

Questions and Answers on Mortgages

WHAT is meant by mortgage discounts? A mortgage is "discounted" when it sells for less than the principal amount of the mortgage. Example, a \$10,000 mortgage which sells for \$9,800 was discounted \$200, or 2%. This \$200 is the "mortgage discount." Similarly, if a \$10,000 mortgage were discounted 5%, the discount would be \$500.

WHY is it necessary to discount mortgages? The Federal Government controls the interest rate on FHA and VA mortgages. At present, the authorized interest rate is less than the going or prevailing rate of interest.

Therefore, VA and FHA mortgages at these low fixed interest rates are less desirable than other investments such as bonds or conventional mortgages which yield a higher return. The only way a mortgage may be made equally desirable is to "discount" it.

DO conventional loans have to be discounted? Almost never, because the interest rate is flexible and can be varied to meet the requirements of investors or those having or controlling savings.

WHO PAYS the discount on FHA and VA loans? Where a new FHA or VA loan is placed on a piece

of property, so that the seller can get cash for the property, the seller pays the discount.

WHY SHOULD it be the seller who pays the discount on FHA and VA mortgages? Under Federal law, the buyer is prohibited from paying the discount. Since the discount is a means of raising the effective interest rate or yield, if the buyer were allowed to pay the discount, he would be paying higher interest than the law allows.

The buyer, of course, is required to pay all other expenses connected with the loan except the discount.

WHO GETS the discount on FHA and VA loans? The mortgage banker or other lender collects the discount at the time the loan is made, and generally must then pass the discount on by payment to the permanent investor. This money is then placed in reserve and "fed back" over a period of years as additional interest.

DOES the mortgage banker make a profit on discount? Almost never, and certainly not as a general rule. In most cases, the mortgage banker gets a commitment, or agreement to buy, from one of the investors he represents, before the loan is closed, at a specified discount.

In other cases he may feel he knows the policy of his investors so well, he may close without a firm "take-out" and depend on his ability to sell the loan later. Sometimes, therefore, he may make a profit or take a loss. He tries at least to break even.

WHAT IS the amount of the discount? The amount of discount is controlled by the difference between

the fixed rate chargeable on FHA or VA mortgages, and the "going" rate as established by conventional mortgage rates. Contact lending institutions for current quotations.

WHAT ABOUT discounts on purchase money mortgages? Individual sellers of real estate sometimes sell their property or equity in their property, and take back,

in exchange, mortgages to hold themselves. If a set of circumstances arises where the holder of such a mortgage must sell it, he may have to sell it at a discount to obtain cash.

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