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# Understanding Settlement and Closing

The mortgage closing or settlement, understandably, may be a source of confusion when you are purchasing a home. It may involve several people as well as a variety of fees and a pile of documents. Once you understand what is involved, you may find the entire process far simpler than you may have imagined.

The closing is the event in the mortgage and homebuying process during which all documents associated with the transaction are signed in their final formats and the transfer of ownership takes place. It is overseen by a real estate attorney who will have received instructions from the lender. The attorney also ensures that all funds are properly accounted for when the closing is completed.

Typically, you need to come to the closing with a certified check for the closing costs and the balance of the down payment. The attorney provides that figure to you prior to the closing. If any documents are needed, you will be instructed to bring them as well.

At the closing, you will review and sign the many documents associated with a mortgage loan. The closing agent should explain the nature and purpose of each one and give you and/or your attorney an opportunity to check them before signing. A brief description of the major documents may help you understand their purpose and significance.

## Major Documents Associated with Your Closing

***HUD-1 Settlement Statement***
This form is required by Federal law and is prepared by the closing agent. It provides the details of the sale transaction including the sale price, amount of financing, loan fees and charges, pro-ration of real estate taxes, amounts due to and from buyer and seller, and funds due to third parties such as the selling real estate agent. It must be signed by both buyer and seller and becomes a part of the lender's permanent loan file.

***Truth-in-Lending Statement***
This form is also required by Federal law. You were given an initial TIL shortly after you completed the loan application. If any changes have taken place since that time, you will have to sign a new form before your loan can close.

***The Mortgage Note***
The mortgage note is legal evidence of your indebtedness and your formal promise to repay the debt. It sets out the amount and terms of the loan and also recites the penalties and steps the lender can take if you fail your payments on time.

***The Mortgage or Deed of Trust***
This is the "security instrument" which gives the lender a claim against your house if you fail to live up to the terms of the mortgage note. It recites the legal rights and obligations of both you and the lender and gives the lender the right to take the property by foreclosure if you default on the loan. The mortgage or deed of trust will be recorded, providing public notice of the lender's claim (lien) on the property.

***Miscellaneous Documents***
There will be a number of documents or affidavits that you will be asked to sign at closing. Some are lender requirements, and others are required by state or Federal law. These instruments should not be taken lightly. Some provide for criminal penalties for false information, and some may give the lender the right to call your loan, which means the entire loan amount becomes immediately due and payable. When everything has been signed and the closing agent is satisfied that all of the instructions for closing have been complied with in full, you become the owner and are given the keys to the property.

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## Types of Closing Costs

There are different types of costs associated with your mortgage. It is important to understand them so you can better understand where your money is going. Typically, these are costs that are paid at closing (or credited at closing by monies already paid) but they fall into different categories.

***Closing Costs***

These are the costs and fees directly associated with the writing of your mortgage and establishment of ownership. They may include fees such as:

- Attorney's/legal fees
- Government fees
- Fees paid to vendors (appraiser, credit agency, etc.) on your behalf
- Underwriting fees

***Prepaids/Escrows***

*Prepaid interest* is the interest you pay to cover the interest owed on your home from the day you own it until the beginning of the next payment cycle.

In many cases, the lender is required to establish *escrows* for your taxes and insurance because they are paid on your behalf by the lender. There has to be money in your account in order for them to be paid out. If you refinance or pay off your mortgage, any money sitting in your escrow account must be paid back to you and new escrows will be established on any new mortgages.

## Title & Title Search

The title search is the research done to ensure that the person selling the home is the person who legally owns the home. Your lender will require a clear title to the property before it gives you a mortgage on the house.

A variety of items are examined in a title search including recorded deeds, tax records, survey information, death and divorce records, court judgments and liens, and contests over wills. This research assures both you and your lender that there are no claims against the property you are purchasing.

## Title Insurance

In addition to a formal title search, your lender will require a title insurance policy. The policy guards the lender in the event of a defect in the title. Because public records can be scattered across many government agencies, the occasional error may occur.

Should an error be found after the fact, the lending institution has loaned the homebuyer thousands of dollars to buy a house from someone who did not own it. This is why the lender requires title insurance prior to settlement. The cost of the policy (a one-time premium) is based on the loan amount and is paid by the buyer as part of the closing costs.

*Lender's title insurance protects only the lender.* To protect yourself against unforeseen title problems, you may wish to take out an owner's title insurance policy. There will be an additional premium required for the owner's policy. The policy can be arranged through the closing attorney.

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## Costs Associated with Your Mortgage

Some of the standard costs associated with your mortgage are explained below.

***Application Fee***
This charge covers the initial costs of processing your loan request. In some cases, the credit report and appraisal fees may comprise the application fee.

***Appraisal Fee***
An appraisal is a professional opinion required by the lender to support the market value of the property being financed.

***Survey***
A professional survey determines whether or not the lot has been encroached upon by any structures since the last survey conducted on the property. It also ensures that the house and other structures legally are where they should be.

***Points***
Points are prepaid finance charges, paid at closing, allowing the buyer to obtain a lower rate on the mortgage. One point equals one percent of the loan amount.

***Underwriting Fees***
These are fees charged for the lender's work in evaluating and preparing your mortgage loan.

***Mortgage Insurance***
Mortgage insurance may be required on loans considered to be higher risk, thus allowing many buyers to qualify for mortgage financing. Often, buyers putting down less than 20 percent of the purchase price may be required to pay mortgage insurance. The policy covers the lender's risk in the event the buyer fails to make the loan payments. Certain types of loans require mortgage insurance, regardless of down payment.

***Homeowner's Hazard Insurance***
This is insurance protecting against physical damage to the house by fire, wind, vandalism, and other causes. Your lender will require you to have a policy in effect at closing. If you are purchasing a condo, it may not be required, but is recommended to ensure that the internal structure and your personal belongings are protected.

## Understanding and Anticipating Your Closing Costs

With such a long list of potential charges at settlement, it is important to know what to expect. Your mortgage lender is required by law to supply you certain documents within three business days of your application for a loan.

- **Good Faith Estimate** provides an estimate of all of the costs associated with your loan. Should these change, your lender must provide you with an updated Good Faith Estimate prior to settlement.
- **Settlement Costs—A HUD Guide** is an informational booklet providing more information about settlement or closing costs.
- You will receive a document stating your total finance charge and your **annual percentage rate** (APR) for the mortgage. The APR expresses the cost of your loan as a yearly rate and it is likely to be higher than the stated interest rate on your mortgage because it takes into account points, mortgage insurance, and other fees that add to the cost of your loan.

*This has been prepared to help you understand some of the settlement costs associated with buying and financing your home. Every transaction is different; this information should not be viewed as a replacement for professional advice. Speak with professionals and never hesitate to ask the questions that will ensure that you have a firm grasp of the financial commitment you are about to undertake.*