***Financial Markets and Institutions, 7e* (Saunders)**

**Chapter 7 Mortgage Markets**

1) The largest category of mortgages by dollar volume is commercial mortgages.

2) The process of mortgage securitization results in a separation between mortgage origination and mortgage financing.

3) A subprime mortgage is a mortgage made to a borrower who has a below normal credit rating.

4) Federally insured mortgages are called conventional mortgages.

5) Private mortgage insurance (and hence, that part of the homeowner's monthly payment) is automatically removed from a mortgage when the loan-to-value ratio on the mortgage falls below 80 percent.

6) A borrower using a conventional mortgage will have to put up at least a 20 percent down payment or purchase private mortgage insurance.

7) Discount points are paid to reduce the down payment required.

8) On a fixed-rate mortgage the dollars of interest the homeowner pays falls each year the mortgage is outstanding.

9) A large portion of the mortgage payment goes towards the principal, during the early life of a mortgage loan.

10) Subprime mortgage borrowers usually have poorer credit ratings or lower income levels compared to conventional mortgage borrowers.

11) Pass through mortgage securities are for primary market investors.

12) GNMA role is to provide insurance to pass through mortgage securities.

13) Risk attributes of collateralized mortgage obligations differ based on tranches.

14) In synthetic securitization, the transfer of risk on a pool of assets is achieved by the use of credit derivatives or guarantees to a third party.

15) For CMOs, prepayment risk is the risk that a borrower may prepay the mortgage before maturity when interest rates decrease.

16) Rank the following types of mortgages by amount outstanding from largest to smallest.

I. Home mortgages

II. Multifamily mortgages

III. Farm mortgages

IV. Commercial mortgages

A) I, II, III, IV

B) I, II, IV, III

C) II, I, IV, III

D) IV, II, III, I

E) I, IV, II, III

17) The process of packaging and/or selling mortgages that are then used to back publicly traded debt securities is called

A) collateralization.

B) securitization.

C) market capitalization.

D) stock diversification.

E) mortgage globalization.

18) A \_\_\_\_\_\_\_\_ placed against mortgaged property ensures that the property cannot be sold (except by the lender) until the mortgage is paid off.

A) collateral

B) lien

C) writ of habeas corpus

D) down payment

E) writ of certiorari

19) If a borrower makes a 20 percent down payment on a conventional mortgage, she will be required to obtain

A) FHA insurance.

B) VA insurance.

C) private mortgage insurance.

D) GNMA payment guarantees

E) None of these choices are correct.

20) Mortgage payments are \_\_\_\_\_\_\_\_ on a 15-year fixed-rate mortgage than on a 30-year fixed-rate mortgage, and \_\_\_\_\_\_\_\_ is paid on a 15-year mortgage than on a 30-year mortgage; ceteris paribus.

A) lower; less interest

B) lower; less principal

C) higher; less interest

D) higher; more principal

E) higher; more interest

21) With a fixed-rate mortgage, the \_\_\_\_\_\_\_\_ bears the interest rate risk and with an ARM the \_\_\_\_\_\_\_\_ bears the interest rate risk.

A) borrower; lender

B) borrower; borrower

C) lender; lender

D) lender; borrower

E) federal government; pool organizer

22) The schedule showing how monthly mortgage payments are split into principal and interest is called a(n)

A) securitization schedule.

B) balloon payment schedule.

C) graduated payment schedule.

D) amortization schedule.

E) growing equity schedule.

23) You purchase a $255,000 house and you pay 20 percent down. You obtain a fixed-rate mortgage where the annual interest rate is 5.85 percent and there are 360 monthly payments. What is the monthly payment?

A) $1,215.27

B) $1,203.48

C) $1,194.45

D) $1,367.22

E) $1,504.35

24) You obtain a $265,000, 15-year fixed-rate mortgage. The annual interest rate is 6.25 percent. In addition to the principal and interest paid, you must pay $275 a month into an escrow account for insurance and taxes. What is the total monthly payment (to the nearest dollar)?

A) $2,272

B) $1,632

C) $2,547

D) $1,907

E) $2,311

25) You purchase a $325,000 town home and you pay 25 percent down. You obtain a 30-year fixed-rate mortgage with an annual interest rate of 5.75 percent. After five years you refinance the mortgage for 25 years at a 5.1 percent annual interest rate. After you refinance, what is the new monthly payment (to the nearest dollar)?

A) $1,422

B) $1,401

C) $1,366

D) $1,335

E) $1,296

26) A borrower took out a 30-year fixed-rate mortgage of $2,250,000 at a 7.2 percent annual rate. After five years, he wishes to pay off the remaining balance. Interest rates have by then fallen to 7 percent. How much must he pay to retire the mortgage (to the nearest dollar)?

A) $2,122,426

B) $2,225,330

C) $2,015,678

D) $2,212,041

E) $1,999,998

27) A home buyer bought a house for $245,000. The buyer paid 20 percent down but decided to finance closing costs of 3 percent of the mortgage amount. If the borrower took out a 30-year fixed-rate mortgage at a 5 percent annual interest rate, how much interest will the borrower pay over the life of the mortgage?

A) $224,655

B) $180,622

C) $228,477

D) $188,265

E) $248,575

28) A homeowner could take out a 15-year mortgage at a 5.5 percent annual rate on a $195,000 mortgage amount, or she could finance the purchase with a 30-year mortgage at a 6.1 percent annual rate. How much total interest over the entire mortgage period could she save by financing her home with the 15-year mortgage (to the nearest dollar)?

A) $230,408

B) $190,105

C) $155,612

D) $144,325

E) $138,612

29) A homeowner can obtain a $250,000, 30-year fixed-rate mortgage at a rate of 6.0 percent with zero points or at a rate of 5.5 percent with 2.25 points.

If you will keep the mortgage for 30 years, what is the net present value of paying the points (to the nearest dollar)?

A) $9,475

B) $8,360

C) $7,564

D) $7,222

E) $6,578

30) A homeowner can obtain a $250,000, 30-year fixed-rate mortgage at a rate of 6.0 percent with zero points or at a rate of 5.5 percent with 2.25 points.

How long must the owner stay in the house to make it worthwhile to pay the points if the payment saving is invested monthly?

A) 7.15 years

B) 3.33 years

C) 6.04 years

D) 5.90 years

E) More than 30 years

31) A homeowner can obtain a $250,000, 30-year fixed-rate mortgage at a rate of 6.0 percent with zero points or at a rate of 5.5 percent with 2.25 points.

How long must the owner stay in the house to make it worthwhile to pay the points if the payment saving is not invested?

A) 7.15 years

B) 3.33 years

C) 6.04 years

D) 5.90 years

E) More than 30 years

32) The least used form of mortgage securitization is the \_\_\_\_\_\_\_\_.

A) second mortgage

B) mortgage-backed bond

C) mortgage pass-through

D) CMO

E) home equity loan

33) You want to buy a $250,000 house and you will use a conventional mortgage. What is the minimum down payment you have to make to avoid having to purchase mortgage insurance?

A) $10,000

B) $20,000

C) $30,000

D) $40,000

E) $50,000

34) The FHA charges the homeowner \_\_\_\_\_\_\_\_ to insure an FHA mortgage.

A) nothing

B) 0.5 percent of the loan amount

C) $500

D) 1 percent of the loan amount

E) $1,500

35) A(n) \_\_\_\_\_\_\_\_ is used to help retired people receive monthly income in exchange for the equity in their home.

A) SAM

B) Equity Participation Mortgage

C) RAM

D) PLAM

E) GEM

36) Which of the following statements about mortgage markets is/are true?

I. Mortgage companies service more mortgages than they originate.

II. Servicing fees typically range from 2 percent to 4 percent.

III. Most mortgage sales are with recourse.

IV. The government is involved in the residential mortgage markets.

A) I, III, and IV only

B) II, III, and IV only

C) I, II, and IV only

D) II and III only

E) I and IV only

37) Which of the following statements about GNMA is/are true?

I. GNMA provides timing insurance.

II. GNMA creates pools of mortgages and issues securities.

III. GNMA insures only FHA, VA, HUD's Office of Indian and Public Housing, and USDA Rural Development loans.

IV. GNMA requires that all mortgages in the pool have the same interest rate.

A) I, II, III, and IV are true.

B) I, III, and IV only

C) I, II, and III only

D) II, III, and IV only

E) III and IV only

38) A $25,000 face value GNMA pass-through quote sheet lists a spread to average life of 103, PSA of 220, and a price of 101-09. This means that

I. the pass-through yield is 103 basis points above the comparable maturity Treasury bond.

II. the pass-through is being prepaid more quickly than standard PSA.

III. the pass-through is priced at $25,272.50.

A) I, II, and III are correct.

B) I and II only

C) I and III only

D) II and III only

E) III only

39) Mortgage fees paid by the homeowner at, or prior to, closing upon the purchase of a house typically include all but which one of the following?

A) Application fee

B) Title search fee

C) Title insurance fee

D) Appraisal fee

E) Prepayment penalty

40) An MBB differs from a CMO or a pass-through in that

I. the MBB does not result in the removal of mortgages from the balance sheet.

II. a MBB holder has no prepayment risk.

III. cash flows on a MBB are not directly passed through from mortgages.

A) I, II, and III

B) I and II only

C) II and III only

D) I and III only

E) I only

41) One fixed-rate mortgage pool has a 750 PSA and a second fixed-rate pool has 150 PSA. The pool with the higher PSA \_\_\_\_\_\_\_\_ than the pool with the lower PSA.

I. probably has a higher coupon

II. probably has lower default risk

III. will mature more quickly

A) I, II, and III

B) I and II only

C) II and III only

D) I and III only

E) I only

42) As compared to fixed-rate mortgages, ARMs result in which of the following for the lender?

I. Higher interest rate risk

II. Lower default risk

III. Greater prepayment penalty fees

A) I, II, and III

B) I and II only

C) II and III only

D) I and III only

E) None of these choices are correct.

43) Which one of the following types of mortgages is likely to become more popular as the average age of the U.S. population increases?

A) GEM

B) GPM

C) SAM

D) PLA

E) RAM

44) Which one of the following entities is an actual government-owned enterprise dealing with mortgages?

A) GNMA

B) FNMA

C) FHLMC

D) PIP

E) CMO

45) A fixed-rate mortgage originator is adversely affected by \_\_\_\_\_\_\_\_ interest rates while the borrower is adversely affected by \_\_\_\_\_\_\_\_ interest rates.

A) increasing; decreasing

B) increasing; increasing

C) decreasing; decreasing

D) decreasing; increasing

E) stable; decreasing

46) An adjustable rate mortgage originator is adversely affected by \_\_\_\_\_\_\_\_ interest rates while the borrower is adversely affected by \_\_\_\_\_\_\_\_ interest rates.

A) increasing; decreasing

B) increasing; increasing

C) decreasing; decreasing

D) decreasing; increasing

E) stable; decreasing

47) The borrower of an amortized mortgage makes most of the payment during the early life of the mortgage:

A) towards the principal.

B) towards the interest.

C) equally towards the principal and interest.

D) mostly towards the principal rather than interest.

E) None of these choices are correct.

48) A Collateralized mortgage obligation (CMO) has:

A) no interest rate risk.

B) no default risk.

C) no prepayment risk.

D) high degree of interest rate risk.

E) no default, no prepayment and no interest rate risks.

49) If the current interest environment is low, lenders tend to prefer \_\_\_\_\_\_\_\_ ; while borrowers tend to prefer \_\_\_\_\_\_\_\_.

A) ARM; fixed-rate mortgage

B) ARM; ARM

C) fixed-rate mortgage; fixed-rate mortgage

D) fixed-rate mortgage; ARM

E) None of these choices are correct.

50) Construct an amortization schedule for the first three months and the final three months of payments for a 30-year, 7 percent mortgage in the amount of $90,000. What percentage of the third payment is principal? What percentage of the final payment is principal? What do these differences imply? (Hint: The balance after the 357th payment is $1,775.56.)

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | Amortization Table: | | | | | | | | | | | | | | | | | | | |
| # |  |  | | Payment | | | Interest | | |  | | Principal | | | |  | | Balance | | |  | |
| 0 |  |  | |  |  |  |  |  |  | |  | |  |  |  | |  | | $ | 90,000.00 | |  | |
| 1 |  |  | | $ | 598.77 |  | $ | 525.00 |  | |  | | $ | 73.77 |  | |  | | $ | 89,926.23 | |  | |
| 2 |  |  | | $ | 598.77 |  | $ | 524.57 |  | |  | | $ | 74.20 |  | |  | | $ | 89,852.03 | |  | |
| 3 |  |  | | $ | 598.77 |  | $ | 524.14 |  | |  | | $ | 74.64 |  | |  | | $ | 89,777.39 | |  | |
| ... |  |  | |  |  |  |  |  |  | |  | |  |  |  | |  | |  |  | |  | |
| 358 |  |  | | $ | 598.77 |  | $ | 10.36 |  | |  | | $ | 588.41 |  | |  | | $ | 1,187.15 | |  | |
| 359 |  |  | | $ | 598.77 |  | $ | 6.93 |  | |  | | $ | 591.85 |  | |  | | $ | 595.30 | |  | |
| 360 |  |  | | $ | 598.77 |  | $ | 3.47 |  | |  | | $ | 595.30 |  | |  | | $ | 0.00 | |  | |

51) Why do mortgage lenders prefer ARMs while many borrowers prefer fixed-rate mortgages, ceteris paribus.

52) A homeowner is looking to buy a home in Marvin Gardens. The most he can afford to pay in total is $1,800 per month. Yearly property taxes will be about $3,000 (escrowed monthly) and insurance is $110 per month. There are no other costs.

If mortgage rates are 6.25 percent for a 30-year fixed-rate mortgage, how large can his mortgage be?

53) A homeowner is looking to buy a home in Marvin Gardens. The most he can afford to pay in total is $1,800 per month. Yearly property taxes will be about $3,000 (escrowed monthly) and insurance is $110 per month. There are no other costs.

If his parents give him $20,000 for a down payment, what is the most he can pay for a house with a 15-year mortgage if the interest rate is 5.50 percent?

54) What three major ways has the federal government assisted the mortgage markets? Explain.

55) Why have FNMA and Freddie Mac, considered government-sponsored enterprises (GSEs), been in the news lately? Explain.

56) Who are the major buyers of mortgages after they have been originated? What is the difference between selling with recourse or without recourse? Which is most common?

57) How does GNMA improve mortgage marketability?

58) Explain each term of the following pass-through quote:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 15 year | Price |  | Avg Life | | | PSA | | |
| FMAC Gold 7.0% | 97-31 |  |  | 5.9 |  |  | 150 |  | |

59) You bought your house five years ago and you believe you will be in the house only about five more years before it gets too small for your family. Your original home value when you bought it was $250,000, you paid 20 percent down, and you financed closing costs equal to 3 percent of the mortgage amount. The mortgage was a 30-year fixed-rate mortgage with a 6.5 percent annual interest rate. Rates on 30-year mortgages are now at 5 percent if you pay 2 points. Your refinancing costs will be 1.5 percent of the new mortgage amount (excluding points). You won't finance the points and closing costs this time. A new down payment is not required. Should you refinance? Ignore all taxes and show your work.

60) Why were CMOs created?