Closing on Your Home

Settlement (or closing) is the process that passes ownership of a property from seller to purchaser. Going to settlement on a new home can be bewildering. Home buyers are usually required to sign a seemingly endless pile of documents, most of which are written in terminology not used outside of the housing industry and that can be complicated to understand.

Before You Go to Settlement

Before closing day, there are certain important items you should know about so that you can achieve the best possible terms for yourself in the transaction.

- Ask a lender for a copy of the HUD pamphlet: "Buying Your Home: Settlement Costs and Helpful Information." Most lenders are required to provide their loan applicants with a copy of this document under the Real Estate Settlement Procedures Act (RESPA), but you will be able to shop more wisely for settlement services if you have read the pamphlet before you apply. It provides a good description of the settlement process and explains most of the expenses you will encounter.
- When you apply for a loan, the lender is required by law to provide you with a good faith estimate of settlement costs. Shortly before settlement, you will be told exactly how much you owe so that you can get a bank check. A personal check is generally not acceptable. In some instances, you may have money returned to you instead of having to pay.
- Before you go to settlement, familiarize yourself with important settlement terms.

Important Settlement Terms

Appraisal Fee. An appraisal is an estimate of the fair market value of your home. Appraisals help both the lender and the buyer to determine if the sales price is consistent with the actual value. An appraiser inspects the house and the neighborhood and makes an estimate based on the price of comparable houses and other factors. The appraisal provides no guarantee that the property is free of defects. Lenders insist on an appraisal to see how much they could recover by selling your house if you default. The fee for this service may vary considerably depending on the specific characteristics of your house.

Attorney's Fees. If the lender requires an attorney to draw up any of the settlement documents, you may be charged a fee — a flat amount or a percentage of the loan. If you hire a lawyer to assist with the settlement, you will have to pay an additional fee at or immediately following settlement.

Credit Report. The lender may charge a fee for investigating your credit history.

Earnest Money. Earnest money is a deposit paid to a seller to show you are serious about buying a house. Your receipt for this payment is called a binder. If you later buy the home, the earnest money is applied to your down payment. If not, the earnest money is returned, minus expenses for processing. Be sure that you understand the refund procedures before you make a deposit.

Escrow Fees and Accounts. Escrow involves having a third-party hold funds and/or documents until you and the seller complete settlement. Depending on the circumstances of your loan, you may be asked to make monthly payments to an escrow account after you purchase your home. Money in the account may be used to pay taxes, insurance, and any other regular assessments as they fall due. Such accounts serve a similar purpose to withholding income tax from your paycheck; by putting aside money each month, you avoid large annual or semiannual payments. You may be charged a fee for the service. In some states, escrow accounts draw interest.

Sometimes, escrow agents handle settlements. Rather than you and the lender meeting to sign all the documents and transfer money, the agent works with you and the lender separately to ensure that everything is done properly. Once again, a fee is required for this service.

Loan Origination Fee. A lender will charge a fee for the cost of processing the loan, usually calculated as percentage of the loan amount.

Loan Discount (Points). The largest of your settlement cost may be the "points" lenders require to make the yield on your loan more profitable. A point is one percent on your loan amount. If you are borrowing $50,000, one point equals $500. Points are tax deductible if they are paid separately and not deducted from the loan amount. For VA loans, you can be charged a maximum of one point, but the number of points can be higher for FHA and conventional loans.

On a 30-year loan, each point that you pay reduces your interest rate by roughly 1/8 of a percent. You may be faced with a choice between two mortgages in which one has lower monthly payments but involves paying more points up front. Annual percentage rate calculation includes buyers' points, so ask for the APR to help you make your assessment. Keep in mind that an APR is calculated on the basis of the total life of the loan. For a 30-year loan, the APR is a 30-year composite figure. If you sell your new home after a few years, the average annual cost of your points will be much higher than is reflected in the APR. If you plan to move soon, you might be better off with a loan that has a slightly higher rate but fewer points.

Property Survey Fee. You may have to pay to have your lot surveyed, especially if there is a question about the boundaries. The cost will depend on the complexity of the survey.

Recording Fee. Because the title is changing hands, the transaction must be recorded with your city, county, or other appropriate branch of government. The fee covers administrative costs.

State and Local Transfer Taxes. Some jurisdictions levy taxes on the transfer of property or on real estate loans.

Settlement Costs Between Buyer and Seller. Your builder may have already paid the annual property taxes on your new home or "filled up your fuel tank." When the title changes hands, you must reimburse the builder for a proportional share of the taxes, any fuel that remains in the tank, and any other prepaid costs.

Title Search and Insurance. A title search involves having someone look through public records to see if anyone else has a claim to your property. A lender does not want to lend you money only to learn in the event of foreclosure that somebody other than you have a prior claim to the property.

You will normally be required to purchase lenders' title insurance to guard against a faulty title search as well as hazards that even the most thorough search will not reveal — such as a forged deed that does not transfer title, a claim by a previously undisclosed relative of a former owner, or a mistake in the records. For a one-time premium at closing, title insurance will clear up title problems, pay the lender's legal expenses for defending against an attack on title, or pay claims on property the lender may lose.

Lenders' title insurance does not compensate buyers for any legal expenses they might incur, or the value of property they might lose. A separate owners' title insurance is available to safeguard the buyer. Whether the seller or the buyer pays for owners' title insurance depends on local custom.

This list of settlement terms is not all-inclusive. You may also be charged fees for notarizing documents and other miscellaneous items.

Key Settlement Documents

Once all the forms have been signed, you can move into your new home. But before ending the settlement session, make sure that you have received or will be sent copies of all the important documents, including:

- Sales contract
- Land survey
- Warranties and instruction booklets from manufacturers for equipment in the house
- All tax payment receipts
- Certificate of occupancy (required in some areas)
- Certificates from the health department for plumbing and sewer installations (required in most areas)
- Other certificates of code compliance (required in most areas)
- All insurance policies (some might be sent later after they have been properly endorsed)
- The note and deed to your property (which will probably be mailed to you after being placed on record in your local registry of deeds office)
- Home maintenance and care instructions from your builder