SELECT PORTFOLIO MANAGEMENT, INC.
Integrated Wealth Management
A Registered Investment Advisor

White Paper

Home Ownership:

Mortgage Clauses

www.selectportfolio.com • Toll Free 800.445.9822 • Tel 949.975.7900 • Fax 949.900.8181

Securities offered through Securities Equity Group Member FINRA, SIPC, MSRB

Table of Contents

Title .... **Error! Bookmark not defined.**

Header .... **Error! Bookmark not defined.**

Disclosures 5

Mortgage Clauses

What are mortgage clauses?

Mortgage clauses are provisions contained in a mortgage contract that outline special rights, powers, or remedies. Mortgage contracts also contain various covenants, which are promises or agreements between the lender and borrower. Because there are many different types of mortgage contracts (which may be subject to both state and federal law), mortgage contract provisions can vary widely.

Why are mortgage clauses important?

As a homebuyer, you'll sign a mountain of paperwork at the closing or settlement meeting. If you required mortgage financing to purchase your property, one of the most important documents you'll sign is the mortgage contract. Few closing attorneys or settlement agents review each and every provision of the mortgage contract with a homebuyer. It's important, therefore, to understand the clauses or provisions contained in your mortgage. Although there are many different types of clauses and covenants, some of the more important ones are summarized here.

What is an acceleration clause?

An acceleration clause in a mortgage contract allows the lender, in certain circumstances, to demand that the entire balance of the loan be repaid in a lump sum immediately. This clause may be triggered, for instance, if the borrower defaults on a regularly scheduled payment. Generally, the lender is required to give notice to the borrower before acceleration is invoked. Specifically, the buyer is notified of the default, the action required to cure the default, and the date by which the default must be cured. If the default is cured, the mortgage is reinstated. If it's not cured, the lender may invoke a statutory power of sale and begin foreclosure proceedings. (See due-on-sale clause below.)

What is an assumption clause?

With an assumable mortgage, the assumption clause allows a buyer to take over the home seller's mortgage loan and monthly payment obligations, instead of obtaining a new mortgage. In many cases, the buyer may also be able to assume the seller's interest rate. By assuming a mortgage, a buyer can avoid settlement costs and loan application procedures. However, most conventional mortgages at present are not assumable (i.e., there is a "nonassumption" clause in the mortgage contract).

Fully assumable mortgages

With a fully assumable mortgage, the lender places no restrictions on who may assume the loan. Fully assumable mortgages were available in the 1980s, but many of these have either been paid off or ended

through new refinancing terms. Those that still exist are generally not very attractive to homebuyers because they often have relatively high interest rates and the balance is usually quite low. The new borrower would then have to obtain other financing sources to cover the difference between the home's selling price and the mortgage balance being assumed.

Qualified assumptions

Modern assumable mortgages are usually qualified, which means that the loan can be assumed only if the lender approves the new borrower. Approval standards are often stringent, and the new borrower may have to pay various fees and charges before taking over the loan. The approval standards for assuming fixed rate mortgages are generally stricter than for assuming adjustable rate mortgages (ARMs).

What is a conversion clause?

Conversion clauses are often found in ARM contracts. This feature allows you to convert the ARM to a fixed rate mortgage at a designated time. The terms and conditions vary from lender to lender. Generally, though, you must give your lender 30 days' notice before converting. You must also pay a fee, usually $250 to $500. Some lenders specify when a conversion can be made, while others allow it any time during the first three to five years of the loan.

The interest rate for a convertible ARM may be somewhat higher than for a nonconvertible ARM, and your up-front costs may be greater. When you convert, your new fixed interest rate is generally set at the current market rate for fixed rate mortgages. (Again, though, this can vary from lender to lender.)

What is a due-on-sale clause?

A due-on-sale clause allows a lender to accelerate the loan if the borrower transfers a substantial beneficial interest in the property to another party. This may happen, for example, if the home is sold, the title to the property is changed, or the loan is refinanced.

What is an escrow covenant?

In many cases, you're required to pay hazard insurance and property tax installments to the lender in advance. With an escrow covenant, the lender holds the funds in an escrow account until the payments are due to the insurer and property tax authority. Normally, either you'd submit the tax and insurance bills to your lender, or the lender would receive the property tax bill from a tax service and the insurance bill from your homeowners insurance carrier. The lender would then make payments to the proper party.

What is an insurance covenant?

The insurance covenant requires the borrower to keep the property insured against loss by fire and certain other hazards (at least up to the amount of the mortgage). If the borrower fails to maintain adequate hazard insurance coverage, the lender may obtain this coverage at the borrower's expense. In the event of any loss, the borrower promises to give prompt notice to the insurance carrier and the lender.

What is a prepayment clause?

Some mortgages charge a prepayment penalty if the borrower pays off the loan prior to maturity. A prepayment clause generally gives the borrower the right to pay off the loan prior to maturity without paying such a penalty.

Disclosures

This material does not constitute the rendering of investment, legal, tax or insurance advice or services. It is intended for informational use only and is not a substitute for investment, legal, tax, and insurance advice.

State, national and international laws vary, as do individual circumstances; so always consult a qualified investment advisor, attorney, CPA, or insurance agent on all investment, legal, tax, or insurance matters.

The effectiveness of any of the strategies described will depend on your individual situation and on a number of other factors. After reviewing your personal situation, we may recommend that you not use any strategy in this document but instead consider various other strategies available through our practice.

Securities offered through Securities Equity Group, member FINRA, SIPC, MSRB

Copyright 2006 Forefield, Inc. All rights reserved.