

What Are Closing Costs?

The home purchasing process can be quite confusing, especially for [first-time homebuyers](#). Therefore, it is vital that you do your homework before you start house hunting.

You should carefully consider your budget and [calculate your approximate monthly mortgage payment](#). This ensures that your new home does not become a financial burden.

Additionally, you should calculate how much money you must bring to the closing table. Along with your down payment amount, you will need to provide funds to cover closing costs. These costs vary depending on several factors, and they can drastically impact your total out-of-pocket expenses.

What are closing costs? Here we break down the various fees that are included in closing costs and discuss how you may be able to reduce your out-of-pocket obligations.

What Are Closing Costs?

Closing costs are fees that are paid at settlement (“the closing table”) in addition to the down payment amount. While closing costs are typically thought of as a buyer’s expense, sellers also incur expenses. However, the buyer’s closing costs are often covered out of pocket or [financed into the loan](#), whereas the seller’s closing costs are deducted from the proceeds of the deal.

Financing Your Closing Costs

Pay Less Out-of-pocket at the Closing Table. In addition to your down payment, you’ll be responsible for paying closing costs – the fees that your Lender and other third parties charge as part of the home financing process.

These fees may include:

A mortgage loan origination fee	Loan discount points
Appraisal fees	Credit report costs
Taxes and insurance	Title fees
Recording fees	Funding fees for specific programs

Fortunately, a variety of purchase programs allow you to include these costs in the loan or negotiate with the seller to pay them for you.

FHA Home Loans

With an FHA home loan, you can finance your closing costs or negotiate with the seller to contribute toward them. However, the seller can only contribute up to 6% of the lesser of the home's sales price or property appraised value.

USDA Rural Home Loans

In addition to great benefits like 100% financing and flexible credit requirements, you may be able to finance the closing costs associated with a USDA rural home loan (depending on the appraised value of the property).

VA Home Loans

A VA home loan provides great benefits for those who've served in the U.S. military, such as 100% financing and no mortgage insurance. You can also negotiate with the seller to determine who will pay closing costs. You can pay them, the seller can, or they can be shared. However, the only financeable closing cost charge is the VA Funding Fee. All other closing costs must be paid at closing.

Refinances

Most refinance loans in the above programs allow closing costs to be financed. If you still have questions about closing costs, don't hesitate to contact us today. A licensed loan officer will be happy to walk you through the process and inform you on your options.

Several factors impact total closing costs, including the type of loan you are obtaining and what state you live in. For instance, FHA loans and conventional mortgages involve a few slightly different closing costs.

What Is Included in Closing Costs?



Closing costs are not a single expense; they are the cumulative {combined} total of multiple expenses.

Property Taxes

Many lenders will require you to make a deposit toward the property taxes for the home. Buyers may need to provide up to a year's worth of taxes, but mortgage lenders have different requirements. The timing of *when* a buyer is purchasing their house is also a factor in how much property tax is due based on the property tax schedule.

Property tax deposits will be wired to an escrow account at the time of closing. The lender will maintain the escrow account. Part of your mortgage payment will include funds for this account. Each year, your lender will draw from the account to pay your annual property taxes when they are due to the county government.

Application Fees

Mortgage applications are complex sets of documents. Naturally, processing these documents, verifying income, and taking other steps to determine loan eligibility is a labor-intensive exercise. That is why lenders charge an application fee to process your request for a mortgage.

When speaking to prospective lenders, ask what their application fee is. While this can be a relatively minor expense, rates vary from lender to lender. Some lenders could even waive your application fee if you meet certain requirements.

Title Searches

Title companies will review public records for the property you are buying to ensure that there are no liens or ownership disputes. The title company charges for this service. This expense is referred to as a "title search fee" on your itemized list of closing costs. When the results are "clean title", the buyer may purchase a buyer title binder and a lenders title binder is also available. The title binder serves as a guaranteed protection to the new property owner.

Loan Origination Fees

Loan origination fees cover a financial institution's costs of processing a mortgage. Traditionally, origination fees are 1% of the total loan amount. For example, if your loan amount is \$450,000, then your origination fee will likely be \$4,500.

Keep in mind that this fee can vary from lender to lender. Some lenders will waive this fee but charge you a higher interest rate.

Deposits for Escrow Accounts

Funds for your property taxes are not the only monies that are held in escrow. Your lender will also require you to deposit funds at the time of closing to cover private mortgage insurance and your homeowners' insurance.

Private mortgage insurance is required if a buyer pays less than 20% toward down payment, which means your loan amount exceeds 80% of the home's appraised value. If you have a conventional loan, you will no longer need PMI after your mortgage balance drops below the 80% threshold. All mortgages require you to have a homeowners insurance policy.

A portion of your monthly mortgage payment will be deposited into the escrow account to cover homeowners' insurance, PMI, and property taxes. All three of these fees are paid annually.

Appraisal Fees

Lenders want to ensure that they can recoup their losses if you default on a loan. That is why they require an appraisal before finalizing a real estate deal. A third-party appraiser will determine an approximate market value for the home based on local comparable properties and other data.

Typically, buyers can cover appraisal fees out of pocket. However, there are instances where buyers pay these fees as part of their closing costs.

Home Inspection

Like the appraisal, the home inspection is usually paid for by the buyer before closing. In most real estate deals, buyers request an inspection period as a contingency for purchasing the home. If the inspection uncovers concerns about the home, the buyer can back out of the deal without repercussions.

Although you will likely pay for the home inspection before closing, it is important that you are aware of this additional expense. Generally, you should budget \$400–\$800 for a home inspection.

Pest Inspection

Certain states and some types of mortgages require a pest inspection as part of real estate deals. The inspector will look for evidence of wood-destroying organisms (WDOs) like termites. They will check for signs of wood rot and other damage. Pest inspection fees can be covered upfront or as part of closing costs.

Real Estate Agent Fees

The real estate agent fee is one of the costs covered by sellers during a transaction. The seller will pay a commission for both the buyer's agent and their own agent if they are using one.

Each real estate agent's commission fee ranges from 2.5% to 3% of the home's total purchase price. Therefore, sellers can expect to pay 5% to 6% of their home's purchase price toward real estate commission. The fee is always divided evenly between both agents.

Who Pays Closing Costs?

Both parties in a real estate transaction pay closing costs. Sellers usually pay more total closing costs, but these expenses are deducted from their profits from the transaction.

A seller's closing costs usually range from 8% to 10% of their home's purchase price. These figures include 5% to 6% real estate agent commission fees as well as taxes and other miscellaneous fees. A seller's closing costs may be higher if they agree to cover a portion of the buyer's out-of-pocket expenses.

Buyers will pay 2% to 5% of the total purchase price toward closing costs. Most of these costs cover the lender and title company fees.

How to Reduce Closing Fees

As you can see, closing costs can be quite high. Fortunately, as a buyer there are several ways that you can reduce your out-of-pocket expenses.

Obtain Mortgage Lender Comparisons

Once a lender runs your credit to determine mortgage eligibility, you have a 14-day window to compare other offers. All credit inquiries conducted during that time will not negatively impact your credit score.

You should use this grace period to compare mortgage lenders and find the company that offers the most affordable closing costs.

Request Seller Concessions

One of the best ways to reduce closing costs is to negotiate "seller concessions" as part of your real estate deal.

For example, suppose that you want to purchase a house listed at \$400,000. Your real estate agent advises you that \$390,000 is a fair purchase price for the home. Instead of bidding \$10,000 below asking, you could submit a bid for \$400,000, but ask the seller to contribute \$10,000 toward closing costs.

Keep in mind that there are limits to how much sellers can contribute. The exact limits vary depending on the type of mortgage. Cash gifts from agents, family, friends, employers, payment assistance programs, government agencies are also allowable up to a certain percent. Certain loan types also allow gifts of equity.

Explore Down Payment Assistance Programs

Down payment assistance programs provide prospective buyers with loans or grants. These funds can be potentially used to meet down payment obligations or to cover closing costs. Generally, only first-time homebuyers can access these programs, but there are a few rare exceptions.

If you are a first-time homebuyer, research down payment assistance programs in your state. Carefully review eligibility requirements. If you meet the criteria, these programs are a great way of funding the purchase of your first home.

Clarifying Closing Costs

As you begin your journey of buying a home, use this information to help you successfully navigate the process. Make sure to compare multiple lenders before committing to a single institution, but more importantly, find a great agent who can guide you and negotiate with the seller on your final closing costs.

The combination of an experienced agent and an established lender can make the process of purchasing a home enjoyable and seamless.