

Financing Residential Real Estate Practice Exam (Sample)

Study Guide



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SAMPLE

Questions

- 1. What type of premium is required when using an FHA loan for a single-family home?**
 - A. A one-time premium only**
 - B. An upfront premium that can be financed plus an annual premium**
 - C. Only an annual premium**
 - D. No premium required**
- 2. What does "qualified mortgage" refer to?**
 - A. A mortgage designed for first-time homebuyers**
 - B. A category of loans that meet specific criteria to ensure repayment ability**
 - C. A loan that has a lower interest rate**
 - D. A type of mortgage with flexible eligibility requirements**
- 3. In most transactions financed with a land contract, what happens to legal title?**
 - A. It is transferred to the buyer immediately**
 - B. It remains with the vendor until full payment is made**
 - C. It gets split equally between buyer and seller**
 - D. It goes to a neutral third party**
- 4. What does "loan modification" refer to in mortgage terms?**
 - A. A process to fully pay off a loan early**
 - B. An adjustment to a mortgage's original terms**
 - C. The act of refinancing a mortgage**
 - D. A legal agreement to forfeit a property**
- 5. Under the Equal Credit Opportunity Act, lenders are prohibited from discriminating based on what criteria?**
 - A. Income level**
 - B. Age or marital status**
 - C. Employment history**
 - D. Credit card debt**

- 6. In qualifying a buyer for a conventional loan, which liability is least likely to be considered by the underwriter?**
- A. A car loan with 4 \$200 monthly payments remaining**
 - B. A personal loan with 6 months left to pay**
 - C. A credit card with a zero balance**
 - D. A mortgage payment on an investment property**
- 7. What happens in wrap-around financing?**
- A. The seller assumes the buyer's debt**
 - B. The seller continues to make payments on the underlying loan**
 - C. The buyer makes payments directly to the lender**
 - D. The property is placed in a trust until paid off**
- 8. What type of financing allows homeowners to borrow against the equity of their home?**
- A. Home Equity Loan**
 - B. Standard Mortgage**
 - C. Line of Credit**
 - D. FHA Loan**
- 9. What effect does an escrow account have on a borrower's finances?**
- A. It reduces monthly payments significantly**
 - B. It helps to simplify the payment of property taxes and insurance**
 - C. It necessitates higher interest rates on the mortgage**
 - D. It eliminates the need for a down payment**
- 10. What must secondary financing comply with when used in conjunction with a conventional loan?**
- A. It must meet government regulations**
 - B. It must follow the restrictions of the primary lender**
 - C. It can have its own terms disregarding primary loan conditions**
 - D. It requires a higher interest rate**

Answers

SAMPLE

- 1. B**
- 2. B**
- 3. B**
- 4. B**
- 5. B**
- 6. C**
- 7. B**
- 8. A**
- 9. B**
- 10. B**

SAMPLE

Explanations

1. What type of premium is required when using an FHA loan for a single-family home?

A. A one-time premium only

B. An upfront premium that can be financed plus an annual premium

C. Only an annual premium

D. No premium required

When using an FHA loan for a single-family home, borrowers are required to pay both an upfront mortgage insurance premium (MIP) and an annual premium. The upfront premium, which is typically a percentage of the loan amount, can be financed into the loan itself, meaning it is added to the total loan balance and can be paid off over the term of the loan. This arrangement allows borrowers to avoid a significant out-of-pocket payment at closing. In addition to the upfront premium, borrowers must also pay an annual mortgage insurance premium, which is calculated based on the remaining loan balance and is typically divided into monthly payments. This annual premium provides ongoing insurance for the lender in the event of default on the loan, ensuring that the lender is protected while the borrower is able to access the benefits of a lower down payment and more favorable loan terms associated with FHA loans. The combination of an upfront premium that can be financed and an annual premium ensures that FHA loans remain accessible to a wide range of homebuyers, including those with lower credit scores or limited savings, while still providing necessary protections for lenders.

2. What does "qualified mortgage" refer to?

A. A mortgage designed for first-time homebuyers

B. A category of loans that meet specific criteria to ensure repayment ability

C. A loan that has a lower interest rate

D. A type of mortgage with flexible eligibility requirements

A "qualified mortgage" refers to a category of loans that meet specific criteria established by regulatory bodies to ensure that borrowers have the ability to repay their loans. These criteria were introduced as part of the Dodd-Frank Act to protect consumers from risky lending practices that contributed to the housing crisis. Qualified mortgages typically have features that limit the lender's risk and enhance borrower protection, such as caps on fees and points, limitations on loan terms, and requirements for comprehensive documentation of a borrower's income and financial history. The focus is on ensuring that borrowers can sustain their mortgage payments, thereby reducing the likelihood of default. In contrast, a mortgage designed specifically for first-time homebuyers might offer unique benefits, but it doesn't inherently ensure the borrower's ability to repay. Similarly, lower interest rates are attractive, but they do not indicate whether a mortgage is qualified. Finally, flexible eligibility requirements typically suggest a broader access to loans, but this flexibility can sometimes lead to less thorough assessment of repayment ability, which is contrary to the principles behind a qualified mortgage.

3. In most transactions financed with a land contract, what happens to legal title?

- A. It is transferred to the buyer immediately**
- B. It remains with the vendor until full payment is made**
- C. It gets split equally between buyer and seller**
- D. It goes to a neutral third party**

In transactions financed with a land contract, legal title typically remains with the vendor, or seller, until the buyer fulfills the terms of the contract, which usually means making all required payments. This arrangement is significant because it protects the seller's interest in the property until the buyer has completed the payment obligations. This method allows the buyer to take possession of the property and use it while making payments, but it does not transfer full ownership (legal title) until the seller has been fully compensated. The structure of a land contract is designed to facilitate a gradual transfer of ownership, emphasizing buyer responsibility for payments while still securing the seller's legal interest in the property. The other choices do not accurately reflect how land contracts typically function. Immediate transfer of title would undermine the protective intent of a land contract for the seller. Splitting legal title doesn't align with the principle that one party retains rights until obligations are fulfilled, and involving a neutral third party for holding title is not a standard practice in land contracts. Thus, choice B accurately captures the nature of legal title in land contract transactions.

4. What does "loan modification" refer to in mortgage terms?

- A. A process to fully pay off a loan early**
- B. An adjustment to a mortgage's original terms**
- C. The act of refinancing a mortgage**
- D. A legal agreement to forfeit a property**

Loan modification refers to an adjustment to a mortgage's original terms. This process typically involves changing one or more aspects of the mortgage agreement, such as the interest rate, loan term, or monthly payment amount, to make it more manageable for the borrower. Loan modifications are often utilized when a borrower is experiencing financial hardship and needs to avoid foreclosure or make their payments more affordable. This differs from paying off a loan early, which is about settlement rather than modification of the original terms, and refinancing, which involves taking out a new loan to replace the old one rather than altering the existing agreement. The option regarding forfeiting a property is associated with foreclosure or short sales, which are separate from the concept of modifying loan terms. Understanding loan modification is critical for borrowers facing economic difficulties, as it can provide them with a more sustainable path to homeownership.

5. Under the Equal Credit Opportunity Act, lenders are prohibited from discriminating based on what criteria?

A. Income level

B. Age or marital status

C. Employment history

D. Credit card debt

The Equal Credit Opportunity Act (ECOA) is designed to ensure that all individuals have an equal chance to obtain credit. One of the fundamental principles of this act is to prevent discrimination based on specific, protected characteristics. Among these characteristics, age and marital status are expressly identified as factors that lenders cannot use to make credit decisions. By prohibiting discrimination based on age, the ECOA protects individuals from being denied credit simply because of their age, whether they are younger or older. Similarly, marital status discrimination ensures that lenders cannot deny an application based on whether or not an individual is married, single, divorced, or widowed. This protection is crucial in promoting fairness in the lending process and enabling all applicants, regardless of these status factors, to receive equitable consideration. Other factors listed, such as income level, employment history, and credit card debt, while relevant in determining creditworthiness, do not fall under the discriminatory practices prohibited by the ECOA in the same way. These factors are considered standard criteria that can impact an individual's ability to repay a loan and are not protected under the same provisions for discrimination.

6. In qualifying a buyer for a conventional loan, which liability is least likely to be considered by the underwriter?

A. A car loan with 4 \$200 monthly payments remaining

B. A personal loan with 6 months left to pay

C. A credit card with a zero balance

D. A mortgage payment on an investment property

In the process of qualifying a buyer for a conventional loan, underwriters assess various financial liabilities to determine the borrower's ability to repay the loan. When considering which liability is least likely to factor into this assessment, a credit card with a zero balance stands out. A credit card with a zero balance does not represent an existing financial obligation that the buyer must accommodate in their budget. Since there is no outstanding debt, it does not contribute to the monthly debt obligations that an underwriter would use to calculate the debt-to-income ratio. In contrast, liabilities such as a car loan, personal loan, and mortgage payment on an investment property all represent active debts that impact a borrower's financial health and repayment capacity. These payments would be included in the debt calculations because they impose a financial commitment on the borrower. Understanding the treatment of various liabilities allows buyers and agents to better navigate the loan qualification process, emphasizing the importance of managing outstanding debts before applying for financing.

7. What happens in wrap-around financing?

- A. The seller assumes the buyer's debt
- B. The seller continues to make payments on the underlying loan**
- C. The buyer makes payments directly to the lender
- D. The property is placed in a trust until paid off

In wrap-around financing, the seller continues to make payments on the underlying loan while simultaneously creating a new loan to the buyer that wraps around the existing mortgage. This means that the buyer makes payments to the seller instead of directly to the lender, and the seller uses these payments to meet their obligations on the original mortgage. This arrangement allows the buyer to purchase the property without needing to qualify for a new loan, as they are essentially taking over the financing through the seller. This type of arrangement can be beneficial in situations where the existing mortgage has a lower interest rate than current market rates, allowing the buyer to secure financing at a better rate without having to refinance or apply for a new mortgage. It also creates a streamlined process for both the seller and buyer, as it avoids the need for a traditional mortgage application. Overall, wrap-around financing provides a unique option for sellers looking to sell their property and for buyers who may face challenges in securing conventional financing.

8. What type of financing allows homeowners to borrow against the equity of their home?

- A. Home Equity Loan**
- B. Standard Mortgage
- C. Line of Credit
- D. FHA Loan

A home equity loan is specifically designed for homeowners to borrow against the equity they have built up in their property. Equity refers to the difference between the market value of the home and the outstanding balance on the mortgage. Homeowners can tap into this equity as a lump-sum loan, which is often used for various purposes like home renovations, debt consolidation, or major expenses. The way a home equity loan works is that the homeowner borrows a specific amount of money, secured by the equity in their property. This type of financing typically has a fixed interest rate and repayment schedule, making it a popular choice for those who prefer predictable monthly payments. In contrast, a standard mortgage is primarily used to purchase a home, and while it can lead to equity buildup over time, it is not a tool for directly borrowing against that equity after the purchase. A line of credit, while also providing access to funds based on home equity, operates differently by allowing homeowners to borrow as needed, up to a certain limit, rather than providing a fixed loan amount up front. An FHA loan is a type of mortgage insured by the Federal Housing Administration, aimed at helping low-to-moderate-income buyers, but it does not specifically relate to borrowing against existing equity.

9. What effect does an escrow account have on a borrower's finances?

- A. It reduces monthly payments significantly**
- B. It helps to simplify the payment of property taxes and insurance**
- C. It necessitates higher interest rates on the mortgage**
- D. It eliminates the need for a down payment**

An escrow account plays a significant role in managing a borrower's finances by simplifying the payment of property taxes and homeowners insurance. When a borrower obtains a mortgage, lenders often require them to establish an escrow account to collect and hold funds dedicated to these recurring expenses. Each month, a portion of the borrower's mortgage payment is directed into the escrow account, ensuring that there are sufficient funds available when property taxes and insurance premiums come due. This arrangement helps borrowers avoid the financial stress of needing to pay a large lump sum at the time these expenses are due. By spreading out the payments over the year, borrowers can better manage their monthly budgeting and cash flow. Furthermore, having an escrow account enables lenders to ensure that these important obligations are met, protecting both the borrower and the lender's interest in the property. In contrast, the other options do not accurately reflect the function of an escrow account. For example, while an escrow account can influence the total monthly payment, it does not usually reduce payments significantly (which suggests an idea of a lower principal or interest rate). Also, it does not necessitate higher interest rates nor eliminate the need for a down payment, as these factors are governed by other conditions of the mortgage itself.

10. What must secondary financing comply with when used in conjunction with a conventional loan?

- A. It must meet government regulations**
- B. It must follow the restrictions of the primary lender**
- C. It can have its own terms disregarding primary loan conditions**
- D. It requires a higher interest rate**

When secondary financing is utilized alongside a conventional loan, it is essential for it to adhere to the restrictions set forth by the primary lender. This requirement stems from the fact that primary lenders often impose specific guidelines regarding how additional financing can be structured. These restrictions may include limits on the amount of secondary financing, requirements for the interest rate, and terms that impact the overall financial stability and risk profile of the loan. In a real estate transaction, the priority of liens is crucial; primary lenders want assurance that their interests are secured before any secondary financing is considered. If secondary financing does not align with the primary lender's conditions, it can create conflicts that may jeopardize the first mortgage. Consequently, secondary financing must be structured in a way that is compatible with the terms of the conventional loan to ensure compliance and prevent complications during the approval process. This context also illustrates why the other options do not apply as fully to the relationship between secondary financing and conventional loans. For instance, while government regulations may apply broadly to much of the lending environment, they are not specifically tailored to the relationship between primary and secondary financing. Similarly, the notion that secondary financing can disregard primary loan conditions runs counter to the fundamental principle of cooperation between the two. Lastly, while higher interest rates