

# Escrow Accounts

## Understanding the How and Why

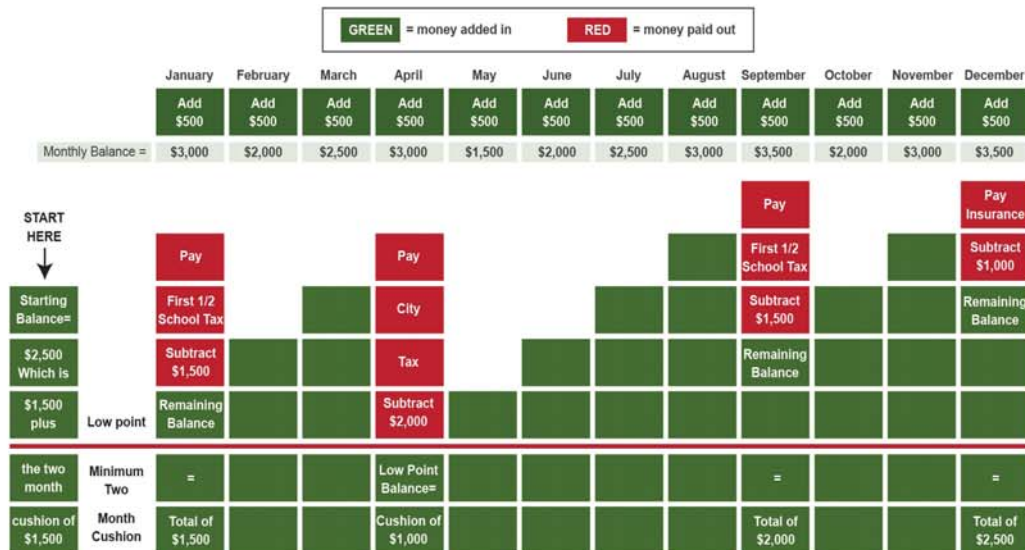


Many borrowers wonder why they must have an escrow account or why they must put what seems like extra money into it up front. This flyer should help to answer these questions.

Your account will start with a balance calculated to assure sufficient funds are available as each tax or insurance payment is made. This calculation is made by projecting the "low point" which will equal the minimum required reserve and also factors in the regular monthly installments you will make with each monthly loan payment.

In this illustration: School and City taxes total \$5000 per year and insurance = \$1000 per year for a total of \$6000. This is paid in equal monthly installments of \$500

Each installment (and block) in this example is \$500. Each month, you add a block/installment and the balance builds until an outgoing payment is made.



The minimum required balance - Will usually be equal to a two month cushion. This is to assure that there are sufficient funds in the account even if two payments were missed or if an outgoing bill is paid prior to your monthly installment being received. In this example, the cushion equals \$1000 (two regular monthly installments at \$500 each).

Why are escrow accounts usually required? - A "municipal" or "tax" lien can be the result of unpaid taxes. These can overrule an owner's or lender's interest in a property and means that the town can actually "take" your property and sell it at auction for back taxes owed. Insurance is equally important as few people could pay out of pocket to rebuild their home in the event of a disaster.

Having an escrow account makes the lender/servicer responsible for the timely payment of your taxes and insurance. In this case, even if you fell behind on your payments, the other obligations would still be kept up to date. As most loans are ultimately securitized in the Mortgage Backed Securities market, escrow accounts are perceived as adding enhanced safety and in turn, allow for more competitive interest rates. These accounts also mean that your housing payments will usually be consistent from month to month rather than having large lump sum payments due a few times per year. The money in this account always belongs to you and whatever balance remains at sale or refinance will be returned to you.

I hope this explanation and visual aid help, yet I'm always happy to review your personal situation whenever you have questions.



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