What is Escrow?

An **escrow** is a crucial arrangement in which two parties appoint a third party to receive, hold, and disburse funds while executing mutually agreed-upon instructions. In the context of purchasing a home, you will encounter two distinct **escrows**. The first begins when your offer is accepted by the seller and concludes at the closing of the transaction. The second escrow starts at closing and lasts until you pay off your mortgage.

Facilitating Closing Through Escrow

The initial **escrow** focuses on the essential details needed to finalize your real estate transaction. Your escrow agent acts as a neutral third party, coordinating instructions from all participants—including you, the seller, lenders, Realtors, contractors, and insurance agents. This ensures that everyone is aligned and facilitates a smooth closing process.

The responsibilities of your escrow agent are significant. They are in charge of holding and distributing funds and documents, paying any liens and encumbrances, managing necessary accounting, and handling administrative tasks. If conflicting instructions arise, the agent will promptly alert all parties involved and postpone the closing until clarification is provided.

In states like Oregon and Washington, as well as most of the western U.S., title companies typically serve as escrow agents. Once you and the seller agree on the terms of the home purchase, the seller's real estate agent will open escrow with a title company. You will generally submit your earnest money check to the title company and sign all closing documents at their office. It is at this closing stage that your second **escrow** is established.

Property Tax and Insurance Escrow

Most mortgages include an escrow account for property taxes and homeowners insurance. If your loan features an **escrow account**, you'll pay one-twelfth of your annual taxes and insurance along with your monthly loan payment. Your lender will deposit these payments into the escrow account and will disburse funds to cover taxes and insurance when they are due.

To determine if you have an **escrow account**, you can review the deposits on page 2 of your HUD-1 settlement statement from closing, check your monthly loan statement, or simply contact your lender.

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Annual Escrow Review

Each year, usually in January, your loan servicer will conduct an analysis of your **escrow account**. You'll receive a statement detailing what you've contributed and what your lender has paid out throughout the year. At its lowest point—typically right after taxes are settled—your escrow balance should still cover one to two months' worth of taxes, acting as a cushion for any increases.

As is common, expect annual rises in taxes and insurance, which may lead to a shortage in your **escrow account**. You'll typically have two options to address this shortage:

1. Your lender may adjust your monthly payment to include an additional amount, allowing you to repay the shortage in installments.
2. You can pay the shortage in a lump sum.

Opting for the first option effectively allows you to benefit from an interest-free loan, as your loan servicer will cover your taxes and insurance in the interim. Just remember that your monthly payment will increase to account for the shortage, ensuring you save adequately for the following year.

If you choose to pay the shortage outright, your payment will still adjust but only to reflect the actual difference in taxes and insurance.

Important Note on Automatic Payments: If you've set up automatic payments through your loan servicer, your payment will change automatically. However, if you use your bank's bill payment service for automatic payments, monitor your annual **escrow account** statement closely and adjust your payments accordingly. Failure to do so could lead to late fees, damaged credit, and unnecessary stress.

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