The Basics of Loan Structuring

August 22, 2023

About this Material

The information presented in these training materials is for general information only, and is based on guidelines and practices generally accepted within the mortgage finance industry and is not intended to be all-inclusive. The MPF® Provider makes no representations or warranties of any kind with respect to the accuracy, completeness or suitability for any purpose of the information contained in this training. In addition, certain information included here speaks only as of the particular date or dates included in this communication, and the information in the communication may have become out of date.

The MPF Provider expressly disclaims any and all warranties, express or implied, including without limitation warranties of merchantability and fitness for a particular purpose regarding these materials and our training program. In no event will the MPF Provider be liable for any direct, indirect, incidental, punitive or consequential damages of any kind with respect the training or materials provided.

All examples are hypothetical and are for illustrative purposes only. This training is not intended and should not be interpreted or relied upon as legal advice. We encourage you to seek advice from a qualified professional.

mpf Mortgage Partnership Finance™

What is Loan Structuring?

Loan structuring is simply designing the loan to fulfill the financing needs of the borrower

- Ask the right questions
- Know your product options
- Understand the borrower’s goals
- Compare and explain the pros and cons

Purchase Transactions

Mortgage
Partnership
Finance™

Where to Start

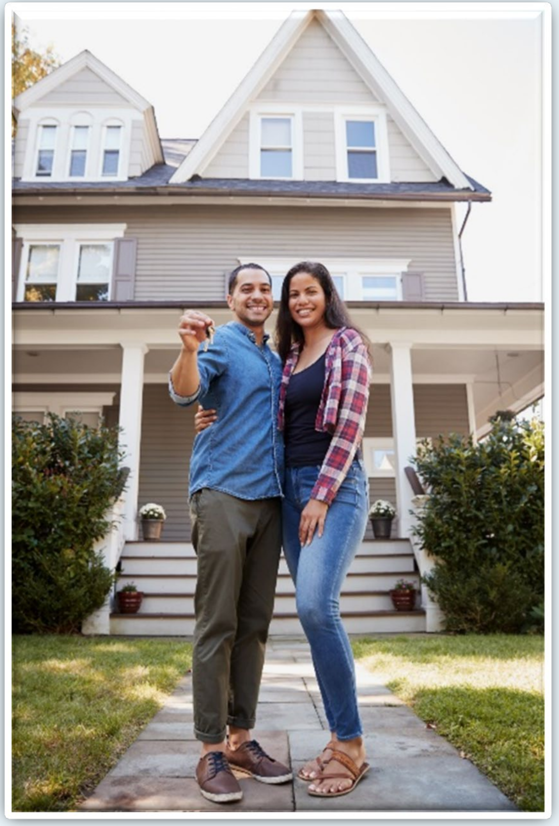
What are some of the key questions that need to be asked in order to better understand the borrower's needs?

- How much do they intend to put down as a down payment?
- Where are the down payment and closing costs coming from?
- Are there any closing credits being provided?
- When is the closing date?
- Do they have an idea of how long they plan to live in the home?
- Are they first-time buyers?

Loan Options

When purchasing a home, borrowers need to make decisions about their financing options. Can you name at least three?

- The loan term
- The interest rate
- Loan type (fixed, adjustable*)
- Loan product (conventional, government, jumbo*)
- Closing costs, escrows and mortgage insurance (if applicable)
- Interested party contributions and seller concessions
- Lock or float?



**The MPF Program does not purchase adjustable rate or jumbo mortgages.*

mpf Mortgage Partnership Finance™

Down Payments

Gina and Charlie have limited funds for their down payment and closing costs. What do you think is the most important aspect that may help you broaden their financing options?

a. Credit Scores
b. Gross Monthly Income
c. Location of the Property
d. Loan Amount

b. If their gross monthly income is at or below 80% of the Area Median Income (AMI) they may qualify for the HomeReady® (MPF Xtra® only) option or, a variety of down payment assistance programs.

Mortgage Partnership Finance™

Limited Down Payment Options

Product Type	Maximum LTV/CLTV	Income Limit	Minimum Credit Score	Homebuyer Education Requirement	First Time Buyer Requirement
MPF Traditional	95%	None	620	None	None
MPF Traditional using DPA funds	100% / 105%	None but usually the DPA provider has a requirement	620	No but the DPA provider may require	No but the DPA provider may require
MPF Xtra Standard 97	97% / 105% an eligible Community Second	None but usually the DPA provider has a requirement	DU determines	Only if all borrowers are first time buyers	At least one borrower must be a first time buyer
MPF Xtra HomeReady	97% / 105% with an eligible Community Second	80% of the AMI	DU determines or if manually underwritten refer to the Eligibility Matrix	Only if all borrowers are first time buyers	None

All scenarios are subject to the applicable MI company eligibility guidelines.

Down Payment Assistance

Your local Federal Home Loan Bank is a great resource for down payment assistance funds

Boston: Equity Builder Program®
Chicago: Down Payment Plus Programs
Dallas: Homebuyer Equity Leverage Partnership (HELP)
Des Moines: Home$tart®
Pittsburgh: First Front Door
Topeka: Homeownership Set Aside Program

FHLBANKS
A NATION OF LOCAL LENDERS

mpf Mortgage Partnership Finance™

Subordinate Financing

Mortgage Partnership Finance™

Subordinate Financing/Purchase Transactions

While not as common as they once were, purchase money seconds (otherwise known as piggyback loans) can sometimes be an option to consider.

- Can be used to reduce a first mortgage amount so it is within the conforming loan limits.
- Can be used to avoid payment mortgage insurance (i.e. an 80-10-10 loan).

Jon needs $750,000 and wants a 30-year fixed mortgage.
If jumbo rates are higher than conforming, take a look at breaking the $750,000 into two loans, one for $726,200 and a small second loan of $23,800

What kind of details should you consider to break this out for Jon?

mpf Mortgage Partnership Finance™

Subordinate Financing/Purchase Transactions

What are some things that need to be considered when presenting a comparison for Jon?

- The rate difference/payment difference between conforming and jumbo products*
- The size of the second loan
- The rate on the second loan
- The type of product for the second loan (HELOC? fixed term loan?)

**The MPF Program does not currently purchase jumbo mortgages.*

mpf Mortgage Partnership Finance™

Mortgage Insurance Options

Mortgage Partnership Finance™

Mortgage Insurance

Mortgage insurance is required when the LTV is above 80%. There are three different MI options available to borrowers:

The Monthly Premium option is paid monthly from the borrower's escrow account.

- **Benefits:** There is no upfront cost and there are no add-ons to the Note rate or loan amount.
- Borrower can initiate cancelation when the LTV drops below 80%.*
- Automatically cancels once the loan reaches 78% LTV.*

**Restrictions and additional requirements may apply.*

Mortgage Insurance Options

The Single Premium option consists on a one-time premium paid at closing.

- There are no monthly payments.
- The premium can be paid by:
  - ✓ The borrower
  - ✓ An interested third party such as the seller or builder (subject to contribution limits)
  - ✓ Financed into the loan amount
  - ✓ The lender buys the MI and increases the Note rate or discount points to indirectly cover the cost of the MI premium.
- The **Single Premium** option is only available for purchase, construction to perm and limited cash-out refinances of 1-unit primary residences or second homes.
- **Benefits**:
  - ✓ Has the highest potential for tax deductibility since the cost is either funded by a higher interest rate or financed in the loan amount.
  - ✓ Lower monthly payments.

mpf Mortgage Partnership Finance™

Mortgage Insurance Options

The Split Premium option includes both an upfront premium paid at closing and reduced monthly payments

- The **Split Premium** option is only available for purchase, construction to perm and limited cash-out refinances of 1-unit primary residences or second homes.
- **Benefits**:
  - ✓ The monthly PITIA is lower than if paying monthly without an upfront premium.

Mortgage Insurance Comparison

Considerations*

Purchase, 1-unit primary residence
$100,000 loan amount
90% LTV
720 Credit Score

MI Option	Monthly Payment Amount	Upfront Premium Amount	Total Cost After 70 months
Monthly	$38.33	None	$2,683
Single Premium	None	$1,480	$1,480
Split Premium	$30.83	$500	$2,658

**For illustration purposes only. Amounts may vary, and additional adjustments may apply.*

mpf Mortgage Partnership Finance™

Interested Party Contributions and Sales Concessions

Mortgage Partnership Finance™

Interested Party Contributions

Interested party contributions (IPCs) are costs that are normally the responsibility of the borrower that are paid by someone else who has a financial interest in the transaction

Which of the following is not considered an interested party?

a. Seller
b. Builder/developer
c. Lender
d. Realtor
e. Borrower's employer

c. and e. are both correct answers. The lender is not considered an interested party unless they are the seller of the property.

mpf Mortgage Partnership Finance™

IPC Limits

LTV/CLTV	Maximum IPC
Greater than 90%	3% of purchase price
75.01-90%	6% of purchase price
75% or less	9% of purchase price
Investment Properties (MPF Xtra only)	2% of purchase price

IPCs are categorized as either a
financing concession or a **sales concession**

It is important to know how each may impact how a loan is structured

Knowledge Check

If a financing concession exceeds the limit, the remaining amount must be:

a. Given back to the provider of the concession (seller/builder).

b. Reported as income to the IRS.

c. Deducted from the purchase price.

d. Used to buydown the interest rate.

The answer is c.

Knowledge Check

Which of the following are considered sales concessions?

a. Gift Cards
b. Furniture
c. Decorating credits
d. Moving costs
e. All of the above

e. All of the above are considered to be sales concessions

Financing vs. Sale Concessions

Financing concessions

- Typically referred to as a seller credit, it is meant to cover closing costs, pre-paid items and/or a permanent or temporary buydown.
- If the financing concession exceeds the total closing costs, pre-paid items and/or buydowns, the remaining amount is considered a *sales concession* and must be deducted from the sales price.

Sales concessions

- Items included with the transaction that don't relate to the home value like furniture, cars, boats, giveaways, and moving costs.
- The value of any sales concessions must be deducted from the purchase price before the LTV/CLTV is calculated.

Buydowns

Buydown Types

Permanent Buydowns

- Lowers the interest rate for the life of the loan.
- A lower rate can be "purchased" by paying points.
- In most cases, the cost of the buydown is paid by an interested party, such as the seller or builder.

Temporary Buydowns

- Lowers the interest rate for up to the first three years of the loan.
- Popular options are a 2-1 buydown or a 3-2-1 buydown.

Using the 2-1 buydown as an example, the interest rate is lowered by 2% in the first year, 1% in the second year and the full interest rate becomes effective beginning in year three.

Temporary Buydowns

Which of the following statements about temporary buydowns are true?

a. The borrower qualifies using the note rate.

b. The buydown terms must be outlined on the promissory note.

c. The cost of the buydown is subject to interested party contribution limits.

d. Borrowers can use cash-out funds to cover the cost of the buydown.

a. and c. are true.

Temporary Buydowns

How is the buydown cost calculated?

- The cost of the buydown is equal to the P&I payment differences (temporary vs. permanent payment) over the duration of the temporary period.

The borrower signs a written buydown agreement at closing that outlines the terms of the buydown plan

- Agreements are the responsibility of the originating lender (consult with your legal/compliance team for assistance).

The funds collected to "purchase" the buydown are held in an account with the lender and used to fund the difference between the reduced P&I and the actual P&I owed the investor.

2-1 Buydown Scenario

David and Tammy are purchasing a new construction home for $333,000. They plan to borrow $300,000. The builder is giving them a 3% ($9,990) closing cost credit.

Per the lender's buydown agreement, $7,284 is collected at closing and held by the lender

$7,284 equals the total differences between the temporary and permanent P&I payments

YEAR 1 (6%)

Borrower pays $1,799 P&I

Lender pays the full $2,201 to the investor each month using the $1,799 P&I payment plus an additional $402 from the monies collected at closing

YEAR 2 (7%)

Borrower pays $1,996 P&I

Lender pays the full $2,201 to the investor each month using the $1,996 P&I payment plus an additional $205 from the monies collected at closing

YEARS 3-30 (8%)

Borrower pays full P&I $2,201

Amounts are rounded to the nearest dollar and therefore the total cost of the buydown may differ by a small amount.

Temporary vs. Permanent Buydown

What if David and Tammy want to use a portion of their builder credit towards a permanent buydown? Do you think that will be a better deal for David and Tammy?

Let's assume that it will cost 2 points ($6,000) to buy the rate down by .250% to 7.750% ($2,149 per month)

2-1 Temporary Buydown 6%, 7%, 8% Total Payments	Permanent Buydown at 7.75%
5 Years: $124,776	5 Years: $128,954
10 Years: $256,836	10 Years: $257,908
15 Years: $388,896	15 Years: $386,862
20 Years: $520,956	20 Years: $515,816
25 Years: $653,016	25 Years: $644,770
30 Years: $785,076	30 Years: $773,724

These numbers are for estimate purposes only, rates and the cost/points needed for permanent buydowns does vary. Amounts are rounded.

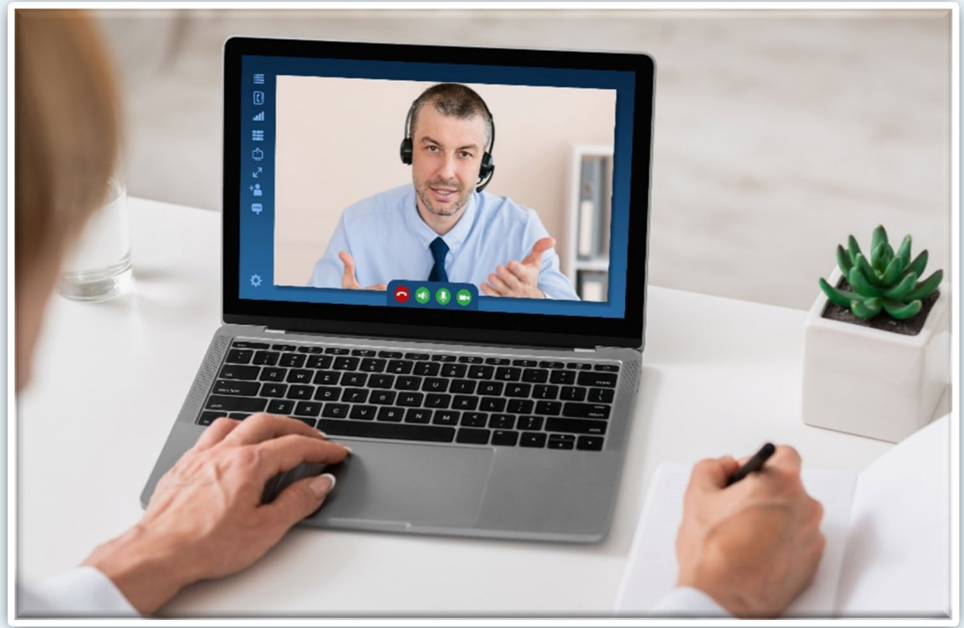
Structuring Refinances

Refinances: Where to Start

A borrower contacts you and says they want to refinance. What's one of the first questions you should ask?

a. How much do you owe?
b. What's your current interest rate?
c. What would you like to accomplish by refinancing?
d. How many years do you have left on your mortgage?

c. While they are all good questions, asking the borrower about their financial goal is far better place to start.



A Thorough Consultation

Once you know what the borrower is looking to accomplish, be prepared to show them all of the pros and cons.

- Is the payment reduction enough to justify the closing costs?
- How long will it take to recapture closing costs?
- How much will they spend over the life of the loan?
- Should they consider lowering the term to save over time?

Remember, always prioritize relationships over immediate dollars!

mpf Mortgage Partnership Finance™

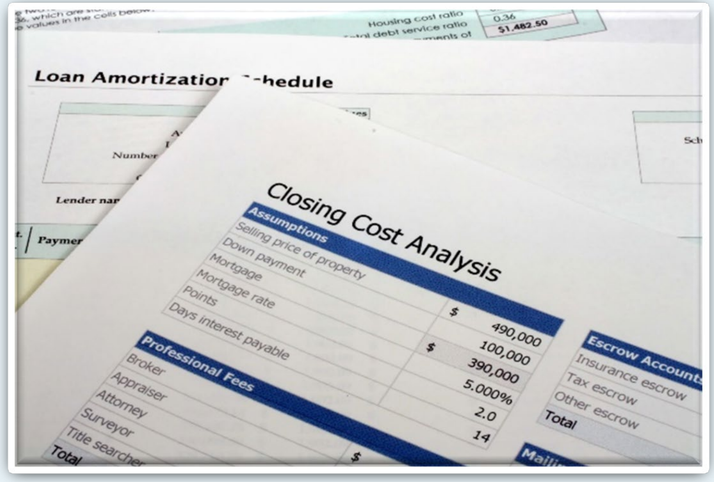
Closing Costs

Mortgage Partnership Finance™

Closing Costs

There are a number of ways refinance closing costs can be covered

- Paid out of pocket (usually not that common if a refinance).
- Roll them into the loan amount (refinances).
  - ✓ Watch your LTV as it could impact the LLPAs (MPF Xtra) or MI.
  - ✓ Over estimating could result in too much cash back to the borrower.
  - ✓ Under estimating could result in the borrower having to bring cash to closing.
- Covered by a premium pricing credit from the lender
  - ✓ This usually translates into a higher interest rate.



Mortgage Partnership Finance™

Closing Costs

A careful calculation can help your borrower decide to roll in costs or take a higher rate with a premium pricing credit or pay out of pocket

Gail was quoted $3500 in closing fees and can't decide if she should increase her loan amount or take the higher interest rate:

Option	Loan Amount	Rate	P&I Payment	Difference over 30 years
Roll into Loan Amount	$203,500	7.500%	$1,423	$512,245
Higher Rate w/ Premium Pricing	$200,000	7.750%	$1,433	$515,880
Pay Out of Pocket	$200,000	7.500%	$1,398	$506,934 (includes $3500)

For illustration purposes only, rates, premium pricing and closing costs will vary.

mpf Mortgage Partnership Finance™

Escrow Accounts

When rolling costs into the loan amount (refinances), escrows should be considered and discussed with the borrower

- Escrow accounts for taxes and insurance are typically re-established when a borrower refinances.
- If a borrower has a shortage in their current escrow account, it must be collected so the new escrow account(s) begins with sufficient funds.
- How is the balance in the borrower’s current escrow account being refunded?
  - ✓ Refunded after the loan is paid off?
  - ✓ Applied to the pay-off balance?

Successful Loan Structuring

- Take the time to explain and outline the options. This **actually helps you** better understand how they compare.

- Understand your products and guidelines.

- Know your borrower and what's important to them.

- When more than one option exists, provide your borrower with a comparison.

- Educate the borrower on the pros and cons of each option.

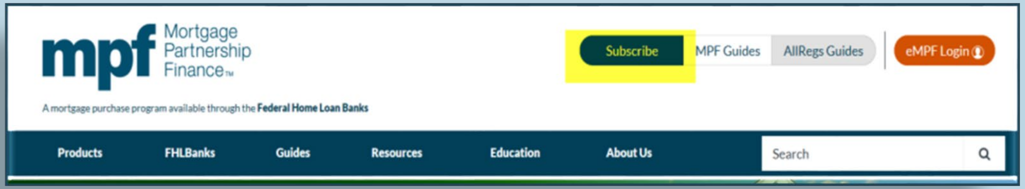
MPF Contacts and Resources

MPF Service Center

Email - MPF-Help@FHLBC.com
Hours - 8:30 am to 4:30 pm CST
Phone: (877) 345-2673

Keep up with MPF Program guideline updates by subscribing to MPF Announcements:

www.fhlbmpf.com



MPF National Education

Check out our upcoming webinars:
https://www.fhlbmpf.com/education/upcoming-webinars

Register for MPF University
www.fhlbmpf.com

MPF National Education
mpftraining@fhlbc.com

Follow the Mortgage Partnership Finance Program (MPF) on Social media!