

A Table of Contents has been provided on pages 2 and 3 above for your ease of reference and navigation. Before you read the entirety of the pamphlet, the authors urge you to review the questions, helpful tips, fraud avoidance suggestions, discussion items, and points set forth in the Table of Contents and take a look at the sections of this pamphlet that address those matters that you find to be the most interesting or useful. At the end of the pamphlet, we have provided some “reference” materials for readers who want to learn more, or who desire greater detail and/or additional information, about escrows in California.

## **B. Escrow Basics.**

### **1. What is escrow?**

At its essence, escrow is the process whereby parties to the transfer or financing of real estate deposit documents, funds, or other things of value with a neutral and disinterested third party (the escrow agent), which are held in trust until a specific event or condition takes place according to specific, mutual written instructions from the parties. Escrow is essentially a clearinghouse for the receipt, exchange, and distribution of the items needed to transfer or finance real estate. When the event occurs or the condition is satisfied, a distribution or transfer takes place. When all of the elements necessary to consummate the real estate transaction have occurred, the escrow is “closed”.

Section 17003(a) of the California Financial Code defines escrow as "...any transaction in which one person, for the purpose of effecting the sale, transfer, encumbering, or leasing of real or personal property to another person, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by that third person until the happening of a specified event or the performance of a prescribed condition, when it is then to be delivered by that third person to a grantee, grantor, promisee, promisor, obligee, obligor, bailee, bailor, or any agent or employee of any of the latter”.

For your reference, the California Escrow Law (“Escrow Law”) is contained in Division 6 of the Financial Code, commencing with Section 17000, and Subchapter 9, Title 10 of the California Code of Regulations, commencing with Section 1700.

In addition to its elusive nature, escrow transactions can be unpredictable and stressful for the participants. It is safe to say that you cannot fully understand and appreciate how escrow works and what to expect until you have personally been involved in an escrow transaction. A successful escrow is usually the product of an experienced team of real estate, title, and escrow professionals working together to guide you through this short lived, yet very important, arrangement.

## **2. Why is escrow important?**

Escrow is a service that protects the public and minimizes the potential risk involved in any real estate transaction. With an experienced neutral third party in possession of the legal documents and funds, which party is obligated to safeguard the instruments and funds, buyers and sellers, as well as lenders and borrowers, can safely interact with one another and be assured that no legal documents will be recorded, and no funds will be released, until all of the conditions of the real estate contract or agreement between the parties have been completed.

## **3. Who can provide escrow services in California?**

In order to perform escrow services in California, the Escrow Law states that an escrow must be a corporation, in the business of receiving escrows for deposit or delivery, and be licensed by the California Corporations Commissioner. However, there are exemptions provided in the Escrow Law which allow other entities and persons not licensed by the Department of Business Oversight (“DBO”) to perform escrow services. Such escrow agents are exempt from the licensing requirements of the Escrow Law and include the following: 1) any bank, trust company, building and loan or savings, or insurance company under any law of this State or the United States; 2) any California licensed attorney who has a bona fide client relationship with a principal in a real estate or personal property transaction and who is not actively engaged in the business of escrow; 3) any title company licensed by the California Insurance Commissioner; and 4) any real estate broker licensed by the California Department of Real Estate while performing acts in the course of or incidental to a real estate transaction in which the broker is an agent or a party to the transaction and in which the broker is performing an act for which a real estate license is required.

The Escrow Law also states that with respect to 2) and 4) above, the exemption is personal to the licensed persons listed (attorneys and real estate brokers, respectively), and those persons shall not delegate any duties other than duties performed under the direct supervision of those persons. Also, the exemption is not available for any arrangement entered into for the purpose of performing escrows for more than one business.

In the terminology of the escrow industry, all escrow agents performing escrow services in California are either “licensed” or “controlled” escrow companies. A “licensed” escrow company, which is also known as an “independent” escrow company, is licensed by the DBO. This license can only be obtained after the escrow company has met and satisfied all of the licensing requirements set forth by the Escrow Law, which are enforced by the DBO. A “controlled” escrow, which may be known as a “non-independent” escrow, is not licensed by the DBO. A controlled escrow could be owned and operated by any of the persons or entities mentioned above, such as a real estate broker or title insurance company. The licensing and regulation of controlled escrows depends on the jurisdiction of the licensing and regulatory authority that they are

operating under. Therefore, the licensing requirements, laws, and regulations that they are subject to vary widely.

**4. Are there any major differences between independent escrow agents licensed by the Department of Business Oversight and controlled escrow companies performing escrows under the exemption of the Financial Code's Escrow Law?**

Yes, there are many differences between independent and non-independent escrows which largely lie in the licensing requirements and laws that govern them. The DBO's website ([www.dbo.ca.gov](http://www.dbo.ca.gov)) lists the requirements for obtaining a license to do business as an independent escrow. These requirements are much more stringent than the licensing requirements placed on non-independent escrows. One of those requirements is membership in the Escrow Agents' Fidelity Corporation (EAFC) if the escrow company will be engaging in escrows specified under Section 17312 (c) of the Financial Code, including but not limited to, real property escrows, bulk escrows, escrows involving manufactured homes and mobile homes, and fund or joint control escrows. The EAFC indemnifies member escrow companies against loss of trust obligations caused by or resulting from the fraudulent or dishonest abstraction, misappropriation, or embezzlement of such obligations by an officer, director, trustee, stockholder, manager, or employee of a member. The coverages schedule for losses is set forth in Section 17314 of the Financial Code. Pursuant to the current schedule (as of October 17, 2010), the minimum coverage by EAFC for each licensed location shall be \$1,000,000 and the maximum coverage for each licensed location shall be \$5,000,000<sup>2</sup>. Those individuals who have a history of misconduct or criminal record for crimes involving dishonesty are denied membership in EAFC and are restricted from working for a member escrow company.

If an escrow company handles transactions not listed under Section 17312 (c) of the Financial Code, they are required to file a fidelity bond with the Commissioner for each officer, director, trustee, or employee in coverage of not less than \$125,000. Another licensing requirement mandates that an "independent" escrow agent must have one or more persons with at least five years of responsible escrow experience on site at the main licensed location during business hours. All other branch offices must have one or more persons with at least four years of responsible escrow experience on site. Other requirements include background checks and fingerprinting for each officer, director, manager or employee of the escrow company, surety bonding, proof of minimum financial stability requirements, a required audit performed by a licensed CPA, and payment of application fees and DBO assessments.

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<sup>2</sup> Claims against the EAFC may only be made by EAFC member escrows. However, under Sections 17202-17203 of the Financial Code, escrow customers/consumers can make claims against a DBO escrow licensee's bond. It should also be noted that reference to EAFC membership in any member escrow advertisements are subject to the restrictions of Section 17346 of the Financial Code against representing that trust obligations of escrow agents are "protected", "guaranteed" or "insured", and must have a clear and conspicuous statement that EAFC is a private corporation and not a government agency.

The licensing requirements of non-independent escrow companies are much less intensive. For example, under the Real Estate Law, only real estate licensee applicants undergo a background and fingerprint check. Additionally, an escrow manager or officer need not be licensed by the Department of Real Estate (DRE) to work for a broker escrow division, and such a manager or officer does not have to apply for or undergo any special licensure. Because a real estate broker may hire anyone to work for his broker escrow division and that individual does not have to be licensed, the potential escrow manager, officer, or assistant working for the real estate broker is not by law subjected to any fingerprint or background check. Another difference is the lack of bonding requirements placed upon non-independent escrow companies. For example, unlike the fidelity and surety bonding requirements for DBO licensed escrow agents, a real estate broker only has to maintain a fidelity bond if an unlicensed person is a signatory on the trust account. If there are no unlicensed individuals on the trust account, a real estate broker is not subject to any fidelity bond requirement. Finally, there are no minimum work experience requirements for individuals who are working for a real estate broker as escrow managers and officers. Thus, these individuals do not need any escrow experience or history of working in an escrow company. If the escrow manager or officer is a real estate licensee, then they are subject to the normal real estate licensing requirements. While there is no separate bonding requirement for a non-independent real estate broker controlled escrow, with the exception mentioned above, the DRE does have a Recovery Account, which is a "victim's fund" of last resort, and it can pay victims of intentional fraud that has been perpetrated by real estate brokers. Under current law, the Recovery Account's payout limits are \$50,000 per transaction and up to \$250,000 per licensee.

In addition to the differences in licensing, another major difference between an independent escrow company and non-independent escrow company is that a DBO licensed escrow company can perform the escrow for any principal, broker, or person, whereas a DRE or California Department of Insurance (CDI) regulated escrow can only perform escrow functions when they are a party to the transaction. This is the reason why DBO licensed escrow companies are referred to as "independent" escrows -- they are a neutral party in the transaction, unlike a DRE or CDI escrow company which is only able to perform those functions when they are performing other related functions in the transaction under the authority of their real estate or title insurance license.

Finally, independent escrow companies are subject to the requirements and regulations of the Escrow Law, and certain requirements of the Civil Code, while DRE or CDI controlled escrows are subject to the bodies of law that govern real estate licensees and title insurance and underwritten title companies, respectively, as well as certain applicable Civil Code mandates.<sup>3</sup> Therefore, the ways in which they are regulated and enforced vary greatly.

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<sup>3</sup> Financial Code Section 17006 exempts DRE and CDI licensees from the entire Escrow Law, yet some case decisions refer to the Escrow Law or portions of it (*e.g.*, Section 17003's escrow definition, which actually codified language from an historic case, is applied almost verbatim). Regarding Civil Code Sections pertaining to escrows and escrow holders and agents, see 1057-1057.7, 1103.22, 1812.210, 1812.214, 1812.314, 2995, and 3110.5.

## **5. How does a real estate broker controlled escrow work?**

A real estate "broker controlled" escrow, also known as a "broker run" escrow, means that a real estate broker is conducting the escrow while performing acts in the course of or directly incidental to a real estate transaction in which the broker is a party or in which the broker is an agent performing an act for which a real estate license is required. For example, a real estate broker representing a buyer in the purchase of real property may also perform escrow services in connection with that purchase pursuant to the exemption of the Escrow Law. However, if the real estate broker were performing escrow services with respect to a transaction where they are not a party or not an agent performing underlying real estate services, they would be unlawfully performing escrow services and in violation of the Escrow Law. Under the latter scenario, the DRE could issue a Desist and Refrain Order against that broker for engaging in an activity that is in violation of Division 6 of the Financial Code and for not being exempt under the Escrow Law.

Because non-independent escrows have restrictions under the Escrow Law, you should be aware of these restrictions and properly identify and confirm the escrow's license status with their regulatory agency before working with the person or company. Recently, a regulation of the California Real Estate Commissioner was adopted which requires that if a real estate broker is using a fictitious business name with the word "escrow" in it, the name must also include the term "non-independent broker escrow" in any advertising, signs or electronic promotional material. For example, if ABC Realty were also doing business as ABC Escrow, they would have to state that they are "ABC Escrow, a non-independent broker escrow." This is important for you to know since some names of escrows may suggest that they are doing business as a licensed, independent escrow company when in reality, they are not independent. It is to be noted here that real estate brokers who conduct broker escrows are responsible for those escrows, cannot delegate that responsibility, must follow the California Real Estate Law (which is set forth in Sections 10000, et seq. of the Business and Professions Code, and which includes Regulations of the Real Estate Commissioner) with respect to the handling and accounting of monies provided to the brokers in trust, and appropriate discipline can be imposed against those licensees by the DRE where violations of the law have occurred.

## **6. How can I identify which type of escrow holder I am working with?**

Pursuant to 17403.4 of the Financial Code, all written escrow instructions and instructions electronically transmitted over the Internet must include the escrow's license name and the identity of the supervising agency. You will most likely find an escrow company's license number along with this information. In the event you are unable to locate the license name, agency information, or license number disclosure, be sure to ask your escrow officer for this information. You as the escrow consumer have a right to know if the company handling your escrow is licensed and in good standing with the department which regulates it. In order to verify this information, you will need

to check the status of the escrow. With the license name, number and/or agency information, you will be able to call the regulatory agency or search that department's website to determine the license status of the escrow. You will also be able to see if the escrow has ever been the subject of any disciplinary action. For example, if the escrow was previously revoked or suspended, or even unlicensed altogether, this is pertinent information you need to know if you have enlisted this escrow to hold your money in trust and facilitate an important real estate transaction. Therefore, always check the status of an escrow prior to working with them.

The following agencies can assist you when inquiring about the licensing status of an escrow:

For independent escrow companies, contact the Department of Business Oversight at (866) ASK-CORP or go to [www.dbo.ca.gov](http://www.dbo.ca.gov).

For broker controlled escrows, contact the Department of Real Estate at (877) 373-4542 or go to [www.DRE.ca.gov](http://www.DRE.ca.gov).

For title insurance/underwritten title companies performing controlled escrows, contact the California Department of Insurance at (800) 927-HELP or go to [www.insurance.ca.gov](http://www.insurance.ca.gov).

## **7. Who chooses the escrow holder?**

The choice of escrow is normally agreed upon by the principals to a real estate transaction and reflected in writing in the purchase contract. A seller may elect to choose "ABC Company" and the buyer may choose "DEF Company," but both parties must ultimately agree, like they must on all terms and conditions of a sale. If a real estate broker is involved, it may be a common practice for the broker to recommend an escrow company, especially if the broker continually does business with a particular escrow officer or company. With a refinance transaction, if you are a borrower refinancing your property and working with a mortgage broker, it is usually the broker who will select and/or recommend an escrow provider for you. However, while a real estate broker may suggest an escrow holder, he or she may not designate an escrow holder as a condition precedent to a transaction.

It is also important to note that there are laws which prohibit the payment of referral fees, rebates, and/or kickbacks between escrow, title, and real estate companies, for the referral of business. Except for normal compensation between an escrow company and its employees, Section 17420 of the Financial Code provides that for those under the jurisdiction of the Escrow Law, it shall be unlawful for any person who pays over to any other person any commission, fee, or other consideration for referring, soliciting, handling, or servicing escrow customers or accounts. Basically, escrow holders are prohibited by law from the giving of any consideration to a party as an inducement for receiving an escrow. There are comparable laws that prohibit referrals fees and rebates that govern real estate brokers and title insurance companies as well.

Please remember that when it comes down to the selection of the escrow holder, you as the consumer always have the right to choose an escrow that is professional, competent, reasonably priced, and which will fulfill your transactional needs.

## **8. When does escrow typically open and how does it work?**

In the typical escrow, the principals to the real estate transaction that requires an escrow (borrower, lender, buyer and/or seller) cause escrow instructions to be created, signed, and delivered to the escrow officer. In the case of a real estate sale/purchase, escrow usually opens when a fully executed purchase agreement has been delivered to an escrow holder. The good faith deposit or initial down payment may or may not be deposited at the same time. The delivery of the signed purchase agreement and/or accompanying deposit to an escrow company is usually facilitated by the listing or selling broker involved. Upon receipt of a fully executed purchase contract and/or good faith deposit, the escrow officer will normally assign the transaction an escrow number. When calling your escrow officer with questions or concerns, it is helpful to have this escrow number handy because this will allow the escrow officer to locate your file more easily.

The applicable broker will typically provide the escrow officer with important information regarding the transaction, such as the names and contact information for the principals, lending and title information, selection of service providers, and other necessary details. After escrow opens, the escrow officer will order a real property title search with the title company designated by the parties, if this has not already been done by the listing broker, and prepare escrow instructions. These instructions are normally pre-approved by the brokers involved in the transaction. Once they are deemed to be error free and finalized, the instructions are sent to the parties for signature. These instructions essentially tell the escrow officer what to do and when to do it, and basically give the escrow officer the authority to act. It is worth pointing out that there are some aspects of a real estate transaction that are not part of the escrow. For instance, the purchase agreement contains several items that are not handled by escrow holders, such as buyer and seller agreements regarding property fixtures, personal property, removal of contingencies, liquidated damages, arbitration and mediation. It is important to remember that if you have specific questions about the purchase agreement, you should contact your licensed real estate broker or licensed attorney.

Basically, the escrow officer can only process the escrow in accordance with the escrow instructions. Therefore, without signed instructions, the escrow officer cannot act or proceed. The escrow officer will then perform those functions that they were authorized to do in writing by the mutual agreement of the parties to a transaction, unless an instruction(s) is unlawful and/or against the policy of the escrow holder. The required conditions, processing, and facilitation of the escrow may differ depending on the type of transaction and property involved. However, regardless of the type of escrow being performed, it is only when all of the conditions required in the escrow instructions have been satisfied that the escrow will be complete. At the close of escrow, the escrow

officer will release funds and documents in accordance with the escrow instructions, pay all bills as authorized, and prepare and deliver a final closing statement to the parties.

### **9. Exactly what are escrow instructions?**

Escrow Instructions, which are prepared by the escrow officer, identify all of the terms and conditions of the escrow, as well as the escrow holder's general provisions and legal responsibilities and limitations. They are usually detailed in nature and prepare the escrow officer for every situation. The instructions typically identify the escrow holder's contact information and escrow number, license number, important dates including the date escrow opened, as well as the date it is scheduled to close, the names of the parties to the escrow, property address and legal description, purchase price and terms, how buyer's title is to vest, proration adjustments, matters of record to which buyer is subject when he or she acquires title, disbursements to be made, fees and charges and who is responsible for payment, documents to be signed, delivered, and recorded, and the process and roadmap that must be followed by the escrow holder in handling the escrow. Additionally, escrow instructions usually reflect the agreements made between the parties with respect to the escrow and the duties of the escrow officer. These duties typically include, but are not limited to, ordering the title search, requesting payoff demands and beneficiary statements, facilitating the receipt and approval of reports, making prorations and adjustments, paying bills, obtaining the buyer's or borrower's approval and signature on loan documents, requesting closing funds and authorizing recording, closing the escrow after confirmation of recording, preparing final closing statements, disbursing funds, and delivering documents to the appropriate parties. In sum, escrow instructions indicate all of the specific steps to be completed and conditions that must be satisfied before the escrow is complete. Because an escrow holder may only act upon specific written and mutual instructions of the principals, the escrow instructions must be clear in content, accurately reflect the intention of the parties and the duties of the escrow holder, and avoid ambiguity. When fully executed by all parties, the instructions become an enforceable contract and the escrow becomes effective.

As a consumer, it is important for you to know that an escrow officer may not solicit or accept an escrow instruction, or supplemental escrow instruction, containing any blank that can or is to be filled in after signing or initialing of such escrow instruction. An escrow officer is also prohibited from allowing any person to make any additions, deletions, or alterations to an escrow instruction unless the changes are signed or initialed by all persons who had signed or initialed the original escrow instruction prior to the modification.

### **10. What types of transactions go through escrow?**

All sorts of transactions use escrows to facilitate the transfer, lease, or financing of real or personal property. Escrows are most commonly used when – real property is bought, sold, or refinanced, but they are also utilized for the purchase or sale of



business opportunities or mobile homes. Bulk sales, stock transfers, and holding escrows are less well known, but are other types of transactions handled by an escrow company. Escrows in non-real estate transactions (e.g., those for personal property) are beyond the scope of this publication.

## **11. What is the role of the escrow officer?**

In accordance with the escrow instructions, the escrow officer will process the escrow and handle the funds and documents from start to finish. As stated above, the instructions outline all of the duties of the escrow officer. An escrow officer is responsible for the preparation and processing of a significant amount of paperwork. That paperwork includes, but it is not limited to, escrow instructions and amendments, grant deeds and quitclaim deeds, estimated and final closing statements as well as HUD-1 statements required by lending institutions. Escrow officers also facilitate the request, delivery, and signing of documents, not only for the benefit of the principals, but for the real estate brokers, and the applicable title company and lending institution. The escrow officer must also comply with local, county, State and federal requirements relative to required documentation and fees. If the buyer is obtaining financing, the escrow officer will work with the mortgage broker and/or lender to help move the loan approval and underwriting process along, satisfy the lender's conditions, and will likely coordinate the loan document sign-up. Additionally, escrow officers will request closing funds, authorize the release and recording of documents, and are the primary party responsible for all of the accounting of an escrow transaction and disbursement of funds held in the escrow. Another large part of an escrow officer's job is requesting payoff demands and lien releases, and working to ensure that free and clear title will be conveyed to the buyer and in compliance with the lender's instructions, if applicable. In some ways, the escrow officer has one of the most difficult jobs in a real estate transaction as he or she is the neutral party to which all buyers, sellers, borrowers, lenders, real estate brokers, and title companies look to for the proper, efficient and effective administration of an escrow. An escrow officer is the communication link for all of the parties and the central place where buyers, sellers, real estate and mortgage brokers, and lenders go for updates, answers, and problems. Finally, it is the escrow officer's duty to ensure that all of the conditions of the escrow have been met before closing, where documents can be released and/or recorded, and funds transferred and/or disbursed.

It is also important to understand that because the escrow officer is a neutral third party, he or she does not represent or favor any one party to an escrow, and is instead an agent of the principals to the escrow. An escrow officer's role as a disinterested and neutral third party is very clear. For that reason, an escrow officer will never be involved in the negotiation of the contract or advise the principals with respect to the same.

When obtaining a loan, it is the responsibility of the buyer or agent of the buyer to arrange for a loan and negotiate with the lender, not the escrow holder. Similarly, in a short sale transaction, where the sale is contingent upon the approval of the short sale

lender, it is the responsibility of the seller or agent of the seller to negotiate with the short sale lender, and not the duty of the escrow officer. Because an escrow officer may only act on instructions and documents agreed to by the parties to a transaction, if a dispute or disagreement occurs, the escrow officer must remain neutral and will not proceed until the parties have reached a mutual agreement. It should also be noted that an escrow officer is not an attorney and cannot give you legal advice. Only a licensed attorney can provide you with legal advice under California law. If legal and/or tax questions arise, it is recommended that you consult with a licensed attorney or qualified tax professional for assistance.

Finally, because escrows are confidential in nature, the escrow holder has a responsibility to not give out any information to third parties concerning an escrow without the approval of the appropriate parties and principals to the escrow. At the same time, escrow holders have a legal obligation to reveal and disclose any new, detrimental, or material information that was previously unknown to the parties. Moreover, an escrow officer must maintain the highest level of trust and maintain a good working relationship with all of the escrow participants.

## **12. Are there any differences in the way escrows are conducted in northern and southern California?**

Yes. Escrow procedures differ between northern and southern California, and certain customs have arisen over time that differ between the north and the south, and even between certain counties of the State. In northern California, most escrows are performed by title insurance companies while in southern California, there is usually a separate escrow and title company involved. Although title companies in southern California as well as anywhere in the State may perform escrows under the exemption in the Financial Code as mentioned above, title companies almost always perform the escrow function of a real estate transaction in northern California. With title companies performing both title and escrow functions in northern California, they ordinarily charge only one fee for both services as opposed to southern California where there are two separate fees charged.

With respect to escrow instructions, in northern California buyers and sellers sign separate, unilateral escrow instructions normally a few days before closing. By comparison, in southern California, buyers and sellers sign joint, bilateral escrow instructions after the purchase contract has been signed and escrow has been opened.

The escrow closing statement is usually referred to differently in both regions of the State as well. In northern California, the closing statement is called the Buyer's Statement or Seller's Statement depending on the recipient, while in southern California the closing statement is most commonly referred to as the Final Closing Statement, Settlement Statement, or HUD-1.

The division of escrow and title charges also differs. In southern California, sellers usually pay for title insurance and the documentary county transfer tax, and split the

escrow fee with the buyer. In northern California, there are some counties where buyers and sellers split title insurance and escrow charges equally, but in other counties they may pay different percentages of the total cost. An example would be where sellers pay 75% and buyers pay 25%. However, even though it might be customary for fees to be paid in a specific way in an escrow transaction, it ultimately is decided by agreement between the parties. If you have questions about the escrow process and procedures, ask your escrow officer at the beginning of an escrow transaction.

### **13. Are escrow costs fixed by law: and how much do escrow services cost?**

Escrow fees are not fixed by law or regulated by the State. The escrow fee is typically commensurate with the size and complexity of the transaction, the cost of performing the services, overhead expenses, and the liability involved. Some escrow holders may have a set fee schedule in place, or a formula that they use to calculate their escrow fee by using the selling price of the property in a sales transaction or loan amount in a refinance transaction. There could also be additional fees charged for drawing the grant deed, working with your lender, and/or printing loan documents. As a result, escrow fees may vary between escrows and in different locales and regions of California

That being said, you are certainly able to try and might be able to negotiate the fee charged by escrows, but it is important to do so before you enter escrow. Additionally, you might also shop around and locate comparable escrows with lower escrow fees.

Please note that escrow fees are only a portion of your closing costs. There are other closing costs that you will be responsible for that are not controlled by escrow holders. If you are using the services of a title company, mortgage broker and/or securing a new loan with a lender, there will most certainly be fees charged by those respective parties. All of the closing costs will be reflected on the estimated closing statement prior to the closing of the transaction, and on the final closing statement once the escrow has closed.

### **14. Who pays for the escrow fee?**

In a real estate transaction, it is customary that the escrow fee be split between the buyer and seller, although, as noted above, the northern and southern regions of California have different customs. Ultimately, however, the buyer and seller may negotiate and agree to any arrangement. This agreement should be reflected in writing in the purchase contract. With a real property refinance, the borrower is usually responsible for the escrow fee.

In the event that the escrow officer has discounted, waived, or reduced the escrow fee of one party or principal due to the prospect of repeat business, this could be a violation of 17420 of the Escrow Law, as briefly discussed above, as well as a federal Real Estate Settlement Procedures Act ("RESPA") violation. However, the parties and principals to an escrow may freely negotiate escrow fees with escrow agents as long as

the selection of the escrow (or the fee structure) was not induced by the offer of a reduced or discounted escrow fee. If an escrow holder does depart from their normal fee schedule as a result of negotiation between the escrow holder and principal, as long as all parties to the escrow are aware of the fee being charged and said fees are clearly disclosed in the escrow instructions, there is no apparent violation of the law. For more information on this topic, you can take a look at DBO's website and/or review an excellent escrow bulletin issued by the DBO which discusses payment for escrow fees. The citation for the bulletin is:  
[http://www.dbo.ca.gov/Archives/Laws/Escrow/pdf/EscrowBulletin\\_0107.pdf](http://www.dbo.ca.gov/Archives/Laws/Escrow/pdf/EscrowBulletin_0107.pdf).

### **15. What are closing costs?**

Closing costs refer to and include a variety of costs incurred by either a buyer or seller in excess of the selling price of a property. They are largely determined by the terms and conditions of the contract, the type of transaction, and where the property is located. Having said that, there are certain fees and charges that are expected regardless of the above factors. For example, in a real estate transaction, it is customary that there would be fees in connection with obtaining a new loan, paying off an old loan, fees for escrow and title, recording documents, documentary transfer taxes, real estate commissions, prepaid property taxes, home warranties, and insurance premiums. If applicable, there may also be several recurring costs or fees, or prepaid items that are prorated through escrow. Again, all of these fees and charges will be reflected on the escrow's closing statement.<sup>4</sup>

### **16. What are proration?**

In a real estate transaction, there are usually expenses and payments that must be "prorated" (or properly distributed or divided proportionately) so that the parties are equitably responsible for amounts owed during their respective ownership of the property. For example, the seller is the beneficial owner of the property until the close of escrow, when ownership and possession is delivered to the buyer. Naturally, there are some items or expenses that have been prepaid by the seller. In order to equitably reconcile these prepaid items or recurring costs in connection with the property, the escrow holder may be instructed by the parties to prorate those expenses. Examples of these items/expenses include property taxes, rental income, security deposits, property insurance, interest, and homeowner association dues. The items are usually prorated using the date of the close of escrow and some other "paid to" date. For example, if a seller paid \$300 in homeowner association dues for the month of May and escrow were scheduled to close on May 15th, the escrow officer, if instructed, would likely prorate said dues from the close of escrow to June 1st. This proration would result in a credit

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<sup>4</sup> It should also be noted that whenever California real estate is sold or transferred, there are specific State and federal real estate tax withholding requirements that may apply pursuant to the California Revenue and Taxation Code and/or the Internal Revenue Code, respectively. For more information, you should visit [www.ftb.ca.gov](http://www.ftb.ca.gov) and [www.irs.gov](http://www.irs.gov).

(reimbursement) to the seller for the period of time he or she is no longer the owner of the property, and a debit to the buyer for the period of time that he or she has been the owner of the property and responsible for the dues. If you are a buyer or borrower and obtaining a loan, you will most likely pay a proration of mortgage interest in connection with, and as a requirement of, your new loan. If you have questions regarding the prorations of items on your estimated or final closing statement, your escrow officer will be able to help you.

### **17. What is a closing statement?**

A closing statement is an accounting or itemized list of all of the charges and credits in connection with your escrow account which is prepared by the escrow officer. In addition to closing costs, the closing statement will reflect the purchase price and financial terms, funds deposited, debits or credits, payments to third parties, and payoffs of existing loans and/or liens. The closing statement will indicate how much money you may need to bring into the escrow or how much money you are to receive at the close of escrow.

When buying or refinancing a residential property (1-4 dwelling units), the Department of Housing and Urban Development (“HUD”) requires both a Good Faith Estimate and a final HUD-1 statement of closing costs to be provided to the buyer/borrower at specific times in the transaction. These requirements are part of RESPA. Please take a look at [www.hud.gov](http://www.hud.gov) if you want more information.

### **18. In a typical real estate transaction, what are the buyer's and seller's responsibilities?**

Buyers and sellers have different responsibilities in an escrow transaction. For buyers, if the transaction is contingent upon a loan, they must arrange the loan directly with a lender of their choice or choose to work with a mortgage broker to arrange the necessary loan for them. A buyer or his or her real estate agent or broker must provide the escrow officer with the contact information of the mortgage broker and/or lender because part of the escrow officer's duties is to follow-up on the progress, approval, processing, and funding of the buyer's loan. Also, when a lender is involved, a buyer will have to obtain a new hazard insurance policy on the property that is acceptable to the lender. This information will also be requested by the escrow officer and the buyer will be expected to provide it to the escrow. Lastly, buyers are responsible for instructing the escrow officer about the way in which they will take title to the property. Title vesting options and decisions should be taken seriously, fully researched by the buyer, and a licensed attorney and/or tax professional should be consulted if questions arise.

Sellers must provide escrow officers with different types of information. If the property is mortgaged, the seller will have to provide the escrow officer with the name of their mortgage lender, loan number, and contact information. Additionally, sellers have to provide information related to their property taxes, homeowner's insurance, rental data

in the case of investment property, and homeowner association information in the event of a condominium. If title to the property is in trust, the seller may have to provide a copy of the trust and/or certificate of trust to both the escrow and title company.

The requirements placed and imposed on the parties to an escrow vary depending on the nature of the transaction and may change due to unexpected circumstances. In an effort to fully understand what will or may be expected of you, it is important to communicate with your escrow officer about these items in advance.

### **19. How should I take title to my property?**

As noted above, one of the decisions you will have to make when you are purchasing a property will be how you would like to hold title to the property. There are several different title vesting options (joint tenancy, community property, community property with right of survivorship) in California, and each one has different tax, legal, and/or estate consequences. It is wise not to rush through this part of the escrow paperwork. Rather, you should do your homework and consult a licensed attorney or tax professional if you have questions.

### **20. What documents need to be acknowledged in front of a notary?**

The answer is that a notary (which some may refer to as a notary public) must acknowledge any real estate or related document that will be recorded in the office of the County Recorder where the real estate transaction will occur. Notaries are individuals authorized by the State to certify documents and attest to the authenticity of signatures, among other things.

If you are a buyer obtaining financing on a real estate purchase or a borrower refinancing your property, there are several documents included in the loan packet, particularly the deed of trust, that require a notarial acknowledgment. Typically, the lender will send your loan documents to escrow, and the escrow officer will coordinate the signing of your loan documents with a notary.

If any party to an escrow is in a trust, or taking title in trust, a certification of trust -- which is a notarized document -- is often required by the title company.

If you are a seller, you will need to sign a grant deed and have it acknowledged by a notary. If any party is granting or conveying an interest or quitclaiming to another, he or she will need to have their signature notarized by a notary.

A California notary must be registered with the Secretary of State, and will be subject to several requirements before being commissioned to perform notarial duties. Please see the California Secretary of State's website, [www.sos.ca.gov](http://www.sos.ca.gov), for more information.

## **21. What if I have to remit (pay or add more) funds at closing?**

If you are required to deposit funds into escrow at the close of a transaction, you must keep in mind a few important things. First, you will need to provide "good" funds or certified funds to escrow in the form required by the escrow holder. The closing of an escrow can actually be delayed if funds are not deemed to be "good" funds. For example, if you deposit an out of state check or personal check, it could take several days for that check to clear. Most escrow companies will require either a cashier's check or wire transfer. Second, in order to close on time, these funds will be due in escrow by a certain time and date. The escrow holder's policy on closing funds is often found in the escrow instructions. However, it is always a good idea to be in communication with your escrow officer about the necessity of depositing funds into escrow at the closing. Be sure to confirm the escrow company's policy as well as make the necessary arrangement to guarantee that your funds will be delivered correctly and "cleared" on time.

It is important to know that escrow officers only authorize recording of the closing documents when all funds on deposit have been collected and cleared. The so-called "Good Funds Law" in California, found in Section 12413.1 of the California Insurance Code, requires that a controlled escrow company and a title company must have in possession sufficient good funds in order to close a real estate transaction.

## **22. What do the terms "funding" and "recording" mean?**

The term "funding" usually refers to when your lender actually "funds" (provides the money to finance) your loan. The funding of a loan will occur only after all of the lender's conditions have been satisfied and escrow has requested funding from your lender. The escrow officer will work with the lender, as well as the mortgage broker if there is one, to ensure that the loan funds in accordance with the lender instructions and the contractual timeline of the escrow. Please note that even when all of the lender's conditions and requirements have been satisfied, the escrow officer will not authorize funding until all of the required conditions of the escrow have been met.

The term "recording" signifies when the title company has released all of the documents which must be recorded to the County where the property is located and those documents have been recorded (usually by the office of the County Recorder). Unless there are unexpected problems or delays either in escrow or title or both, it is only after the escrow officer determines that all of the conditions of the escrow have been met that they in turn authorize title to record the documents. "Recording" is also sometimes used interchangeably with "closing." It is typical that when a loan funds, the recording will take place the following business day. However, there are Counties that perform same day recordings, where the recording takes place on the same day that the loan funds.

### **23. How long does an escrow take to complete?**

The length or term of an escrow is largely determined by the mutual agreement of the parties to the escrow. The number of days it will take to complete the escrow and/or the target closing date are indicated in the purchase contract and escrow instructions. Sometimes, the closing of an escrow can be delayed by the time it takes to approve and underwrite the loan if a lender is involved and new financing is being obtained by a buyer or borrower. Also, an escrow may not close on time as a result of unexpected circumstances, documents that have not been signed, or disputes between the parties.

### **24. What happens when escrow closes?**

When an escrow has “closed”, this means that all of the conditions of the escrow have been met, the loan has funded in the case of transactions involving new financing, documents have been recorded, and the property and funds have legally changed hands. At closing, your escrow officer will be responsible for several things. Specifically, the escrow officer will be preparing your final closing statement which is essentially an itemized accounting of the escrow which reflects all of the non-recurring and recurring closing costs, credits and debits, and prorations. The final closing statement will represent all of the financial terms of the transaction. If funds are due you at the close of escrow, the escrow officer will be responsible for disbursing those funds. The escrow officer will also be responsible for the disbursement of commissions to real estate brokers and mortgage brokers, as well as payments due to homeowner associations, termite companies, insurance companies, notaries, natural hazard disclosure companies, and other third party and service providers.

### **25. What happens when a transaction fails to close and the escrow cancels?**

Many escrow instructions provide for cancellation of escrow in the event of a default. Where a transaction fails to close, the parties will need to execute a cancellation agreement. If the parties are able to come to a mutual agreement to cancel, it is likely that the parties will execute a “cancellation of contract” completed by a real estate broker. Also, most escrow companies will prepare and require their own mutual cancellation instructions to be executed, and this is especially true in cases where the escrow holds funds on deposit. Before the escrow officer can release any funds, the parties must agree to the disposition of the funds in writing. This instruction will include the payment of any applicable fees or charges incurred by the escrow holder or other costs indicated in the escrow instructions. In some cases, the escrow officer may charge an escrow cancellation fee, if such a fee had been disclosed and agreed upon by all parties in the escrow instructions. If there is no agreement between the parties as to the disposition of funds on deposit, the escrow officer will not release any funds until an agreement is reached in writing.