Topic 8: Closing the Real Estate Transaction
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I. The Closing Process
A real estate transaction must follow a more formal procedure than do many other types of transactions for a number of reasons:

- Large dollar values are involved
- Lack of solid evidence of seller's ownership and good title until a transaction is well underway
- Legal matters (statute of frauds, fair housing laws)
- Need to prorate certain expenses

Steps in the transaction:

- Formal *contract*, with offer (and perhaps a series of counteroffers) and acceptance, consideration, competent parties, all major terms specified.
- Usually there are *contingencies*, such as a favorable report from a home inspector and title company, and perhaps from a surveyor if the parcel's acreage or boundaries are unclear, and the buyer's ability to obtain standard financing, which nullify the offer if the outcomes do not meet the criteria specified. (This type of contingency is a *condition*, as discussed in our Topic 7 Contracts coverage, such that a lack of fulfillment could enable the buyer to rescind the contract and get back any money paid, but a court likely would require a good faith effort to get financing so that a buyer who has had a change of heart could not just decline applying for loans and say "I didn't end up getting financing" as an easy excuse for backing out of an otherwise binding agreement. Real estate brokers encourage potential buyers to get "pre-qualified" or "pre-approved" with lenders to prevent unexpected loan denials from interfering with sales.)

Note: advertising a property for sale at a specified price is not an offer to sell; rather, it is an invitation for buyers to make offers to purchase that spell out important terms in addition to just the price. However, if a buyer offered the full advertised price in cash, agreed to any other terms the seller may have specified, and had no unreasonable or unusual demands, but the seller refused to sell, then the seller could potentially be 1) obligated to pay a commission to the listing broker and 2) subject to penalty under the fair housing laws.

A. The closing
The *closing*, or *settlement*, of a transaction brings about the final conveyance of a bundle of rights in real estate from a grantor to a grantee. At the closing the deed replaces the contract as the guiding document. A "table" closing of the type usually used in Illinois brings the buyer and seller, their brokers and attorneys, and the buyer's lender together in a meeting to personally exchange money and documents (in an "escrow" closing the affected parties do not have to actually meet – and even in a table closing an attorney could represent an absent grantor or grantee). The closing is organized by a "settlement agent," typically the buyer's lender or one of the attorneys (or an escrow agent), who will maintain a special checking account into which loan proceeds and the buyer's down-payment are paid, and from which checks are written to pay the property seller and other parties who are to receive money from the sale. In our area the closing typically is organized by the buyer's lender, who computes relevant dollar amounts and reports the transaction to the Internal Revenue Service and the state's department of revenue (states record sale prices in monitoring property tax assessment, and a sale could result in a capital gain on which income tax is owed).

[Closings now can be done fully on-line in 43 states, including Illinois. With videoconferencing and electronic signatures now common in the business world the obstacles to fully remote closings have been legal more than technological; some states require signatures on legal documents to be notarized in-person, rather than on-line. If the Securing and Enabling Commerce Using Remote Notarization Act (SECURE Notarization) becomes law (it passed in the U.S. House of Representatives in February of 2023 and was still working its way through the Senate a year later), it will allow notarizing to be done online by notaries public anywhere in the country (remote online notarization, or RON). Real estate brokers and lenders have commented that feelings of acrimony sometimes develop between home buyers and sellers as a transaction progresses, and it can be best if the parties do not meet face to face at the closing; remote closings may help address that issue as well. But parties in some states that do not allow remote closings have worried that large nationwide companies will take over the process, with far-away lawyers taking business from attorneys in the sold houses' local areas. And an early 2024 news account warned of cybercriminals who have successfully hacked the systems of real estate brokers or closing agents and directed buyers to send money to fraudulent accounts.[1]]

The sale contract should specify a date and place for the closing. Enough time should be allowed so that the title search, inspections (appraiser, termite), and document preparation (mortgage, deed) can be completed. If the contract does not contain a "time is of the essence" clause, the closing may take place a reasonable time after the stated date, in many cases without any penalty to the party causing the delay. The time needed to close on a home mortgage loan as of late 2023 averaged 30 to 45 days, according to the Mortgage Bankers Association[2] – not much changed from the average over recent decades. But that period is sure to continue declining, as lenders keep gaining better access to computerized information (*e.g.*, credit histories), perhaps falling to a matter of days or even hours in the future as technology advances, especially if formal appraisals of purchased homes are not required.

Under the common law "doctrine of merger by deed," once the closing has taken place, with title transferred to the buyer, any issues regarding title that were addressed in the contract become merged into the deed, even if the deed deviates from what the contract called for; the buyer is deemed to have accepted whatever rights the deed delivers even if different title provisions were in the contract. So if the contract calls for fee simple absolute title but the deed specifies fee simple determinable with only agricultural use permitted, and the closing proceeds, the buyer generally can not sue later for having received a less valuable restricted estate. Or the deed presented at closing could contain covenants or "deed restrictions" not mentioned in the contract; if the buyer accepts the deed by going through with the closing then the deed's wording supersedes the contract's. In one case the sales contract reserved for seller *S* a right of first refusal if buyer *B* decided to "sell or dispose of" the land, but the deed mentioned only "sell," and when *B* later *gave* it to a conservation group the court ruled that *S*'s right of first refusal did not apply.

Specific language can be added that says certain contract provisions will "survive" the closing; one issue could be confidentiality matters spelled out in the purchase contract but not the deed, but even title issues are covered if specified. (Courts' application of the merger doctrine, especially in Illinois, allows for wide exceptions under which a buyer can later sue a seller for non-title matters, like having misrepresented a material fact or failed to make a repair that the contract required – whereas under longer standing common law even non-title issues like those often were seen as being merged into the deed at closing.)

B. What is exchanged at the closing?

1. *Seller's mortgage is released*, or discharged – the "settlement agent" who organizes the closing should obtain information from the seller's lender(s) on principal and interest (interest owed increases on a daily basis) owed up to the date of the closing (which reduces the amount payable to the seller from the sale proceeds), along with any overages in escrow or impound accounts (these increase the amount payable to the seller). The buyer's lender will not provide a loan until all money owed by the seller to the seller's lender has been repaid, because the buyer's lender wants the mortgage it accepts (pledge of the property as collateral) to be senior to all other voluntary liens; it needs proof that the seller's lender has been paid back in full and no longer has a claim on the property's value. The two lenders must cooperate, or the closing process can be delayed.

2. *Cash is paid to the seller*, normally in the form of a cashier's check from the buyer's lender (in this area, the closing typically takes place at the office of the buyer's lender). Commissions to brokers typically also are paid from the sale proceeds, so those amounts could further reduce what the seller receives in cash.

3. *A deed is given to the buyer*. It is prepared by the seller's attorney, with some of the language dictated by law, some by the seller's wishes or bargaining strength (*e.g.*, type of deed), and some reflecting the buyer's wishes (*e.g.*, taking title as joint tenants). It is important that everyone's name be spelled correctly. The deed should convey *marketable title* (no major questions or defects) to the buyer.

4. *Affidavit of title* is given to the buyer – a statement signed by the seller attesting that no activity that might create liens or otherwise endanger the buyer's title has occurred since the title search was completed. Lien waivers for mechanic's liens may be required if the seller has hired anyone to do work maintaining/improving the property.

5. *Homeowner's insurance documents*, if the buyer takes over the coverage provided in the seller's policy (not typically done in residential real estate transactions).

6. *Title insurance policies* – usually in Illinois the buyer pays for the policy that covers the lender's risk relating to potential title problems, and the seller pays for the policy that covers the buyer's risk. The two policies together might be expected to cost ½ % to 1% of the price paid for the home (one-time charges that then provide insurance coverage as long as the loan remains outstanding or the buyer still owns the property).[3] A newspaper article indicated that the policy that protects the lender's claim might cost about $600, while the policy protecting the owner's interest might cost about $500. The lender's policy could cost a little more, even though the lender's claim declines over time as principal is repaid, because the lender typically has more money at risk in the early years following a purchase, when title problems would be more likely to surface. The buyer's policy generally would provide coverage for the dollar amount the buyer paid for the property.

7. Receipts or bills for property tax payments (recall that if the prior year's taxes have not yet been paid, as typically would be the situation in Illinois, they typically are prorated based on local custom, with the seller paying the buyer in advance for the taxes that accrued while the seller still owned the property).

8. If the improvements are new construction, a certificate from local government stating that the property is fit for occupancy (some Illinois communities require such a statement even for older properties).

9. Termite inspection report is given to buyer and lender by seller (a lender will not make a loan on a termite-infested house).

10. Buyer should receive a bill of sale for any personal property purchased with the real estate.

11. For income-producing properties, copies of leases, maintenance contracts, and employee records should be given by the seller to the buyer.

C. What are the costs paid at closing? Some examples are:
"Debits" for buyer: downpayment, loan application fees (which sometimes include a separate charge for paying the lender's attorney), discount points (extra interest collected by the lender at closing; see Topic 12), mortgage insurance (typically purchased by the borrower for the lender's protection if the loan is for more than 80% of the purchase price, or more technically more than 80% of the appraised value), credit report fee, premium for lender's title insurance policy, recording fees for deed the buyer receives and mortgage the buyer pledges to her lender.

"Debits" for seller: property taxes prorated for the period when the seller still owned the property, premium for buyer's title insurance policy, attorney's fee for document preparation, broker's commission, recording fees for release(s) on seller's mortgage(s), transfer tax paid to state and county ($1.00 to the state of Illinois, usually 50¢ to the county – although it is higher in Cook, and Chicago has its own especially high additional transfer tax for commercial property of $10.50 – for every $1,000 of transaction price, rounded to the nearest $500). Home rule communities in the state can also have their own added transfer taxes, as many Chicago suburbs do. Sometimes they are proportional (running from 50¢/$1,000 of transaction price in River Forest to $10/$1,000 in jurisdictions including Berwyn and Harwood Heights), and in other cases are flat fees (running from $10 in Dolton to $50 in Bedford Park and Countryside). Peoria seems to be the only downstate community to levy its own transfer tax on top of the state and county charges ($2.50/$1,000 of transaction price).[4]

The real estate transfer tax, or RETT, is imposed for the "privilege of transferring title," which the seller holds, not the buyer, so the seller pays the tax by purchasing "stamps" from the county recording office – although the Chicago city transfer tax usually is paid partially by the real estate buyer and partially by the seller, and we can always debate the extent to which a seller passes the anticipated cost along to the buyer through a higher negotiated price. Interesting tidbit: before buying the tax stamps the seller must show proof that she has paid all utility bills for the property up to the closing date. You can sometimes look at the state tax stamps on the first page of a recorded deed in Illinois to get a close estimate of the sale price; $185 in state transfer tax means that the sale price was about $185,000 – although the buyer can opt to have the stamps affixed after the deed is recorded, so a deed found in the public records might or might not show tax stamps (and in the 12 "nondisclosure" states, primarily located in the western U.S., prices paid in real estate transactions are not reported in public records).

State and local governments commonly require payment of a transfer tax when real estate ownership changes hands through a sale, but typically not when ownership passes through gift or inheritance (since no consideration is paid), or through a lender's foreclosure on a mortgage (but transfer tax will be due when the lender sells the property to a third party). If real estate constitutes 75% or more of an Illinois corporation's asset base, a change in ownership of more than half of the common shares is treated as a sale of the real estate that requires a transfer tax to be paid. But the merger of two corporations that both own real estate as substantial assets does not trigger a transfer tax, just as the tax is not owed if the transaction involves a "partition" of joint ownership among multiple existing owners. Finally, no transfer tax is due if the buyer or seller is a government agency or qualifying charitable organization.

D. *Proration of Ad Valorem Property Tax*
At the closing, there may be several *accrued* (still owed by the seller) or *prepaid* (already paid by the seller) expense items. Prepaid items could include insurance premiums, homeowner association dues, or utilities (especially heating oil in an on-site tank) already paid for, along with property tax paid for in advance. The buyer should pay the seller at closing for items the seller has paid for but that the buyer will benefit from, like heating oil already in the tank that will heat the house after the buyer moves in. In Illinois, however, property tax is paid in a later year, so property tax typically is an accrued item that must be prorated, with the seller providing money to the buyer, at closing.

Different methods for prorating property tax exist; we will concentrate on the "actual days in the year" method typically used in practice (although the brokerage license exams in Illinois used to assume monthly proration, with twelve 30-day months) and determine approximately the amount the seller should pay the buyer at closing.

For example, 2023 property taxes of $3,600 are to be paid in June and September of 2024. Closing is held on March 31, 2024, before 2023 tax bills have even been sent out. So at closing, the seller should pay to the buyer: $3,600 for 2023 taxes yet to be paid plus approximately a fourth of the expected $3,600 taxes for 2024, which is $900; total of $3,600 + $900 = $4,500. (The seller lived in the house and received the benefit of local government services in all of 2023 and about ¼ of 2024.) Then when the 2023 tax bill arrives in May of 2024 and the 2024 tax bill arrives in May of 2025 the buyer will have the money available to pay the amounts rightfully attributable to the seller. (Recall that property taxes constitute a lien against the property; the county sends the bill to the current owner. Also note that the seller does not directly write a check to the buyer; the adjustment for property tax is just a debit for the seller and credit for the buyer that nets out to reduce the amount of cash the buyer needs to have at the closing.)

Local customs generally treat the seller as liable for tax on the day of the closing. In our example 2024 taxes are estimated to be the same as 2023's, but property taxes tend to go up over time. If the contract called for proration based on the most recent actual known taxes, the buyer would just accept the loss if the actual bill ended up being higher. (One mitigating factor is that the buyer gets to collect a few months' interest on the tax money prepaid by the seller at closing.) But the buyer and seller could agree to adjust the payment after the actual tax bill is known.

II. *Real Estate Settlement Procedures Act* (RESPA) [1974, amended 1975, 2009, 2015]

Someone who borrows money to buy a house, especially if a first-time buyer, can be taken aback at the amount of money she has to come up with in connection with the purchase; think of loan application fees, costs of credit reports and termite inspections and appraisals and recording, mortgage and title insurance premiums, "points" charged by lenders to increase their returns. RESPA, now integrated with the older Consumer Credit Protection or "Truth in Lending" Act (TILA), provides home borrowers with fairly comprehensive information on closing and overall borrowing costs, helps prevent "sticker shock" for buyers, and addresses abuses that lawmakers felt lenders might be inclined to engage in. [Sellers usually do not face cash flow problems in connection with the transaction, because generally their costs merely reduce the net amount received from the total sales price at closing.]

TILA-RESPA applies when any lender that is federally insured, or that lends more than $1 million per year, lends on a one-to-four family owner-occupied property. Special rules apply to mortgage loan brokers that bring borrowers together with the ultimate lenders. (But interestingly, TILA-RESPA does not apply to reverse mortgage loans or home equity lines of credit, discussed in later Topics.) The law initially was administered by the federal Department of Housing and Urban Development, but since Dodd-Frank was passed in the wake of the 2000s financial crisis TILA-RESPA has been enforced by the new Consumer Financial Protection Bureau (CFPB). Under TILA-RESPA the loan officer, attorney, or other party who manages the closing process (the "settlement agent") must:

1. Provide loan applicants ("consumers" per the law) with CFPB informational pamphlets on closing costs.

2. Provide a borrower with an estimate of closing costs when the application is made, and with complete, accurate figures prior to the closing. In late 2015 CFPB created new documents for those purposes. (The new requirements combine aspects of Regulation Z, the "Truth in Lending Act" and Regulation X, or RESPA, into "TRID," or TILA-RESPA Integrated Disclosure.) A three-page *Loan Estimate* (LE) must be given to the borrower no more than three days after the loan application is completed. The LE is designed to help borrowers compare terms available from different lenders by spelling out details that include total borrowing costs over the first five years, total borrowing costs over the loan's life, and an estimate of total cash the borrower will need to have in hand at the closing. Closing costs generally run from 2% to 5% of the purchase price; think $6,000 to $15,000 for a $300,000 house.[5]

Then a five-page *Closing Disclosure* (CD) must be in the borrower's hands at least three business days before the closing occurs (it can be delivered in paper form or electronically). The CD is designed to facilitate comparisons with the LE, so the borrower can easily tell whether the lender has tried to change any loan terms between the application date and the closing. The new documents are an attempt to make all dollar and percentage costs of borrowing (including interest rate; monthly payment; principal, interest, mortgage insurance, homeowner insurance, and property tax portions of monthly payments) easier to understand, and to provide some information borrowers did not have under the earlier system (notably overall closing costs and the amount of cash the borrower needs to have at the closing). A goal is to let a borrower compare overall costs across different possible loans. To address this issue the new system requires disclosing an annual percentage rate (APR) cost of borrowing that includes loan brokerage fees and loan closing costs on top of the interest rate, and also requires disclosing the total dollar amount the borrower would spend on a loan if it remained in place for five years.

[By way of analogy: Chocolate City advertises that it sells twenty pounds of chocolate almond clusters for $6.00 per pound, while competitor Candy Corner quotes twenty pounds for a seemingly higher $7.50 each. However, to get Chocolate City's $6.00 price you must pay $30.00 in dues to join the Chocolate Lovers Club, and also must pay $10.00 in delivery fees, so a one-time purchase effectively costs [$6.00 (20) + $30 + $10]/20 = $160/20 = $8.00 per pound – while Candy Corner has no membership fee and charges only $2.00 for delivery, so its effective cost is [$7.50 (20) + $2]/20 = $152/20 = $7.60 per pound. The APR reported to a home mortgage borrower similarly distills all of the required costs of obtaining a loan, and not just the advertised interest rate, into a single number so that prospective borrowers can compare financing costs accurately across different lenders; the lender quoting the lowest interest rate may not have the lowest effective borrowing cost when other requirements are factored in.]

The new documents show what portion of each payment goes to pay interest, property taxes, property insurance, and mortgage insurance. They also make clear that the borrower has the right to shop for some of the services the lender requires as a condition of making the loan; termite inspections and title search/insurance companies are examples. The waiting periods necessitated by tasks required under the new system might be expected to prolong the closing process; some sources indicate that closings often occur later than the initially scheduled date. A "Supplement" to Topic 8 on our course web site has links to U.S. Consumer Financial Protection Bureau documents that explain the Loan Estimate and Closing Disclosure forms, with examples containing sample dollar and percentage figures.

3. Hold only a small cushion over amounts actually needed for the lender to pay property tax and homeowner insurance premiums in an "impound" (or escrow) account required because the loan is for more than 80% of the appraised value (an impound account allow the lender to know that these important bills have been paid, because the lender pays them with money provided by the borrower). Generally, a lender can require a borrower to pay only a small amount (such as two months of expected payments) at closing, and then the lender collects one twelfth of the expected annual costs as part of each month's payment. [A few states' laws require lenders to pay interest on impound balances, but Illinois is not one of them.]

It is also illegal under TILA-RESPA for a lender, broker, or attorney to receive a "kickback" for referring a home buyer/borrower to a service provider, like a mortgage insurance or title insurance company. Lenders/brokers/attorneys must disclose to buyer/borrowers any ownership interests they have in such service providers, and disclose that the buyer/borrower is free to obtain those services from other providers.

III. *Escrow closings* – as opposed to ordinary "table" or conference or face-to-face closings – are used extensively in California and some other jurisdictions (not much in Illinois). An *escrow* is a disinterested third party that holds all money and documents until all parties to the agreement have performed as specified under the agreement. This type of closing is said to be helpful in encouraging all parties to perform; it also works well in situations involving many parties, or if a seller dies (or just has a change of mind) during the transfer process (the deed's transfer is said to "relate back" to when the grantor delivered it to the escrow agent). •

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[1] Dumas, Breck. "Real Estate Fraud Risk Is On the Rise, and Victims Are Sounding the Alarm." *Fox Business*, February 6. 2024.
[2] See Osipovich, Alexander. "NYSE Owner Ais to Expedite Mortgages." *The Wall Street Journal*, October 9, 2023, B1, B2,
[3] Fontinelle, Amy. "What is Title Insurance, And Do I Need It?" *Forbes Advisor*, June 24, 2023.
[4] Chicago Title Transfer Tax Listing, December 2021. https://cmetro.ctic.com/CTRSCMetro/media/publications/Chicago-Title-Transfer-Tax-Listing-December-2021.pdf.
[5] Kiplinger Consumer News Service. "More Than a Mortgage: A Look at Some of the Hidden Costs of Homeownership." *The Pantagraph*, July 6, 2024, A7. See also Marquand, Barbara. "Mortgage Closing Costs: How Much You'll Pay." *NerdWallet*, January 8, 2024.