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What Will Your House Really Cost?

Closing Fees Can Be a Real Eye-Opener at Settlement

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You finally found a house you like. You and the seller have agreed on a price, even though it was more than you hoped you would have to pay. You have signed a contract and set a settlement date.

So that's the end of your money worries, right?

Wrong.

To make that home yours, you will have to pay thousands of dollars more than the price you negotiated with the seller, usually about 3 to 5 percent of the sales price. That means that a \$300,000 house will actually cost \$309,000 to \$315,000.

The additional money covers all kinds of closing costs, such as insurance payments, fees to the lender, fees to the jurisdiction where the property is located, and some prepaid charges that go into an escrow account. And you are expected to have it all with you on settlement day in the form of a certified check. Sorry, personal checks are not accepted.

A couple of recent real-life examples:

Dale Mattison, an associate broker with Long & Foster Real Estate Inc., recently sold a \$1 million property in the District. The settlement charges totaled \$36,181, or 3.6 percent, he said, looking at the settlement form. That form, called a HUD-1, was developed by the Housing and Urban Development Department; legally, it is supposed to be given to both the buyer and seller 24 hours before closing. In reality, many times buyers do not see it until they are already sitting at the settlement table.

Kathleen Herbert, a settlement lawyer and general counsel at MBH Settlement Group LC, looking at another HUD-1, said total settlement charges on a \$382,000 property that recently changed hands at her Fairfax office came to \$8,300, or 2.2 percent. Virginia tends to have the lowest settlement charges, compared with the District and Maryland, largely because of lower state transfer and recordation taxes and lower title insurance rates, settlement lawyers said. "However you want to cut it, you need a lot of money to close," Mattison said. "I've seen settlements delayed so that buyers can beg, borrow and steal the money they need."

And there is not much you can do about it -- precious few of these fees are optional.

The Greater Capital Area Association of Realtors, or GCAAR, divides closing costs into five basic categories -- loan-related fees, prepaid or escrow items, title charges, recordation and transfer charges,

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and additional settlement fees -- on a closing worksheet widely used by local agents. The agents use the GCAAR worksheet to show buyers the costs they will face at closing.

Loan-Related Fees

One of the largest fees related to getting a mortgage is the loan discount fee, also called points. Each point equals 1 percent of the loan amount. On a \$300,000 mortgage, for example, the fee would be \$3,000. Buyers pay points to reduce their interest rate.

"For many years, it was necessary to pay points to lower the interest rate for the purpose of qualifying for the loan," said Keith Gumbinger, a mortgage industry analyst at financial publisher HSH Associates.

In this period of low mortgage rates, though, few buyers are paying points on their loans, settlement lawyers say. Rates on 30-year fixed-rate mortgages averaged 5.98 percent with 0.7 points this week, up slightly from 5.94 percent last week, according to secondary mortgage giant Freddie Mac.

Consumers often confuse discount points with loan origination fees, which can be also called points, Gumbinger said. Loan origination fees are also often denominated as a percentage of the loan amount. "Even if the broker tells you your mortgage has no points, that doesn't mean it doesn't have loan origination fees," he said.

It is no wonder people get confused. Even the Internal Revenue Service calls both charges points; they are tax-deductible in many circumstances.

Loan-related fees also include what GCAAR calls assumption fees -- costs associated with a lender assuming a mortgage. Those include charges for documentation preparation, processing, tax service, underwriting and more. Assumption fees can run anywhere from \$450 to \$1,000, according to GCAAR. Some of these assumption fees, though, are controversial with buyers, settlement lawyers say.

"One of the things that takes buyers most by surprise is the extra charges the lender throws in, such as document preparation fees, processing fees and underwriting fees," lawyer Herbert said. "Most people call those 'junk fees,' " also known as "garbage fees."

To cut down on junk fees and make the settlement process more transparent, with exact and binding closing fees disclosed well in advance, HUD is seeking to reform the Real Estate Settlement Procedures Act, the federal law that governs much of the home-closing process. The HUD proposals are meeting with some industry resistance, however, and it is unclear if the changes will be adopted.

Now, the good-faith estimates of closing costs that lenders must give borrowers are not legally binding. And real estate agents and settlement lawyers say the estimates are often wrong.

Other charges that some buyers consider to be junk fees include flood certification fees, to determine whether the property is in a flood zone, and tax service fees, to set up an escrow account to pay property taxes.

"We get a lot of comments on the flood certification fee," said lawyer Kathleen Shank of Heritage Title & Escrow Co. in the District. "It's usually anywhere from \$11 to \$50. It's not that much, but it's the principle of the thing that gets people. Lenders charge it whether you're buying a house, a condo or a co-op. People wonder if they're actually checking anything." Still, even condos in the Washington area have been known to flood.

Shank said lenders these days have begun to combine their fees into one lump charge. Doug Duncan, chief economist of the Mortgage Bankers Association in Washington, said lenders are experimenting with fee-bundling in reaction to the HUD proposals to streamline the closing process.

"Before, lenders' fees used to be a list of nickel-and-dime stuff," Shank said. "Now, a lot of them are combining the fees. There's less fees, but in the end larger amounts. They're making the same money, if not more."

Some fees that are generally paid before settlement are also considered part of the transaction and listed on the HUD-1. On the form, they are marked as POC, or paid outside closing. Such fees include the cost of an appraisal, which can run from \$250 to \$700, and credit report fees, usually \$60 to \$75 per person or married couple.

"Buyers need to be careful what lender they go with," said Connie Maffin, an agent at Coldwell Banker Residential Brokerage Pardoe and chairman of the D.C. Real Estate Board. "I've seen buyers find what they think is a real deal on the Internet only to then find they've been charged \$750 for a drive-by appraisal."

Maffin said she has seen cases of buyers working with non-local lenders, who omitted from their good-faith estimates the state-mandated transfer and recordation taxes that are due in this region. The buyers working with these lenders were shocked after closing costs added up to thousands of dollars more than they anticipated.

Then there are the fees associated with getting a second mortgage -- any points or assumption fees associated with obtaining an additional trust beyond your primary mortgage. Many borrowers these days are taking out first and second mortgages, also called "piggyback" mortgages, in 80-10-10 or the 80-15-5 loans.

In an 80-10-10 loan, for example, a borrower takes out a first mortgage for 80 percent of the purchase price and a second mortgage for 10 percent. A down payment of 10 percent is made. These loans allow a borrower to make a down payment of less than 20 percent while avoiding private mortgage insurance.

Lawyer Herbert said about a third of buyers closing at her Northern Virginia office are now taking out first and second trusts.

Escrow Fund

The next big chunk of money goes out in the form of prepaid or escrow charges. These include advance payments for homeowners insurance, mortgage insurance and property tax. The lender holds these in trust in an escrow account and directly makes the payments.

Borrowers need to pay a full year of homeowners insurance, also called hazard insurance and sometimes paid before closing, to settle on a property because the lender wants to fully insure its collateral. On top of that, two months of premium payments are held in escrow. So a buyer needs a full 14 months of insurance payments to settle on a property.

Homeowners insurance policies cost about \$3.50 for every \$1,000 in purchase price, although prices can vary according to the deductibles selected and the perceived risk involved.

Lenders generally also require a full year of private mortgage insurance premiums up front. Some also

want a couple of premium payments held in escrow, just like for hazard insurance.

Settlement lawyers say that the escrow requirement that seems to most irritate borrowers is the one for property tax payments. Lenders routinely hold the equivalent of seven months of property tax payments in escrow -- one semi-annual tax payment, with some spare in the case of an increased tax assessment. For absentee owners, that can rise to 14 months.

"Most people don't want their taxes escrowed," said Shank of Heritage Title. "We get a good percentage of people who would much rather pay their own taxes. It's a control thing. They want to control their own money."

Mark Vitner, senior economist at Wachovia Corp., said the reason lenders hold tax payments in escrow is to protect their collateral.

"Having the money for the tax payment gives a lender greater confidence that the buyer won't fall behind in their taxes. These days, with interest rates so low, it's not a matter of making money" on the cash held in escrow, he said.

Gumbinger from HSH Associates said, however, that even though interest rates are low at the moment, having "hundreds of thousands of escrow accounts, if not millions, absolutely makes the cash register ring" for a lender.

Shank said only some lenders will agree to let the homeowners pay their own taxes and usually only after the homeowners push for the right.

Lenders usually charge one-fourth or one-eighth of a percent higher interest rate to let borrowers pay their own taxes, Shank said.

"They're trying to discourage people from doing that," she said. "Holding a lot of tax money in escrow is a moneymaker for them." The amount lenders can hold in escrow is regulated, however.

Then there is the prorated interest to the lender, which will vary depending on the day of the month the settlement occurs. Borrowers need to pay the interest from the day they close to the end of the month.

"When buyers are marginal on cash, they want to settle the last day of the month so they don't owe any interest to the lender at closing," broker Mattison said. "But when you do that, your mortgage payment comes around quicker. It's really a wash. But it can affect how much a buyer needs to bring to the table."

Title Charges

Title insurance charges can also raise a buyer's hackles, settlement lawyers say, although title insurance is one charge that can be reduced. The owner's part of the coverage is voluntary, whereas the lender's part is mandatory, so a homeowner can opt out of the owner's part of title insurance.

Of course, that means the homeowner is taking on the risk of a title problem. The lender's policy only covers problems up to the amount of the mortgage.

A title insurance premium, unlike other insurance premiums, is collected as a one-time charge at settlement. There are no future payments owed. Title insurance costs about \$3.50 to \$4.50 per \$1,000 of purchase price, according to settlement lawyers, and protects from any past claims or liens on the

property.

"People do balk at the title insurance fees," lawyer Herbert said. "But they balk because often they don't understand what it is. It looks like a huge amount of money on the settlement statement, so it's difficult for people to swallow."

She said, "It's difficult for people to understand because it's different from any other insurance policy. You can't pay it in installments and it's a policy that only looks backward."

The title premium the buyer pays is split between the insurance company issuing the policy and the title agent, which is usually also the settlement company.

The settlement company also charges its own fees, which GCAAR said are \$500 to \$1,000. Included are charges such as document preparation, courier, title binder, title search and notary fees.

The Government's Share

A big chunk of closing costs come in the form of government-mandated transfer and recordation fees. These vary among local jurisdictions.

In the District, buyers and sellers generally split a tax amounting to 3 percent of the purchase price on all non-owner-occupied properties and on owner-occupied properties priced more than \$250,000. That is up from 2.2 percent divided between buyer and seller last year. For properties priced up to \$250,000, the recordation tax is still split 1.1 percent for the buyer and 1.1 percent for the seller.

The District has a homeownership tax abatement program, however, where eligible lower-income buyers can be exempt from the recordation tax and even have the seller pay their part of the tax to the borrower as a closing cost credit.

In Maryland, buyers and sellers usually split three taxes: a county transfer tax, which varies from county to county (in Montgomery County it is 1 percent; in Prince George's County, it is 1.4 percent), a state recordation tax, also varying from county to county (0.69 percent in Montgomery County) and reduced somewhat if buyer intends to reside in the property, and a state transfer tax of 0.5 percent. Maryland provides tax breaks for first-time buyers and owner-occupiers in the state.

"In the later part of the '90s, a lot of people complained about the high closing costs in Maryland," said settlement lawyer Randy Rothstein, principal at Paragon Title & Escrow Co. in Bethesda and the District. "In an effort to reduce closing costs and induce people to want to buy here, Maryland passed a law for first-time buyers in the state."

Virginia tends to have the lowest closing costs -- and the lowest property taxes -- of the three jurisdictions, settlement lawyers said. In Virginia, the recordation and transfer tax is 0.3 percent, which includes both state and local taxes. The buyer pays 0.2 percent of that fee and the seller pays 0.1 percent. Additional charges can vary by county.

But Wait, There's More

You're not done yet.

Other potential settlement charges include a survey of the property, which if it is a location drawing can

cost \$150 to \$300, according to GCAAR, and if it is a boundary survey can cost \$450 to \$2,000.

There are also various inspection costs, such as a termite inspection, usually paid by the seller in this area, and then a home inspection, a lead inspection and a radon inspection, which are at the buyer's discretion.

To top it all off, there is often a condominium, co-op or homeowners association fee to be paid, prorated from the settlement date plus usually a full month or quarter payment in advance.

Lawyer Rothstein said, "Most people are bug-eyed at how much closing costs are." But he said he is finding that most buyers these days are not blindsided by what they owe.

"If people have a qualified Realtor, they're not usually going to find themselves writing a contract on a house they can't afford," he said. Real estate agents who work with buyers say they review closing costs in detail with their buyers.

"I don't want someone calling me in a year swimming in debt hysterical they're going to lose the house," agent Maffin said. "An unhappy client can do far more damage to you than 20 happy ones. I've had to tell young couples, 'See you in six months. You've got to save about \$1,000 a month for this. You're going to be eating in a lot.' "

Melinda Estridge, a Long & Foster agent, said she is finding that buyers nowadays are more conservative than they were not long ago. "Just three to four years ago, buyers were often trying to buy at the top of their limit and even beyond," Estridge said. "Now they're often buying under what they can afford. They don't want to have all their money tied up in their house."

There are ways to finance closing costs. Mortgage analyst Gumbinger said lenders give buyers the opportunity to roll closing costs into their mortgages in the form of a higher interest rate.

Sometimes, mostly with refinancings, buyers can also take out a larger loan.

"Fees don't just go away though," Gumbinger said. "You will still pay them. You just get to choose your poison."

Beyond the Closing Table

So you have made it through settlement, managing to come up with the thousands of dollars extra in closing charges, taxes, escrow payments and insurance premiums you had to pay. Now you're done, right?

Wrong.

Kermit Baker, director of the Remodeling Futures Program at Harvard University's Joint Center for Housing Studies, said recent buyers tend to spend two to 2 1/2 times more money in the first year after they purchase than do typical homeowners.

Trade-up buyers spend more than first-time buyers, Baker said -- the first-timers just don't have the cash.

"First-time buyers are usually tapped out just getting the down payment and closing costs together," Baker said. "Even if they want to remodel, some of them are forced to defer home improvements until

they've been in their properties a few years."

Okay, so forget remodeling for awhile.

You still have to move in, though. So unless you've got a few strong friends who want to help you cart your furniture, you should budget for the moving company, too.

And don't forget: The movers expect a tip.

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