

Unit 14: Closing the Real Estate Transaction

LECTURE OUTLINE

- I. Preclosing Procedures—Closing is the point at which ownership of a property is transferred in exchange for the payment of the selling price. Promises made in the sales agreement are fulfilled and loan funds are distributed.
- A. Buyer's concerns—the buyer will want to be assured that:
 - 1. The seller is delivering good title.
 - 2. The property is in the promised condition. This involves examining
 - a. results of any property inspections (see Figure 14.1),
 - b. the survey,
 - c. title evidence, including the seller's deed and any documents demonstrating removal of undesired liens and encumbrances, and,
 - d. any lease, if there is a tenant on the premises.
 - 3. Buyer's final property inspection (walk-through) indicates:
 - a. Necessary repairs have been made.
 - b. Property is well maintained.
 - c. Fixtures and any personal property to be left behind by seller are in place.
 - d. There have been no unauthorized removals or alterations.
 - 4. Survey gives information about the exact size and location of the property.
 - 5. Title evidence
 - a. The buyer needs to be assured that the seller's property and title comply with the sales contract requirements.
 - b. The seller is usually required to show proof of ownership by producing current title evidence (form that is customary in your area).
 - c. The title or abstract company usually makes two title searches.
 - i. The first shows the seller's status as of the contract date.
 - ii. The second is made for the date the deed is recorded.
 - iii. The seller may be required to execute an affidavit of title affirming that there have been no defects on the title since the date of the title examination.

- B. Seller's concerns—the seller will want to be assured that:
 - 1. The buyer has obtained the stipulated financing.
 - 2. The buyer has sufficient funds to complete the sale.
 - C. Real estate professional's role at closing
 - 1. Varies, depending on local practice
 - 2. Often, parties look to real estate professionals for guidance and assistance at closing
 - D. Lender's interest in closing is to protect its security interest in the property. The lender can require:
 - 1. Title insurance policy
 - 2. Fire and hazard insurance policy
 - 3. Survey
 - 4. Termite or other inspection report
 - 5. Certificate of occupancy (for newly constructed buildings)
 - 6. Reserve or escrow account for tax and insurance payments
 - 7. Representation by its own attorney at the closing
 - E. Internal Revenue Service reporting requirements on Form 1099-S:
 - 1. Contains the seller's Social Security number, the sales price, and the amount of property tax, if any, that reimbursed to the seller by the buyer.
 - 2. Must be filed by the closing agent; if this person does not, the responsibility rests on the mortgage lender or ultimately the brokers involved.
- II. Conducting the Closing—terminology varies by region, and may be called settlement and transfer, passing papers, or closing escrow.
- A. Face-to-face closing is the gathering of the parties interested in the real estate transaction at which the promises made in the real estate sales contract are kept or executed
 - 1. May be held at:
 - a. Title insurance company
 - b. Lending institution
 - c. One of the parties' attorney's office
 - d. Broker's office
 - e. County recorder (or other local recording official) office
 - f. Escrow company

2. May be attended by:
 - a. Buyer
 - b. Seller
 - c. Real estate licensees (brokers and sales associates)
 - d. Attorney for seller and attorney for buyer
 - e. Representative of the involved lending institution(s)
 - f. Representative of the title insurance company
3. The closing agent or closing officer presides over the closing.
4. The exchange is made when all parties are satisfied that everything is in order.

B. Closing in escrow

1. Disinterested third party is authorized to act as the escrow agent and coordinate the closing activities.
2. Escrow agent may be an attorney, a title company, a trust company, an escrow company, or the escrow department of a lending institution.
3. Escrow procedure
 - a. After escrow agent selected and contract signed, broker deposits earnest money with escrow agent.
 - b. Before the closing, the seller will deposit the following with the escrow agent:
 - i. The deed conveying the property to the buyer
 - ii. Title evidence (whatever is customary in the area)
 - iii. Existing hazard insurance policies
 - iv. Letter or mortgage reduction certificate from the lender stating the exact principal remaining if the buyer is assuming the seller's loan
 - v. Affidavits of title (if required)
 - vi. Payoff statement if the seller's loan is to be paid off
 - vii. Other documents necessary to clear the title or complete the transaction
 - c. Before the closing, the buyer will deposit with the escrow agent:
 - i. The balance of the cash needed to complete the purchase, in the form of a certified check or via an electronic fund transfer (EFT)
 - ii. Loan documents if the buyer is securing a new loan

- iii. Proof of hazard insurance, including, if required, flood insurance
- iv. Other documents necessary to complete the transaction
- d. The escrow agent is given the authority to examine the title evidence.
 - i. If the title is marketable and all other conditions are met, the escrow agent will disburse the funds and record the documents.
 - ii. If the title has liens that are to be cleared, they will be paid off first.
 - iii. If the sale cannot be completed, the parties will be restored to their former status.

III. Legislation Related to Closing

- A. Real Estate Settlement Procedures Act (RESPA)—federal law intended to:
 - 1. Provide consumers with greater and more timely information on the nature and costs of settlement
 - 2. Eliminate "kickback" and other referral fees that tend to unnecessarily increase the costs of settlement
 - 3. Prohibit lenders from requiring excessive escrow account deposits
- B. RESPA requirements must be complied with when the purchase of a one-to-four-family residential unit is financed by a federally related new first mortgage loan that is
 - 1. Made by a federally chartered lending institution;
 - 2. Made by an institution whose deposits are federally insured;
 - 3. FHA-insured;
 - 4. VA-guaranteed;
 - 5. Administered by HUD; or
 - 6. Intended to be sold to Fannie Mae, Ginnie Mae, or Freddie Mac
- C. Exceptions to the "new loan" requirement include:
 - 1. Loans on large properties (i.e., more than 25 acres);
 - 2. Loans for business or agricultural purposes;
 - 3. Construction loans or other temporary financing;
 - 4. Vacant land (unless a dwelling will be placed on the property within two years);

5. A transaction financed solely by a purchase-money mortgage taken back by the seller;
 6. An installment contract (contract for deed); and
 7. A buyer's assumption of a seller's existing loan, but if the terms of the assumed loan are modified, or if the lender charges more than \$50 for the assumption, the transaction is subject to RESPA regulations.
- D. Affiliated business arrangements (ABAs)—affiliated firms can offer package of services to consumers in compliance with RESPA if:
1. The relationship between the firms is disclosed to consumers;
 2. Consumers are free to obtain the services elsewhere; and
 3. Fees are not exchanged among the affiliated companies simply for the referral of business.
- E. Other RESPA Requirements
1. RESPA prohibits the lender from requiring the borrower to deposit funds in an escrow account for taxes and insurance that exceed certain limits, thus preventing the lender from taking advantage of the borrower.
 2. A **mortgage servicing transfer statement** is required if the lender intends to sell or assign the right to service the loan to another loan servicer.
- F. TILA-RESPA Integrated Disclosure Rule
1. Requires two forms, Loan Estimate and Closing Disclosure for transactions originating on or after October 3, 2015.
 2. The Loan Estimate form (See Figure 14.2) must be provided to the consumer three business days after a loan application is submitted to the lender.
 - a. Once the Loan Estimate is issued, the lender is committed to making the loan on the indicated terms and may only modify the Loan Estimate in certain specific instances.
 - b. Some closing costs or fees may or may not change prior to settlement.
 - c. Three categories of fees:
 - i. No tolerance—fees that may not change before closing.
 - ii. 10 percent tolerance—fees that cannot increase by more than 10%.
 - iii. Unlimited tolerance—fees for services that are out of the lender's control.
 - d. The lender is responsible for the accuracy of the Loan Estimate.

3. The Closing Disclosure form (See Figure 14.3) itemizes all charges that are normally paid by a borrower and a seller in connection with settlement, whether required by the lender or another party, or paid by the lender or any other person.
 - a. The borrower must receive a completed Closing Disclosure at least three business days before the closing.
 - b. If a new Closing Disclosure is required because a creditor has made a significant change to the loan terms (such as an increase in the APR greater than 0.125%, a different loan product, or the addition of a prepayment penalty), a new three-day waiting period begins.

G. *Your Home Loan Toolkit*

1. Information booklet developed by the CFPB which must be provided by a creditor to a mortgage applicant as part of loan application process.
2. Effective October 3, 2015, *Your Home Loan Toolkit* replaced the previously mandated *Settlement Cost Booklet*.

H. Kickbacks and referral fees

1. Kickbacks and *unearned* referral fees are prohibited.
2. The payment or receipt of any fee or thing of value where no service is actually rendered is prohibited.

I. Mortgage Disclosure Improvement Act

1. The intent of this law is to prevent the consumer from receiving an enticingly low interest rate at the initial loan application and then learning at settlement that the lender is charging more in fees.
 - a. The requirements of the MDIA are now incorporated into the CFPB disclosure requirements.
 - b. Before closing, everyone involved in the real estate transaction should check and double-check that the Loan Estimate and Closing Disclosure forms are consistent with the original application.

IV. Preparation of Closing Statements

A. How the closing statement works (see Figure 14.4)

1. A debit is a charge (an expense).
2. A credit is an amount entered in a person's favor.

- B. The buyer's debits and credits are totaled; when the credits are subtracted from the debits, the difference is the cash the buyer must bring to the closing or transfer before closing.
- C. The seller's debits and credits are totaled; when the debits are subtracted from the credits, the difference is the amount the seller will receive at closing.
- D. Expenses
 - 1. Broker's commission
 - 2. Attorney's fees
 - 3. Recording expenses
 - 4. Transfer tax
 - 5. Title expenses
 - 6. Loan fees
 - 7. Tax reserves and insurance reserves (escrow or impound accounts)
 - 8. Appraisal fee
 - 9. Survey fee
 - 10. Additional fees
- V. Prorations are divided between the seller and the buyer, including accrued items (such as real estate taxes) and prepaid items (such as fuel oil in a tank) (See Figure 14.4)
 - A. General rules for prorating
 - 1. General guidelines
 - a. In most states, the seller owns the property on the day of closing and prorations are made to and including that date.
 - b. Accrued real estate taxes are usually prorated; special assessments for public improvements are not.
 - c. Rents are usually prorated based on the actual number of days in the month of closing.
 - d. Security deposits made by tenants must be transferred intact from the seller to the buyer.
 - 2. Real estate taxes
 - a. If they are paid in advance, the seller should be reimbursed for the portion of the year remaining after the buyer takes ownership.
 - b. If they are paid in arrears, the buyer is credited for the time the seller was occupying the property.
 - 3. Mortgage loan interest is usually paid in arrears

B. Accrued and prepaid items

1. Accrued items = buyer credit
- 2.
2. Prepaid items = seller credit

C. The arithmetic of prorating—four considerations

1. The nature of item being prorated.
2. Whether it is an accrued item requiring determination of earned amount.
3. Whether it is a prepaid item that requires the unearned amount refunded.
4. What calculation must be used.
 - a. The yearly charge is divided by a 360-day year (commonly called a banking or statutory year) or 12 months of 30 days each.
 - b. The yearly charge is divided by 365 to determine the daily charge; then, the actual number of days in the proration period is determined and this number is multiplied by the daily charge.
 - c. The final figure will vary depending on the method used and the number of decimal places to which the division is carried.