

## Defining Closing Cost and Pre-Paid Cost

I want to review some of the costs you can expect to pay associated with any new home loan. With any luck, the builder or seller will agree to pay at least some of these expenses for you. But regardless of who pays them, these costs are part of the price of buying your next home, so let's take a look. They are closing costs, loan discount points and prepaid items.

Closing costs are the actual expenses that the lender incurs in the origination of a new home loan. Some of the costs are related to your loan application, such as the expense of newly updated credit reports on all applicants. Other fees are related to the house itself such as: the appraisal of the property, the flood certification, the attorney fees, title insurance, state tax stamps, and recording fees. Others are payment to the lender for processing your application, such as the loan origination fee. All these costs are lumped into a broad category called "closing costs." Unless the seller offers to pay them for you, this area of expenses is charged to the buyer, and often runs between 2 and 3 percent of the amount being borrowed. Because different states have different fees and taxes that are a part of these costs, it's impossible to generalize nationwide. So it's important that you talk with a reputable lender ahead of time about what costs you can expect to pay in your part of the country.

Loan discount points are, in essence, a form of prepaid interest. One discount point is exactly equal to one percent of the amount being borrowed. It is paid in cash at closing to the lender as a form of interest. Discount points have the effect of lowering the stated interest rate you will pay on the loan you obtain. For example, a lender might offer you a 30 year fixed rate loan at 6% with zero points or the same loan at 5.5% with 2 discount points. Because the points are considered interest, the yield to the lender is approximately the same. So why, you are asking, would I want to pay points? Sometimes new home builders or employers will offer to pay up to a certain number of points as an incentive, and I want to make sure you get everything that's coming to you. Also, it may be financially beneficial to pay discount points to lower your rate if you plan to live in the home for a very long time.

Last, there is the issue of prepaid items. Most home lenders want you to set up what is called and "escrow" account. This is nothing more than a savings account that the lender holds. Every month you will, in addition to your regular loan payment, deposit a sum for property taxes and for home owners insurance into this account. And when the next bill comes due for taxes or insurance, your lender will make the payment for you. Additionally, interest on a mortgage is paid in arrears, so you will pay interest on your new loan from the date of closing until the end of that month in the form of pre-paid interest. The reason that all this matters today is that, on the day of your purchase, you will be required to set up an escrow account with about 9 months worth of taxes and about 2 months worth of insurance payments. In addition, you will have to pay for the first year's insurance policy in full. These costs are called prepaid items, and you must pay for them yourself.

Because regulations and customs vary from state to state, the amount you need at settlement may be more or less than the amounts I have discussed here. Talk to a reputable lender to get an accurate estimate of how much you will need to buy your next home. Lenders are required by Federal Law to provide you with a Good Faith

estimate of cloning cost and pre-paid expenses within three days of taking an application.