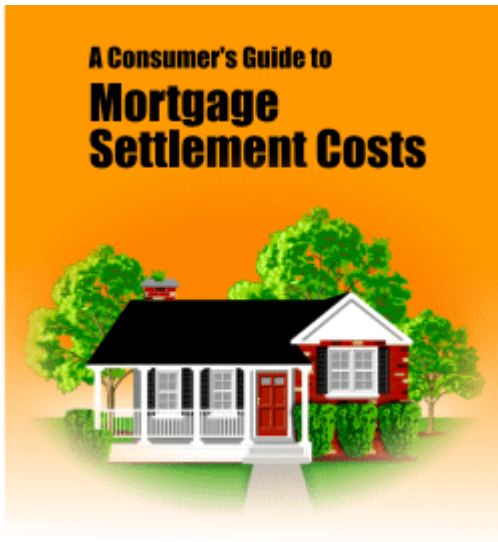




The Federal Reserve Board



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Mortgage settlement--sometimes called mortgage closing--can be confusing. A settlement may involve several people and many documents and fees. This information will help you understand all that is involved. Although the focus of this guide is on settlements for home purchases, much of it will also be useful if you are refinancing a mortgage.

Settlement costs can be high, so it pays to shop around and negotiate with the seller, your lender, and your attorney or settlement agent. The less you have to pay in settlement costs, the more funds you will have for other things.

Different regions have different customs and practices regarding who pays for what at settlement. Buyers and sellers are free to negotiate certain fees. In slow-moving real estate markets, the seller may agree to pay points or fees for the buyer. In fast-moving markets, the buyer may have to agree to pay more costs to close the deal. Whatever you negotiate will become the sales contract. However, be careful; if some buyer's costs are shifted to the seller, it may increase the price you pay for the property.

You can reduce some settlement costs by shopping around for the services. The point is this: the more you know about the process, the better your chances are for saving money at settlement time.

Because practices vary significantly from area to area, it is difficult to provide estimates for settlement costs that fit everywhere. However, one rule of thumb for buyers is to figure that settlement costs will be about 3% of the price of your home. In some relatively high-tax areas of the country, 5% to 6% is more common.

Some settlement costs, such as homeowner's insurance, private mortgage insurance, or points can be more expensive if your credit rating is low. Knowing your credit score can help you understand how lenders will evaluate your applications. Beginning December 2004 your lender is required to give you a copy of your credit score.

Mortgage- and Lender-Related Settlement Costs

Most people associate settlement costs with mortgage loan charges. These fees and charges vary, so it pays to shop around for the best combination of mortgage terms and settlement costs. Mortgage-related costs that may apply to your loan include the following items.

Application fee

Imposed by your lender or broker, this charge covers the initial costs of processing your loan request and checking your credit report.

Estimated cost: \$75 to \$300, including the cost of the credit report for each applicant

Loan origination fee

The origination fee (also called underwriting fee, administrative fee, or processing fee) is charged for the lender's work in evaluating and preparing your mortgage loan. This fee can cover the lender's attorney's fees, document preparation costs, notary fees, and so forth.

Estimated cost: 1% to 1.5% of the loan amount

Points

Points are a one-time charge imposed by the lender, usually to reduce the interest rate of your loan. One point equals 1% of the loan amount. For example, 1 point on a \$100,000 loan would be \$1,000. In some cases--especially in refinancing--the points can be financed by adding them to the amount that you borrow. However, if you pay the points at settlement, they are deductible on your income taxes in the year they are paid (different deduction rules apply when you refinance or purchase a second home). In your purchase offer, you may want to negotiate with the seller to have the seller pay your points.

Estimated cost: 0% to 3% of the loan amount

Appraisal fee

Lenders want to be sure that the property is worth at least as much as the loan amount. This fee pays for an appraisal of the home you want to purchase or refinance. Some lenders and brokers include the appraisal fee as part of the application fee; you can ask the lender for a copy of your appraisal. If you are refinancing and you have had a recent appraisal, some lenders may waive the requirement for a new appraisal.

Estimated cost: \$300 to \$700

Lender-required home inspection fees

The lender may require a termite inspection and an analysis of the structural condition of the property by an engineer or consultant. In rural areas, lenders may require a septic system test and a water test to make sure the well and water system will maintain an adequate supply of water for the house (this is usually a test for quantity, not for water quality; your county

health department may require a water quality test as well, but this test may be paid for outside of the settlement). Keep in mind that this inspection is for the benefit of the lender; you may want to request your own inspection to make sure the property is in good condition.

Estimated costs: \$175 to \$350

Prepaid interest

Your first regular mortgage payment is usually due about 6 to 8 weeks after you settle (for example, if you settle in August, your first regular payment will be due on October 1; the October payment covers the cost of borrowing the money for the month of September). Interest costs, however, start as soon as you settle. The lender will calculate how much interest you owe for the part of the month in which you settle (for example, if you settle on August 16, you would owe interest for 15 days--August 16 through 31).

Estimated cost: Depends on loan amount, interest rate, and the number of days that must be paid for (a \$120,000 loan at 6% for 15 days, about \$300; a \$142,500 loan at 6% for 15 days, about \$356).

Private mortgage insurance (Private MI)

If your down payment is less than 20% of the value of the house, the lender will usually require mortgage insurance. The insurance policy covers the lender's risk in the event that you do not make the loan payments. Typically, you will pay a monthly premium along with each month's mortgage payment. Your private MI can be canceled at your request, in writing, when you reach 20% equity in your home, based on your original purchase price, if your mortgage payments are current and you have a good payment history. By federal law your private MI payments will automatically stop when you acquire 22% equity in your home, based on the original appraised value of the house, as long as your mortgage payments are current.

Estimated cost: 0.5% to 1.5% of the loan amount to pre-pay for the first year

Some lenders will pay for private MI--called lender's private mortgage insurance (LPMI)--and in turn will charge a higher interest rate. Unlike private MI that you pay, there is no automatic cancellation once you acquire 22% equity. To eliminate the LPMI, you must refinance the loan, which in turn means carefully considering market interest rates and settlement costs at the time to see if refinancing would be an advantage, rather than keeping your current mortgage.

FHA, VA, or RHS fees

The Federal Housing Administration (FHA) offers insured mortgages and the Veterans Administration (VA) and the Rural Housing Service (RHS) offer mortgage guarantees. If you are getting a mortgage insured by the FHA or guaranteed by the VA or the RHS, you will have to pay FHA mortgage insurance premiums or VA or RHS guarantee fees. As with Private MI, insurance premium payments will stop when you acquire 22% equity in your home. FHA fees are about 1.5% of the loan amount. VA guarantee fees range from 1.25% to 2% of the loan amount, depending on the size of your down payment (the higher your down payment, the lower the fee percentage). RHS fees are 1.75% of the loan amount.

Homeowner's insurance

Your lender will require that you have a homeowner's insurance policy (sometimes called hazard insurance) in effect at settlement. The policy protects against physical damage to the house by fire, wind, vandalism, and other causes. This insures that the lender's investment will be secured even if the house is destroyed. If you are buying a condominium, the hazard insurance may be part of your monthly condominium fee; you may still want homeowner's insurance for your furnishings and valuables.

Estimated cost: \$300 to \$1,000 (depending on the value of the home and the amount of coverage; you can estimate the cost to be about \$3.50 per \$1,000 of the purchase price of the home).

Flood determination fee

If your home is in a flood hazard area where federally subsidized flood insurance is available, lenders cannot make a mortgage loan for your home unless you buy flood insurance. Your lender may charge a fee to find out whether the home is in a flood hazard area.

Estimated cost: \$15 to \$50 (this is not the cost for the flood insurance; flood insurance, if required, would be in addition to your homeowners insurance and may cost from \$350 to \$2,800 depending on location and property value)

Escrow (or reserve) funds

Some lenders require that you set aside money in an escrow (reserve) account to pay for property taxes, homeowner's insurance, and flood insurance (if you need it). Lenders use escrow funds to ensure that these items are paid on time to protect their interest in your home. With an escrow account, money is held by the lender or the lender's agent, who then pays the taxes and insurance bills when they are due. At settlement, you may need to provide some payment into this account, depending on when payments will be due. For example, if you are buying your home in August and property taxes are due the following January, you will need to deposit funds into your escrow account at settlement so that you have enough to pay the taxes when they become due in January.

Survey costs

Lenders require a survey to confirm the location of buildings and improvements on the land. Some lenders require a complete (and more costly) survey to ensure that the house and other structures are legally where you and the seller say they are.

Estimated cost: \$150 to \$400

Other miscellaneous settlement costs

Depending upon the location and type of property, and the extra services you or your lender request, you may also have to pay some of the following fees at settlement:

- **Assumption fee.** If you are assuming (or taking over) an existing mortgage, the lender may charge a fee.

Estimated cost: Depends on the lender, but will range from several hundred dollars to 1% of the amount of the loan you are assuming

- **Expenses prorated between the seller and the buyer.** In your purchase contract, you may agree to split some costs with the seller. In addition to prorated property taxes, some of these expenses may involve large amounts. For example, annual condominium fees, homeowners' association fees, water bills, and other lump-sum service charges may be split between you and the seller to cover your respective periods of ownership for the calendar year or tax period.
- **Inspections.** As a buyer, if you make your purchase offer contingent on the results of a home inspection--such as testing for structural damage, water quality, and radon gas emissions--you will have to pay for these inspections.
- **Escrow account funds.** In the purchase contract, you can request that the seller set up an escrow account to cover any costs for repairs, radon mitigation, house painting, or other items. For example, if you have not had a chance to test all the appliances (for instance, if you buy in the summer, you may not test the furnace), you may request an escrow account to cover repairs if they are needed in the future. The seller may agree to split the costs with you, in which case you would need these funds at settlement.
- **Fees paid to find a lender.** As a buyer, you may work with a mortgage broker or other third party to find a mortgage loan. For example, you may want to work with a broker to find a loan with nonstandard terms or conditions. Brokers arrange transactions rather than lending money directly; in other words, they find a lender for you. Brokers will generally contact several lenders regarding your application, but they are not obligated to find the best deal for you unless they have contracted with you to act as your agent.

Estimated cost: Depends on agreement with the broker; can range from no fee to a percentage of the loan amount

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Charges for Establishing and Transferring Ownership

Title search

The goal of a title search is to assure you and your lender that the seller is the legal owner of the property and that there are no outstanding claims or liens against the property that you are buying. The title search may be performed by a lawyer, an escrow or title company, or other specialist.

Public real estate records can be spread among several local government offices, including surveyors, county courts, tax assessors, and recorders of deeds. Liens, records of deaths, divorces, court judgments, and contests over wills--all of which can affect ownership rights--must also be examined.

If real estate records are computerized, the title search can be completed fairly quickly. In some cases, however, the title search may involve visiting courthouses and examining other public records and files, which is more time-consuming.

Title insurance

Most lenders require a title insurance policy. This policy insures the lender against an error in the results of the title search. If a problem arises, the insurance covers the lender's investment in your mortgage.

The cost of the policy (a one-time premium) is usually based on the loan amount and is often paid by the buyer. However, you may negotiate with the seller to pay all or part of the premium.

The title insurance required by the lender protects only the lender. To protect yourself against title problems, you may want to buy an "owner's" title insurance policy. Normally the additional premium cost is based on the cost of the lender's policy, but this premium can vary from area to area.

Some advice on keeping title insurance costs low: If the house you are buying was owned by the seller for only a few years, check with the seller's title company. You may be able to get a "re-issue rate," because the time between title searches was short. As well, if you are refinancing, you may be able to get a "re-issue rate" on your title insurance. The premium is likely to be lower than the regular rate for a new policy. If no claims have been made against the title since the previous title search was done, the insurer may consider the property to be a lower insurance risk.

Usually you will have to buy title insurance from a company acceptable to your lender. However, you can still shop around for the best premium rates (which can vary depending on how much competition there is in a market area). If you decide to buy an "owner's title policy," look for one with as few exclusions from coverage as possible. Exclusions are listed in each policy, and if a policy has many exclusions--that is, situations under which the insurer will not pay for your title problems--you may end up with little coverage. The estimated cost of title services and title insurance varies by state. For example, a lender's policy on a \$100,000 loan can range from \$175 in one state to \$900 in another. In some states, the price can even vary by county.

Settlement companies and others conducting the settlement

Settlements are conducted by title insurance companies, real estate brokers, lending institutions, escrow companies, or attorneys. In most cases, the settlement agent is providing a service to the lender, and you may be required to pay for these services. You can also hire your own attorney to represent you at all stages of the transaction, including settlement.

You may be involved in some of the closing activities and not in others, depending on local practices and on the professionals with whom you are working. In some regions, all the people involved in the sale--the buyer; the seller; the lender; the real estate agents; attorneys for the buyer, seller, and lender; and representatives from the title firm--may meet to sign forms and transfer funds. In other regions, settlement is handled by a title or escrow firm that collects all the funding, paperwork, and signatures and makes the necessary disbursements. The firm delivers the check to the seller and the house keys to you.

Costs for settlement services vary widely, depending on the professional services involved. Regardless of the way settlement is handled in your region, shop around and ask for information on all services provided and all fees charged.

Amounts Paid to State and Local Governments

In some parts of the country transfer and recording fees are low. In other parts of the country costs of transfer fees, recording fees, and property taxes collected by local and state governments may be as much as 1.25% of the loan amount. Some of these fees, such as the recording fee and transfer fee, are one-time fees. Although there is no way to avoid paying these fees and taxes, you may be able to negotiate with the seller to pay some of these costs. But remember, you must include these terms as part of the purchase offer for the property.

Amounts for property taxes may go into an escrow account. The amount you will need depends on when property taxes are due and the timing of the settlement. The lender should be able to give you an approximation of these costs at the time you apply for the mortgage.

“All-in-One” Pricing of Settlement Costs

Some lenders have bundled most of their settlement costs into a single price. Generally, they combine the following fees:

- application
- origination
- underwriting and processing
- points
- pest inspection
- appraisal
- credit reports
- lender’s attorney
- flood certification
- title search and title insurance
- recording
- and fees for other tax services

This all-in-one price, however, does not include all of the fees needed at settlement. You will also need funds for the following:

- prepaid interest (based on the day of the month you settle)
- mortgage and transfer taxes (determined by your state or local taxing agency)
- private mortgage insurance (if needed)
- homeowners (hazard) insurance
- flood insurance (if needed)
- and reserve (or escrow) funds for property taxes and homeowners insurance.

Estimates of Settlement Costs

At various points in your loan application process, you are entitled to get estimates of the costs and fees associated with getting a mortgage and going through settlement.

The “good faith estimate”

With such a long list of potential charges at settlement, it is important to know what to expect. The Real Estate Settlement Procedures Act (RESPA) requires your mortgage lender to give you a “good faith estimate” of all your closing costs within 3 business days of

submitting your application for a loan, whether you are purchasing or refinancing the home. This is a good faith estimate, but the actual expenses at closing may be somewhat different. If you are purchasing the home, you will also get an information booklet, *Buying Your Home: Settlement Costs and Helpful Information*.

Truth in lending information

For home purchases, the lender is required, under the Truth in Lending Act, to provide a statement containing “good faith estimates” of the costs of the loan within 3 business days of submitting your application. This estimate will include your total finance charge and the annual percentage rate (APR). The APR expresses the cost of your loan as an annual rate. This rate is likely to be higher than the stated contract interest rate on your mortgage because it takes into account discount points, mortgage insurance, and certain other fees that add to the cost of your loan. When refinancing your mortgage, you will receive the truth in lending disclosures before you settle.

The “HUD-1” statement

When you purchase a home or refinance your mortgage, the Real Estate Settlement Procedures Act also requires the lender to give you a copy of the HUD-1 or HUD-1A Settlement Statement 1 day before you go to settlement, if you request it. This final statement of settlement costs will show all the fees and charges you will be expected to pay at settlement.

Fees paid outside of settlement

Some fees may be listed on the HUD-1 and marked as “Paid Outside of Closing” (or “POC”). You will pay some of these fees, such as for credit reports and appraisals, before settlement. Other fees, such as those to a mortgage broker, you will pay at settlement.

Sample Settlement Costs

Because costs may vary from one area to another and from one lender to another, the following example is an estimate only. This example is based on a \$150,000 home with a 5% or a 20% down payment. Excluding reserves for property taxes and down payment, settlement costs for the 5% down payment loan vary between \$4,690 and \$13,940; settlement costs for the 20% down payment loan vary between \$4,285 and \$12,060. Your costs may be higher or lower than the examples below.

Item	Typical range (percent except as noted)	Estimate for \$150,000 house (in dollars except as noted)	
		5% down payment	20% down payment
Down Payment	--	7,500	30,000
Mortgage amount	--	142,500	120,000
Items payable in connection with the loan ("800" series on HUD-1 form)			
Application fee (may include credit report fees)	--	75 to 300	75 to 300
Loan origination fee			

(may also include underwriting fees, administrative fees, lender's attorney fees, notary fees, and so on)	1 to 1.5 of loan	1,452 to 2,137	1,200 to 1,800
Points	0 to 3	0 to 4,500	0 to 3,600
Appraisal fee	--	350 to 700	350 to 700
Lender's inspection fee	--	175 to 350	175 to 350
Assumption fee (if applicable)	\$300 to \$1,000	--	--
Broker fee (if applicable)	<u>1</u>	<u>1</u>	<u>1</u>
Items payable in advance ("900" series on HUD-1 form)			
Prepaid interest	<u>2</u>	350	295
Homeowner's insurance (hazard insurance)	\$500 to \$700	525 ³	525 ³
Flood determination (flood insurance, if needed, is additional)	--	15 to 50	15 to 50
Reserves (escrow) deposited with lender ("1000" series on HUD-1 form)			
Homeowners insurance	--	250 to 350	250 to 350
Private MI	--	125 to 250	--
Property taxes	<u>4</u>	--	--
Title charges ("1100" series on HUD-1 form)			
Title search and lender's title insurance	--	700 to 900	700 to 900
Owner's title insurance	--	--	--
Government recording and transfer fees ("1200" series on HUD-1 form)			
Recording fees for deed, mortgage, city/county taxes, and state taxes	0 to 1.5 of loan	0 to 2,137	0 to 1,800
Additional charges ("1300" series on HUD-1 form)			
Survey	--	150 to 300	150 to 300
Pest inspection	--	50 to 90	50 to 90
Settlement fees	--	500 to 1,000	500 to 1,000
Other amounts due from borrower ("100" series on HUD-1 form)			
Personal property; assessments; prorated condominium fees; homeowners' association fees; prorated taxes; fuel, oil, and propane; and so forth	<u>5</u>	<u>5</u>	<u>5</u>

Note:

"--" = not applicable

1. May be a dollar amount or a percentage. [Return to table](#)
2. Depends on interest rate, the day of the month that settlement takes place, and the amount borrowed. The example assumes that there are 15 days left in the month and that the interest rate on the loan amount is 6%. [Return to table](#)
3. These are the fees if using \$3.50 per \$1,000 of purchase price as an estimate. [Return to table](#)
4. Varies greatly and depends on local tax rates. [Return to table](#)
5. These items vary depending on your agreement with the seller. [Return to table](#)

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Settlement Cost Tips

- Think about settlement fees before you submit your purchase offer.
- Remember many fees and charges are negotiable.
- Use the Settlement Costs Worksheet and compare costs by shopping among several lenders and brokers.

This information has been prepared to help you make the important decisions involved in buying and financing your home. However it should not be viewed as a replacement for professional advice. Talk with attorneys, mortgage lenders, real estate agents, and other advisers for information about lending practices, mortgage instruments, and your own interests before you commit to a specific loan.

The information on this site is adapted from the brochure "A Consumer's Guide to Mortgage Settlement Costs." Single or multiple copies of the brochure are available without charge. Order the brochure [by telephone, mail, or fax](#). Order [online](#).

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Last update: April 26, 2005