

Closing Cost Credits

What are legally defined 'Closing Cost Credits'?

A buyer and seller may agree when negotiating the purchase price of a home that the seller will give the buyer a closing cost credit -- that is, money to pay for closing expenses allowed by the lender. This agreement is typically written in special conditions of a purchase and sale agreement or in a separate, signed addendum. The agreement either states the credit is "up-to" a certain amount or that the credit amount may be reduced depending on policy of the lender. The allowable credit categories are found outlined on the HUD 1 Settlement Statement, in the section entitled "Settlement Charges".

What are the benefits?

In some instances, a seller's agreement to pay closing cost credits is the only way an otherwise qualified buyer can purchase. Buyers who rely on financing may have only enough available cash to cover the down payment, which ranges from 3.5% for FHA loans to 20% with conventional financing. A seller contemplating paying a buyer's costs simply negotiates the sale price with this credit in mind.

Restrictions / Surplus Possibility

A lender will generally allow a credit for up to 3% of the purchase price for a home, but this varies by the type of loan and the mortgage company policy. The credit may ONLY be applied toward legitimate closing costs [defined in Settlement Charges] and if a buyer runs out of allowed closing costs, the lender will not allow further credits to be applied, regardless of what is written into the purchase agreement.

What is the downside?

If a buyer increases their offer to offset a closing cost credit, but did not verify that (1) the lender will allow the entire credit or (2) that the costs will be approximately that amount, they will lose the difference. Buyers should always ask their lender about the expected and approved closing costs during the mortgage application period.

Example: During negotiations, a buyer and seller agree that an acceptable purchase price is \$100,000. The buyer, knowing they do not have more cash than the down payment, offers a purchase price of \$103,000 with a note in the special conditions that the seller will pay "up to 3%" in closing cost credits. If the buyer only has \$2,300 in approved closing costs, the seller will only pay \$2,300 for those legitimate costs, and the purchase price will NOT be lowered. The buyer will lose the \$700 difference.

Appraisal Considerations

If the Buyer inflates the purchase price beyond the value of the home in the eyes of the lender to offset the credit, the mortgage will be denied. The home's value, determined by the appraisal, must meet or exceed the amount of the total purchase price, including credits.

The Housing and Urban Development (HUD) Form 1 L. Settlement Charges

800. Items Payable in Connection with Loan

- 801. Our origination charge
- 802. Credit or charge (points) for the interest rate
- 803. Adjusted origination charges
- 804. Appraisal fee
- 805. Credit report
- 806. Tax service
- 807. Flood certification

900. Items Required by Lender to be Paid in Advance

- 901. Daily interest charges
- 902. Mortgage insurance premium
- 903. Homeowner's insurance

1000. Reserves Deposited with Lender

- 1001. Initial deposit for your escrow account
- 1002. Homeowner's insurance
- 1003. Mortgage insurance
- 1004. Property Taxes

1100. Title Charges

- 1101. Title services and lender's title insurance
- 1102. Settlement or closing fee
- 1103. Owner's title insurance
- 1104. Lender's title insurance
- 1105. Lender's title policy limit
- 1106. Owner's title policy limit
- 1107. Agent's portion total title insurance premium
- 1108. Underwriter's portion total title insur. premium

1200. Government Recording and Transfer Charges

- 1201. Government recording charges
- 1202. Deed, Mortgage, Release
- 1203. Transfer taxes
- 1204. City/County tax/stamps Deed, Mortgage
- 1205. State tax/stamps Deed, Mortgage