

What Do Americans Pay for Not Having a Public LIS?

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ABSTRACT

In most developed countries, including those of western Europe, land registers and cadastres are kept – often in computer form and easily accessible – by public administration bodies or courts. There are often very long and strong traditions of doing so. Efforts are continually made by governments to enhance these systems, through legislative changes, technical development or changes to organizational structures. Transparency, low transaction costs and efficient property markets are key objectives for this development. The development of these functions was also put high on the agenda as part of the recent dramatic political changes in eastern and central Europe. They were seen as very important steps in order to establish market oriented economies as well as strengthening democracy.

The situation in the United States is very different. The US has a unique position among the most developed countries, having no state or federal system for land registration in a title system or computerized deeds system. Instead the property market relies on title insurance companies to provide stability and order. Public initiatives seem to be restricted to information about federal land. A number of actors not seen in other parts of the world are involved in conveyance and mortgage transactions.

The paper presents an attempt to compare transactions concerning the refinancing of residential property in the United States with European jurisdictions. This is a transaction of the most common kind on both sides of the Atlantic, and therefore a good indicator of efficiency. This benchmarking illustrates the differences between having and not having a well-developed public land registration system for property owners, both in the way of cost and time, and the consequences of this.

The outcome shows that it takes considerable longer time to process such a transaction in the United States, and at a considerable higher cost than the most advanced European jurisdictions. European jurisdictions have distinct advantages over their American counterparts. Most important perhaps is the fact that American homeowners have to pay considerably higher fees for refinancing transactions. The difference in costs do not seem to correspond to any benefits in the form of lower interest rates when compared to rates for other kinds of loans available in the market. As things stand today, the American property market suffers from what can only be termed as extremely large transaction costs. Furthermore there are few moves to streamline and integrate processes in the whole chain of events in property transactions.

There are many reasons for this situation, but one obvious factor is the lack of easy access to reliable and up-to-date land information. Investments made in Europe, by national governments, in well-organized land registers, computerization and the provision of the relevant information to the market has increased transparency and resulted in much lower transaction costs compared to the United States.

This leads to the question whether public investments in the creation of a modern public land register in the United States would be profitable. In fact, the cost differences are so large that it can be argued that a total reform of the government's role in keeping and guaranteeing land records is justifiable from an economic point of view. The answer to this question must of course take into consideration the possibilities to recoup the money invested through fees from the use of the information.

In addition, European governments are taking active efforts to increase transparency and lower transaction costs. Work processes and systems within the public and private sectors interact more. This development might well lead to a growth in the cost differences.

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1. INTRODUCTION

Markets require information to function properly. The better informed the players in the market are, the better the market works, no matter the kind of goods that are traded in that particular market. Low transaction costs, reduced risks, easy access to the market and equality among the players are some of the characteristics we normally associate with well-functioning markets, and they all depend on access to information. The way information is created and structured varies between different kinds of markets – from looking and touching fruits and comparing prices in the local grocery market to reading annual reports and having subscriptions to different services for following what happens on the global stock markets. And like other markets, the players in the property market need information if they shall be able to do their business.

As part of the dramatic changes that have taken place in eastern and central Europe the development of property markets has been seen as very important in order to establish market oriented economies as well as strengthening democracy. By creating sound and safe conditions for homebuyers as well as for investors in real property, the possibilities for economic growth as well as better housing conditions improve. Information for and from the property market has been part of this development.

In most developed countries, land registers and cadastres are kept – often in computer form and easily accessible – by public administration bodies or courts. This has often been the case for hundreds of years. Access to up-to-date and reliable information on real property is of utmost importance for many different sectors of the property market, in the private as well as the public sector. Improvement of registration systems, be they deeds or title systems, and provision of information through direct access are steps currently being taken in many European jurisdictions in order to better meet the demands from the market. Efforts are continually made by governments to enhance these systems, through legislative changes, technical development or changes to organizational structures. Transparency, low transparency costs and efficient property markets are key objectives for this development. The same development is also taking place in other places around the world, with governments pushing hard for property information and matters to become part of e-government initiatives. This has resulted in new Internet services, the emergence of electronic conveyancing, etc.

So far, little in this way has been heard from the United States. The American property market has many unique features, e.g. the strong role played by title insurance companies. It is therefore of interest to look at and compare the most frequent property transactions in the American and European contexts. In the following, common, simple mortgage transactions for residential property in the US as well as European jurisdictions will be described, and the

differences highlighted. Finally an attempt will be made to compare the efficiency of the markets, and to see what these differences cost the customers.

2. THE AMERICAN TRANSACTION

2.1 Background

Looking at real property matters in the United States from a European perspective, one is struck by several things. Like other federal countries this is a state matter and not a federal responsibility, meaning that there are differences from state to state. There are similarities between the states, but there are also differences from state to state (DETR 1998).

The American property market to a large extent relies on title insurance companies (except in one or two of the states) to provide stability and order. It is not easy to get access to land information in the USA. A number of actors not seen in other places are therefore involved in conveyance and mortgage transactions.

This means that the United States has a unique position among the most developed countries, having no state or federal system for land registration in a computerized title or deeds system.

With some exceptions, deeds registration dominates in all the states. Courts are responsible for registering the deeds. Like in other parts of the world, professionals involved in property transactions, i.e. lenders, realtors (brokers/real estate agents), surveyors, local government, solicitors (attorneys), etc., are the main users of the information. It does however seem that the end users often enlist the services of title search companies or others to get the information required. They are not directly in touch with the keepers of the land registers. Furthermore, the title insurance companies are of course an important user group.

2.2 Getting the Loan

2.2.1 Contact with the Lender

The first step on the way to refinancing a home will, like in most other places, be to find the most suitable lender. There is an increasing amount of possibilities available on the Internet, but these often consist of comparisons of interest rates rather than actual loan offers. The customer will have to discuss and compare both interest rates and costs with the lending institutions.

There are possibilities, which are not very common in other jurisdictions, to make use of origination points and discount points. This means a choice between paying a transaction cost (beside other charges) as a certain number of points (1 "cost" point being 1 percent of the amount borrowed) or a higher interest rate over the life of the loan. One point paid (to cover some transaction costs) will reduce the interest rate of the mortgage from one-eighth to one-quarter percentage point (Fogarty 2001 (4)).

In most cases, as part of the negotiations with the lending institution, an appraisal of the property will be required. This will have to be done by a professional appraiser, who will make a physical visit to the property and compare the property with those that have been sold recently in the same area.

The lending institution will also look at the need for new title insurance, which depends on the length of time since insurance was last bought. In a case of refinancing, with no change of ownership, the cost of title insurance will most probably be discounted (Fogarty 2001 (3)).

In order to ensure that there are monies available for the payment of property taxes and hazard insurance premiums the lending institution will hold a certain balance in an escrow account. This is a normal procedure in the US, and used for most transactions. This means that the opening of such an account is only a cost when a person enters the circle of property owners the first time. For all subsequent transactions, it is more a question of substituting one escrow account with another. The escrow agent is a unique feature of the US (DETR 1998).

2.2.2 Registration

Registration, i.e. the entering of the existence of the mortgage contract into a register of deeds at the county court, is a relatively simple matter. In most cases this seems to be done by closing departments at the lending institution or a realtor.

Having deeds registration means that the contents of the register is not collected in the systematic way that characterizes title registration, and that there is no such thing as a government guaranteed land register. An interested party will have to make a thorough search the register and the deeds themselves in order to be able to establish the legal facts for a specific property. There are title search companies that specialize in this work.

Title insurance companies have gathered large amounts of information, which they use for their operations.

2.2.3 Time Needed

The time needed for a lending institution to process a loan application depends on many things. The rise in the number of refinancing applications during 2001, as a result of historically very low interest rates, has led to longer processing times. At the middle of last year it took 6 weeks from application to closing, which is twice the normal time in America (Fogarty 2001 (2)).

The time needed for registration of course varies between all jurisdictions and, considering the number of counties across the United States it can only be said this requires anything from a few days to a number of weeks.

2.2.4 Costs

The costs associated with the refinancing of a home depend on a number of circumstances, but the following list (Fogarty 2001 (3)) gives a good indication of the typical costs normally incurred with a refinanced mortgage of 200,000 USD and paying 2 points.

Points	4,000 USD
Processing fee	300 USD
Appraisal fee	300 USD
Credit report	16 USD
Flood certification fee	24 USD
Title insurance	906 USD
Settlement fee	450 USD
Document preparation	150 USD
Notary fee	50 USD
Tax stamps, recording fee	350 USD
Total	6,546 USD

2.3 Access to Information and Computerization

Credit reports can be had instantly, but there is a lack of direct access to land information in most American jurisdictions. The same applies when it comes to access to relevant appraisal information in the form of reliable sales data and property characteristics. Information is not easily accessible for those directly involved in a transaction, and this means that considerable efforts have to be made in retrieving the relevant information.

Computerization within the organizations involved is obviously not complete and the amount of paperwork seems extensive. On average 40 to 50 people in the lending institution touch a loan application as it is passed from the risk department to credit scoring and then on to title, etc. (Dugas 1999). More sophisticated technology now seems to have streamlined the application process and made it cheaper (Fogarty 2001 (1)), although there still seems to be a substantial number of departments and persons involved.

3. THE EUROPEAN TRANSACTION

3.1 Background

Europe consists of a large number of countries, and even more jurisdictions, and therefore there is of course no such thing as a European transaction. There are however a large number of similarities between the different systems of land registration and provision of land information throughout Europe. The reasons for this mainly have to do with historical developments and shared legal concepts between countries. So far, the European Union has not had any influence on legislation related to land and real property (this being outside the Rome treaty). But there are signs of an emerging interest in property information because of

needs from the environmental sector as well as part of the efforts to create a single, integrated financial market, including mortgages.

This means that we have to identify some typical features of the different European markets when trying to describe a European transaction. The European jurisdictions operate under two main registrations systems, deeds or title registration. A simple description would be that title registration is a typical North European feature, while deeds registration dominates the south, with the two “meeting” in the Netherlands (having a deeds system with some title features). This also means that the use of notaries (Public Notaries) are more common in the southern parts of Europe, while the prescribed use of different kinds of experts is more rare in the north. In a similar way, public access to information about real property and its ownership without any restrictions is more common the further north we look.

This means that the public sector has a strong if not dominating role when it comes to land registration in Europe. Land registration is the responsibility of local courts (e.g. in the Scandinavian countries), of separate registration organizations (e.g. in Great Britain) or of the cadastral organization (e.g. in the Netherlands). The registers are typically under a state guarantee; i.e. the government guarantees the contents of the register and will compensate whoever suffers economic losses because of errors in the register. The notaries and the Spanish “registradores” do however play very important roles where they do operate, but under strong government supervision. In other countries, with well-developed title systems, the main role of private sector is related to handling of land information. Private companies are used to provide the information to the end users, and to provide value-added services.

The largest groups of users of land register information throughout Europe are of course those involved in property transactions, i.e. financial institutions, notaries, solicitors, real estate agents (brokers) and insurance companies. To an increasing extent computerized land register systems and the IT systems of e.g. mortgage institutions interact, taking advantage of possibilities to make use of each others activities and information in order to increase efficiency and make cost reductions.

3.2 Getting the Loan

3.2.1 Contact with the Lender

In general, the process of getting an additional mortgage, or refinancing your home, starts by establishing contact with the lender. When deciding on which lending institution to do business with, the decisive factor for most property owners would be the interest rate offered. Even if the rates are advertised and published in the financial pages of most daily newspapers in Europe, it is advisable to talk to the various institutions in order to get the best possible rate. In most countries loans are offered with fixed rates (from one year up to 20 or 30 years) or with adjustable rates. In e.g. Sweden, the so-called experts recommend a combination of fixed and adjustable rates, with a certain preference among borrowers for adjustable rates during most of the last decade.

The discussions with the lender will ultimately lead to the signing of a mortgage contract. In countries like Finland, Norway and Sweden this is done without the assistance of outside experts (standard contracts being used), but in other places solicitors for both the bank and the lender may be involved.

Before the financial institution makes its final decision there might be need for an appraisal of the property. This is now often done without a physical inspection of the property, as banks and other mortgage institutions have direct access not only to the land register but also to valuation data and valuations systems.

Of course the borrower will also be subject to a closer look, the lending institution always making a credit check on the lender.

More and more possibilities to use the Internet have appeared with some lending institutions only operating through the Internet (e.g. www.europeloan.com).

3.2.2 Registration

When the lender and the borrower have agreed on the terms and conditions for the loan it is time to conclude the paperwork. First of all the mortgage contract is signed. The lending institution has checked the land register already when the negotiations started (and in some cases also temporarily prohibited the registration of other interests in the property through a search or an application for a pending registration). This makes it possible to have the loan paid out when the contract is signed. At the same time the application for registration of this interest in the land register (if needed – Sweden operates with a system of mortgage certificates which makes it possible for property owners to refinance without registering new mortgages) is signed by the borrower. It is then handed in to the registration office, often by the lending institution.

Registration then takes place, and the resulting certificates are sent to the lodger. He pays fees and stamp duty (tax) in advance or after registration.

3.2.3 Time Needed

The time required for this process of course differs between jurisdictions. The time needed for a mortgage institution to grant a new loan depends on a number of things, e.g. if the customer is known or not, the amount under discussion, the risks involved and the level of IT support for the business. But it is a general picture that the lending institutions, because of competition, are trying to cut down the time as much as possible.

In Sweden it is often possible to come to a closing two or three days after having first started the discussions with the lending institution. The mortgage offices located in city centers in some European countries also operate with similar time schedules.

3.2.4 Costs

Costs have to an increasing extent become a very important competitive tool for the financial institutions, and especially so among the specialized mortgage institutions (mortgage banks, building societies). As more and more tasks have been computerized, the possibilities to advertise about low fees (or no fees at all) have grown. In some cases it is a fact that it would cost more than the fee to charge the customer for that fee. This of course means that the costs that still are incurred as part of the transaction become part of the interest rate charged, but it is still a fact that costs have been reduced drastically over the last 15-20 years.

Using Sweden as an example of the costs that a property owner would have to pay for when refinancing his home, these add up to nothing if no new mortgage certificates are needed. If fees are charged, they are generally not negotiable. There is also no such thing as exchanging costs for points.

However, if additional mortgage certificates are required a registration fee of 375 SEK (the exchange rate is 1 USD to about 10.50 SEK per January 1, 2002) per mortgage certificate has to be paid. The reason for this can be that the property owner wants to make use of the increase in value since the property was last subject to refinancing, and increase the amount borrowed. A stamp duty of two percent of the mortgage sum is also charged upon registration. Using the example of a total refinancing package of 200,000 USD, it can be assumed that the need for additional mortgage certificates will not exceed 50,000 USD.

If an appraisal by means of a physical inspection has to be made the bank will charge for this. The cost for this is less than 2,000 SEK.

This means that the costs (using the example with a need for an additional mortgage certificate of 50,000 USD, but with no physical inspection of the property) can be summarized as follows:

Stamp duty and recording fees	1,035 USD
Total	1,035 USD

3.3 Access to Information and Computerization

The operations of the European lending institutions rely on direct access to information from various sources. Credit checks (often from bank owned operators) and access to land register information (directly or indirectly from national government agencies) as well as valuation information with recent sales and characteristics of properties sold can be made from all bank desks, and generally at low costs. The fact that most lending institutions operate on a national level means that costs for IT-solutions can be distributed among a very large number of transactions. Computerization has advanced more in some parts of Europe, especially in the Nordic countries that have a very high degree of PC's both in offices and homes. Nordea (a bank operating in the Nordic and Baltic countries) has largest number of log-ins for Internet

banks (76 million in 2001) with Bank of America coming in at number two with around half that figure (Edenhall 2002).

In addition, the work processes have been much more streamlined compared to the US. The operations of the largest mortgage lender in Sweden means that not more than 3 persons are involved in a normal refinancing transaction (less than a tenth of the American figure).

Jurisdictions that have had direct access to land information in operation for a long time (e.g. Austria, England and Wales, Finland, the Netherlands, Norway, Scotland, Sweden) have reached very considerable numbers of subscribers and transactions. The information services have developed in close contact with the main users, and the users have made good profits from the use of these direct access services. Additional development steps have been taken whereby computer systems within the public and private sectors interact more with each other. The objectives for such work is often to reduce duplication of efforts, reduce errors and increase efficiency on both sides.

4. THE MAIN DIFFERENCES

4.1 The Procedure

When looking at this very common kind of transaction, it is quite obvious that there are large differences in the way they are being processed. The American system undoubtedly is more complicated, involving more people and professions, and more time-consuming. It seems that American lending institutions operate in a more divided, if not hierarchical way, than their European counterparts. An application for a loan using real property as security is handled by a very large number of people within the American financial institution, while e.g. a British mortgage supplier with High Street offices operates with a much more streamlined procedure, involving fewer levels of authority and departments. A high degree of computerization and IT support enables the clerk behind the counter to decide, in most cases, on loan applications without too much waste of time.

4.2 Information about the Person

The lender's need for information required before coming to a decision in a refinancing situation concern two things: the person and the property.

Information about the person has to do with risk assessment – can this borrower be expected to fulfill his engagement? There seems to be no difference between American and European institutions when making this analysis, as the decisions are based on credit checks. The credit report is a well-trusted instrument for establishing a person's credit history and general financial situation, and commonly used in all kinds of business transactions. On both sides of the Atlantic access to credit reports is instantaneous, and the cost for reports is relatively small.

4.3 Information about the Property

On the other hand, there are huge differences when it comes to land information. Most European countries, including the transition countries of East and Central Europe, have or are developing efficient registration systems with easily accessible information about who owns what and any encumbrances affecting a particular property. Direct access to the information is being provided for professional users at a charge, and having direct access to this kind of information is taken for granted within large parts of the financial community in Europe. The American lending institutions have a more complicated process to go through to find the land information they need.

By having easy access to land information financial institutions have also been able to restructure their way of handling applications for home financing, and in some jurisdictions (e.g. Sweden) the way they handle the security during the life of the loan.

5. CONCLUSION

The United States has never attempted to develop a federal or state land registration system similar to those in operation in most parts of Europe, in Australia, Canada and in several countries in South-east Asia (and being developed in many emerging economies around the world). This means that it is in a unique position. In no other country at the same level of economic standing and development is there such a lack of public sector involvement in what is often regarded as a very basic feature of property markets. Instead there is a heavy reliance on the private sector in the form of title insurance companies to provide the stability in the market place otherwise provided by the state guaranteed registers. This ultimately must lead to the question of what alternative actually provides the best and most efficient solutions to the property market.

This is a question that can be studied and analyzed in many different ways. But by looking at comparable transactions concerning residential property, i.e. transactions of the most common kind involving the ordinary citizen, it should be possible to get a rough idea of the outcome. What are the average times for processing a transaction, what are the costs, and to what extent can the transactions be carried out without the involvement of different professionals?

The result of this simple study indicates that European jurisdictions have distinct advantages over their American counterparts. Most important perhaps is the fact that American homeowners have to pay considerably higher fees for refinancing transactions. The difference in costs do not seem to correspond to any benefits in the form of lower interest rates when compared to rates for other kinds of loans available in the market. So far, no other major benefits of the American system have been identified. In fact, the cost differences are so large that it can be argued that a total reform of the government's role in keeping and guaranteeing land records is justifiable from an economic point of view.

The reasons for this are many, but one obvious factor is the lack of easy access to reliable and up-to-date land information. Investments made in Europe, by national governments, in well-

organized land registers, computerization and the provision of the relevant information to the market has increased transparency and resulted in much lower transaction costs compared to the United States.

This leads to the question whether public investments in the creation of a modern public land register in the United States would be profitable. The answer to this question must of course take into consideration the possibilities to recoup the money invested through fees from the use of the information. As things stand today, the American property market suffers from what can only be termed as extremely large transaction costs.

The development in Europe might well lead to a growth in the cost differences. Initiatives in several jurisdictions to introduce electronic conveyancing (e.g. in both England and Wales and the Netherlands) will lead to increased efficiency and higher security. The project launched to establish a pan-European land information service (EULIS, co-financed by the European Union as part of its eContent program) should result in increased competition between lending institutions.

European governments are taking active efforts to increase transparency and lower transaction costs, but so far it is hard to identify the existence of similar initiatives in the US. There seem to be few moves to streamline and integrate processes in the whole chain of events in property transactions.

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BIOGRAPHICAL NOTES

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