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

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

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.

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