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The "Beyond the Rate" podcast series is provided as a service to those who wish to educate themselves on mortgages and the mortgage industry. This information represents my opinions and understanding of mortgage-related topics, and it mirrors the advice I give to clients everyday. Generalizations are made to simplify complex issues. All generalizations have exceptions. The intent is to provide insights, not absolute coverage. This information is provided free of charge. No liability is assumed.

Beyond the Rate – Chapter 8

Is anyone telling the TRUTH in the mortgage business??

Hello and welcome to Beyond the Rate, a series of podcasts that are designed to educate the listener on the world of finance and in particular, the mortgage business. This is Chapter 8 and we'll go through the entire loan signing process. There's a lot of paper involved and we'll point out which forms are most important and what to look for.

My name is Patrick and I'm a Mortgage Banker here in the San Francisco Bay Area. I'm your host and I really encourage you to subscribe to this series for an informative and detailed account of how the mortgage industry operates and how to navigate through all the confusing programs and deceptive marketing techniques being used by some of today's Mortgage Brokers.

Please note that the text versions of these podcasts are now available for free download at my website at www.beyondtherate.com along with a bunch of related materials and resources. You can also sign up for my monthly email newsletter and/or a quarterly mailer at the site.

Okay. So, signing loan documents can be intimidating even for the most seasoned real estate professional. But things are even worse today because most Title Companies offer their clients the convenience of having a mobile notary bring the loan documents to their homes to get signed. That means the Escrow Officer is nowhere to be seen and most notaries don't know enough about the process to answer peoples' questions. Without any way of getting clear answers, the signing process has become even more frightening than before.

Well, as usual, a little knowledge goes a long way to reduce the fear factor. Certain forms are more important that others and an educated borrower can quickly establish if the documents meet their expectations or not. Unfortunately, it's not uncommon for Mortgage Brokers to change little (and sometimes not so little) things right at the end of the process and many people end up with surprises when it's clearly too late to make changes.

I should know. Before doing loans, I had a signing service and did hundreds of signings in peoples' homes and offices. When I would show up, I would always start out as the enemy. These people would look at me with such suspicion and distrust, like I was part of a conspiracy trying to rip them off. Truth be told, it was that experience that motivated me to take the approach I've chosen in the mortgage business. I believe there's a real need for open and honest communication in this business and most people are starving for a reality check. I hope this podcast series provides that.

Anyway, I used to always start out by showing the borrowers the most important documents and explaining what to look for. I'd ask them if the numbers corresponded with what they'd been told by their Mortgage Broker. If they didn't, I'd tell them what courses of action they had available and what it would probably cost them to pursue it. As soon as we'd get through those first few documents, they'd know I was on their side and was only trying to help them understand the forms in front of them.

So let's look at the specifics. There are two forms in California loan packages that are more important than all the others; the Estimated Closing Statement and the Note itself. If everything's right on those two forms, the rest of the package will probably be fine as well.

The Estimated Closing Statement is usually at the very top of the stack. It's compiled by the Title Company so it'll have the name and contact information of the Title Company on the top of the page. It's usually on legal-sized paper and details all the costs and fees associated with the transaction. In most cases, there will be two columns going down the right-hand side of the page; one for debits and the other for credits.

You can think of the far right-hand column as the 'source of funds' and the left column as the 'use of funds'. So your new loan amounts will be listed on the right-hand side, along with any deposits or credits issued along the way. On the left-hand side, it will show either the old loans being paid off (for a refinance) or the money going to the seller of the property (for purchase transactions).

The left-hand column will also list all the fees of the transaction. These fees should closely correspond to the fees listed on the original Good Faith Estimate provided by your Mortgage Broker. You should immediately look at these fees to see if there's something there you didn't expect. Keep in mind that this list is the most recent and most reliable estimation of the final closing figures, and there are often unforeseen details that only pop up at this final stage. Some of those details come up through the title report. If there are delinquent property taxes on record, for example, they'll have to get paid. There may be another lien on the property or the next tax installment might be due. These examples are clearly unavoidable but there are others that may have been added at the last minute to boost profitability either for the Mortgage Broker or the Title Company. These are the things you need to be wary of.

The Estimated Closing Statement will usually be broken down into two main sections; lender fees and title & escrow fees. All of the fees charged by OR through the lender will be listed in the first section. This is where you want to look out for the agreed upon origination fees and any points you decided to purchase. These fees are discussed in Chapter 5. You also want to look out for inflated processing fees or other unexpected "junk fees" like administration fees or application fees that you didn't agree to at the beginning.

This first section will also list the prepaid items being collected by the lender. Examples of these items would include prepaid interest as well as reserve funds for property taxes and hazard insurance IF you're getting an impound account. An impound account is where your property taxes and insurance are both collected WITH your monthly mortgage payment. The advantage is that you don't have any unexpected bills showing up during the year. But the downside is that you have to bring in some extra funds to the closing to setup the "reserve account". This reserve account ensures there will always be enough money available to pay these bills at the time they are due, plus some extra just in case.

These reserves can add up to a significant chunk of change so the decision to have impounds can significantly affect the amount of cash you have to bring to the Title Company. Also, if you requested NO impounds and the Mortgage Broker put them in anyway, you'll see it right away because the prepaid items will be much higher than previously disclosed. Keep in mind that some A-paper lenders offer modest pricing improvements for loans WITH impounds so some Mortgage Brokers try to sneak them in as a way of improving the loan's profitability.

The second section details all the fees paid to OR through the Title or Escrow Company. These would include the title insurance, escrow fees, recording, courier, notary and any liens or delinquent taxes listed on the title report. Although the signing is often too late for negotiation, both the title insurance AND the escrow fee may have some flexibility so it never hurts to request a discount. Ask your Mortgage Broker about this earlier in the process.

At the bottom of the Estimated Closing Statement, it should tell you exactly how much you still owe to close escrow or how much you can expect back after the transaction closes. Although this figure will rarely be identical to the original estimate provided in the Good Faith Estimate, it's proximity to the original figure is an extremely good gauge of you Mortgage Broker's competence and experience. If it's way off, you might want to think about using someone else.

The second important form in the package is the Note, which will usually be located about half way through the stack, either in front of or behind the Deed of Trust. The Deed is usually pretty easy to find because it's a 14 or 15-page document with "page 1 of 15", "page 2 of 15" and so on at the bottom of each page, so you can flip through the stack and find it pretty quickly. The Note is usually near by.

The Note is generally a 4 or 5-page document and details the loan amount, lender, interest rate, date of your first payment, length of time the interest rate is fixed for, any interest-only options and the prepayment penalty stipulations. You will have already seen some of this on the Estimated Closing Statement but you should definitely look at (1) the interest rate – make absolutely sure that's correct, (2) the length of the fixed period – that's important and (3) the prepayment penalty – that will be on page 2 or 3. Many Notes have addendums, particularly for prepayment penalties, so make sure to look past the Note to see if there's an addendum.

If everything on the Note looks good and the Estimated Closing Statement is also as you expected, the rest of the package should be fine. Once you've gone through those two documents, the heavy lifting is over. But there are still a number of things you should know while signing the rest of the documents.

First, the Note describes everything to do with the loan, but it hardly mentions the property at all. The Deed of Trust deals with the property and your obligation to keep it insured and in livable condition, etc. Deeds of Trust are all standardized these days so if there's anything unusual, it will be detailed in a separate document called a "rider", similar to an addendum. You can have riders for all kinds of things, including an adjustable interest rate, a balloon payment, a condominium, a rental property, a trust, a planned unit development (or PUD) or a second home. Don't be alarmed by riders. They do it this way to simplify the underlying Deed and make it easier to understand. Just know that the Deed is almost entirely boiler plate copy – very standard stuff. In fact, you can see what's filled in because it's usually in a different font. Everything else is standard.

Also, there will be a document in the package called the Truth-in-Lending Disclosure. This is the most regulated document in the entire industry and is required for all lenders. Along with a variety of other items, the Truth-in-Lending disclosure tells you your APR, and everybody has to calculate the APR the same way. Unfortunately, there are so many loan options these days that it's hard to put 2 programs together in a head-to-head comparison, but it's still good to know what this form attempts to do.

When you get a loan, you normally pay some money – closing costs – to complete the deal. So let's say you're getting a $300K loan and you're paying $5K in fees directly related to the origination of that loan. So you pay $5K in and get $300K out. $5K in, $300K out. So it's really the same as paying nothing and getting $295K out. Same thing. If you pay $5K in and then get $300K out, it's the same as getting $295K with no fees. Well, the APR takes that into consideration and calculates an interest rate that wraps in all these fees as if they were already included, making the APR generally HIGHER than the rate specified on the Note.

For Intermediate ARMs (discussed in Chapter 4), the APR also takes the adjustable portion of the loan into consideration, including the index and the margin. It provides a weighted average interest rate for the entire 30-year period based on the initial fixed period of 5, 7 or 10 years and then the remaining years at the adjustable equivalent, assuming interest rates remain exactly as they are today. Although this attempts to provide borrowers with more complete information, it actually obscures the APR and makes it less relevant considering the objectives for the loan. For example, most people who get a 5/1 ARM, (that's a loan that's fixed

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for the first 5 years) have no intention of keeping the loan longer than 5 years, making the index plus margin completely irrelevant.

This is particularly dangerous for Subprime loans where the index plus margin might be 2 or even 3 percentage points higher than the starting rate, making the APR MUCH higher than it would otherwise be. If you only plan to keep the mortgage for the fixed period, don't spend too much time on the APR. It'll be a high number that will probably frustrate and confuse you. Rather, spend more time on the starting interest rate and the closing costs required to get that loan.

Overall, you can expect your loan package to have two sets of instructions; one from the lender and the other from escrow. You can expect all the documents we've discussed in this Chapter and you can also expect a long list of individual affidavits including a Signature Name Affidavit, a Compliance Agreement, an Occupancy & Financial Status Affidavit and various disclosures describing your rights in the transaction. Keep in mind that any refinance transaction in California provides borrowers 3 business days to review all the documentation and cancel the transaction if necessary.

This time is provided for your protection. Take the opportunity to review all the documents. I know it probably all seems confusing or even boring, but you'll learn a lot about the process by reading the documents involved. I know I did when I still had my signing business, and now I'm doing loans full time. You never know where this stuff leads.

Okay, so if you like what you hear on this podcast, please tell a friend about it. My goal is to become a recognized authority in my field without having to sacrifice my freedom to tell the truth, even if it reflects poorly on my industry. Technology like podcasts can help elevate new and innovative thinkers but we all have to play our part to help spread the word for those who deserve our endorsements. If I am deserving of yours, my thanks.

If you are considering a purchase or a refinance, please call me to discuss the options. I'm a Mortgage Banker. It's what I do for a living. Interest rates change everyday but I'll promise you two things; I'll tell you the truth and I'll do the best I can. My office phone number is 925-465-1223. Again, that's 925-465-1223. You can also reach me by email at patrick@beyondtherate.com.

See you next time for Chapter 9. We'll take a look at some financing strategies for real estate investors who approach the market with more sophistication and very different objectives than the average homeowner. Some aggressive loan programs may be inappropriate for most homeowners but may be perfect for investors and we'll look at the best way to manage those risks. It's fascinating stuff. Stay tuned.

Bye for now.