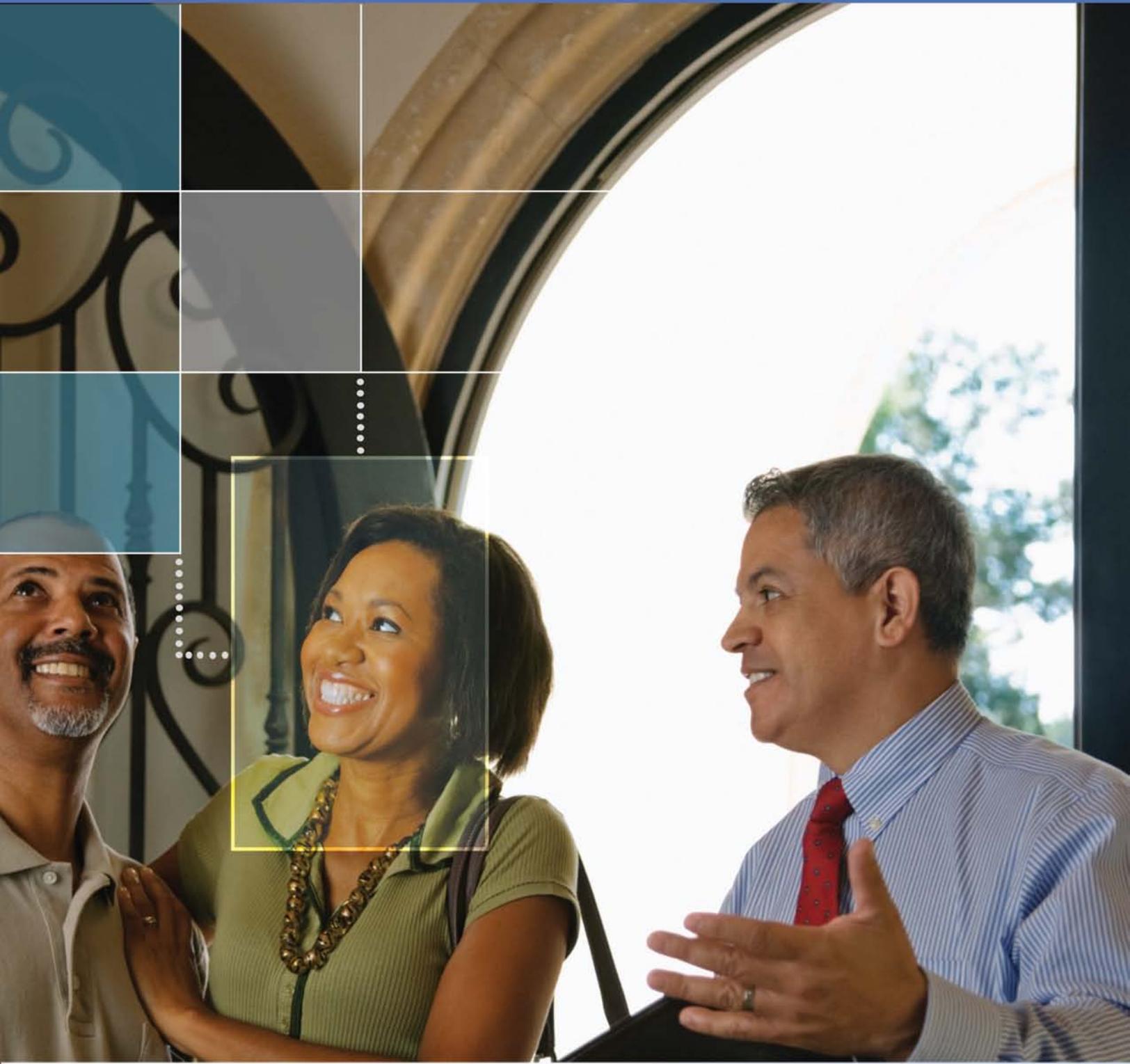


# Closing and Settlement Costs



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# Principles of Real Estate Closing and Settlement Costs

<b>Introduction</b> <ul style="list-style-type: none"> <li>• Learning Objectives</li> <li>• Key Terms</li> </ul>	<b>20 minutes</b>
<b>Lesson 1: Real Estate Closings</b> <ul style="list-style-type: none"> <li>• Pre-Closing Requirements</li> <li>• Closing Procedures</li> <li>• Reporting Transactions to the IRS</li> <li>• Licensee's Role</li> <li>• Real Estate Settlement Procedures Act (RESPA)</li> </ul>	<b>40 minutes</b>
<b>Lesson 2: Expenses</b> <ul style="list-style-type: none"> <li>• Allocating Expenses</li> <li>• Credits and Debits</li> <li>• Prorating Expenses</li> </ul>	<b>40 minutes</b>
<b>Lesson 3: The HUD-1 Settlement Statement</b> <ul style="list-style-type: none"> <li>• General Guidelines for the HUD-1 Settlement Statement Form</li> <li>• Settlement Charges</li> <li>• Summary of Borrower's Transaction</li> <li>• Summary of Seller's Transaction</li> </ul>	<b>90 minutes</b>
<b>Lesson 4: Real World Practice</b> <ul style="list-style-type: none"> <li>• Field Application of Settlement Statement Knowledge</li> <li>• Insight into Closings and Settlement Costs</li> </ul>	<b>40 minutes</b>
<b>Total Lesson Time:</b>	<b>230 minutes (3 Hours 50 Min)</b>

## INTRODUCTION

Some real estate licensees believe that their job ends when the purchase and sales contract is signed, and in fact, in many states, the licensee has no official duties throughout the closing process. However, transactions can and do fall apart during the closing stage. Licensees who are familiar with closing procedures and settlement costs can stay involved and make sure that their transactions meet the desired end.

This course covers the buyer's and the seller's concerns at closing, the required documents to close a transaction and the rules and regulations of the closing process. It covers a broad range of issues related to closing and settlement. To help the student learn ways to help clients through this at times complicated process, it includes the following lessons:

- Real Estate Closings
- Expenses
- The HUD-1 Settlement Statement

In addition, this course includes a final practice lesson. This concluding lesson presents real-world dilemmas and concrete applications of the information presented in the rest of the course. As the student completes this course, he or she should try to develop a broad picture of closing and settlement and how they fit into the larger practice of real estate. The last lesson will help with this project by presenting comprehensive content questions, practice problems and case studies.

## KEY TERMS

**Accrued Item:** Seller expenses that are treated in a particular way at closing. Accrued items are prorated costs that a seller owes (such as real estate taxes in states where these are not prepaid), but which will ultimately be paid by a buyer after he or she receives title to a property. That is to say, these expenses have been (or are being) incurred, but need not be paid at the time the sale closes. In an effort to ensure that these expenses are handled fairly, the seller generally pays the buyer for these items through credits at closing. For example, a seller might credit a buyer for the proportion of annual real estate taxes that were charged during the part of the year that the seller occupied the property.

**Affidavit of Title:** A legal guarantee regarding the condition of a property's title. In this affidavit, the seller swears to his or her legal identity and marital status; the seller also testifies that he or she has had no, bankruptcies, divorces or legal judgments made against him or her since the date of the title examination—i.e., that the title is in the same condition as it was at the time of the examination. The affidavit also generally entails that there are no unrecorded deeds or contracts for the property and that the owner has paid for all repairs and improvements that have been made recently or that were stipulated as part of the sale.

**Banking Year:** A 360-day year (or 12 months of 30 days each) that is often used in banking and other financial practices.

**Closing Date:** (also sometimes called the “settlement date”) The closing date is the culmination of a real estate transaction; it is date on which a seller delivers the deed to a property (transferring title to the buyer) and the buyer pays for the property. This date is generally specified in the purchase and sales agreement.

**Closing Statement:** (also sometimes called a “settlement statement”) The closing statement is a detailed, comprehensive document that summarizes each party's debits and credits, as well as the funds that each party has contributed to the transaction thus far. This document is also often used to calculate the total amount that the buyer must bring to the settlement.

**Credit:** A credit is a positive balance or a positive amount. For our purposes, it is a figure entered in a party's favor when determining the overall costs associated with a transaction. On closing statements, credits reflect expenses that have been paid by a particular individual or expenses that are owed to that individual. Credits stand in contrast to debits.

**Debit:** A debit is a negative balance or a negative amount. For our purposes, it is an amount due from or owed by a particular individual when determining the overall costs associated with a transaction. On closing statements, debits reflect

charges made to the parties involved in the transaction. Debits stand in contrast to credits.

**Escrow:** An agreement between two or more parties which establishes that certain instruments, funds or property are to be placed with a third party for safekeeping, pending the fulfillment of certain conditions or the performance of specific acts.

**Escrow Closing:** The term “escrow closing” describes a closing transaction in which a disinterested third party (often an escrow agent) presides over the closing. This disinterested third party generally acts according to escrow instructions that have been created by the principals involved in a transaction. It is usually the case that this third party is entrusted with funds and many of the important documents that are involved in a real estate transaction; paperwork is often handled through this third party, and the other parties might not be present at the closing.

**First User Loan:** The Department of Housing and Urban Development (HUD) defines a first user loan as “a loan to finance construction of a new structure or purchase of manufactured home where the structure was constructed for sale or the manufactured home was purchased for purposes of resale and the loan is used as or converted to a loan to finance purchase by the first user.”

**Mortgage Reduction Certificate:** (sometimes called a “reduction certificate” or a “payoff statement”) A document issued by a mortgage lender (i.e., a mortgagee) that records the amount owed on a mortgage loan as of a certain date. A mortgage reduction certificate is issued in some cases when the buyer takes over the seller’s mortgage loan. However, this document can be useful in nearly all transactions, as it is both the seller and the buyer’s best interests to have a clear legal picture of a property’s mortgage.

**Payoff Statement:** (sometimes called a “reduction certificate” or a “mortgage reduction certificate”) A document issued by a mortgage lender (i.e., a mortgagee) that shows the exact amount required to pay an existing loan. This document can be useful in nearly all transactions, as it is both the seller and the buyer’s best interests to have a clear legal picture of a property’s mortgage.

**Passing Papers:** The phrase “passing papers” describes a closing transaction in which the principals meet face-to-face and exchange documents. This phrase is sometimes also used informally to refer to closing in general, but it most accurately describes a closing in which the principals meet to exchange documents.

**Principal:** For our purposes, a “principal” is one of the primary parties involved in a real estate transaction. For example, in a standard two-party sale, the buyer and the seller are the principals to the transaction.

**Prepaid Item:** The term “prepaid items” refers to certain seller’s expenses on a closing statement. A prepaid item is an item that has been paid for ahead of time, generally by the seller. For example, a seller might have prepaid an insurance policy that is required by the local homeowner’s association. A buyer must then generally “purchase” this item from the seller at the time of the sale, either with cash, credits or in some other way that the principals have negotiated.

**Proration:** Proration is a means of calculating partial costs owed (or benefits due) so that they are distributed proportionately between two or more parties. For example, if a buyer purchases a home in the middle of the tax year, it would be unfair for that buyer to pay **all** of the year’s property taxes when he or she only occupied the property for **part** of the year. In this case, proration would be used to determine what proportion of the property tax the buyer should pay for that year. In this course, the term “proration” will be used to describe the process of dividing prepaid items or accrued items (such as utility bills) between a buyer and a seller.

**Settlement:** The division of expenses and funds between a buyer and a seller. This term is sometimes used interchangeably with “closing,” but it more accurately describes the process that occurs as a buyer and a seller settle their costs and payments with one another.

**Settlement Statement:** (also commonly called a “closing statement”) The settlement statement is a detailed, comprehensive document that summarizes each party’s debits and credits, as well as the funds that each party has contributed to the transaction thus far. This document is also often used to calculate the total amount that the buyer must bring to the settlement.

**Survey:** A survey is a detailed legal description of a property that is created through surveying, which is the process of measuring a property’s exact boundaries. There are a variety of legitimate survey methods that are documented in different ways. The sort of property at issue usually determines the most appropriate survey method.

**Title Evidence:** Title evidence is documentation regarding the current condition of a property’s title. This evidence generally includes the abstract of title as well as the attorney’s opinion of the title, the title insurance and the certificate of title. This evidence may include other documentation, such as a title commitment or a title report; the overarching objective of assembling title evidence is to collect all relevant information about the documents, records, judgments, liens, and other public records data pertaining to the history and current condition of a property’s title.

## LEARNING OBJECTIVES

Upon completion of this course, the student will be able to:

- Outline the primary concerns that arise throughout the closing process, for both the buyer and the seller.
- Describe what both the buyer and the seller must do to prepare for the closing date.
- List the documents that the buyer and the seller must complete to close a typical real estate transaction.
- Explain a licensee's responsibility with respect to IRS Form 1099-S and HUD's "Notice to the Homebuyer" form.
- Name and distinguish the different types of closings.
- Describe the licensee's role in the closing process.
- Outline the basic requirements and regulations imposed by the Real Estate Settlement Procedures Act (RESPA).
- Identify which party is responsible for each expense in a typical closing transaction.
- Explain the concept of credit and the concept of debit.
- Prorate prepaid items and accrued expenses.

# LESSON ONE

## REAL ESTATE CLOSINGS

This lesson focuses on the following topics:

- Pre-Closing Requirements
- Closing Procedures
- Required Documents
- Reporting Transactions to the IRS
- Licensee's Role
- Real Estate Settlement Procedures Act (RESPA)

### INTRODUCTION

In many states, a real estate licensee's official, legal responsibilities to the principals involved in a real estate transaction end with the signing of the sales contract. Even though a licensee may not have any legal obligation to provide services throughout the closing process (the final stage of the real estate transaction), it is not prudent simply to walk away from a transaction after the sales contract has been signed. Deals can and *do* fall apart during the closing process, and when a transaction fails to close this can mean unsatisfied clients and no commission. Real estate professionals who understand closing procedures and regulations can stay involved right up to the end of a transaction, helping to ensure that their principals' transactions close appropriately.

**NOTE:** Most real estate licensees are **not** lawyers; unless a real estate professional is also a licensed attorney, he or she does not have the authority to give legal advice and can face liability and punishment for the unauthorized practice of law. If the buyers and sellers with whom you work need legal advice, or if they ask you for legal advice, you should recommend that they consult real estate attorneys before signing any legally binding documents.

### PRE-CLOSING REQUIREMENTS

The closing process is the culmination of a real estate transaction, in which a buyer pays a seller to transfer the property's title to the buyer. This process will proceed more smoothly if both the buyer and the seller have made the appropriate preparations beforehand.

## **SELLERS' CONCERNS**

In most transactions, a seller is primarily concerned with getting as much as possible of his or her requested purchase price. Therefore, a seller should verify that a prospective buyer has the necessary funds or has obtained appropriate financing before agreeing to close a real estate transaction. To prevent any delays, a seller should also make certain that he or she has complied with all of the prospective buyer's requirements, such as making repairs to the property or having the property inspected for rodents and insects.

Though price is an important consideration for most sellers, each transaction will present its own unique issues that will be determined by a seller's specific goals and desires. Regardless of a transaction's distinctive features, sellers should be discouraged from becoming so focused on price that they neglect other significant concerns.

## **BUYER'S CONCERNS**

As we noted, a seller will generally be quite concerned about a prospective buyer's ability to pay for the property. Before closing, then, a prospective buyer must do everything he or she can to demonstrate that he or she will be able to complete the transaction that has been negotiated with the seller. The specific things that a particular buyer must do to demonstrate this will vary from case to case, but licensees can be of great help by providing general guidance about financing and directing prospective buyers to financial professionals who can help them with funding and documentation.

Once a buyer has secured funding for the transaction, he or she is generally primarily concerned with getting a marketable title from a seller—that is to say, most buyers are focused on obtaining a title that is apparently complete and otherwise in proper order. This does not mean that it is *in fact* free of defects or other inaccuracies, only that it seems to cover the subject property in its entirety and to be otherwise complete.

A marketable title need not be perfect; it may have liens, encumbrances or other defects as long as the buyer openly accepts these as part of the purchase contract. A marketable title is one that permits an owner to sell or transfer a property freely, and it is generally understood to be a title that prospective buyers can or should accept without objection. When a buyer accepts a marketable title, he or she can usually feel secure in the purchase because a marketable title is one that the buyer will not have to defend against other claimants.

A marketable title, then:

- Allows the recipient of the title to exercise ownership rights without having to defend those rights through litigation.

- Shows that the property can be sold or mortgaged at fair market value by a practical and knowledgeable individual.
- Does not have any defects that have not been openly accepted by the buyer.
- Does not have any liens or encumbrances that have not been openly accepted by the buyer.

Many real estate transactions *aim* at exchanging a marketable title for a property's purchase price, but it is not always easy to ensure that a title is actually marketable. A clear or marketable title can only be provided through the work of a seller's attorney or title insurance company.

Before closing, a buyer will want to do the following things to help ensure that he or she receives a marketable title:

- Ensure that the proper professionals (e.g., title abstracters or title insurance agents) examine all records and paperwork associated with the title, including public records, current and past leases, evidence of title, the deed and any documents connected with liens or other encumbrances.
- Make certain that the property survey is accurate, perhaps by asking an independent surveyor to examine it.
- Conduct a final inspection (or walk-through) with a professional inspector to ensure that the property is as the seller has represented it to be.

## **PRE-CLOSING RESPONSIBILITIES REGARDING FHA-INSURED MORTGAGES**

When working with borrowers on transactions that rely on FHA-insured mortgages, lenders are required to give buyers the one-page *Notice to the Homebuyer* form. This form was created as part of NAR® and HUD's joint Homebuyer Protection Initiative; it explains the difference between an appraisal and a home inspection and recommends that buyers obtain an inspection. We have provided a copy of this form here for educational purposes only.

**Part 3: Comprehensive Valuation Package  
Homebuyer Summary**

**Department of Housing  
and Urban Development**  
Office of Housing  
Federal Housing Commissioner

OMB Approval No. 2502-0538 (exp. 06/30/2006)

Case Number: \_\_\_\_\_

Property Address: \_\_\_\_\_

**Important**

**NOTICE TO THE HOMEBUYER**

**Read Carefully**

As part of our job insuring the mortgage for the lender, the FHA requires the lender to conduct an appraisal to:

- estimate the value of your potential new home
- make sure it meets *minimal* FHA standards
- ensure that it will be marketable

*Appraisals are different from home inspections. Home inspections give more detailed information about your potential new home.*

This report is a summary of the observations of an appraiser who visited the property. If there was a problem, the appraiser answered "YES" under "Problem".

If any condition is marred [yes], this means that the property you want to buy does not currently meet FHA's Minimum Property Standards. Until this condition is resolved, your lender may not provide you with an FHA insured loan consistent with FHA procedures.

You should speak to your lender about how this situation needs to be handled. You should also make sure that you are confident that the physical condition of this property meets all of your expectations.

For a copy of the full appraisal, contact your lender.

If you have any questions, call us at **1-800-569-4287**.

Physical Condition	Problem (Y)	Comments
Site Hazards	<input type="checkbox"/>	
Soil Contamination	<input type="checkbox"/>	
Grading and Drainage Problems	<input type="checkbox"/>	
Well, Individual Water Supply and Septic Problems	<input type="checkbox"/>	
Wood Destroying Insects	<input type="checkbox"/>	
Private Road Access and Maintenance Problems	<input type="checkbox"/>	
Structural Deficiencies	<input type="checkbox"/>	

(continued)



(continued)

Physical Condition	Problem (Y)	Comments
Foundation Deficiencies	<input type="checkbox"/>	
Roofing Deficiencies	<input type="checkbox"/>	
Mechanical Systems Problems	<input type="checkbox"/>	
General Health and Safety Deficiencies	<input type="checkbox"/>	
Deteriorated Paint	<input type="checkbox"/>	
Manufactured Housing	<input type="checkbox"/>	

The conditions listed above are reflected on the Valuation Conditions Form (Part 2 of the Comprehensive Valuation Package) of this appraisal. **The lender is required to transmit this Notice to the Homebuyer form to the buyer at least five business days prior to loan closing.**

\_\_\_\_\_  
FHA Roster Appraiser Signature

\_\_\_\_\_  
ID Number

\_\_\_\_\_  
Valuation Date

\_\_\_\_\_  
Homebuyer acknowledges receipt of Part 3: Summary:

\_\_\_\_\_  
Homebuyer(s) Signature(s)

\_\_\_\_\_  
Date Received

Form HUD-92564-HS (07/2003)



Provided by Tennessee Association of Realtors® 2006  
F50 HUD-92564-HS (Part 3: Homebuyer Summary)- Page 2 of 2

Modified 1/1/2006

## **CLOSING PROCEDURES**

Let's assume that Broker A, Seller B and Buyer C have arrived at an agreement about the sale of Seller B's condominium. The principals have settled on a price and taken all the necessary steps to ensure a smooth sale: they have hired professionals to research and insure the title; they have had the property professionally appraised and inspected; and the buyer has secured appropriate financing. It is now time to transfer the title from Seller B to Buyer C and sign all of the important documents associated with the sale.

The first step in closing the property is to make sure that all principals understand the terms and conditions of the purchase contract, as well as any addenda. One or both parties may wish to consult an attorney before signing the sale paperwork; licensees should encourage those who desire legal advice (or any other guidance that falls outside the licensee's field(s) of expertise) to enlist the help of a professional. Once the parties are sure they understand everything to which they are agreeing, there are a variety of ways the contract and the other essential paperwork associated with the closing process can be completed.

### **FACE-TO-FACE CLOSING**

Some closings are aptly described by the phrase "passing papers"—a process in which principals and their representatives meet face-to-face and exchange documents required to close the sale.

Face-to-face closings can be held in a variety of locations, including a broker's office, the buyer's attorney's office, the seller's attorney's office, a title company office, lending institution office or at the offices of the county clerk or recorder or at the escrow company. A face-to-face closing involves the principals to the transaction, but it frequently involves other individuals as well. For example, buyers and sellers may have their attorneys and brokers present, if they wish. In addition, representatives from lending institutions and the title insurance companies may attend closings.

Usually one person presides over the closing, such as a broker, the buyer's or the seller's attorney, a representative from the lending institution or a title company representative. He or she is responsible for calculating the settlement, that is, for calculating the division of expenses and funds between the buyer and the seller.

### **ESCROW CLOSING**

The term "escrow closing" describes a closing transaction in which a disinterested third party (often an escrow agent) presides over the closing. This third party has no personal interest in the transaction and does not represent either of the principals.

One of the parties selects a company or individual to serve as the escrow agent (or escrow holder); this might be the escrow department of a bank or other lending institution, an attorney, a title company, a trust company or an escrow company. This disinterested third party generally acts according to escrow instructions that have been created by the principals involved in a transaction. It is usually the case that this third party is entrusted with funds and many of the important documents that are involved in a real estate transaction; paperwork is often handled through this third party, and the other parties might not be present at the closing. If one or both of the principals is absent from the closing meeting, copies of the settlement statement should be mailed or delivered to the absent parties immediately after closing.

**NOTE:** Some states have laws or regulations specifying which party (or parties) may choose the escrow agent. Otherwise, the parties negotiate to decide which party gets to choose or to select an escrow agent together.

In an escrow closing, the buyer and the seller first sign the sales contract, and then the broker gives the earnest money to the escrow agent to deposit in a trust account; this money is described as being held in escrow. Before the closing date, the buyer and seller must give the escrow agent all of the completed, legally valid documents that will be needed to complete the closing.

## **REQUIRED DOCUMENTS**

Diverse individuals have an interest in the outcome of any real estate transaction; these varied interests are reflected in the documentation that is required for a real estate sale. For example, the lender that is helping to finance the purchase has an interest in the property and will want assurance that its title is marketable, that the property's taxes and insurance are maintained and that the lender's mortgage lien will have priority over any other liens. Before closing, a lender may require the following items:

- A title insurance policy
- A fire and hazard insurance policy
- A survey
- A pest inspection certificate
- A reserve account for property taxes and insurance

These documents help lenders to identify and evaluate the property for which the loan is intended, and to determine whether the risks associated with that loan are ones they want to assume. Lenders may require other documents as well; the list above is only meant to convey a general idea of the kind of supporting paperwork that is likely to be required.

Beyond these documents, the buyer and seller will have to supply additional paperwork to complete the transaction. If the closing will be face-to-face, they can bring the documents with them. If an escrow agent is conducting the closing, the buyer and seller will need to give the documents to the escrow agent before the closing date.

The documents that the seller must supply include:

- Title evidence (legal documentation regarding the current condition of a property's title)
- The deed
- Hazard insurance policies
- Any affidavits of title or other documents needed to clear the title
- Any payoff statements or mortgage reduction certificates (documents issued by a mortgage lender that show the exact amount required to pay an existing loan)

The documents that the buyer must supply include:

- Evidence that he or she has secured a loan
- Property insurance policies
- The agreed-upon amount of cash (usually in the form of a cashier's check) needed to close on the property
- Any other documents required by the title company

The particular features and requirements of a transaction determine the specific documents necessary in any given transaction. The documents listed here are only intended to give a general picture of the paperwork that is often involved in a typical real estate sale.

## **REPORTING TRANSACTIONS TO THE IRS**

### **FORM 1099-S**

Licensees need to be aware that the sale of stock in cooperative housing corporations, as well as sales of land, condominium units and permanent structures, including residential, commercial and industrial buildings, must be reported to the Internal Revenue Service (IRS). Usually the closing agent or the mortgage lender will fill out the Form 1099-S for this type of transaction, but any licensees involved in the transaction could be held liable if the IRS is not properly notified.

Various parties can be designated as the person responsible for filing the 1099-S, including the transferor's attorney, the transferee's attorney and the disbursing

title or the escrow company. The IRS provides extensive guidelines about who can be held responsible for filling this form, and in what circumstances.

**LEARN MORE:** IRS instructions for Form 1099-S can be found online at: <http://www.irs.gov/instructions/i1099s/ar02.html#d0e189>.

## **FOREIGN INVESTMENT IN REAL PROPERTY TAX ACT**

If a transaction is subject to the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), then the person who is buying or receiving property must determine whether the individual who is selling or transferring property is a citizen of the United States. If the seller is *not* a citizen, then the buyer (or his or her representative) must withhold 10 percent of the sale proceeds and send it to the IRS within 10 days of closing. A comprehensive purchase and sale agreement should include a paragraph that explains this act, to ensure that all parties are advised of their responsibilities in this regard.

There are exceptions to FIRPTA. One of the most common exceptions to FIRPTA releases a transferee (i.e., a purchaser or a buyer) from the obligation to withhold tax in cases in which the buyer purchases real estate for use as his or her home and the purchase price is not more than \$300,000. Residential property transactions that meet these conditions are thus often exempt from FIRPTA's requirements. Licensees should encourage principals to consult with tax attorneys on this point, however, and should not advise people about whether FIRPTA applies to their transaction.

**LEARN MORE:** IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*, can be found online at:

<http://www.irs.gov/publications/p515/index.html>.

Of special interest for our purposes is the section of Publication 515 that discusses U.S. real property interest; this section can be found online at:

<http://www.irs.gov/publications/p515/ar02.html#d0e5964>.

You may also write to receive advice and information on FIRPTA from the IRS at:

Director, Philadelphia Service Center  
P.O. Box 21086  
Drop Point N-423 FIRPTA Unit  
Philadelphia, PA 19114-0586

## LICENSEE'S ROLE

As we noted earlier, a licensee's official responsibilities in the closing process vary from state to state. However, *all* licensees can do things that can help to make sure a transaction goes smoothly, regardless of what their state-mandated responsibilities may be.

Licensees can help to facilitate transactions in a variety of ways, including the following:

- When working with buyers, communicate with their lenders. Find out exactly which documents are required, and the date by which they must be submitted.
- When working with sellers, make sure that they comply with all requirements imposed by the buyer and the lender.
- Regardless of whether your client is a buyer or a seller, ensure that the client is meeting important deadlines.
- Communicate with the other party's broker.
- Stay involved!

Use the following checklist to keep track of all of the details in the closing process.

<b>Closing Checklist</b>		
<b>Name of Client:</b>		
<b>Loan Information:</b>		<b>Additional Information:</b>
Type	_____	
Amount	_____	
Down payment	_____	
Interest rate	_____	
Loan fee	_____	
Points	_____	
<b>Processing</b>		
	<b>Due Date</b>	<b>Completed</b>
Trust account deposit	_____	_____
Loan application completed	_____	_____

Appraisal ordered	_____	_____
Credit report ordered	_____	_____
Income & funds verified	_____	_____
Loan approved	_____	_____
All parties notified of approval	_____	_____
Termite inspection completed	_____	_____
Other work completed	_____	_____
_____	_____	_____
_____	_____	_____
Buyer's hazard insurance	_____	_____
Loan documents signed	_____	_____
Arrange possession date	_____	_____
Loan funded	_____	_____
Loan funds disbursed	_____	_____
Keys to buyer	_____	_____
Remove sold sign & lock box	_____	_____
Other _____	_____	_____
Other _____	_____	_____
Other _____	_____	_____

## **REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)**

The Real Estate Settlement Procedures Act (RESPA) was enacted in 1974 by the U.S. Department of Housing and Urban Development (HUD). RESPA is a consumer protection statute that aims to help educate consumers about closing and settlement services. One important goal of RESPA is to provide information that will teach consumers to be savvy judges of these services' proper cost, and thus eliminate referral fees and other questionable tacked-on fees that can unnecessarily increase the cost of closing and settlement services. HUD's Office of RESPA and Interstate Land Sales enforces RESPA.

RESPA applies to most loans secured by a mortgage lien placed on one- to four-family residential properties. These loans include most purchase loans, assumptions and property improvement loans; they also generally include refinancing loans and equity lines of credit. The primary condition for a loan's falling under RESPA is that it be what is called a "federally related mortgage loan," defined broadly in RESPA as a loan that is directly or indirectly supported by federal regulation, insurance, guarantees, supplements or assistance. This term also covers loans that the originating lender intends to sell to a federal program, such as Fannie Mae. This range of loans covers the majority of loans that are secured for home purchases.

When a borrower applies for a loan that is covered by RESPA, the Act requires that the lender or mortgage broker provide the borrower with a variety of disclosure information, including the following:

- A Special Information Booklet, containing consumer information about real estate transactions and real estate settlement services. To view or print the most recent version of this booklet in PDF format, click on this link: <http://www.hud.gov/offices/hsg/rmra/res/settlement-cost-booklet03252010.cfm>. A Good Faith Estimate (GFE) of closing and settlement costs. This estimate of the amount the borrower is likely to pay at closing should include origination fees, points and the maximum amount to be collected at closing. This GFE is merely an estimate; actual settlement costs may vary considerably. If the lender or mortgage broker requires the borrower to use a particular settlement services provider, that requirement must be disclosed in the GFE.
- A Mortgage Servicing Disclosure Statement. This statement tells the borrower whether the lender will service the loan or transfer it to another. It also gives information about complaint resolution.

Ideally, the lender will provide this disclosure information at the time of application. If the lender does not give the borrower this information at that time, it must be mailed within three business days of receiving the loan application. If the loan is declined within three days, the lender is not obligated to provide these disclosures.

RESPA also requires that both the borrower (i.e., the buyer) and the seller receive the HUD-1 Settlement Statement at closing. The HUD-1 Settlement Statement is a standardized form that shows all of the borrower's and seller's charges arising from the settlement of their real estate transaction. We will discuss this form in greater detail in Lesson Three.

**NOTE:** Some states require that licensees give their clients an estimate of the expenses involved in closing the transaction at the time the purchase contract is signed. The HUD-1 Settlement Statement can be used to figure these estimates, as can the Good Faith Estimate form.

Some of RESPA's regulations—such as its disclosure requirements—apply only to lenders. However, RESPA includes sections that impose regulations that also apply to licensees. For example, one section of RESPA is specifically concerned with reducing the unnecessary and ethically dubious charges that can sometimes be associated with settlement and closing services. This part of RESPA explicitly “prohibits anyone from giving or accepting a fee, kickback or any thing of value in exchange for referrals of settlement service business involving a federally related mortgage loan.” This means, for example, that licensees cannot accept payment of any sort for referring clients to a bank. Licensees who provide

computerized loan origination services also need to comply with RESPA regulations.

Violations of RESPA regulations can lead to serious penalties for both licensees and lending institution employees. Fines of up to \$10,000 can be assessed, as can prison terms for up to a year. Further details about penalties can be found in Section 8 of RESPA.

**LEARN MORE:** You can read more about RESPA on HUD's Website at: <http://www.hud.gov/offices/hsg/sfh/res/respahm.cfm>. Specific details about the requirements imposed by the RESPA statutes can be found at: <http://www.hud.gov/offices/hsg/ramh/res/respamor.cfm>

## SUMMARY

Licensees' responsibilities vary from state to state, and in many areas, their official legal responsibilities end with the signing of the purchase contract. However, when a licensee understands the closing process, he or she can stay involved in a transaction after the purchase contract is signed. Licensees who remain involved can use their professional expertise to ensure that their hard work culminates in a transaction that closes smoothly.

Before closing a real estate transaction, buyers and sellers should ensure that their interests in the transaction are secure. The buyer should hire professionals (e.g., title abstractors) to examine all relevant documentation related to the property; he or she should also hire an inspector to conduct a final inspection of the property. The seller should make sure that he or she has satisfied all of the buyer's requirements and that the buyer has obtained appropriate financing. Both parties must work to ensure that all of the preliminary conditions imposed on their transaction have been met; once they agree that this is the case, the licensee needs to work with the buyer and seller to ensure that they completely understand the purchase contract.

Though licensees are unlikely to be held legally responsible for these issues, they should still help to ensure that principals receive proper loan disclosures retain appropriate withholding for sales that fall under FIRPTA withholding requirements. Buyers with FHA-insured mortgages should receive the one-page *Notice to the Homebuyer* form. The Real Estate Settlement Procedures Act (RESPA) requires that borrowers who apply for federally related mortgage loans receive the following disclosures:

- A Special Information Booklet containing consumer information about real estate transactions and real estate settlement services.
- A Good Faith Estimate (GFE) of closing and settlement costs.
- A Mortgage Servicing Disclosure Statement.

Once the principals have judged all documentation and funding to be satisfactory and the licensee and other professionals overseeing the transaction believe everything is in order, the transaction can move toward closing. Closing can be conducted through a face-to-face meeting between the principals and their representatives; the closing process can also be overseen and conducted by an escrow agent. In all cases, the documents that the seller must supply include:

- Title evidence (legal documentation regarding the current condition of a property's title)
- The deed
- Hazard insurance policies
- Any affidavits of title or other documents needed to clear the title
- Any payoff statements or mortgage reduction certificates (documents issued by a mortgage lender that show the exact amount required to pay an existing loan)

The documents that the buyer must supply include:

- Evidence that he or she has secured a loan
- Property insurance policies
- The agreed-upon amount of cash (usually in the form of a cashier's check) needed to close on the property
- Any other documents required by the title company

The lender may also require additional documents before approving the loan for the transaction. The particular features and requirements of the transaction determine the specific documents that are necessary. The documents listed here are only intended to give a general picture of the paperwork that is often involved in a typical real estate sale.

RESPA is a consumer protection statute that aims to help educate consumers about closing and settlement services. One important goal of RESPA is to provide information that will teach consumers to be savvy judges of these services' proper cost, and thus eliminate referral fees and other questionable tacked-on fees that can unnecessarily increase the cost of closing and settlement services. HUD's Office of RESPA and Interstate Land Sales enforce RESPA.

Although some of RESPA's regulations (such as its disclosure requirements) apply only to lending institutions, licensees need to be aware that the act also prohibits licensees from accepting fees, kickbacks or any kind of payment in exchange for their referrals of settlement service business involving a federally related mortgage loan. Specific information about these prohibited payments can be found in the RESPA statutes.

# LESSON TWO

## EXPENSES

This lesson focuses on the following topics:

- Allocating Expenses
- Credits and Debits
- Prorating Expenses

### INTRODUCTION

The closing statement (also called a “settlement statement”) is a document that provides a detailed list of each party’s expenses as well as how much he or she has already contributed to the transaction thus far. This statement also provides an accounting of the final amount that the buyer must bring to the closing. To complete a closing or settlement statement properly, one must know which principal is responsible for each transaction expense. A licensee must also have a clear understanding of credits and debits and should know how to prorate expenses that must be divided between the principals.

### ALLOCATING EXPENSES

There are a variety of expenses associated with any real estate transaction. For example, brokers’ commissions must be paid and loans often come with significant fees. These expenses can be divided in various ways between the principals involved in the transaction; their legal responsibility varies from state to state, and many expenses can be negotiated between the principals. These variables mean that there is no single set of general guidelines that can teach a licensee how these expenses are divided between principals.

Nonetheless, there are conventions that often determine the way these expenses are allocated in a typical real estate transaction. The following table illustrates the general guidelines for allocating expenses.

<b>ITEM</b>	<b>PAID BY</b>
<b>Brokers' Commissions</b>	Either party or both, by agreement
<b>Attorneys' Fees</b>	Either party or both, by agreement
<b>Title Expenses</b>	Both parties responsible for different title expenses
<b>Transfer Tax</b>	Seller
<b>Recording Expenses</b>	Both parties responsible for different recording expenses
<b>Loan Fees</b>	Both parties responsible for different loan fees
<b>Appraisal Fees</b>	Either party or both, by agreement
<b>Survey Fees</b>	Both parties responsible for different survey fees
<b>Tax and Insurance Reserves</b>	Buyer

**Brokers' Commissions:** A seller usually pays the commission for any broker who has been hired to represent the seller. If a broker represents the buyer or if each party has a broker of his or her own, each party may pay some part of the total cost of commission(s).

**Attorneys' Fees:** If a buyer and a seller are paying their attorneys out of their own pockets, then the attorneys' fees are often omitted from the closing statement. However, if one or more attorneys' fees are to be deducted from the proceeds in the closing, then the party who hired the attorney as his or her representative will generally be debited for the attorney's fees.

**Title Expenses:** Generally, a seller is required to pay for the title search. However, if a buyer conducts another search of his or her own, then he or she usually pays for that additional research. The buyer also usually pays for title insurance policies.

**Transfer Tax:** Transfer taxes are usually a seller's responsibility.

**Recording Expenses:** A seller is generally responsible for recording expenses (i.e., filing fees and other similar costs) related to clearing defects from the property's title, such as recording satisfactions of liens, affidavits and quitclaim deeds. A buyer is usually responsible for the recording expenses associated with the title transfer, such as the costs associated with publicly recording the deed that gives him or her title.

**Loan Fees:** A buyer is usually responsible for paying loan origination fees for a new loan, and for paying assumption fees if he or she assumes the seller's existing loan. If a seller is paying off a mortgage before its due date, he or she may be required to pay a prepayment fee.

**Appraisal Fees:** The party that ordered the appraisal usually pays the fees associated with it.

**Survey Fees:** A buyer usually pays property survey fees, especially if he or she obtains a new mortgage.

**Tax and Insurance Reserves:** A buyer is often required to open an escrow account to cover real estate taxes that are assessed during the time the transaction is taking place. In this case, he or she generally deposits at least enough in the account to pay for the taxes through the end of the month of closing. However, a seller is debited and a buyer is credited for any of the seller's unpaid taxes. A buyer often also pays at least the first year's premium on fire or hazard insurance at closing.

It is worth repeating that state laws may stipulate arrangements other than those described above, as may the regulations associated with certain types of financing. In addition, many transactions leave substantial leeway for the principals to negotiate about how expenses are allocated. In all of these cases, the final division of fees may look considerably different than the general example given previously. Purchase contracts should reflect all negotiated and stipulated agreements regarding the allocation of expenses.

## **ADDITIONAL TRANSACTION FEES**

Certain kinds of financing can result in additional transaction costs. These expenses include the following stipulations:

- If a loan has private mortgage insurance, then a buyer generally pays for one year's premium at or before the time of closing.
- If a loan is FHA-insured, a buyer is usually debited for the mortgage insurance premium unless it is financed with the loan.
- If a loan is a Veterans Affairs loan, the buyer is debited for a funding fee to the VA.

## **CREDITS AND DEBITS**

A closing statement provides a detailed accounting of each party's debits and credits. A credit is a positive balance or a positive amount. For our purposes, it is a figure entered in a party's favor when determining the overall costs associated with a transaction. On closing statements, credits reflect expenses

that have been paid by a particular individual or expenses that are owed to that individual. Credits stand in contrast to debits.

A debit is a negative balance or a negative amount. For the purposes of our discussion, it is an amount due from or owed by a particular individual when determining the overall costs associated with a transaction. On closing statements, debits reflect charges made to the parties involved in the transaction.

The actual amount that a buyer is to pay at closing is calculated by subtracting the buyer's total credits (such as prepaid earnest money or the balance of a loan that the buyer will assume from the seller) from the buyer's total debits (such as the purchase price). The remaining total is the amount that the buyer must bring to the closing to complete the transaction.

To determine how much money a seller will receive from a transaction, we subtract the seller's total debits (such as the balance of a mortgage loan) from the seller's total credits (such as the purchase price). The remaining total is the amount that the seller will receive.

In most cases, when we are tallying up credits and debits, it will be clear which party is responsible for a given transaction expense. However, some expenses cannot be allocated so easily. Many items that are prepaid or paid after a certain amount of time has passed, such as taxes, need to be divided proportionately between a buyer and a seller. The process of making this proportional division is called "proration."

## **PRORATING EXPENSES**

For our purposes, the proration process is a method of dividing accrued items and prepaid items between a seller and a buyer. Accrued items are costs that a seller owes (such as real estate taxes in a state where these are not prepaid), but which will ultimately be paid by a buyer after he or she receives title to a property. That is to say, these expenses have been (or are being) incurred at the time of sale, but need not be paid at the time the sale closes. In an effort to ensure that these expenses are handled fairly, the seller generally pays the buyer for these items through credits at closing. For example, a seller might credit a buyer for the proportion of annual real estate taxes that were charged during the part of the year that the seller occupied the property.

A prepaid item of course is an item that has been paid for ahead of time, generally by the seller. For example, a seller might have prepaid an insurance policy that is required by the local homeowner's association. A buyer must then generally "purchase" this item from the seller at the time of the sale, either with cash, credits or in some other way that the principals have negotiated.

The following table shows examples of prepaid items and accrued items.

PREPAID	ACCRUED
<ul style="list-style-type: none"> <li>• Fuel oil on hand</li> <li>• Insurance and tax reserves for the mortgage</li> <li>• Prepaid water charges and other utility bills</li> <li>• General real estate taxes in a state where these are prepaid</li> </ul>	<ul style="list-style-type: none"> <li>• Interest on an existing mortgage assumed by the buyer</li> <li>• Unpaid water charges and other utility bills</li> <li>• Unpaid taxes</li> <li>• General real estate taxes in a state where these are <i>not</i> prepaid</li> </ul>

Accrued items are generally debited to the seller and credited to the buyer, and prepaid items are credited to the seller and debited to the buyer.

## CALCULATING PRORATED EXPENSES

Federal and state laws, as well as the negotiated terms of a particular purchase agreement, may dictate whether certain expenses can be prorated or how they should be prorated. The following guidelines for calculating a prorated expense are provided for educational purposes and may not reflect the actual procedures that are required in a specific case. A prudent licensee will not make assumptions about prorated expenses. Instead, familiarize yourself with relevant state laws and check with local lenders to identify the procedures they generally follow when prorating property taxes, insurance and interest.

When calculating prorated expenses, the first step is determining an annual charge for the item being prorated. To calculate the monthly charge for the item, then divide by 12. It may be necessary to go further and calculate a daily charge for the item. In this case, there are two methods commonly used to calculate daily charges:

- **A 360-day year:** The 360-day year is known as the “banking year”; it is commonly used in banking and other financial calculations, and is divided into 12 months of 30 days each. To figure daily charges using a 360-day year, you can divide the yearly charge by 360 or divide the monthly charge by 30.
- **A 365-day year:** The 365-day year is sometimes also called the “conventional calendar year,” because its divisions reflect the actual months of the calendar that most of us use. To calculate the daily charge for an item using the conventional calendar year, divide the yearly charge by 365 (366 in a leap year).

The actual number of days or months in the period for which you are calculating the prorated expense is then multiplied by the monthly or daily charge (whichever is appropriate) to determine the accrued amount or prepaid amount for the item.

Before you begin calculating prorations, then, you will need to answer the following three questions:

- What kind of item is being prorated? Is the charge for the item assessed daily, monthly, annually or according to some other schedule?
- Is this item accrued or prepaid?
- Which calculation method should be used?

**NOTE:** Throughout this course, we will use the 360-day year. However, regulations in your area may require that you use the 365-day year. Also, in our calculations we will assume that the seller is responsible for expenses incurred on the closing date. However, state laws determine whether the seller is in fact legally responsible for charges incurred on this date; these laws vary and you should confirm the standard used in your state before finalizing your calculations.

Now let's look at some examples.

### **PRORATING AN ACCRUED ITEM**

A sale is to be closed on the second of July. The property's water bill for the entire year has been estimated at \$300. Assuming that the seller is responsible for expenses on the day of closing, the accrued period is six months (January through June) and two days (July first and second). This is the amount of time for which the seller should be held responsible for the property's water bills, because he or she occupied or was otherwise responsible for the property during this time. Let's calculate the monthly and daily prorated costs for the water bill, using a 360-day year:

$$\text{Monthly charge: } \$300 \div 12 \text{ months} = \$25$$

$$\text{Daily charge: } \$25 \div 30 \text{ days} = \$0.833$$

Now we will multiply the monthly and daily charge by the number of months and days in the period:

$$\$25 \times 6 \text{ months} = \$150$$

$$\$0.833 \times 2 \text{ days} = \$1.666$$

Finally, we add the two amounts together:

$$\$150 + \$1.666 = \$151.666$$

We can then round this figure to the second decimal place, giving us a total of \$151.67. This is the amount that should be **credited to the buyer** and **debited to the seller** as we calculate the various settlement expenses associated with the transaction.

## PRORATING A PREPAID ITEM

When calculating prorated expenses for a prepaid item, it is first necessary to determine the period of time for which the expense has been prepaid. For example, let's assume that a seller lives in a state in which real estate taxes are prepaid. He or she has prepaid all real estate taxes for the year 2005, up to and including December 31; the total amount of prepaid taxes is \$2000. The sale's closing date is October 5, 2005. Using a 360-day year, we can calculate the number of prepaid months and days **beyond the closing date** as follows:

	Months	Days	
Amount paid to Dec. 31	12	30 per month (in a 360-day year)	
Closing date = Oct. 5	<u>-10</u>	<u>-5</u>	
Prepaid period	2 months	25 days	

As we noted above, the total paid was \$2,000. Now that we know the number of prepaid months and days beyond the closing date, we can calculate the amount that will be credited to the seller and debited to the buyer using the following formulas:

$$\begin{aligned} \text{Total amount} \div 12 \text{ months} &= \text{Monthly charge} \\ \$2,000 \div 12 \text{ months} &= \$166.666 \end{aligned}$$

$$\begin{aligned} \text{Monthly charge} \div 30 \text{ days} &= \text{Daily charge} \\ \$166.666 \div 30 \text{ days} &= \$5.555 \end{aligned}$$

$$\begin{aligned} \text{Monthly charge} \times \text{Number of months in period} &= \text{Monthly amount} \\ \$166.666 \times 2 \text{ months} &= \$333.332 \end{aligned}$$

$$\begin{aligned} \text{Daily charge} \times \text{Number of days in period} &= \text{Daily amount} \\ \$5.555 \times 25 \text{ days} &= \$138.875 \end{aligned}$$

$$\begin{aligned} \text{Monthly amount} + \text{Daily amount} &= \text{Total} \\ \$333.332 + \$138.875 &= \$472.207 \end{aligned}$$

We can then round this figure to the second decimal place, giving us a total of \$472.21. This is the total amount that the seller has prepaid beyond the closing date—that is, the seller has paid \$472.21 in taxes for a period during which the *buyer* should be held responsible for these charges. This amount will be **credited to the seller** and **debited to the buyer** as we calculate the various settlement expenses associated with the transaction.

## **ADDITIONAL GUIDELINES FOR CALCULATING PRORATED EXPENSES**

- In many states, the seller is held responsible for any expenses incurred on the closing date. However, some states specify that the buyer owns the property as of the closing date, and he or she is therefore held responsible for any expenses incurred on that date. Check your state regulations to determine the specific standard used in your state.
- Estimates of utility charges and other similar expenses are often based on the most recent bill.
- Rents are usually prorated using a 365-day year, which reflects the actual amount of days for which rent is collected. The seller generally receives rents that are due as of the closing date, but again, you should check your state laws to be certain of the regulations in your state.
- Security deposits are usually transferred from the seller to the buyer; these funds are held in trust for tenants, and are not properly understood to be either the seller or the buyer's property.
- The way in which one is to calculate prorated real estate taxes varies from state to state. Check the rules for your state before finalizing any calculations.
- Expenses like water and other utilities, mortgage interest and real estate taxes are frequently prorated using the 360-day banking year. However, some areas require that the 365-day year be used. Familiarize yourself with local laws, and contact local lenders to determine the standards they use when calculating prorated expenses.
- Some special assessments are billed in installments (such as assessments for sewer improvements). When a transaction involves expenses of this sort, the buyer often assumes all future payments with interest. This amount is not generally prorated at closing.

## **SUMMARY**

There are a variety of expenses associated with any real estate transaction. For example, brokers' commissions must be paid and loans often come with significant fees. These expenses can be divided in various ways between the principals involved in the transaction; their legal responsibility varies from state to state, and many expenses can be negotiated between the principals. These variables mean that there is no single set of general guidelines that can teach a licensee how these expenses are divided between principals.

Dividing the various expenses associated with a transaction is essential in the preparation of a closing statement (also called a "settlement statement"). The details of this preparation process are the topic of our next lesson; for now, it is enough for us to know that a closing statement provides a detailed accounting of each party's debits and credits. A credit is a positive balance or a positive

amount. For our purposes, it is a figure entered in a party's favor when determining the overall costs associated with a transaction. On closing statements, credits reflect expenses that have been paid by a particular individual or expenses that are owed to that individual. Credits stand in contrast to debits.

A debit is a negative balance or a negative amount. For the purposes of our discussion, it is an amount due from or owed by a particular individual when determining the overall costs associated with a transaction. On closing statements, debits reflect charges made to the parties involved in the transaction. A careful accounting of credits and debits will allow a licensee to determine exactly how much a buyer must pay to complete a transaction, as well as the amount that a seller will actually take away from a sale, which is rarely the same amount as the purchase price.

Some of the expenses associated with a real estate transaction, such as transaction fees, are clearly the responsibility of either the buyer or the seller. State laws and the negotiated terms of the purchase contract will offer further guidelines that help a licensee determine which party is properly held responsible for a given expense. Other expenses must be divided proportionally between the parties, so that the charges to each party properly reflect the amount of money he or she owes or has prepaid. We call these "prorated expenses," and the process by which we calculate them is called "proration."

For our purposes, the proration process is a method of dividing accrued items and prepaid items between a seller and a buyer. Accrued items are costs that a seller owes (such as real estate taxes), but which will ultimately be paid by a buyer after he or she receives title to a property. That is to say, these expenses have been (or are being) incurred, but need not be paid at the time the sale closes. In an effort to ensure that these expenses are handled fairly, the seller generally pays the buyer for these items through credits at closing. For example, a seller might credit a buyer for the proportion of annual real estate taxes that were charged during the part of the year that the seller occupied the property.

A prepaid item is an item that has been paid for ahead of time, generally by the seller. For example, a seller might have prepaid an insurance policy that is required by the local homeowner's association. A buyer must then generally "purchase" this item from the seller at the time of the sale, either with cash, credits or in some other way that the principals have negotiated.

When calculating prorated expenses, the first step is determining a yearly charge for the item. To calculate the monthly charge for the item, divide the amount by 12. It may be necessary to go further and calculate a daily charge for the item. In this case, there are two methods commonly used to calculate daily charges: the 360-day banking year and the 365-day conventional calendar year; which one is appropriate in a particular case will depend on your state's laws and

regulations in this regard. Once you have determined the daily or monthly charge for the item, you can multiply it by the number of days or months in the period for which the prorated expense is being calculated.

The next lesson will discuss preparing pre-settlement estimates of closing costs and settlement statements.

# LESSON THREE

## HUD-1 SETTLEMENT STATEMENT

This lesson focuses on the following topics:

- General Guidelines for the HUD-1 Settlement Statement Form
- Settlement Charges
- Summary of Borrower's Transaction
- Summary of Seller's Transaction

### INTRODUCTION

As we discussed in the previous lesson, the settlement statement (also called a “closing statement”) is a detailed, comprehensive document that summarizes each party's debits and credits, as well as the funds that each party has contributed to the transaction thus far. This document is also often used to calculate the total amount that the buyer must bring to the settlement. There is no generally accepted format that **all** settlement statements must follow.

However, all transactions that fall under RESPA regulation are required to use the HUD-1 Settlement Statement form. This means that all transactions involving a federally related loan used to purchase a one- to four-family home must use the HUD-1 Settlement Statement form; this in turn means that nearly all residential purchase transactions will require this form. Therefore, the HUD-1 Settlement Statement is the most commonly used form for settlement statements, and all licensees who deal in residential property should be familiar with it.

**NOTE:** The HUD-1 Settlement Statement may also be used for transactions that are not covered by RESPA regulations—that is to say, there are no prohibitions against using it for sales that fall outside of RESPA's domain.

There are many details to consider when filling out a HUD-1 Settlement Statement. The settlement agent is responsible for this task; in some states, licensees may act as settlement agents. Regardless of who acts as a settlement agent, that individual must be careful and accurate. The material in this lesson will familiarize you with this common form and educate you about how to complete it properly.

## GENERAL GUIDELINES FOR THE HUD-1 SETTLEMENT STATEMENT FORM

In most states, the settlement agent completes the HUD-1 Settlement Statement. Current RESPA regulations do not define the term “settlement agent,” but previous definitions suggest that we should understand this term to mean “the individual who is conducting or handling the settlement of the transaction.” If the lender and the principals have not designated a particular individual as the settlement agent, then the lender is often considered to be the settlement agent.

However, licensees should familiarize themselves with the requirements imposed by the states in which they live. State laws may require that this form be completed by a particular party, or may stipulate that only certain individuals can serve as settlement agents. These sorts of details cannot be left to chance, and a prudent licensee will do everything that he or she can to ensure that all transactions go as smoothly as possible.

As we have already noted, the settlement statement provides a detailed accounting of the principals’ debits and credits; this is true of the HUD-1 form as well. However, some of the settlement information may not be available until the last minute; there is no legal requirement that the form be fully completed before closing. The buyer may request to receive a copy of the HUD-1 Settlement Statement one day before closing, but even at this late stage, some important expenses or credits may remain unknown. In such cases, the settlement agent should complete the settlement statement to the best of his or her knowledge and ensure that all parties are aware that at least some of the costs given at that point are only estimates.

At closing, the settlement agent should ensure that both the buyer and the seller receive a copy of the settlement statement. Some sections of the form allow for the seller’s information to be omitted from the buyer’s copy of the statement, and vice versa, thus protecting each party’s privacy (see, for example, Section J, which is discussed in detail later in this lesson). However, each principal should receive a copy of the form that has been adequately completed, so that they may use it to draw conclusions about their transaction. In addition, the settlement agent should retain a copy of the settlement form that includes any omitted information for both principals, to provide the fullest possible accounting of the closing transaction.

For escrow closings in which the buyer, the seller or both principals are absent, the settlement statement should be mailed or delivered immediately after closing. In **all** types of closings, the buyer and the seller should carefully review the settlement statement with their attorneys and brokers to ensure that all of the information it contains is accurate.

The settlement statement must be completed in a clear and legible fashion, though it may be handwritten, typed or completed on a computer. If any of the expenses mentioned on the form have been paid outside of the settlement, their respective lines should be marked "P.O.C.," indicating that they were paid outside of closing. Additional pages may be attached to the statement to include information required by local or state laws, or to make sure that the purchase contract's settlement provisions are thoroughly explained in the statement.

We will now examine the HUD-1 form in greater detail.

## **GENERAL GUIDELINES FOR ENTERING BASIC TRANSACTION INFORMATION ON THE HUD-1 FORM**

Let's assume that Seller A's property is located at 100 Olive Street, Smallville, Texas 78702; Seller A currently resides at this address. The home is listed with Pro Real Estate, which is located at 550 Congress Street, Smallville, Texas 78702. Buyer B (who lives at 325 W. Mary St., Smallville, Texas, 78702) and Seller A have agreed that Buyer B will purchase the house for \$115,000, and that the transaction will be closed on July 10, 2005, at the Pro Real Estate office. Buyer B has obtained a new conventional loan through Your Bank, which is located at 100 Main Street, Smallville, Texas 78702, and Buyer B did not need to buy insurance for the loan because the loan-to-value ratio is less than 80 percent. The file number and loan number are not available at this point.

How would we enter this information into the blank HUD-1 Settlement Statement form?

<b>A. U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT SETTLEMENT STATEMENT</b>				
<b>B. TYPE OF LOAN</b>	1. <input type="checkbox"/> FHA	2. <input type="checkbox"/> FmHA	6. File Number	7. Loan Number
3. <input type="checkbox"/> CONV. UNINS.	4. <input type="checkbox"/> VA	5. <input type="checkbox"/> CONV. INS.	8. Mortgage Insurance Case No.	
C. NOTE: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.				
D. NAME AND ADDRESS OF BORROWER:	E. NAME AND ADDRESS OF SELLER:		F. NAME AND ADDRESS OF LENDER:	
G. PROPERTY LOCATION:	H. SETTLEMENT AGENT:			
	PLACE OF SETTLEMENT:		I. SETTLEMENT DATE:	

Section A. Do not enter any information here.

Section B. Check the appropriate loan type and then enter the specific loan information in spaces 6, 7 and 8.

Section C. No entry required.

Section D. Enter the full legal name of the borrower (buyer), along with his or her current mailing address and zip code. If there is more than one buyer, enter complete information for all of them. Use an additional page if necessary.

Section E. Enter the full legal name of the seller, along with his or her current mailing address and zip code. If there is more than one seller, enter complete information for all of them. Use an additional page if necessary.

Section F. Enter the name, current mailing address and zip code of the lender.

Section G. Enter the street address and zip code of the property. If no street address is available, you may enter a legal description instead, but the zip code must still be entered.

Section H. Enter the full legal name of the settlement agent, current mailing address and zip code. Enter the address and zip code of the place of settlement.

Section I. Enter the date of settlement.

Now, recalling the information from our example, let's look at the completed form for this situation.

<b>A. U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT SETTLEMENT STATEMENT</b>				
<b>B. TYPE OF LOAN</b>	1. <input type="checkbox"/> FHA	2. <input type="checkbox"/> FmHA	6. File Number	7. Loan Number
3. <input checked="" type="checkbox"/> CONV. UNINS.	4. <input type="checkbox"/> VA	5. <input type="checkbox"/> CONV. INS.	8. Mortgage Insurance Case No.	
C. NOTE: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.				
D. NAME AND ADDRESS OF BORROWER:  <b>Buyer B 325 W. Mary St. Smallville, TX 78702</b>	E. NAME AND ADDRESS OF SELLER:  <b>Seller A 100 Olive St. Smallville, TX 78702</b>		F. NAME AND ADDRESS OF LENDER:  <b>Your Bank 100 Main St. Smallville, TX 78702</b>	
G. PROPERTY LOCATION: <b>100 Olive St. Smallville, TX 78702</b>	H. SETTLEMENT AGENT: <b>Pro Real Estate</b>			

	PLACE OF SETTLEMENT: <b>550 Congress Street Smallville, TX 78702</b>	I. SETTLEMENT DATE: <b>July 10, 2005</b>

This, then, is the preliminary part of the HUD-1 Settlement Statement, which identifies the principals involved in the transaction as well as the property being transferred. This part of the form also specifies what kind of funding will be used in the sale, and designates a settlement agent. We will now look in detail at the *body* of the HUD-1 form. The main part of this form is divided into three major sections:

- Summary of Borrower's Transaction (Section J)
- Summary of Seller's Transaction (Section K)
- Settlement Charges (Section L)

Although the Settlement Charges section (Section L) is the final section of the form, you will probably want to fill out this section *first* because the totals from this section are needed for calculations in other sections of the form.

**A. Settlement Statement**

U.S. Department of Housing  
and Urban Development

OMB Approval No. 2502-0265

<b>B. Type of Loan</b>			6. File Number:	7. Loan Number:	8. Mortgage Insurance Case Number:
1. <input type="checkbox"/> FHA	2. <input type="checkbox"/> FmHA	3. <input type="checkbox"/> Conv. Unins.			
4. <input type="checkbox"/> VA	5. <input type="checkbox"/> Conv. Ins.				

C. Note: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.);" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.

D. Name & Address of Borrower:	E. Name & Address of Seller:	F. Name & Address of Lender:

G. Property Location:	H. Settlement Agent:	I. Settlement Date:
	Place of Settlement:	

J. Summary of Borrower's Transaction		K. Summary of Seller's Transaction	
<b>100. Gross Amount Due From Borrower</b>		<b>400. Gross Amount Due To Seller</b>	
101. Contract sales price		401. Contract sales price	
102. Personal property		402. Personal property	
103. Settlement charges to borrower (line 1400)		403.	
104.		404.	
105.		405.	
<b>Adjustments for items paid by seller in advance</b>		<b>Adjustments for items paid by seller in advance</b>	
106. City/town taxes to		406. City/town taxes to	
107. County taxes to		407. County taxes to	
108. Assessments to		408. Assessments to	
109.		409.	
110.		410.	
111.		411.	
112.		412.	
<b>120. Gross Amount Due From Borrower</b>		<b>420. Gross Amount Due To Seller</b>	
<b>200. Amounts Paid By Or In Behalf Of Borrower</b>		<b>500. Reductions In Amount Due To Seller</b>	
201. Deposit or earnest money		501. Excess deposit (see instructions)	
202. Principal amount of new loan(s)		502. Settlement charges to seller (line 1400)	
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204.		504. Payoff of first mortgage loan	
205.		505. Payoff of second mortgage loan	
206.		506.	
207.		507.	
208.		508.	
209.		509.	
<b>Adjustments for items unpaid by seller</b>		<b>Adjustments for items unpaid by seller</b>	
210. City/town taxes to		510. City/town taxes to	
211. County taxes to		511. County taxes to	
212. Assessments to		512. Assessments to	
213.		513.	
214.		514.	
215.		515.	
216.		516.	
217.		517.	
218.		518.	
219.		519.	
<b>220. Total Paid By/For Borrower</b>		<b>520. Total Reduction Amount Due Seller</b>	
<b>300. Cash At Settlement From/To Borrower</b>		<b>600. Cash At Settlement To/From Seller</b>	
301. Gross amount due from borrower (line 120)		601. Gross amount due to seller (line 420)	
302. Less amounts paid by/for borrower (line 220)	( )	602. Less reductions in amt. due seller (line 520)	( )
<b>303. Cash</b> <input type="checkbox"/> From <input type="checkbox"/> To Borrower		<b>603. Cash</b> <input type="checkbox"/> To <input type="checkbox"/> From Seller	

Section 5 of the Real Estate Settlement Procedures Act (RESPA) requires the following: • HUD must develop a Special Information Booklet to help persons borrowing money to finance the purchase of residential real estate to better understand the nature and costs of real estate settlement services; • Each lender must provide the booklet to all applicants from whom it receives or for whom it prepares a written application to borrow money to finance the purchase of residential real estate; • Lenders must prepare and distribute with the Booklet a Good Faith Estimate of the settlement costs that the borrower is likely to incur in connection with the settlement. These disclosures are mandatory.

Section 4(a) of RESPA mandates that HUD develop and prescribe this standard form to be used at the time of loan settlement to provide full disclosure of all charges imposed upon the borrower and seller. These are third party disclosures that are designed to provide the borrower with pertinent information during the settlement process in order to be a better shopper.

The Public Reporting Burden for this collection of information is estimated to average one hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number. The information requested does not lend itself to confidentiality.

**L. Settlement Charges**

<b>700. Total Sales/Broker's Commission based on price \$</b>				@	% =		
Division of Commission (line 700) as follows:							
701.	\$		to			Paid From Borrowers Funds at Settlement	Paid From Seller's Funds at Settlement
702.	\$		to				
703.	Commission paid at Settlement						
704.							
<b>800. Items Payable In Connection With Loan</b>							
801.	Loan Origination Fee			%			
802.	Loan Discount			%			
803.	Appraisal Fee			to			
804.	Credit Report			to			
805.	Lender's Inspection Fee						
806.	Mortgage Insurance Application Fee to						
807.	Assumption Fee						
808.							
809.							
810.							
811.							
<b>900. Items Required By Lender To Be Paid In Advance</b>							
901.	Interest from		to	@ \$	/day		
902.	Mortgage Insurance Premium for				months to		
903.	Hazard Insurance Premium for				years to		
904.					years to		
905.							
<b>1000. Reserves Deposited With Lender</b>							
1001.	Hazard insurance			months @ \$	per month		
1002.	Mortgage insurance			months @ \$	per month		
1003.	City property taxes			months @ \$	per month		
1004.	County property taxes			months @ \$	per month		
1005.	Annual assessments			months @ \$	per month		
1006.				months @ \$	per month		
1007.				months @ \$	per month		
1008.				months @ \$	per month		
<b>1100. Title Charges</b>							
1101.	Settlement or closing fee			to			
1102.	Abstract or title search			to			
1103.	Title examination			to			
1104.	Title insurance binder			to			
1105.	Document preparation			to			
1106.	Notary fees			to			
1107.	Attorney's fees			to			
	(includes above items numbers: )						
1108.	Title insurance			to			
	(includes above items numbers: )						
1109.	Lender's coverage			\$			
1110.	Owner's coverage			\$			
1111.							
1112.							
1113.							
<b>1200. Government Recording and Transfer Charges</b>							
1201.	Recording fees: Deed \$			; Mortgage \$		; Releases \$	
1202.	City/county tax/stamps: Deed \$			; Mortgage \$			
1203.	State tax/stamps: Deed \$			; Mortgage \$			
1204.							
1205.							
<b>1300. Additional Settlement Charges</b>							
1301.	Survey			to			
1302.	Pest inspection			to			
1303.							
1304.							
1305.							
1400.	<b>Total Settlement Charges (enter on lines 103, Section J and 502, Section K)</b>						

We will now discuss each of the HUD-1 form's three sections in greater detail.

## SETTLEMENT CHARGES

As we noted earlier, the settlement charges section of the HUD-1 (Section L) is actually the section of the form. However, information contained there is needed to complete the earlier sections, so we will treat this section of the form first. The first portion of the settlement charges section (Line 700–704) deals with the brokers' commissions. Read the text below for an explanation of how that line should be completed.

L. SETTLEMENT CHARGES		
<b>700. TOTAL SALES/BROKER'S COMMISSION based on price \$ _____ @ ___% = _____</b>	PAID FROM BORROWER'S FUNDS AT SETTLEMENT	PAID FROM SELLER'S FUNDS AT SETTLEMENT
<i>Division of Commission (line 700) as follows:</i>		
701. \$ to		
702. \$ to		
703. Commission paid at Settlement		
704.		

**Line 700:** Enter the commission charged by the licensee. If the commission is a percentage of the purchase, enter the property's selling price, the percentage of the commission and the dollar amount of the total commission paid by the seller.

**Lines 701 and 702:** If the commission is being split between two or more licensees, or between a licensee and some other third party who is legally permitted to receive commissions, enter the respective dollar amounts that these parties will receive on these lines.

**Line 703:** Enter the amount of the sales commission to be paid at settlement. If the licensee is keeping part of the earnest money to pay for all or part of his or her commission, list *only* the commission being paid at settlement and note the amount of the earnest money deposit being kept by the broker on line 704 with a P.O.C. note.

**Line 704:** Enter any additional charges imposed by the licensee, as well as any commission being charged to the buyer that is to be paid out by the settlement agent.

Lines 800 through 811 detail the items payable in connection with the loan(s). Each loan fee and charge needs to be itemized. These lines of the form are fairly self-explanatory; the person completing the form simply needs to fill in the information requested, which should be readily available from the borrower or

from the lender. Lines 808 through 811 should be used to note any additional loan charges. As we discussed in Lesson Two, most loan fees and charges will generally be charged to the buyer (i.e., the borrower), but make certain that the completed settlement form reflects any negotiated arrangements between the seller and the buyer with respect to loan charges.

	PAID FROM BORROWER'S FUNDS AT SETTLEMENT	PAID FROM SELLER'S FUNDS AT SETTLEMENT
<b>800. ITEMS PAYABLE IN CONNECTION WITH LOAN</b>		
801. Loan Origination Fee %		
802. Loan Discount %		
803. Appraisal Fee to		
804. Credit Report to		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee to		
807. Assumption Fee		
808.		
809.		
810.		
811.		

Lines 900 through 905 list items that the lender stipulates must be paid at closing (except for the reserves, which are listed on lines 1000 through 1008). Note, however, that these charges are not necessarily paid to the lender. Generally, the buyer is responsible for these expenses. Read the text below for an explanation of how that line should be completed.

	Borrower's Funds	Seller's Funds
<b>900. ITEMS REQUIRED BY LENDER TO BE PAID IN ADVANCE</b>		
901. Interest from _____ to _____ @ \$ ____/day		
902. Mortgage Insurance Premium for _____ months to		
903. Hazard Insurance Premium for _____ years to		
904. years to		
905.		

Line 900: Do not enter any information on this line.

Line 901: Enter any interest that is being collected at closing for part of a month or part of a payment period that occurs between settlement and the time of the first monthly payment. Include any per diem charges. Do not enter any amount on this line if interest will not be collected until the first monthly payment.

Line 902: Enter mortgage insurance premiums that are due at closing (not including any reserves collected by the lender, which will be recorded elsewhere). If the buyer is paying a lump sum mortgage insurance premium, record that total on this line with a note indicating that this premium covers the life of the loan.

Line 903: Enter hazard insurance premiums that are due at closing (again, not including any reserves collected by the lender, which will be recorded elsewhere).

Lines 904 and 905: Enter any additional items required by the lender (e.g., flood insurance). You should also use these lines to enter here any amounts paid at closing for other insurance not required by the lender. As with the other 900-series lines, do not include reserves in the figures you record here.

As we mentioned earlier, lines 1000 through 1008 detail the reserves that have been or need to be deposited with the lender. Read the text below to see a brief explanation of how that line should be completed.

**IMPORTANT NOTE:** This section requires a different type of accounting than the rest of the settlement sheet. HUD offers the following guidance in this regard:

*“After itemizing individual deposits in the 1000 series using single-item accounting, the servicer shall make an adjustment based on aggregate accounting. This adjustment equals the difference between the deposit required under aggregate accounting and the sum of the deposits required under single-item accounting. The computation steps for both accounting methods are set out in 3500.17(d). The adjustment will always be a negative number or zero (-0-). The settlement agent shall enter the aggregate adjustment amount on a final line in the 1000 series of the HUD-1 or HUD-1A statements.*

*During the phase-in period, as defined in 3500.17(b), an alternative procedure is available. If a servicer has not yet conducted the escrow account analysis to determine the aggregate accounting starting balance, the settlement agent may initially calculate the 1000 series deposits for the HUD-1 and HUD-1A settlement statement using single-item analysis with a one-month cushion (unless the mortgage loan documents indicate a smaller amount). In the escrow account analysis conducted within 45 days*

*of settlement, the servicer shall adjust the escrow account to reflect the aggregate accounting balance.”*

These instructions are taken from HUD’s instructions for completing the HUD-1 Settlement Statement (HUD RESPA Final Regulations, Appendix A), which can be found online at <http://www.hud.gov/offices/hsg/ramh/res/resappa.cfm>.

Sections 3500.17(b) and 3500.17(d), mentioned in these instructions, can be found in the HUD RESPA Final Regulations, Appendix B, which is online at <http://www.hud.gov/offices/hsg/ramh/res/resappa.cfm>.

	Borrower’s Funds	Seller’s Funds
<b>1000. RESERVES DEPOSITED WITH LENDER</b>		
1001. Hazard Insurance _____ months @ \$ _____ per month		
1002. Mortgage insurance _____ months @ \$ _____ per month		
1003. City property taxes _____ months @ \$ _____ per month		
1004. County property taxes _____ months @ _____\$ per month		
1005. Annual assessments _____ months @ \$_____ per month		
1006. _____ Months @ \$_____ per month		
1007. _____ Months @ \$_____ per month		
1008. Aggregate Adjustment _____ months @ \$_____ per month		

Line 1000: This line requires no entry.

Lines 1001 through 1007: Enter amounts collected by the lender and held in escrow or trust for making future payments. Record these amounts as monthly payments of specific amounts, with a total in either the “borrower’s funds” column or the “seller’s funds” column. Lines 1006 and 1007 can be used to account for items other than those listed; for example, a lender might require reserves to cover flood insurance.

Line 1008: Enter the aggregate adjustment amount, per HUD’s accounting instructions, outlined in the earlier note. Remember that HUD’s instructions can be found in HUD RESPA Final Regulations, Appendix A, which is online at <http://www.hud.gov/offices/hsg/ramh/res/resappa.cfm>; further details can be found in Appendix B, which is online at <http://www.hud.gov/offices/hsg/ramh/res/resappa.cfm>.

Lines 1100 through 1113 list title charges and attorneys’ fees associated with the transaction. Read the text below to see an explanation of how each line should be completed.

**NOTE:** In some transactions, a single individual or company performs more than one of the services listed on lines 1101 through 1106, for a single aggregate fee. For example, an attorney might perform notary duties, execute a title examination and prepare documents. In cases like these, that individual's aggregate fee should be entered on line 1107 (if the individual is an attorney) or on line 1108 (for title companies). Under lines 1107 and 1108, space is provided in which you should give the line item number of each service performed by that individual or company. If you do this, you need not itemize each service individually in the "borrower's" and "seller's" columns.

If **more** than one individual performs any single service and each person or company charges a fee, their separate fees must be accounted for in this section. You should show the total paid in either the "borrower's" or the "seller's" column and list their individual charges on the line following the word "to." This is true for all services listed on lines 1101 through 1106.

	Borrower's Funds	Seller's Funds
<b>1100. TITLE CHARGES</b>		
1101. Settlement or closing fee _____ to		
1102. Abstract or title search _____ to		
1103. Title examination _____ to		
1104. Title insurance binder _____ to		
1105. Document preparation _____ to		
1106. Notary fees _____ to		
1107. Attorney's fees _____ to <i>(includes above items numbers; )</i>		
1108. Title Insurance _____ to <i>(includes above items numbers; )</i>		
1109. Lender's coverage \$		
1110. Owner's coverage \$		
1111.		
1112.		
1113.		

Line 1100: Do not enter any information on this line.

Line 1101: Enter the settlement agent's fee.

Line 1102: Enter the fee for the abstract or title search. Remember that if this is part of an aggregate fee charged by a title company or an attorney for a variety of services, you can enter that aggregate fee on line 1108 and provide the line item numbers of the services that were performed for this transaction. This is true for all services listed on lines 1101 through 1106.

Remember, too, that if multiple individuals are paid for the same service, their separate fees must be properly accounted for here.

Line 1103: Enter the title examination fee. If the same person or company performs the abstract or title search and the examination and charges a single fee for both procedures, one fee could be entered on this line. This is only true if that single person or company is **not** a title company or an attorney; if a title company or attorney performs these or any other services for an aggregate fee, that amount should be entered using lines 1107 and 1108.

Line 1104: Enter the title insurance binder fee; this is sometimes also called a “commitment to insure.”

Line 1105: Enter the document preparation fee.

Line 1106: Enter notary fees charged to ensure the authenticity of closing documents.

Line 1107: Enter attorney’s fees. If a transaction involves multiple attorneys, one attorney’s fees should be entered on line 1107, and the others’ fees should be accounted for on line 1111, 1112 or 1113.

Line 1108: Enter total charge for title insurance. If an attorney is also acting as the title agent, note on line 1107 which services are included in the attorney’s fee, and note on line 1113 which services are included in the insurance commission.

Lines 1109 and 1110: Enter the separate charges for the lender’s and owner’s title insurance policies. Do not enter these amounts in the “borrower’s” column or the “seller’s” column, because the total title insurance charges have already been entered on line 1108.

Lines 1111 through 1113: Enter any title fees or charges that have not been accounted for in lines 1101-1110. For example, if one party must pay a public records office for a certificate of title, that charge would be entered here.

Lines 1200 through 1205 itemize government recording and transfer charges associated with the transaction. This is another fairly self-explanatory part of the form; the settlement agent need only list the recording fees on line 1201, the city/county tax/stamps on line 1202 and the state tax/stamps on line 1203. Lines

1204 through 1205 are to be used for any additional charges that are related to government recording and transfer.

	Borrower's Funds	Seller's Funds
<b>1200. GOVERNMENT RECORDING AND TRANSFER CHARGES</b>		
1201. Recording fees: Deed \$____ ; Mortgage \$____ ; Releases \$____		
1202. City/county tax/stamps: Deed \$____ ; Mortgage \$____		
1203. State tax/stamps: Deed \$____ ; Mortgage \$ ____		
1204.		
1205.		

Any other settlement charges that have not already been itemized should be listed on Lines 1300 through 1305. Enter survey costs on Line 1301 and pest or other inspection charges on Line 1302; other inspection charges may be entered here as well, such as hazard inspections (e.g., radon or lead-based paint). Lines 1303 through 1305 are for additional charges not associated with surveys, hazard inspections, or any of the other categories listed in Section L, such as structural inspections or fees for warranty coverage. *Do not* use lines 1303 through 1305 to list the seller's obligatory payoffs, such as liens. These are covered in Section K.

	Borrower's Funds	Seller's Funds
<b>1300. ADDITIONAL SETTLEMENT CHARGES</b>		
1301. Survey to		
1302. Pest inspection to		
1303.		
1304.		
1305.		

When all information has been verified and entered in Section L of the form, add up the charges in the "borrower's funds" column and calculate a similar total for the "seller's funds" column. Enter these totals on Line 1400. These totals will also be entered in Sections J and K, on lines 103 and 502, respectively.

	Borrower's Funds	Seller's Funds
<b>1400. TOTAL SETTLEMENT CHARGES</b> <i>(enter on lines 103, Section J and 502, Section K)</i>		

## SUMMARY OF BORROWER'S TRANSACTION

Having discussed the "Settlement Charges" section of the HUD-1 form, we will now turn to the part of the form that outlines the buyer's (i.e., the borrower's) costs associated with the transaction. Section J of the HUD-1 form lists the buyer's expenses. Line 100 through 120 details the gross amount due from the buyer—that is to say, these lines provide us with a detailed explanation of the buyer's debits. Section J can be left blank on the copy of the HUD-1 form provided to the seller, just as Section K (which details the seller's debits) can be left blank on the copy of the form provided to the buyer. The settlement agent, however, should retain a copy of the form fully filled out with information for both principals.

Read the text that follows to see an explanation of how these lines should be completed.

<b>J. SUMMARY OF BORROWER'S TRANSACTION</b>	
<b>100. GROSS AMOUNT DUE FROM BORROWER:</b>	
101. Contract sale price	
102. Personal property	
103. Settlement charges to borrower(line 1400)	
104.	
105.	
<i>Adjustments for items paid by seller in advance</i>	
106. City/town taxes_____ to	
107. County taxes _____ to	
108. Assessments _____ to	
109.	
110.	
111.	
112.	
<b>120. GROSS AMOUNT DUE FROM BORROWER</b>	

Line 100: Do not enter any information in this line.

Line 101: Enter the property's gross sale price. If the buyer and seller have agreed to separate prices for any personal property being exchanged (such as

carpets or appliances), do not include these in the sale price. These separately priced items will be recorded on line 102.

Line 102: Enter the gross sale price of any items of tangible personal property exchanged between the seller and the buyer, such as carpets or appliances. The specifics regarding what counts as personal property vary from state to state; therefore, settlement agents should consult their states' guidelines about what items are correctly considered to be personal property.

Line 103: Enter the total settlement charges to the buyer. We determined this figure in our discussion of Section L. If the settlement agent has already completed Section L, this amount can be found on line 1400.

Lines 104 and 105: Enter any additional amounts that the buyer owes or amounts for which the buyer is reimbursing the seller (such as security deposits). Also, if the buyer is financing construction on the property or is purchasing a manufactured home and has obtained a loan other than a first user loan, the purchase price of the land must be entered on line 104, and the construction costs or price of the manufactured home being placed there must be entered on Line 105. When buyers are financing construction, line 101 is left blank.

Lines 106 through 108: Enter any city taxes, town taxes, county taxes or assessments that the seller has prepaid and for which the buyer must reimburse the seller.

Lines 109 through 112: Enter any additional prepaid amounts for which the buyer must reimburse the seller.

Line 120: Add the figures from lines 101 through 112, and enter that amount here. This is the buyer's total debit.

Lines 200 through 220 in Section J identify the amounts paid by or on behalf of the buyer (that is to say, this section outlines the buyer's credits). Read the text below for an explanation of how these lines should be completed.

<b>200. AMOUNTS PAID BY OR IN BEHALF OF BORROWER:</b>	
201. Deposit of earnest money	
202. Principal amount of new loan(s)	
203. Existing loan(s) taken subject to	
204.	
205.	
206.	

207.	
208.	
209.	
<i>Adjustments for items unpaid by seller</i>	
210. City/town taxes _____ to	
211. County taxes _____ to	
212. Assessments _____ to	
213.	
214.	
215.	
216.	
217.	
218.	
219.	
<b>220. TOTAL PAID BY/FOR BORROWER</b>	

Line 200: Do not enter any information on this line.

Line 201: Enter the amount of earnest money or any other money paid against the purchase price before closing.

Line 202: Enter the amount of the new loan(s) made by the lender or first user loan(s), if applicable. Throughout the remainder of the form, the settlement agent should be certain that his or her calculations reflect any known adjustments or charges associated with temporary or permanent financing.

Line 203: Enter the amount of any loan the buyer is assuming, or the amounts of any other liens and encumbrances to which the buyer's title is subject, if applicable.

Lines 204 through 209: Enter any other items that have been paid for by the buyer or paid on the buyer's behalf which have not yet been entered in this part of the form. For example, the settlement agent should use these lines to account for cases in which the seller accepts a note from the buyer for all or part of the purchase price, cases in which the seller accepts other property as trade and cases in which the seller gives the buyer an allowance to make specific repairs or improvements to the property.

Lines 210 through 212: Enter any accrued city taxes, town taxes, county taxes or assessments that date from a period prior to closing but which have not yet been paid. Generally, the seller is understood to owe the buyer for these expenses unless they have negotiated another arrangement.

Lines 213 through 219: Enter any additional accrued items dating from a period prior to settlement that have not yet been paid but which will come due to the buyer (such as utilities used but not yet paid for). Again, the seller is generally understood to owe the buyer for these expenses, unless they have negotiated another arrangement.

Line 220: Add the figures from lines 201 through 219, and enter that amount here. This is the buyer's total credit.

Line 300 should be left blank, but lines 301 through 303 are used to calculate the amount of cash due *from* the buyer or the amount of cash due *to* the buyer at closing. On line 301, enter the gross amount due from the buyer, which can be found on line 120. On line 302, enter the buyer's total credit from line 220. Subtract line 302 (the buyer's credit) from line 301 (the gross amount due) to determine the total cash due *from* the buyer (i.e., the borrower) or due *to* the buyer. Enter this amount on line 303. The settlement agent should make certain to avoid confusion by checking the appropriate box on the HUD-1 form to indicate whether the figure on line 303 represents cash due **to** the buyer or cash due **from** the buyer.

300. <b>CASH AT SETTLEMENT FROM/TO BORROWER</b>	
301. Gross amount due from borrower(line 120)	
302. Less amounts paid by/for borrower(line 220)	
303. <b>CASH</b> <input type="checkbox"/> <b>FROM</b> <input type="checkbox"/> <b>TO BORROWER</b>	

It may seem odd that cash would be due **to** a buyer in a real estate transaction. However, one occasionally encounters situations in which the buyer's credit is larger than his or her debit, and in these cases the buyer would *receive* cash at closing. However, in most transactions the amount entered on line 303 will reflect cash *owed by* the buyer.

## SUMMARY OF SELLER'S TRANSACTION

Now we turn to the third part of the HUD-1 form, which is much like Section J except that now we are concerned with the *seller*, not the buyer. Section K details the seller's expenses associated with the transaction. As we noted before, there is no obligation to share this part of the form with the buyer; Section K can be left blank on the seller's copy of the form, though the settlement agent should retain a copy of the form fully filled out with information for both principals.

Lines 400 through 420 list the amounts due to the seller (that is, these lines list the seller's credits). Read the text below to see an explanation of how these lines should be completed.

<b>K. SUMMARY OF SELLER'S TRANSACTION</b>	
<b>400. GROSS AMOUNT DUE TO SELLER:</b>	
401. Contract sale price	
402. Personal property	
403.	
404.	
405.	
<i>Adjustments for items paid by seller in advance</i>	
406. City/town taxes _____ to	
407. County taxes _____ to	
408. Assessments _____ to	
409.	
410.	
411.	
412.	
<b>420. GROSS AMOUNT DUE TO SELLER</b>	

Line 400: Do not enter any information on this line.

Line 401: Enter the property's gross sale price. If the buyer and seller have agreed to separate prices for any personal property being exchanged (such as carpets or appliances), do not include these in the sale price. These separately priced items will be recorded on line 402.

Line 402: Enter the gross sale price of any items of tangible personal property exchanged between the seller and the buyer, such as carpets or appliances. The specifics regarding what counts as personal property vary from state to state; therefore, settlement agents should consult their states' guidelines about what items are correctly considered to be personal property.

Lines 403 through 405: Enter any additional amounts that the seller is owed. Also, if the buyer is financing construction on the property or is purchasing a manufactured home and has obtained a loan other than a first user loan, the purchase price of the land must be entered on line 404, and the construction

costs or price of the manufactured home being placed there must be entered on Line 405. When buyers are financing construction, line 401 is left blank.

Lines 406 through 408: Enter any prepaid city taxes, town taxes, county taxes or assessments that the seller has prepaid and for which the buyer must reimburse the seller.

Lines 409 through 412: Enter any additional prepaid amounts for which the buyer must reimburse the seller.

Line 420: Add the figures from lines 401 through 412, and enter that amount here. This is the seller's total credit.

Lines 500 through 520 identify amounts that the seller must pay and other reductions in the amount due to the seller (that is to say, this section outlines the seller's debits). Read the text below to see an explanation of how these lines should be completed.

<b>500. REDUCTIONS IN AMOUNT DUE TO SELLER:</b>	
501. Excess deposit (see instructions)	
502. Settlement charges to seller (line 1400)	
503. Existing loan(s) taken subject to	
504. Payoff of first mortgage loan	
505. Payoff of second mortgage loan	
506.	
507.	
508.	
509.	
<i>Adjustments for items unpaid by seller</i>	
510. City/town taxes _____ to	
511. County taxes _____ to	
512. Assessments _____ to	
513.	
514.	
515.	
516.	
517.	

518.	
519.	
<b>520. TOTAL REDUCTION AMOUNT DUE SELLER</b>	

Line 500: Do not enter any information on this line.

Line 501: This line is only used in particular circumstances. Specifically, it is for use when someone besides the settlement agent (e.g., the seller's broker) holds an amount of earnest money that exceeds his or her commission **and** the excess amount is to be returned directly to the seller rather than passed through the settlement agent. In these cases, the settlement agent should enter the amount of the excess deposit on this line. The total amount of the deposit, including commissions, should be entered on line 201.

Line 502: Enter the total settlement charges to the seller. We determined this figure in our discussion of Section L. If the settlement agent has already completed Section L, this amount can be found on line 1400.

Line 503: If the buyer is assuming any of the seller's loans or receiving a title subject to other liens or encumbrances, the settlement agent should enter that amount here.

Lines 504 and 505: If any first or second mortgage loans are to be paid off as part of the closing process, the settlement agent should enter those amounts here (including the loans' accrued interest).

Lines 506 and 507: On line 506, enter deposits that the buyer has paid to the seller (or to another party who is not the settlement agent) and which were not entered on line 501. Sometimes the seller (or other party who is not the settlement agent) turns over part or all of the deposit to the settlement agent. In these cases, the settlement agent should use line 507 to enter in parentheses the amount of the deposit that is being distributed as proceeds, and enter on line 506 any amount of the deposit that the seller or other party still holds. Also any time the settlement agent holds the deposit, he or she should make a note on line 507 indicating that it will be distributed as proceeds.

Lines 508 and 509: These lines can be used for a variety of purposes. They might be used to list any liens that the seller must pay off to clear the title. Lines 506 and 507 can be used to list *other* items that the seller is obligated to pay off (i.e., items that are *not* liens). Do not use lines 1301 through 1305 to list the seller's obligatory payoffs. These lines might also be used to detail funds held by the settlement agent for the payment of bills that cannot be prorated at closing due to a lack of information. Any amounts that were entered on lines 204 through 209 (covering general items that have been paid for by the buyer or paid on the buyer's behalf) should be entered here, including seller-financing arrangements.

Lines 510 through 512: Enter any accrued city taxes, town taxes, county taxes or assessments that date from a period prior to closing but which have not yet been paid. Generally, the seller is understood to owe the buyer for these expenses unless they have negotiated another arrangement.

Lines 513 through 519: Enter any additional accrued items dating from a period prior to settlement that have not yet been paid but which will come due to the buyer (such as utilities used but not yet paid for). Again, the seller is generally understood to owe the buyer for these expenses, unless they have negotiated another arrangement.

Line 520: Add the figures from lines 501 through 519, and enter that amount here. This is the seller's total debit.

Line 600 should be left blank, but lines 601 through 603 are used to calculate the amount of cash due *to* the seller or due *from* the seller at closing. On line 601, enter the total amount due to the seller, which is the total entered earlier on line 420. Then, enter the seller's total debit on line 602; this amount is found on line 520. Subtract line 602 (the seller's debit) from Line 601 (the total amount due to the seller) to determine the total cash due *to* the seller or due *from* the seller and enter that amount on line 603. The settlement agent should make certain to avoid confusion by checking the appropriate box on the HUD-1 form to indicate whether the figure on line 303 represents cash due to the buyer or cash due from the buyer.

600. <b>CASH AT SETTLEMENT TO/FROM SELLER</b>	
601. Gross amount due to seller (line 420)	
602. Less reductions in amount due seller (line 520)	
603. <b>CASH</b> <input type="checkbox"/> <b>TO</b> <input type="checkbox"/> <b>FROM</b> <b>SELLER</b>	

It may seem odd that cash would be due **from** a seller in a real estate transaction. However, one occasionally encounters situations in which the buyer's credit is larger than his or her debit, and in these cases the buyer would *receive* cash at closing. However, in most transactions the amount entered on line 603 will reflect cash *owed to* the seller.

## SUMMARY

Settlement statements give a detailed accounting of each principal's expenses associated with a real estate transaction; as a result, these statements also generally reveal the amount that a buyer must bring to the closing. There is no generally accepted format that **all** settlement statements must follow.

However, all transactions that fall under RESPA regulation are required to use the HUD-1 Settlement Statement form. This means that all transactions involving a federally related loan used to purchase a one- to four-family home must use the HUD-1 Settlement Statement form; this, in turn, means that nearly all residential purchase transactions will require this form. Therefore, the HUD-1 Settlement Statement is the most commonly used form for settlement statements, and all licensees who deal in residential property should be familiar with it. We should note that even transactions that do not fall under RESPA regulations are permitted to use the HUD-1 form as a settlement statement.

The preliminary part of the HUD-1 Settlement Statement identifies the principals involved in the transaction as well as the property being transferred. This part of the form also specifies what kind of funding will be used in the sale, and designates a settlement agent. The *body* of the HUD-1 form is divided into three major sections:

- Summary of Borrower's Transaction (Section J)
- Summary of Seller's Transaction (Section K)
- Settlement Charges (Section L)

Although the Settlement Charges section (Section L) is the final section of the form, it is often best to complete this section first because the totals from this section are needed for calculations in the other sections of the form.

Sections J and K provide summaries of the borrower's side of the transaction and the seller's side of the transaction, itemizing each party's debits and credits to determine the amount of cash to be exchanged at closing.

Some of the settlement information may not be available until the last minute; there is no legal requirement that the form be fully completed before closing. The buyer may request to receive a copy of the HUD-1 Settlement Statement one day before closing, but even at this late stage, some important expenses or credits may remain unknown. In such cases, the settlement agent should complete the settlement statement to the best of his or her knowledge and ensure that all parties are aware that at least some of the costs given at that point are only estimates.

At closing, the settlement agent should ensure that both the buyer and the seller receive a copy of the settlement statement. Some sections of the form allow for

the seller's information to be omitted from the buyer's copy of the statement, and vice versa, thus protecting each party's privacy (see, for example, Section J). However, each principal should receive a copy of the form that has been adequately completed, so that they may use it to draw conclusions about their transaction. In addition, the settlement agent should retain a copy of the settlement form that includes any omitted information for both principals, to provide the fullest possible accounting of the closing transaction.

For escrow closings in which the buyer, the seller or both principals are absent, the settlement statement should be mailed or delivered immediately after closing. In **all** types of closings, the buyer and the seller should carefully review the settlement statement with their attorneys and brokers to ensure that all of the information it contains is accurate.

There are many details to consider when filling out a HUD-1 Settlement Statement. The settlement agent is responsible for this task; in some states, licensees may act as settlement agents. Regardless of who acts as a settlement agent, that individual must be careful and accurate. In the next lesson, you will practice filling out a Settlement Statement to increase your understanding of this complex topic.

# LESSON FOUR

## REAL ESTATE PRACTICE

This lesson focuses on the following topics:

- Field Application of Settlement Statement Knowledge
- Insight into Closings and Settlement Costs

### INTRODUCTION

This course has covered a lot of specific information over a relatively short period of time. To ensure a comprehensive understanding of these details, we will now integrate the information provided, using a series of exercises and case studies. The first part of this lesson will describe the closing costs in an imaginary transaction, and you will be required to fill out the HUD-1 Settlement Statement calculating the final costs to the buyer and seller. The second part presents case studies—some drawn from real life situations and others created just for the purposes of this course—illustrating the regulations and concepts covered in the course. Upon completion, you should have a better sense of real-world applications of the information you have been studying.

### FIELD APPLICATION OF SETTLEMENT STATEMENT KNOWLEDGE

It is likely that as a real estate licensee, you will never be asked to fill out the HUD-1 Settlement Statement. However, if you plan to stay involved in the closings of clients' transactions, you will need to be able to explain expenses, debits and credits to buyers and sellers. These parties may wish to negotiate the terms of the settlement statement, and you may assist in that process. Also, you will probably give buyers and sellers estimates of the costs involved in closing, and knowing how to fill out the HUD-1 Settlement Statement will prepare you for this task.

**A. Settlement Statement**

U.S. Department of Housing and Urban Development

OMB Approval No. 2502-0265

<b>B. Type of Loan</b>					
1. <input type="checkbox"/> FHA	2. <input type="checkbox"/> FmHA	3. <input type="checkbox"/> Conv. Unins.	6. File Number:	7. Loan Number:	8. Mortgage Insurance Case Number:
4. <input type="checkbox"/> VA	5. <input type="checkbox"/> Conv. Ins.				
<p><b>C. Note:</b> This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c. )" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.</p>					
D. Name & Address of Borrower:		E. Name & Address of Seller:		F. Name & Address of Lender:	
G. Property Location:			H. Settlement Agent:		
			Place of Settlement:		I. Settlement Date:
<b>J. Summary of Borrower's Transaction</b>			<b>K. Summary of Seller's Transaction</b>		
<b>100. Gross Amount Due From Borrower</b>			<b>400. Gross Amount Due To Seller</b>		
101. Contract sales price			401. Contract sales price		
102. Personal property			402. Personal property		
103. Settlement charges to borrower (line 1400)			403.		
104.			404.		
105.			405.		
<b>Adjustments for items paid by seller in advance</b>			<b>Adjustments for items paid by seller in advance</b>		
106. City/town taxes to			406. City/town taxes to		
107. County taxes to			407. County taxes to		
108. Assessments to			408. Assessments to		
109.			409.		
110.			410.		
111.			411.		
112.			412.		
<b>120. Gross Amount Due From Borrower</b>			<b>420. Gross Amount Due To Seller</b>		
<b>200. Amounts Paid By Or In Behalf Of Borrower</b>			<b>500. Reductions In Amount Due To Seller</b>		
201. Deposit or earnest money			501. Excess deposit (see instructions)		
202. Principal amount of new loan(s) 502.			Settlement charges to seller (line 1400)		
203. Existing loan(s) taken subject to 503.			Existing loan(s) taken subject to		
204.			504. Payoff of first mortgage loan		
205.			505. Payoff of second mortgage loan		
206.			506.		
207.			507.		
208.			508.		
209.			509.		
<b>Adjustments for items unpaid by seller</b>			<b>Adjustments for items unpaid by seller</b>		
210. City/town taxes to			510. City/town taxes to		
211. County taxes to			511. County taxes to		
212. Assessments to			512. Assessments to		
213.			513.		
214.			514.		
215.			515.		
216.			516.		
217.			517.		
218.			518.		
219.			519.		
<b>220. Total Paid By/For Borrower</b>			<b>520. Total Reduction Amount Due Seller</b>		
<b>300. Cash At Settlement From/To Borrower</b>			<b>600. Cash At Settlement To/From Seller</b>		
301. Gross Amount due from borrower (line 120)			601. Gross amount due to seller (line 420)		
302. Less amounts paid by/for borrower (line 220)	(	)	602. Less reductions in amt. due seller (line 520)	(	)
303. Cash <input type="checkbox"/> From <input type="checkbox"/> To Borrower			603. Cash <input type="checkbox"/> To <input type="checkbox"/> From Seller		

Section 5 of the Real Estate Settlement Procedures Act (RESPA) requires the following: • HUD must develop a Special Information Booklet to help persons borrowing money to finance the purchase of residential real estate to better understand the nature and costs of real estate settlement services; • Each lender must provide the booklet to all applicants from whom it receives or for whom it prepares a written application to borrow money to finance the purchase of residential real estate; • Lenders must prepare and distribute with the Booklet a Good Faith Estimate of the settlement costs that the borrower is likely to incur in connection with the settlement. These disclosures are mandatory.

Section 4(a) of RESPA mandates that HUD develop and prescribe this standard form to be used at the time of loan settlement to provide full disclosure of all

charges imposed upon the borrower and seller. These are third party disclosures that are designed to provide the borrower with pertinent information during the settlement process in order to be a better shopper.

The Public Reporting Burden for this collection of information is estimated to average one hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number.

The information requested does not lend itself to confidentiality.

<b>L. Settlement Charges</b>					
<b>700. Total Sales/Broker's Commission based on price \$</b>	<b>@</b>	<b>% =</b>			
Division of Commission (line 700) as follows:					
701. \$	to			Paid From Borrowers Funds at Settlement	Paid From Seller's Funds at Settlement
702. \$	to				
703. Commission paid at Settlement					
704.					
<b>800. Items Payable In Connection With Loan</b>					
801. Loan Origination Fee	%				
802. Loan Discount	%				
803. Appraisal Fee	to				
804. Credit Report	to				
805. Lender's Inspection Fee					
806. Mortgage Insurance Application Fee to					
807. Assumption Fee					
808.					
809.					
810.					
811.					
<b>900. Items Required By Lender To Be Paid In Advance</b>					
901. Interest from	to	@ \$	/day		
902. Mortgage Insurance Premium for			months to		
903. Hazard Insurance Premium for			years to		
904.			years to		
905.					
<b>1000. Reserves Deposited With Lender</b>					
1001. Hazard insurance	months@ \$		per month		
1002. Mortgage insurance	months@ \$		per month		
1003. City property taxes	months@ \$		per month		
1004. County property taxes	months@ \$		per month		
1005. Annual assessments	months@ \$		per month		
1006.	months@ \$		per month		
1007.	months@ \$		per month		
1008.	months@ \$		per month		
<b>1100. Title Charges</b>					
1101. Settlement or closing fee	to				
1102. Abstract or title search	to				
1103. Title examination	to				
1104. Title insurance binder	to				
1105. Document preparation	to				
1106. Notary fees	to				
1107. Attorney's fees	to				
(includes above items numbers: )					
1108. Title insurance	to				
(includes above items numbers: )					
1109. Lender's coverage	\$				
1110. Owner's coverage	\$				
1111.					
1112.					
1113.					
<b>1200. Government Recording and Transfer Charges</b>					
1201. Recording fees: Deed \$		; Mortgage \$		; Releases \$	
1202. City/county tax/stamps: Deed \$				; Mortgage \$	
1203. State tax/stamps: Deed \$				; Mortgage \$	
1204.					
1205.					
<b>1300. Additional Settlement Charges</b>					
1301. Survey	to				
1302. Pest inspection	to				
1303.					
1304.					
1305.					
<b>1400. Total Settlement Charges (enter on lines 103, Section J and 502, Section K)</b>					

We will now go through a sample closing transaction and note expenses incurred. Enter this information on the correct lines of the HUD-1 form. Once we have gone over the necessary information, you will be asked to make calculations and provide totals. If your totals do not match the correct answers given below, please try again.

**NOTE:** The amounts and percentages used in the example do not necessarily reflect standard rates or even rates used in your area.

Buyer B has decided to purchase Seller A's home for \$115,000. Buyer B secures a loan for \$90,000 from Quality Loans, which charges a loan origination fee of 1 percent and a loan discount fee of 2 percent. Buyer B also pays \$400 for appraisal fees and \$35 for a credit report, but these expenses were paid outside of closing. Buyer B's lender requires that he purchase one year of hazard insurance for \$400 and that he deposit the following amounts in escrow:

- For hazard insurance, two monthly payments at \$30 per month;
- For county property taxes, two monthly payments at \$150 per month.

In this transaction, Seller A pays \$20 for the title search and \$20 for the title insurance binder. Seller A must also pay her attorney \$600 for legal representation, document preparation and notary services. Buyer B's title charges include \$600 for title insurance and \$250 paid to his attorney for legal representation and title examination.

Buyer B is charged a total of \$40 for recording fees (\$20 for the deed and \$20 for the mortgage). Seller A is charged \$40 to record two documents to clear title, \$20 to record the release of title and \$150 in state transfer taxes. In this transaction the buyer is responsible for survey charges of \$100, and the seller pays a \$150 termite inspection charge.

Finally, there is the matter of brokers' commissions. In this transaction, only Seller A has a broker, so the commission will not be split. Seller A's broker charges 5 percent of the sale price, so the total commission is \$5,750.

Now calculate Buyer B's and Seller A's settlement charges.

**NOTE:** Remember that you can find detailed instructions about how to fill out the HUD-1 form at <http://www.hud.gov/offices/hsg/ramh/res/resappa.cfm>.

**What are the buyer's total settlement charges?**

**What are the seller's total settlement charges?**

**Feedback:**

Buyer's total settlement charges: \$4,450.00

Seller's total settlement charges: \$6,750.00

As mentioned previously, the purchase price of the property is \$115,000. Buyer B paid \$25,000 as a deposit, and the remainder of the purchase price is covered by the \$90,000 loan he obtained. We already calculated the settlement charges, which are \$4,450 to Buyer B and \$6,750 to Seller A. Seller A also needs to pay off the remaining \$45,920.30 from her first mortgage loan.

Seller A prepaid the real estate taxes on this property for the entire year, which totaled \$1,200. The date of closing is July 10. For this transaction, prorations should be calculated using a 360-day year.

Now figure the total cash due to the buyer or due from the buyer, as well as the total cash due to the seller and due from the seller (that is to say, do the calculations that are necessary to complete line 303 and line 603).

**NOTE:**

Once again, remember that you can find detailed instructions about how to complete the HUD-1 form at

<http://www.hud.gov/offices/hsg/ramh/res/resappa.cfm>.

**1) Is cash due *to* the buyer or due *from* the buyer?**

**2) What is the total amount of cash due from the buyer at closing?**

Remember that you can figure the amount of days in the prorated period in the following way:

	<i>Months</i>	<i>Days</i>
Payment period = full year	12	30/month (note: this is a 360-day year)
Closing date = July 10	<u>-7</u>	<u>-10</u>
Prepaid period =	5 months	20 days

**3) Is cash due *to* the seller or due *from* the seller?**

**4) What is the total amount of cash due to the seller at closing?**

Remember, you should subtract the total on line 520 from the total on line 420.

**FEEDBACK:**

1) Cash is due *from* the buyer.

2) \$5,016.67

3) Cash is due *to* the seller.

4) \$62,896.37

## INSIGHT INTO CLOSINGS AND SETTLEMENT COSTS

This section presents 10 case studies addressing the concepts we have covered in the course. The first five case studies are built around fictional scenarios that put regulations and principles you have learned into practice. You will be asked to draw on your knowledge of closings and settlement costs to answer a question about each of these five situations. The remaining five cases are presentations of actual settlement cases involving RESPA regulations. You will be asked to consider the facts of the case and anticipate the outcome.

### CASE STUDY ONE

In 2001, Broker A assisted her client, Seller X, in the sale of his commercial strip mall. Broker A stayed involved in every step of the transaction and saw the deal through to closing. However, Broker A forgot one important detail, and in 2002, the Internal Revenue Service (IRS) sent Broker A notice about this issue. What could Broker A have forgotten that would have caused the IRS to get involved?

Broker A probably forgot to give her client the one-page Notice to the Homebuyer disclosure form.

Broker A probably forgot to make sure that the closing agent or lender had filed Form 1099-S.

Broker A probably forgot to send a certified copy of the HUD-1 Settlement Statement to the IRS.

Broker A probably forgot to file the affidavit of title with the Department of Licensing.

#### **Feedback:**

Broker A probably forgot to make sure that the closing agent or lender filed **Form 1099-S**. This is the only one of the issues listed above that would concern the IRS. Licensees need to be aware that the sale of stock in cooperative housing corporations, as well as sales of land, condominium units and permanent structures, including residential, commercial and industrial buildings, must be reported to the Internal Revenue Service (IRS). Usually the closing agent or the mortgage lender will fill out the Form 1099-S for this type of transaction, but any licensees involved in the transaction could be held liable if the IRS is not properly notified.

## CASE STUDY TWO

Broker B represents Seller Q. Broker B has just finished negotiating a purchase and sale agreement with Buyer A for the sale of Seller Q's condominium unit. The state in which they live requires that all real estate transactions be closed through escrow, so Seller Q, per the purchase and sale agreement, selects Escrow Agent D to preside over the closing. On the date of closing, who **must** be present?

Only Escrow Agent D

Seller Q, Buyer A and Escrow Agent D

Seller Q's attorney, Buyer A's attorney and Escrow Agent D

Broker B and Escrow Agent D

### **Feedback:**

Only **Escrow Agent D** must be present. In most states, the only person who is required to attend an escrow closing is the individual presiding over that closing process. In this transaction, Seller Q and Buyer A will send all necessary paperwork to Escrow Agent D before closing; after closing she can send a completed settlement statement to Buyer A and Seller Q if they choose not to attend the closing.

## CASE STUDY THREE

Buyer Z applied for a federal loan for a one-family home through Lender B. To comply with RESPA requirements, Lender B gave Buyer Z HUD's Special Information booklet (containing consumer information about real estate transactions and real estate settlement services) and a Mortgage Servicing Disclosure Statement. What else must Lender B provide to the borrower before closing?

A completed HUD-1 Settlement Statement

A Notice to the Homebuyer Form

A Good Faith Estimate of closing and settlement costs

A copy of IRS Form 1099-S

**Feedback:**

Buyer Z applied for a loan that falls under RESPA regulations. Therefore, within three business days of receiving Buyer Z's loan application Lender B must send Buyer Z a **Good Faith Estimate** of the closing and settlement costs, in addition to the HUD Special Information booklet and the Mortgage Servicing Disclosure Statement.

## CASE STUDY FOUR

Buyer X has agreed to purchase Seller M's home for \$150,000. Buyer X puts down a deposit of \$15,000 and has secured a loan for 80 percent of the total purchase price. Excluding any settlement costs and other debits or credits, how much will Buyer X need to bring to the closing?

\$10,000

\$15,000

\$20,000

\$50,000

**Feedback:**

Buyer X will need to bring an additional **\$15,000** to the closing to cover the rest of the purchase price. This amount may change, depending upon Buyer X's other settlement costs, debits and credits.

## CASE STUDY FIVE

Settlement Agent A is filling out a HUD-1 Settlement Statement, but he is having trouble itemizing the title charges in Section L (Settlement Charges). The documents associated with the transaction state that the seller's title examination fee was \$30, the seller's document preparation fee was \$20 and the seller's attorney fees were \$400. However, the seller has included evidence that the attorney conducted the title examination and prepared documents, and that the attorney's \$400 fee included these fees. What should Settlement Agent A do?

Enter the title examination fee of \$30, the document preparation fee of \$20 and an attorney's fee of \$400, as given.

Enter an attorney's fee of \$450 and do not enter the other fees.

Enter the title examination fee of \$30, the document preparation fee of \$20 and an attorney's fee of \$350.

Enter the attorney's fee of \$400 as given and do not enter the other fees.

**Feedback:**

Because the attorney's fee **includes** the title examination fee and the document preparation fee, the settlement agent must account for these fees on the HUD-1 in such a way that they are not charged twice. Therefore, settlement Agent A should **enter the attorney's fee of \$400 as given and not enter the other fees** individually. This figure should be entered on line 1107 of the HUD-1 form; the settlement agent should also include the line numbers of the items that are covered in this overall fee.

## CASE STUDY SIX

The U.S. Department of Housing and Urban Development (HUD) and World Savings Bank, FSB, entered into a settlement on July 2, 2003. This settlement was the result of HUD's investigation into World Savings Bank's "For Services Rendered" program. HUD determined that through this program, the bank "solicit[ed] and compensat[ed] real estate agents ("Agents") for assisting prospective borrowers in the completion and submission of mortgage loan applications" through a Website run by the Bank.

HUD found that the World Savings Bank was thus giving a "thing of value" to real estate licensees in exchange for their referral of business; conduct which violates Section 8 of RESPA. This section of the Act states that "No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." World Savings Bank contested this judgment but agreed to the settlement, which is not interpreted as an admission of guilt.

Using your knowledge of RESPA, what do you think the World Savings Bank was required to do to fulfill the settlement? Write your thoughts below and then compare your answer with ours.

**Feedback:**

Violations of RESPA regulations can lead to serious penalties for both licensees and lending institutions employees. Fines of up to \$10,000 can be assessed, as can prison terms of up to a year. Further details about penalties can be found in Section 8 of RESPA. According to the terms of this particular settlement, World Savings Bank was required to discontinue their "For Services Rendered" program and pay \$7,557 to the U.S. Treasury. The settlement allows World Savings Bank to reinstate the program, but if they do so the program must not pay licensees for referring loan applicants; any consideration granted to

licensees must be “reasonably related” to goods, services or facilities that those licensees actually furnish or perform. Any reinstated program must follow all RESPA regulations and other relevant HUD policies.

## **CASE STUDY SEVEN**

After an investigation into the business practices of ARVIDA/JMB Partners (a large builder and realty services company in Florida), HUD alleged that ARVIDA was in violation of RESPA regulations in section 8(b) and section 9 that prohibit the “giving or receiving of any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a federally related mortgage loan other than for services actually performed.”

HUD found that ARVIDA was charging buyers a percentage of the purchase price of their homes as closing costs; in many cases, this entire percentage fee was not actually used to pay closing costs. The remaining portion of the percentage fee was retained by ARVIDA and not specifically accounted for. ARVIDA also imposed an additional \$300 charge on buyers who elected not to work with ARVIDA’s affiliated title company and instead used independent title agents. ARVIDA denied that these practices violated RESPA but agreed to enter into a settlement with HUD on September 17, 2001.

Using your knowledge of RESPA regulations, what did ARVIDA/JMB Partners do wrong? Write your thoughts below and then compare your answer with ours.

### **Feedback:**

Buyers have the right to use any title company they choose; lending institutions and other realty service providers are not allowed to assess additional fees to penalize individuals who elect not to use title companies affiliated with the service provider. In addition, closing costs must be itemized and properly accounted for, not calculated as a percentage of the sale.

The settlement with HUD required that ARVIDA begin itemizing closing costs, stop imposing extra charges on buyers for using independent title companies and send refund checks to buyers who were charged for using independent title companies within the time period addressed by the settlement. The settlement allowed ARVIDA and its affiliates to continue offering packages of settlement services, as well as discounts and rebates. However, all of ARVIDA’s conduct in this regard must follow RESPA regulations and other relevant HUD policies.

## CASE STUDY EIGHT

HUD investigated the business practices of Fidelity Financial, Inc., Fidelity National Title Insurance Company, Fidelity National Flood Insurance Company, Fidelity National Tax Service Company, Inc., and their affiliates and employees (FNF). HUD concluded that FNF had violated section 8(a) RESPA by “enter[ing] into contracts with lenders (banks, credit unions and mortgage companies) that contained provisions for free review of existing loan portfolios in exchange for future referrals of business.”

Why is this sort of behavior against RESPA regulations? Write your thoughts below and then compare your answer with ours.

### **Feedback:**

As discussed in the first case study, RESPA forbids realty service companies to give things of value in exchange for referrals. HUD determined that a free review of loan portfolios counts as a thing of value.

FNF denied that these practices violated RESPA, but the two parties entered into a settlement on February 28, 2002. This settlement required that FNF abandon this practice, begin charging reasonable fees for all such service, notify existing customers of the change and pay hefty fines.

## CASE STUDY NINE

After an investigation into the business practices of TitleVentures.com and its owners, Jerry D. Holmes, Jr., and Jerry D. Holmes, Sr., HUD declared that TitleVentures.com was in violation of Sections 8(a) and 8(b) of RESPA, which have both been quoted in previous case studies.

One of HUD’s findings was that TitleVentures.com had created “preferred attorney” lists. TitleVentures.com referred clients only to attorneys on the list, and attorneys were placed on that list only if they agreed to use TitleVentures.com for any title work generated by the referral, which violates RESPA regulations for referrals. TitleVentures.com and HUD entered into a settlement on July 10, 2003, which required that TitleVentures.com terminate its preferred attorney lists and programs, terminate the operations of 29 title agencies controlled by the company, hold interest in no more than 12 title agencies for three years after the date of the settlement, operate all title agencies in accordance with guidelines established in the settlement and pay a fine of \$7,750.

If TitleVentures.com wanted to continue to refer its clients to attorneys, how could this be done in compliance with RESPA regulations? Write your thoughts below and then compare your answer with ours.

**Feedback:**

RESPA does not allow companies to give or accept payment or any other “thing of value” in exchange for referrals. TitleVentures.com could refer clients to attorneys as long as there is no pre-established compensation arrangement between the title company and the attorneys, such as their previous agreement that the attorneys will reciprocate for referrals by giving title work back to TitleVentures.com. In addition, TitleVentures.com could not require that their clients use one of the recommended attorneys.

## CASE STUDY TEN

According to HUD’s investigation, Coldwell Banker United, Realtors®, was found to have violated RESPA regulations. HUD asserted that Coldwell was accepting “virtual tours” for free or below cost from various title companies (“virtual tours” are a service which allows a person to use the Internet to find photographs and information about properties for sale, as well as interior and exterior views of those properties). HUD deemed such virtual tours to be “things of value.” Coldwell denied that this practice violated RESPA, but the two parties entered into a settlement on July 22, 2003. The settlement required that Coldwell pay reasonable fees for virtual tours and not accept any tour for free. Coldwell was also required to pay \$5,200 in fines and to notify all of its real estate licensees about the settlement agreement.

Why does RESPA prohibit real estate professionals from accepting virtual tours for free from title companies? Write your thoughts below and then compare your answer with ours.

**Feedback:**

Real estate professionals are not allowed to accept payment or any other “thing of value” from a title company, lending institution or other business in exchange for referring clients. Although in this situation there was no direct arrangement between the real estate firm and the title companies, accepting things of value could create an implied relationship. RESPA regulations require that appropriate compensation be paid for services and goods received.

## **Attention**

Please log back in to your course player to take the Lesson Assessment. You must pass with a 70% or better to receive credit. Once you pass the Lesson Assessment you can proceed to the Post Assessment. You must pass with a 70% or better to receive credit for the course.