debt for a deficiency in the property's value, the owner has up to **one year** after the judicial sale to redeem the property.

Further, a junior trust deed holder may **reinstate** the note by paying the trust deed delinquencies and foreclosure costs, bringing the trust deed note current. The junior lienholder has until the time the property is sold at the judicial foreclosure sale to redeem the property.

Once a property is sold at a judicial foreclosure sale, any liens subordinate to the foreclosing mortgage holder's trust deed are wiped out and eliminated from the title.

The *judicial foreclosure* process can last from eight months to multiple years before it is completed.

Alternatively, when a mortgage holder *nonjudicially forecloses* by a trustee's sale, the property is sold as authorized by the trust deed provisions at a public auction, called a **trustee's sale**.

Unlike a judicial foreclosure sale, the completion of a trustee's sale bars the foreclosing mortgage holder from obtaining a money judgment for any unpaid balance remaining after the foreclosure sale due to *insufficient value* in the secured property.

The nonjudicial foreclosure process has three stages:

- the **notice of default** (**NOD)** is recorded and mailed;
- the **notice of trustee's sale (NOTS)** is recorded, posted and mailed; and
- the **trustee's sale** of the real estate by auction occurs, followed by the execution of the trustee's deed and distribution of sales proceeds.

A first mortgage on a homeowner's principal residence needs to be at least 120 days delinquent before the mortgage holder may cause an NOD to be recorded. A trustee needs to wait at least three months after recording an NOD before posting the NOTS.

After an NOD is recorded and prior to five business days before the trustee's sale, the owner is able to terminate the foreclosure proceedings by paying:

- the *delinquent amounts* due on the mortgage as described in the NOD and foreclosure charges, called **reinstatement**; or
- the *entire amount* due on the mortgage, plus foreclosure charges, called **redemption**.

On average, it takes approximately four months to nonjudicially foreclose on a property, though this can be longer when mortgage holders are inundated with a high volume of foreclosures to process.

Alternatively, when a property owner with *negative equity* defaults, a mortgage holder may first attempt to arrange for a **deed-in-lieu of foreclosure** before initiating a trustee's foreclosure. A *deed-in-lieu* is a grant deed conveying the mortgaged real estate to a mortgage holder which is accepted from the property owner in exchange for cancelling the mortgage debt to avoid foreclosure.

Exam Jargon

Specialized real estate terminology related to financing. See the Real estate glossary on page 331 for the full definitions.

cramdown
implicit rent
intermediation
negative equity
nonrecourse mortgage
REO property
recourse
shadow inventory
teaser rate
tranches

SAMPLE QUESTIONS

1. A second trust deed can be distinguished from a first trust deed by:
   a. the heading of the instrument.
   b. the information contained in the note.
   c. the time and date of recording.
   d. agreement of the principals.
2. All of the following are NOT true regarding promissory notes, except:
   a. They are used as security for trust deeds.
   b. Discounting a note indicates it is being sold at more than the face value, or the amount still owing on the principal.
   c. They are always used when real state is sold.
   d. They are the evidence of the debt.
3. Hypothecate means:
   a. to give a thing as security without giving possession.
   b. to sell.
   c. to substitute.
   d. to alienate.
4. Who generally benefit the most by a subordination clause in a trust deed?
   a. The beneficiary.
   b. The trustor.
   c. The trustee.
   d. The county tax assessor.
5. Total foreclosure time under a trustee's sale on a trust deed is minimally:
   a. one year.
   b. fifteen months.
   c. three months.
   d. four months.
6. The beneficiary of a trust deed is most likely a:
   a. buyer.
   b. bank.
   c. trustee.
   d. borrower.
7. A clause in a trust deed calling for an assignment of rents most benefits the:
   a. trustee.
   b. trustor.
   c. purchaser.
   d. beneficiary.
8. On each payment of an amortized loan:
   a. the same amount applies to principal each month.
   b. there will be a balloon payment.
   c. the amount applying to the principal increases with each payment.
   d. the amount applying to the interest increases with each payment.

9. Which of the following are most related to each other?
   a. Taxes and insurance.
   b. Points and interest.
   c. Assessment and book value.
   d. Interest and taxes.
10. In the context of mortgage finance, a beneficiary statement is made:
    a. to designate the person who will receive the property in the event of the borrower's death.
    b. by the insurer, stating the amount that will be paid to the policyholder if the improvements are destroyed.
    c. by the lender to state the current balance required to pay off a real estate loan.
    d. by the homeowner, listing the beneficial features of an assumable loan.
11. A CalVET buyer finances the property with a:
    a. trust deed and note.
    b. contract of sale.
    c. mortgage.
    d. lease with an option to purchase.
12. When the debt has been paid in full, the trustee will record what legal instrument to remove the lien on a trust deed from the public record?
    a. Statement of complete release.
    b. Satisfaction of payment.
    c. Redemption certificate.
    d. Reconveyance deed.
13. In a period of deflation:
    a. the value of money increases.
    b. profits increase.
    c. the gross national product increases.
    d. the value of commodities increase.
14. When the Federal Reserve (the Fed) increases the reserve requirements, referred to as tight money policy, it will:
    a. result in more construction starts.
    b. increase the supply of funds available for making real estate loans.
    c. reduce deflationary pressures.
    d. decrease loan activity.
15. If a lender accepts a deed-in-lieu of foreclosure, the lender:
    a. also receives a power of sale from the trustor.
    b. takes ownership of the property free and clear of all liens.
    c. goes to court and get a deficiency judgment.
    d. assumes any junior liens.
16. Gale is the beneficiary of a $1,500,000 deed of trust on a single family home. Frank, the trustor, made $200,000 in payments before going into default. At the trustee's sale, the property sold for $1,000,000, resulting in a $300,000 deficiency. In California, a deficiency judgment cannot be obtained:
    a. if the security is a purchase money trust deed.
    b. if foreclosed through a trustee's sale.
    c. if the fair market value (FMV) of the property exceeds the amount due on the trust deed.
    d. Any of the above.
17. When a borrower defaults on a loan and the lender initiates judicial foreclosure, the right of possession to the property is held by the ____________________ during the redemption period.
    a. mortgagee
    b. commissioner designated by the court
    c. mortgagor
    d. sheriff

18. An owner's right to bring current any monetary or curable default stated in the notice of default (NOD) prior to five business days before the date of the sale is called:
    a. refurbishment.
    b. rejuvenation.
    c. reinstatement.
    d. redemption.
19. Bruce sold his home for $215,000 to Maria and carried back a $150,000 note with interest at 6% per annum. The note was secured by a first trust deed. The home had a fair market value (FMV) of $200,000. Later, Bruce sold the trust deed and note at a discounted price of $135,000 to Syndi. On the back of the note, Bruce wrote, "I hereby assign the within note to Syndi without recourse." If Maria defaults before any principal payments are made, Syndi's best legal remedy is to:
    a. foreclose to recover the $135,000 investment.
    b. do nothing since she has no recourse as an investor who purchased an existing loan and has no right to foreclose.
    c. sue her assignor.
    d. foreclose to enforce payment of the $150,000.
20. The power to sell a property in the event of a default under the terms of the trust deed is given by:
    a. trustee to the trustor.
    b. buyer to the beneficiary.
    c. buyer to the seller.
    d. trustor to the trustee.
21. All of the following entities buy loans in the secondary mortgage market, except:
    a. Freddie Mac.
    b. Ginnie Mae.
    c. Fannie Mae.
    d. Federal Housing Administration (FHA).
22. Which of the following loans would be most likely to qualify for Federal Housing Administration (FHA) insurance but not for a Veterans Administration (VA) loan guarantee?
    a. A loan to fund the purchase of agricultural land.
    b. A loan to fund the purchase of one-to-four units of residential rental property.
    c. A loan to fund the purchase of a motel.
    d. A loan to fund the purchase of an existing business.
23. The primary purpose behind the creation of the Federal National Mortgage Association (FNMA) was:
    a. to increase the money available to housing.
    b. to provide funds to large home builders in urbanized areas.
    c. to lend money on FHA Title II loans when banks, savings and loan associations, or private lenders are unwilling to do so.
    d. to supervise public lending agency associations.
24. In real estate loans, the term "impounds" most nearly means:
    a. attachments.
    b. reserves.
    c. court action.
    d. short rate.
25. Inflation can be seen in the:
    a. increase in the cost of living.
    b. reduction of interest rates.
    c. existence of tight monetary policy.
    d. tightening of loan policies.

26. Marta borrowed $25,000 on a straight note. In eight months, she paid $1,500. What was the interest rate:
    a. 8%.
    b. 9%.
    c. 10%.
    d. Cannot be calculated.
27. All of the following directly affect the level and movement of mortgage interest rates, except:
    a. demand for funds.
    b. supply of funds.
    c. inflation rate.
    d. unemployment rate.
28. The term warehousing in reference to mortgage financing describes:
    a. industrial property loans.
    b. jumbo residential loans.
    c. a mortgage broker who arranges loans for an individual borrower.
    d. a mortgage broker who packages loans prior to their sale on the secondary market.
29. The release clause in a trust deed is there to release:
    a. the escrow company of liability.
    b. a borrower from certain obligations.
    c. the lender from future obligations.
    d. some properties upon partial payment, when more than one property is used as security for the debt.
30. A homebuyer may rescind a purchase contract on a property for:
    a. 1 day.
    b. 3 days.
    c. 1 week.
    d. 10 days.
31. One of the primary purposes of the Real Estate Settlement Procedures Act (RESPA) is to:
    a. set the settlement costs in all real estate transactions.
    b. standardize the prices of settlement costs on one-to-four unit residential properties.
    c. provide consumers with enough information to enable them to effectively shop for settlement services.
    d. standardize settlement services throughout the United States.
32. Most junior loans are originated by:
    a. private sources.
    b. commercial banks.
    c. savings and loans associations.
    d. insurance companies.
33. The phrase "the secondary mortgage market" refers to:
    a. government bonds.
    b. junior trust deeds.
    c. the kind of loans made by insurance companies or pension funds.
    d. a resale marketplace for existing trust deed loans.
34. A note payable for "interest only" is called a(n):
    a. straight note.
    b. amortized loan.
    c. nonnegotiable note.
    d. hard money loan.

35. When the buyer takes title to the property subject to the existing loan, “subject to” most nearly means:
    a. both the buyer and seller will then be equally liable for the loan.
    b. the seller has no liability for the loan.
    c. only the buyer will be liable for the loan.
    d. the buyer will not be personally liable for the loan.
36. A(n) ________________ provision in a trust deed allows future loans on the property to have priority.
    a. agency clause
    b. release clause
    c. subordination clause
    d. mediation clause
37. Under the Federal Truth-in-Lending Act (TILA), the cost of credit is expressed as:
    a. a maximum percentage rate.
    b. an annual percentage rate.
    c. a minimum percentage rate.
    d. the annual interest rate.
38. Regulation Z (Reg Z) of the Federal Truth-in-Lending Act (TILA) gives the borrower a 3 day right of rescission when the loan is:
    a. a purchase money loan secured by a deed of trust on commercial property.
    b. a loan to refinance the borrower’s personal residence.
    c. a Federal Housing Administration (FHA) or Veterans Administration (VA) loan to purchase a single family, owner occupied residence.
    d. a loan to purchase a commercial building.
39. The real estate loan that allows interest rates to increase or decrease depending on money market conditions is called a(n):
    a. interim loan.
    b. secured loan.
    c. adjustable interest rate loan.
    d. fluctuating market condition loan.
40. The loan program that requires payment of mortgage insurance premiums (MIPs) and will make loan payments for up to six months if the borrower becomes involuntarily unemployed is called:
    a. Veterans Administration (VA).
    b. Federal Housing Administration (FHA).
    c. California Department of Veterans Affairs (CalVET).
    d. California Housing Finance Agency (CalHFA).
41. A graduated payment adjustable mortgage (GPAM) provides for:
    a. deferment of certain payments on the principal during the early years of the loan.
    b. the loan to be renegotiated at a later date by the mutual agreement of the borrower and lender.
    c. the loan to have several short-term loans at various interest rates embedded within it.
    d. the carryback seller to receive part of the property’s appreciated value as additional interest.
42. All of the following are NOT true concerning a hard money loan, except:
    a. It has a lower interest rate.
    b. It is a purchase money second trust deed.
    c. It is seller financing.
    d. It is a cash loan.

43. A mortgage which provides for securing the amount of the initial loan together with any sums later loaned to the mortgagor is known as a(n):
    a. installment loan.
    b. open-ended mortgage.
    c. wraparound mortgage.
    d. blanket mortgage.
44. The charging by a private lender of more than the maximum amount of interest allowed by law is known as:
    a. unearned increment.
    b. leverage.
    c. usury.
    d. onerous.
45. A buyer is most likely able to borrow 100% of the purchase price with which of the following types of financing?
    a. Federal Housing Authority (FHA).
    b. Veterans Administration (VA).
    c. Fannie Mae (FNMA).
    d. Conventional.
46. All of the following are circumstances under which a lender will generally enforce the due-on sale clause in a promissory note, except:
    a. when a new loan is made at a lower rate of interest than the existing loan.
    b. when high unemployment rates cause a glut of residences to be on the market.
    c. when deflation occurs and there are more houses for sale than there are buyers.
    d. All of the above.
47. Any final payment on a note which is greater than twice the amount of any one of the six regularly scheduled preceding payments is known as a:
    a. private mortgage insurance (PMI) premium.
    b. balloon payment.
    c. due-on clause.
    d. prepayment penalty.
48. A blanket encumbrance created for a real estate loan would most likely benefit the:
    a. trustor.
    b. trustee.
    c. beneficiary.
    d. borrower.
49. The maturity date of a construction loan begins from:
    a. the date of the note.
    b. the date construction begins.
    c. the date of the first disbursement.
    d. the date escrow is formally closed.
50. Compared to a loan insured by a government entity, a conventional loan has a:
    a. lower interest rate.
    b. lower loan-to-value (LTV) ratio.
    c. greater degree of security.
    d. longer amortization period.
51. Lenders use a debt-to-income ratio (DTI) to determine:
    a. the degree of risk they are willing to take.
    b. whether a borrower qualifies for a loan.
    c. the appraised value of a property.
    d. the title insurance fees to be charged.
52. A loan broker arranged a home equity loan for $9,600. The broker must provide the borrower with which of the following?
    a. Mortgage loan disclosure statement.
    b. Regulation Z disclosure statement.
    c. Loan balance statement.
    d. Broker closing statement.

53. The mortgage insurance premium (MIP) paid on a Federal Housing Administration (FHA) loan protects:
    a. the borrower.
    b. the FHA.
    c. Sallie Mae.
    d. the lender.
54. A negative amortizing loan allows unpaid interest to be added to the principle balance. This is an example of:
    a. compounding interest.
    b. double interest.
    c. simple interest.
    d. flexible interest.
55. A prepayment penalty is the opposite of a(n):
    a. alienation clause.
    b. "or more" clause.
    c. choice-of-law provision.
    d. mediation provision.
56. In real estate financing, the acronym "PMI" means:
    a. point margin indicator.
    b. private mortgage insurance.
    c. Professional Maintenance Institute.
    d. Property Managers Incorporated.
57. A "seasoned" loan is a(n):
    a. short-term due date for a balloon payment.
    b. quality loan.
    c. loan made at the beginning of spring.
    d. loan in which there is a record of consistent and timely payments made on the loan.
58. A shared appreciation mortgage (SAM) is most beneficial when:
    a. prices of homes are steadily appreciating.
    b. a reverse mortgage is considered.
    c. a rollover or takeout loan is needed.
    d. prices of homes are declining.
59. A lender most likely to make a loan to a borrower with a FICO score of 500 would be:
    a. the Federal Housing Administration (FHA).
    b. a subprime lender.
    c. an institutional bank.
    d. savings and loan association.
60. The sale of property in which the amount of the net proceeds is less than the principal balance owed but is accepted by the lender in full satisfaction of the loan is called a(n):
    a. reverse mortgage.
    b. short sale.
    c. deed-in-lieu of foreclosure.
    d. piggyback sale.
61. An all-inclusive trust deed (AITD), also known as a(n) ______________, reduces the seller's risk of loss and defers more profit taxes than a regular second trust deed note.
    a. mortgage commitment
    b. wraparound mortgage
    c. land sales contract
    d. equity purchase agreement
62. The buyer in a sale leaseback transaction would be least concerned with the:
    a. original cost to construct the building.
    b. general credit of the lessee.
    c. condition of the improvements.
    d. location of the property.

ANSWER KEY

1. **c —** The **priority** of trust deeds is determined by the time and date of recording.
2. **d —** Promissory notes are the evidence of debt. Trust deeds are security for debt. Though promissory notes and trust deeds are frequently used as the loan instruments, there are alternatives, such as a land sales contract. Note when the word "always" appears in an answer choice, one exception defeats its accuracy.
3. **a —** To **hypothecate** is to offer property (real or personal) as security for a loan without giving up possession.
4. **b —** The borrower (trustor) benefits the most from a subordination clause since this makes it easier to obtain an additional loan on their property. For example, the buyer of vacant land can obtain a construction loan more easily if the loan against the land will be subordinated to the construction loan.
5. **d —** A trustee's sale includes a three month **redemption period** followed by three weeks of advertising the sale for a total just short of four months if the sale is processed without any delay. In practice, it is generally longer.
6. **b —** The **beneficiary** is the lender. Therefore, the only answer selection that applies is the bank.
7. **d —** An assignment of rents clause allows the lender to collect the rents on an income-producing property when the borrower defaults on the underlying loan.
8. **c —** With an **amortized loan**, whether fully or only partially amortized, the balance of the loan is reduced with each payment. Therefore, the interest portion of the payment decreases and the principal portion increases with each payment made.
9. **b —** While all answer selections relate to one another, **points and prepaid interest** are synonymous, making this answer selection the best match.
10. **c —** A lender (beneficiary) delivers a **beneficiary statement** to escrow as a statement of required funds to release the existing debt.
11. **b — CalVET** loans are land contract purchases with the state functioning as the vendor.
12. **d —** A trustee records a **reconveyence deed** to release a trust deed.
13. **a — Deflation** is the opposite of inflation where money becomes worth less.
14. **d —** The tightening of money allows less money to be available for lending, resulting in a decrease of loan activity.
15. **d —** When the holder of the first trust deed accepts a **deed-in-lieu**, they become responsible for all liens junior to their position.
16. **d —** A **deficiency judgment** cannot be obtained through any of the provided answer selections. For example, a deficiency judgment cannot be obtained if the security is a purchase money trust deed (answer selection A). A mortgage holder must use the **judicial foreclosure** option rather than a trustee's sale to receive a deficiency judgment (answer selection B). If the fair market value (FMV) of the property exceeds the amount due on the trust deed, no deficiency would exist (answer selection C).
17. **c —** The borrower (mortgagor) has possession during the redemption period.
18. **c —** When full payment of arrears and costs have been made, the loan has been **reinstated**, bringing the loan current and placing the borrower in good standing.

19. **d** — The demand would be on Maria for the full amount of the monies owed regardless of the discounted price paid for the note.
20. **d** — It is the borrower (trustor) who gives the authority to sell to the trustee.
21. **d** — The **Federal Housing Administration (FHA)** is neither the lender nor purchaser of loans on the secondary mortgage market. The FHA acts as an insurer of the loan which is originated by a lender or mortgage company.
22. **b** — While neither the Federal Housing Administration (FHA) or Veterans Administration (VA) will guarantee properties intended for business (motel or agriculture included), FHA will do small residential rentals (one-to-four units).
23. **a** — The **Federal National Mortgage Association (FNMA)** was created to repurchase qualifying loans, thus placing cash in the lenders' hands to facilitate a continuing source of monies to loan.
24. **b** — When a lender requires **impounds**, they are demanding that monthly payments be made to establish a reserve fund to pay future property tax and insurance expenses.
25. **a** — **Inflation** is the reverse of deflation. Therefore, money becomes worth less and products become more expensive.
26. **b** — This question calls for an interest rate calculation using the following formula: Interest = Principal x Rate x Time (I = PRT).

    $1,500 = $25,000 x R x 8/12

    1,500 = 25,000 x R x 0.667

    1,500 = 16,667 x R

    1,500 / 16,667 = (16,667 x R) / 16,667

    0.09 = R or 9%

27. **d** — Supply and demand affects the return a lender can charge on a loan. Inflation is a risk factor that a lender adds to the yield required to fund. Unemployment indirectly influences the level and movement of mortgage interest rates through actions of the Federal Reserve (the Fed).
28. **d** — **Warehousing** in finance is similar to a retailer concept. Mortgage brokers bundle loans for sale on the secondary market.
29. **d** — When several properties are securing one loan, known as a **blanket mortgage**, a release clause allows individual properties to be withdrawn from the obligation.
30. **b** — The statutory right to rescind certain contracts runs for a three day period starting from the date the contract is entered into.
31. **c** — While standardizing costs may seem likely a reasonable goal, the **Real Estate Settlement Procedures Act (RESPA)** is primarily intended to insure that consumers are not being charged hidden fees and have the information they need to make an educated decision between competing lenders.
32. **a** — Junior loans typically are originated by private sources – most often the seller of the property who extends carryback financing to the buyer.
33. **d** — Don't confuse "second trust deed" with "secondary mortgage market." The **secondary mortgage market** is where lenders resell bundled loans.
34. **a** — Interest only loans are those that are not amortized as payments are not applied to the underlying principal.

35. **d —** As opposed to assuming a loan, when the buyer takes title "subject to" an existing loan, the seller remains liable for the debt.
36. **c —** To subordinate a loan indicates the loan is to take a secondary position. In finance this implies that future loans will have a priority over the subordinated loan.
37. **b —** Financing costs are stated as an **annual percentage rate (APR)**.
38. **b — Regulation Z (Reg Z)** of the **Federal Truth-in-Lending Act (TILA)** applies to one-to-four unit residential properties, therefore answer selections A and D do not apply. Further government loans have their own restrictions.
39. **c —** An adjustable interest rate loan, also known as an **adjustable rate mortgage (ARM)**, allows for interest rate fluctuations based on changes in an agreed to index.
40. **d —** Only the **California Housing Finance Agency (CalHFA)** offers a loan program on these terms.
41. **a —** The unique quality to a **graduated payment adjustable mortgage (GPAM)** is the fact that payments are increased periodically over the life of the loan, making it lower in the early years.
42. **d — Hard money** loans are made by a private lender to generate cash for a property owner.
43. **b —** An open-ended loan is one that allows for future advanced monies as part of the original commitment, such as a home equity line of credit (HELOC).
44. **c — Usury** is the term that describes an interest rate that exceeds the legal limit.
45. **b —** The Federal National Mortgage Association (FNMA) is not a primary lender and neither conventional nor Federal Housing Administration (FHA) lenders have programs that generally allow the borrower to borrow 100% of the purchase price.
46. **d —** All these conditions make it less likely a lender would want to accelerate the loan by enforcing the **due-on clause**.
47. **b —** Any loan that is not fully amortized will require a **final/balloon payment** of the balance owing.
48. **c —** A **blanket encumbrance** gives the lender (the beneficiary) added security for the loan.
49. **a —** The date on the note establishes the beginning of the maturity process.
50. **b — Conventional loan** programs generally require a lower loan-to-value ratio.
51. **b —** The **debt-to-income ratio (DTI)** sets the amount of debt a borrower can carry in relation to their income. A higher DTI represents a higher degree of risk of borrower default.
52. **a —** A lender who originates a **home equity line of credit (HELOC)** is required to deliver a copy of the mortgage loan disclosure statement to the borrower.
53. **d —** The **mortgage insurance** required for Federal Housing Administration (FHA)-insured loans are for the protection of the lender.
54. **a — Compounding interest** causes an additional cost of the interest expense on the interest not paid.
55. **b —** A **prepayment penalty** imposes a charge on the borrower for paying off the debt early. With an 'or more' clause, the borrower is allowed to prepay the loan at any time with no penalty.
56. **b —** PMI is the acronym for **private mortgage insurance** paid to a private mortgage insurer. Alternatively, a **mortgage insurance premium (MIP)** is paid on a government-insured loan.

57. **d —** A **seasoned loan** has a consistent history of loan repayment. An investor may feel more inclined to purchase a seasoned loan as they are confident the borrower will continue to make the required payments.
58. **a —** Steady home price appreciation makes the **shared appreciation mortgage (SAM)** in which the lender receives a share in the future increase in the value of a property a valid choice for both the lender and the borrower.
59. **b — Subprime lenders** are those that make loans to less qualified borrowers and will hold the loans they originate.
60. **b — Short sales** are those where a lender has accepted as full consideration sale proceeds that are short of the amount owed.
61. **b —** Another name for an **all-inclusive trust deed (AITD)** is a **wraparound mortgage**.
62. **a —** In any purchase, the original cost of the construction is of least importance.