

Questions and Answers on: REAL ESTATE CLOSINGS

In the typical residential real estate sales transaction, a buyer offers to purchase property from a seller. After negotiating the price and terms, the buyer and seller sign an offer to purchase and contract, and the buyer gives the seller (or the seller's broker) an earnest money deposit to show good faith in the transaction. Under the standard form Offer to Purchase and Contract, the buyer may also give the seller a "due diligence fee" for the buyer's right to conduct due diligence, including any inspections, loan applications, and appraisals, for a negotiated period of time (the "due diligence period"). Prior to the expiration of the due diligence period, the buyer may terminate the contract for any reason. After the expiration of the due diligence period, the buyer's right to terminate is severely limited.

A real estate "closing" is the final step in the transaction. At closing, the buyer pays the purchase price to the seller (usually with the proceeds from a loan), and the seller gives the buyer a deed transferring title to the property to the buyer. Also, funds are paid to an appraiser, home inspector, and/or other service providers, and to pay off banks or others who may have claims against the property. This pamphlet focuses on questions frequently asked about residential real estate closings. The questions raised are of special concern to real estate purchasers. Consequently, they are posed from the standpoint of the purchaser.

Q: Does a "loan commitment letter" guarantee that I have a loan to buy the property?

A: No. A loan commitment letter does not guarantee that the lender will make the loan. It simply means that, based upon an initial review, your credit appears sufficient to qualify you for the necessary loan amount. After issuing the letter, the lender may refuse to approve your loan if there are any changes in your employment, creditworthiness, or other changes which might affect your ability to repay the loan, or based upon further review by its underwriters. The lender reserves this right until the deed is recorded transferring the title and the loan proceeds are actually disbursed at closing. Note that the standard form Offer to Purchase and Contract does not make the ability to obtain a loan a condition of purchase. Therefore, you should determine whether necessary financing is available prior to the end of the due diligence period.

Q: What kind of inspections do I really need to have to find out about the condition of the property?

A: A number of inspections are highly recommended even if they are not required by the lender. These inspections should be performed during the due diligence period so that you have sufficient time to determine whether to terminate the contract or continue to closing on the property or to negotiate further. Remember, the standard Offer to Purchase and Contract states that "closing shall constitute acceptance of the property in its then existing condition unless provision is otherwise made in writing." In other words, once closing is completed, you may be found to have accepted the property in its existing condition.

The most important inspections are:

- ***Home Inspection***

A home inspector typically examines the condition of the property, including the plumbing, heating, cooling, and electrical systems, and the structural components. In North Carolina, professional home inspectors must be licensed. Read the home

inspection report carefully. Not having a home inspection may save you money “up front”, but it could be very costly if you find after the due diligence period or after closing that there is a major defect in the property. You may also need additional inspections performed by a specialist, such as an electrician, heating and air conditioning contractor, or a structural engineer.

- ***Wood-Destroying Insect Inspection***

Have a licensed pest control operator perform a pest inspection prior to the end of the due diligence period. It should reveal evidence of wood-destroying insects, if any, that could adversely affect the structure.

- ***Survey***

A survey provides accurate measurements of the property, its precise total area, the location of buildings and other improvements to the property, and any encroachments, easements and possible setback violations. You are typically responsible for paying for the survey. Examine the survey prior to the end of the due diligence period to make sure the acreage and other conditions of the property match what you were told by the seller or real estate brokers and what is shown in the purchase contract. You should also be aware that the title insurance company may exclude from coverage problems shown on the survey which are not resolved before closing.

- ***Appraisal***

Virtually all lenders will require you to pay for an appraisal of the property to determine if its market value meets or exceeds the purchase price. Review the appraisal report prior to the end of the due diligence period to make sure the value of the property, its square footage and features match what you were told by the seller or real estate brokers and what is shown in the purchase contract.

- ***Wells and Sewage Disposal Systems***

If you are buying a property served either by a well or a septic system (not city water or sewer), you should have it inspected prior to the end of the due diligence period. A well inspection and separate water test should be done to determine whether there is an adequate amount of water and water pressure for the property and if there are any harmful contaminants in the water. An examination of the septic system should determine if it is adequate to support the property and is properly performing. Repairs to these systems can be very expensive.

- ***Radon***

Radon is a radioactive carcinogenic gas that can be found in homes all over the United States. Any home can have a radon problem, regardless of its age or condition. Therefore, you should have the property tested for radon to make sure that any detectable radon is at or below EPA’s guidelines for an “acceptable” level.

Q: What is title insurance?

A: The lender will probably require you (the borrower) to purchase title insurance to protect its interests from potential title problems. Before issuing a title insurance policy, the title company will require the closing attorney to perform a title search to discover any problems with the title to the property. Problems found during the title search (such as unpaid judgments, taxes, mortgages, etc. on the property) must be corrected before closing.

For a few dollars more you can also purchase your own title insurance policy to cover you from title problems with the property which may not have been discovered prior to closing. If a problem covered by your policy is discovered after closing, the title insurance company will help clear up the problem or compensate you for any losses you have sustained. Like any insurance policy, there may be exceptions in your coverage, so it is critical that you carefully read your policy and refer any questions to the closing attorney.

Q: What if the seller wants to give me a non-warranty, or quitclaim deed?

A: The deed transfers the seller's interest in the property to you. There are many different types of deeds. The best one — the general warranty deed — contains the seller's warranty that good title is being conveyed to you. A quitclaim (or non-warranty) deed contains no warranties at all; therefore, you accept title from the seller "as is." A special warranty deed contains limited warranties from the seller. If you are given anything other than a full or general warranty deed, immediately consult with your attorney.

Q: What is a "homeowners' association"?

A: If you buy in a residential subdivision or planned community, it is likely you will be joining a homeowners' association. A homeowners' association is a group of property owners that acts like a private local government, providing services or benefits to its members such as a clubhouse, pool or trails. Members pay for these benefits in accordance with the association's bylaws. Homeowners' associations may also regulate the use of common areas, paint colors, fences, outbuildings, etc. By exercising their voting rights, members have input into decision-making.

If you are purchasing property in a subdivision or planned community, you should obtain documentation concerning any dues, assessments, covenants, rules, restrictions, and services provided. If the real estate broker(s) or closing attorneys do not give you relevant documentation seek out the most current copy and review it before the end of the due diligence period.

Q: What happens if the property is damaged or destroyed after I sign the purchase contract but before closing?

A: Typically, the purchase contract requires that the property be in substantially the same or better condition at closing as on the date you contracted to buy it (normal wear and tear excepted). If the property is damaged or destroyed by fire or other casualty prior to closing, the risk of loss is on the seller. The buyer has the option to terminate the contract and recover any earnest money deposit and any due diligence fee.

Q: Who closes the transaction?

A: The closing will probably be handled by an attorney chosen by you. In many transactions, the attorney may also represent the lender and the seller. The seller may hire his or her own attorney or pay your attorney to prepare the deed to give to you. Make sure you know "up front" who the attorney is representing. Others involved in the transaction may recommend or offer you financial incentives to hire a particular closing attorney, but you have the final word. Prior to closing, the seller should give the closing attorney a copy of the deed to the property. Also, if there is an outstanding mortgage on the property, the seller should give the attorney any personal information needed to obtain a loan payoff figure so any existing loan(s) can be paid off in full at closing. As the buyer, you will need to give the closing attorney a copy of your contract and contact information about your

lender, any inspectors, or other persons who provided services in connection with the transaction.

Since closing involves several complex phases (examination of the title, completion and explanation of legal documents, and resolution of any possible title problems), you should carefully consider having an attorney assist you throughout the process and during the closing. Also, read each closing document so you fully understand each step of your real estate transaction.

If a non-attorney is handling your closing, that person may render only administrative services related to the transaction — not give you legal advice.

Q: What is a closing disclosure statement?

A: A closing or settlement statement is a document that summarizes all funds received by you and the seller at closing, and all funds paid by you and the seller for various expenses of the transaction (real estate broker commissions, loan payoffs, fees for inspections, property taxes, etc.). For all closings involving federally insured loans, the Real Estate Settlement Procedures Act (RESPA) requires that this information be disclosed on a Seller Disclosure or a Buyer Disclosure form for each party.

A Closing Disclosure is a form created by the Consumer Finance Protection Bureau (CFPB) that is required for all federally insured loans. There are two Closing Disclosure forms: a Buyer/Borrower Disclosure form and a Seller Disclosure form. The Buyer/Borrower form summarizes all funds received and expenses paid on your behalf. It also contains information regarding your loan, such as the interest rate and the lending institution. The Seller Disclosure form summarizes all funds received and expenses paid by the seller.

Typically, you must pay a portion of the property taxes, the cost of all inspections, and all costs associated with the loan, title search and closing. These costs include the appraisal fee, survey, pest inspection, lender fees, fees to establish an escrow balance for homeowner's insurance, taxes and any required private mortgage insurance, attorney fees, title insurance, and recording fees. The seller normally pays the balance due on any existing loans, his portion of the taxes, commissions to real estate brokers, fees for deed preparation, cancellation of existing liens, and revenue stamps payable to the state. In most transactions, payment of these fees is negotiable between the parties. However, if you are getting a VA or FHA loan, the lender may require the seller to pay particular closing costs, such as the pest inspection.

Q: In my contract, the seller agreed to pay \$2,000 in closing costs. What costs are included?

A: The best practice is to itemize the specific costs the seller is willing to pay for. If the contract does not specify which costs are covered by the \$2,000, then you and the seller should discuss this prior to the closing. If the closing costs are less than the amount offered by the seller, then the lender may limit the seller's contribution to the actual amount of the closing costs, in which case you would not be able to receive the full \$2,000. If the lender does not approve some or all of the seller's contribution to closing costs, you cannot receive the difference. All contributions must be shown on the closing statement and approved by the lender.

Q: I am being asked to put something on the statement that is different than what I agreed to. Is that ok?

A: Probably not. A closing/settlement statement or closing disclosure statement should reflect the agreement between the parties and match the terms set out in the purchase contract. You may be committing loan fraud if you make a false

representation to a lender on the loan application or elsewhere in order to obtain a larger loan amount or a loan on more favorable terms than you are otherwise qualified for under the lender's guidelines. **Loan fraud is a federal crime punishable by up to 30 years in prison and \$1 million in fines.** If you are asked to do any of the following, refuse and immediately contact the North Carolina Real Estate Commission:

- create a false gift letter for down payment funds.
- make it appear you made a deposit when, in fact, you did not.
- give the seller a secret or even false or “forgivable” second mortgage.
- make payments outside of closing which are not disclosed on the closing disclosure or closing/settlement statement, such as additional fees paid to service providers, to the seller, or third parties.
- make a false statement that you will occupy the property.
- give false personal information about yourself to the lender.

Q: What is “prorating”?

A: Certain items (real estate taxes, some utility bills, occasionally special assessments, etc.) are prorated at closing. “Prorating” occurs when you and the seller are each responsible for a portion of an expense. For example, property taxes are assessed as of January 1 but not normally payable until the end of the year. The seller is responsible for his share of the property taxes from January 1 through the closing date. You will be responsible for the remainder of the year. Review the contract carefully to be sure you know what items, if any, will be prorated at closing.

Q: What are special assessments?

A: Local governmental units can assess property owners for certain improvements to their property such as sidewalks, sewer lines, street repairs, and drainage systems. Since these assessments run with the property, you should verify with the closing attorney before closing that there are no existing special assessments (either pending or confirmed).

Q: If I'm a seller, when should I get my proceeds from the sale of my property?

A: The closing attorney may disburse funds immediately after closing has been completed, the title has been updated, and the documents have been recorded. Often, time may not permit the closing attorney to record the documents, update title, and disburse funds, or the lender may not be able to wire the loan proceeds, all in the same day. When this happens, a “dry closing” is sometimes held with the funds being disbursed the next business day. If you are a seller, you should discuss the timing of disbursements with the closing attorney in advance so you can be aware of any possible delays. If you are a buyer, be aware that the seller may not be willing to give you possession of the property until he receives his proceeds from the sale.

Q: What if I can't close by the time stated on the contract?

A: The standard form Offer to Purchase and Contract includes a 14-day extension provision to allow the parties a short time to complete settlement. After 14 days, if there is no settlement or written agreement to extend the settlement, the delaying party will be in breach and the other party may terminate the contract. If you are not using the standard form Offer to Purchase and Contract in your transaction, you should consult an attorney regarding the impact of a possible delay in closing.

Related reading available from the Real Estate Commission:

- Questions & Answers on : Earnest Money Deposits
- Questions & Answers on: Condos and Townhouses
- Questions & Answers on: Home Inspections
- Questions & Answers on: Residential Subdivisions & Planned Communities
- Working with Real Estate Agents

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