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WHITE PAPER

What’s the Risk of Not Curating Property Ownership Records?

Quantifying Title Risk and the Industry’s Risk-Mitigating Role in Maintaining Reliable and Accurate Property Ownership Records.

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The economic importance of real estate cannot be overstated. Globally, real estate is the largest asset class at almost $380 trillion U.S. dollars in 2022, and residential real estate constitutes the majority of that value at $288 trillion. The U.S. residential real estate market is, according to one estimate, worth more than $50 trillion as of late 2023. This is not surprising given shelter is a universal basic need, and that homeownership is a central tenet of the "American Dream." Moreover, property ownership is the largest source of wealth for all but the highest income families in the U.S.

The economic activity associated with U.S. residential real estate – building shelter, remodeling, transferring ownership, and the estimated value of the shelter service that residential real estate provides – accounted for 16 percent of the gross domestic product in the second quarter of 2024. The economic success of the United States can partly be attributed to the establishment of well-defined property rights, which is crucial for fostering sustainable economic growth, democracy, and the prosperity of the capitalist system (Driscoll & Hoskins, 2003)[i]. The strong emphasis on property rights enables the real estate economy to function effectively and transparently, but it relies on a public good – the real property records. It is the title insurance industry's efforts to curate that public good and mitigate title risk exposure in those records that maintains the existence of reliable and accurate property ownership records. It is the title insurance industry's efforts to mitigate title risk exposure in those records that maintains the reliability and accuracy of the property ownership records underpinning the real estate economy.

> Today, the modern U.S. title insurance industry is the guardian of private property rights. A title company will review public records, identify potential errors in the public records and help resolve those errors, so the title that is traded in a real estate transaction is clear.

A Non-Excludable and Non-Rivalrous Public Good

The U.S. system of real property records serves as the primary source of information defining land parcels, their associated use rights, and ownership details. It originated from the tradition of recording land conveyance documents during the early colonial days. It is a public good rooted in two important concepts – real property records are non-excludable, meaning anyone can freely use them, and they are non-rivalrous, meaning use by one person does not reduce their availability to another person.

The public record is a key component of the U.S. economy for the clear identification of property rights, and necessary for the reliable, efficient and accurate transfer of property rights. However, the public record is not the authoritative source of those rights. Unlike many other countries (like the United Kingdom, Canada, and Australia) where ownership is reflected in a government-run land registry that is generally conclusive, in the U.S. the purpose and benefit of recording in the public records is to provide public notice and thereby cut off competing claims. In other words, our system of recording permits anyone to publicly assert an ownership interest in land (or other interest like a mortgage, easement, or lease) regardless of whether that claim is in fact valid. Ultimately, any dispute is adjudicated after the fact in the court system, not before the fact as a condition to recording. With our system of open public records and low barriers to accessing and adding to those records, the result is perhaps the most efficient real estate market, without government involvement, in the world (Szypszak 2019)[ii].

> It is the title insurance industry's efforts to curate that public good and mitigate title risk exposure in those records that maintains the existence of reliable and accurate property ownership records.

This unique property market structure has also resulted in a public record that is highly disaggregated, non-standard, and not inherently the authoritative source of property ownership. Under our system, local governments that record documents perform only ministerial functions and are not responsible for screening invalid claims or making authoritative determinations of real property title (e.g. ownership). The cost of maintaining the public good for society's benefit – accurate property ownership records with clear delineation of property rights – is borne by the private sector.

The title insurance industry was born in 1876 as the most efficient and protective private market solution for our system of property rights – notably superior to limited protections provided by attorney opinion letters. Today, the modern U.S. title insurance industry is the guardian of private property rights. The curative work completed by title insurance professionals, which includes aggregating and organizing disparate sources of data affecting real property, identifying and remediating risks, and helping resolve errors in the public record, is necessary to clearly and reliably convey property rights and ownership in a real estate transaction. Title insurers then insure ownership and encumbrance rights in the event the public record is not representative of the legal ownership rights.

The Risk of Free Riders

The non-excludable nature of public records means they are susceptible to the "free-rider" problem, a market failure that occurs when those who benefit from a public good do not pay for it, under pay, or do not contribute to maintaining the public good. For public land records, the free-rider risk is an individual or entity could use them without participating in the effort to maintain their accuracy, thereby benefiting from the corrected public records based on the curative efforts of some entities, without incurring the cost and without risk of being "excluded" from using the public records. As the number of free riders using the public good increases, the entities incurring the costs to produce the public good – the accurate public records necessary to clearly convey property rights – lose the incentive to voluntarily incur the increasing cost that others benefit from. Over time, accurate real property ownership represented by public land records becomes harder to discern and the public good deteriorates, ultimately to the point where the public good loses its value. This scenario is a classic economic tragedy of the commons, a situation where individual users exploit and deplete a shared resource, despite it being in everyone's interest to preserve it.

> Industry investment in the digitization of public records and automation of the "search" is one reason why the overall cost of title insurance is down approximately 5% in the past five years on a current dollar basis and 36% on a constant dollar basis.

Search, Examination and Curation

Assessing the public land records involved in a real estate transaction involves three steps – search, examination and curation. Public land records are filed across more than 3,500 counties and similar recording jurisdictions (using over 80 different software systems). While many jurisdictions have digitized some of their more recent records, they may not have digitized deep historical records that are often necessary for a title search and there are still local jurisdictions that have not yet digitized any of their public records. Therefore, there is a significant fixed initial cost required for the development of the systems for the collection, aggregation, and digitization of those records, as well as the ongoing costs of maintaining and updating the systems.

Whether digitized by the recording jurisdictions or through the efforts of the title insurance industry, access to a collection of public records associated with an individual or multiple properties, known as the “search” in title parlance, is fast, efficient, and relatively inexpensive, where digital records are available. In fact, industry investment in the digitization of public records and automation of the “search” is one reason why the overall cost of title insurance is down approximately 5% in the past five years on a current dollar basis and 36% on a constant dollar basis.[iii] Where digital records are not available, a human is required, at significantly higher expense, to collect and aggregate the public records.

Once the public records are acquired, an assessment or investigation of them – known as an examination – is required to understand which documents have been filed in the public record and which, if any, cloud the representation of clear ownership and need to be corrected.

The examination and curation are distinct and separate steps necessary for the maintenance of accurate public land records. Examination determines what risks to the clear delineation of ownership rights exist via a search of the public records. Only once the examination has determined the risks does the curative process begin, which makes sure any appropriate corrective actions are taken or missed documents are filed in the public record, involuntary liens are paid off, and ownership rights are correctly identified. The expertise to efficiently and accurately curate the history of the public record is a unique feature of the title insurance industry.

How Often Does History Need Curation?

Knowing that a public good is prone to the free-rider problem and requires curation to maintain its shared value to the economy is important, but so is understanding the scale of the effort required to maintain the functional value of the public good. Many people, if not most, are unaware of the effort needed to maintain accurate and clear property records. It's easy to assume the public record is already "clean." If there is little curation required, the public record will remain relatively "clean" and the risk of a tragedy of the commons is low – at least in the near-term. Alternatively, if the opposite is true, then degradation of the public good accelerates, the incentive to curate deteriorates for all entities rapidly, and the shared resource loses its functional value quickly.

Identifying the risks to ownership and curing many of them before a transaction closes is why homeowners so rarely are challenged on their ownership right after closing.

Based on an analysis of First American's public records database, it is possible to estimate the extent of recording activity to demonstrate how often public records are found that require curation. Tallying only the less common non-mortgage-related, publicly recorded liens and other documents (e.g. tax liens, court orders and judgements, HOA or PACE liens) in 2023, our analysis revealed millions of documents requiring examination and possible curation. More than 1.7 million court judgments or orders, 900,000 financing statements, 560,000 state and federal tax liens recorded for unpaid taxes, over 440,000 HOA liens and foreclosures, and 150,000 mechanics' liens were found in the search of the public records. All these liens and judgments require an examination to determine if they impede the efficient transfer of property ownership or encumbrance, and if any curation or correction is required in the public records.

Highlighting just a few types of liens and judgments discovered through the title insurance industry's examination of the public record, industry research shows that in 2022[iv] it collected $2.4 billion overdue federal income taxes, $600 million overdue local property taxes, and $55 million overdue child support payments to clear the associated liens as part of their curative effort. The title insurance industry's multi-billion-dollar collection of overdue taxes means government – at the taxpayer's expense – doesn't have to.

Estimating Title Risk Exposure in the Public Record

Curation reduces title risk exposure for home buyers, mortgage lenders and title insurers before the transfer of ownership or the encumbrance by a new loan. Therefore, it should be considered additive to the observed-claim risk that is the result of insurance policy claims after the transfer of ownership or loan encumbrance. In other words, the total title insurance risk exposure is the combination of pre-transaction public record curative risk mitigation **and** post-transaction observed claims. The latter is well reported in the industry, but what is the risk exposure that the pre-transaction curative process effectively mitigates?

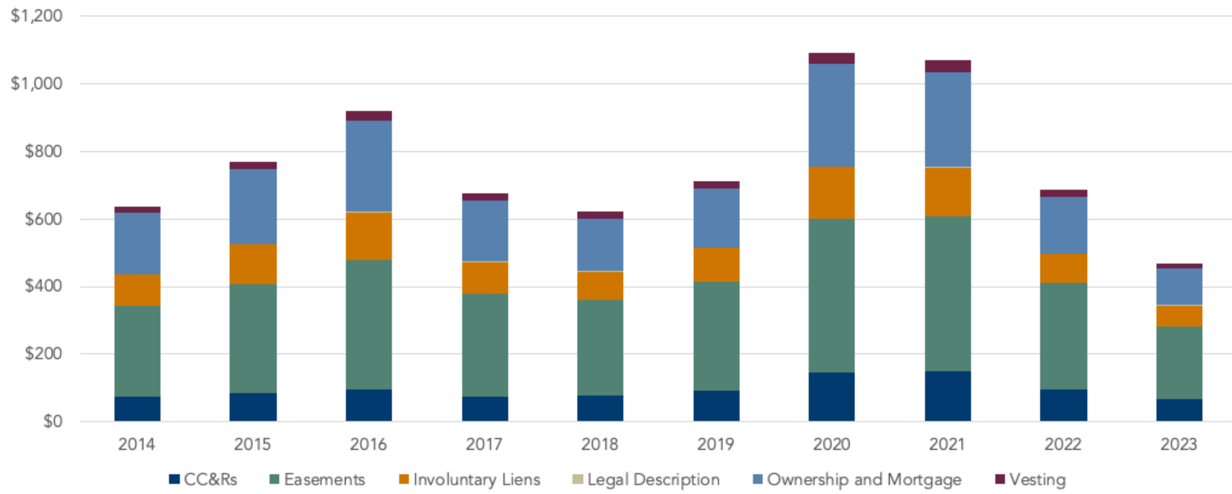
The title risk conditions identified during the examination process represent the potential pre-curative title risk exposure. Multiplying a pre-curative risk condition by an average estimated loss converts the risk condition into a dollar estimate of the pre-curative risk exposure. This estimated risk exposure can be borne by the home buyer or lender directly (self-insuring) or a third party through a risk transfer contract (title insurance) or mitigated by curation[1].

Total estimated industry risk exposure fluctuates over time with the volume of property sales and mortgage refinances, yet remains substantial regardless of market conditions. Annually, prior to the pandemic, the title industry's estimated risk exposure ranged from $600 to $900 billion a year. During the boom in sales and mortgage refinancing in the pandemic total estimated industry risk exposure surpassed $1 trillion a year. In 2023, the most recent year of available ALTA industry data, total estimated industry risk exposure is estimated to have been almost $500 billion. Estimated risk exposure levels in 2022 and 2023 declined in large part due to the significant reduction in the number of sale transactions and mortgage refinances as mortgage rates increased from pandemic-era lows.

[1] See the Methodology for details on the data and estimation of the industry level title risk exposure.

Total Annual Risk Exposure – Sale and Refinance Transactions

What would happen if the title industry didn't do any curative work? Total estimated industry exposure in $Bn



Source: ALTA, First American, Sale and Refinance Transactions By Risk Type and Year (January 2014 - December 2023)

Figure 1 - Total Industry Risk Exposure

Risk Exposure Reduction for Pennies on the Dollar

The premium collected on a transaction by a title insurer is compensation for the pre-transaction search, examination, and risk-mitigating curative work conducted by the industry. The premium also compensates the title insurer for the post-transaction insurance of any off-record risk not found in the search and examination process, fraud and forgery, closing protection and the defense of any covered claims against the insured over the life of the loan or ownership tenure. According to a [recent industry survey](#) [v], title professionals spent 3 hours for an average transaction and as much as 15 hours on a "difficult" transaction clearing curative items.

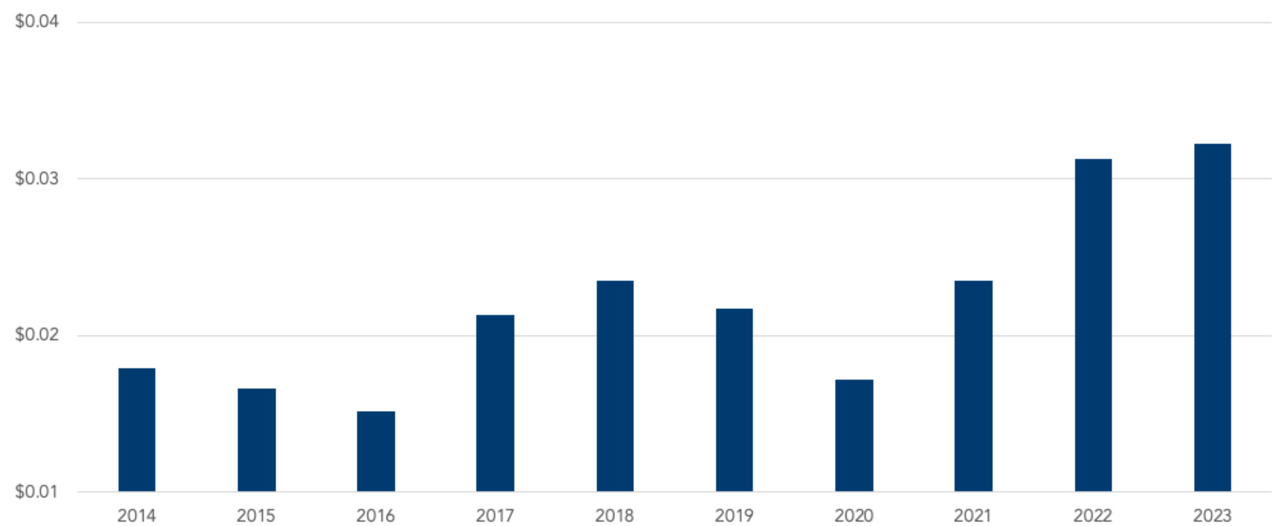
Identifying the risks to ownership and curing many of them before a transaction closes is why homeowners so rarely are challenged on their ownership right after closing.

The coverage provided by title insurance is broader than the protection from title risk exposure calculated above, so collected premiums are not allocated solely to the curative work necessary to eliminate those risks. However, an upper bound of the premium charged per estimated dollar of title risk exposure can be calculated by dividing the annual industry premium by the annual total estimated industry risk exposure. It is apparent, as with total estimated industry risk exposure, that the premium per dollar of risk exposure varies from year to year with changes in the housing market.

Even on the rare occasions when issues arise, the duty of the insurer to defend the insured and indemnify against loss effectively provides continued protection of their interests.

Additionally, the premium per dollar of estimated risk exposure can vary by the mixture of transaction types. When the mortgage market is heavily oriented toward refinance transactions rather than sales with mortgages, the average risk cost decreases because refinance transactions typically involve less title risk exposure compared to purchase (sales with mortgage) transactions (see figures 3 and 4 in the appendix). The mortgage market was refinance dominated for most of the last decade until the Federal Reserve started raising rates in early 2022. Nonetheless, over the last 10 years the premium per dollar of risk exposure has typically been between two and four cents.

Pennies on the Dollar for Risk Exposure Reduction
Premium connected per total estimated industry exposure $



Source: ALTA, First American, Premium Per Risk Exposure $, Sale and Refinance Transactions By Year (2014 - 2023)

Figure 2 - Cost Relative to Risk Exposure

A Potential Tragedy of the Commons

The benefits that the production of public goods provide are often accrued broadly across society (e.g., clean air and water), but rarely "priced" and valued easily. This analysis attempts to estimate that value and shows that there is significant risk exposure to the clear and undisputed ownership of property that costs relatively little to curate pre-transaction. Identifying the risks to ownership and curing many of them before a transaction closes is why homeowners so rarely are challenged on their ownership right after closing. Even on the rare occasions when issues arise, the duty of the insurer to defend the insured and indemnify against loss effectively provides continued protection of their interests.

While it would not happen overnight, if "free riding" on the public record as a reliable source of property rights degrades the quality of the public record over time with ever-decreasing curative effort, the marketability of title will become less clear. At the same time, the cost burden of defending property rights in court will increase (a cost that many families will not be able to afford), and the trust imbued by clear property rights that is central to the success of our economy will erode.

For a one-time fee at closing that over the life of the typical mortgage, approximately seven years, is roughly the same as the cumulative monthly cost of an annual Amazon Prime membership[vi], the price for curating the public record and insuring ownership rights relative to the total estimated risk exposure is a small price to pay for maintaining the public record as a source of authoritative ownership and the continued existence of a reliable and efficient real estate market in the U.S. When the cost of maintaining a smooth-functioning real estate economy is just pennies on the risk-dollar, do we really want to jeopardize that and risk diminishing the economic benefits it provides?

Methodology

In this paper, to identify the complete set of pre-curative risks we have used First American's own direct residential title commitments for sale transactions with or without loans or mortgage refinances between January 2014 and December 2023 that resulted in a policy (lender, owner, or both) written where policy liability amounts were between $1,000 and $15,000,000. These title commitments are the result of the search and examination process and have identified all the risks needing curation or insurance.

For estimates of the losses, First American's closed covered-risk claims related to search and examination from January 2008 to December 2023 were used to estimate, for each title risk type, the outlier-trimmed average net severity (including settlement, claim expenses and recovery costs).

The title risk types are broadly defined as:

- Easements – Encumbrances identified associated with rights granted to non-owners related to access, use, mineral rights or other use-rights.
- CC&R's – Encumbrances identified associated with Covenants, Conditions, and Restrictions. CC&R's restrict the owner's use-rights through, for example, community covenants or local zoning violations.
- Involuntary Liens – Identified liens placed on the property against the will of the owner (e.g., local, state, and federal tax liens, court orders and judgments).
- Ownership and Mortgage – Identified mortgages, commercial loans backed by the property (Financing statements), contracts of sale, probate, trust agreements and other encumbrances that cloud the clarity of title.
- Vesting – Identified documents (or potentially missing documents) that cloud the identification of all owning parties, their ownership interests, and who can voluntarily encumber or transfer the ownership of the property.
- Legal Description – Identification of documents (or potentially missing documents) that cloud the legal definition of the property location and set of use rights associated with it.

Finally, ALTA industry market share and industry direct premium written summary data from 2014 to 2023 was used to identify First American's direct market share annually. These market shares were used to "gross up" industry estimates. Of course, this assumes that the risk propensity and loss experience of other title insurers is like that of First American. Understanding and analyzing differences between insurers could be an area of further research within the industry.

Based on these sources of data, title risk exposure on a title commitment is defined as the sum of the average net severities for all title risks identified. This is the pre-curative total possible risk exposure that can be either self-insured or curated pre-transaction to reduce insurance claim risk and insured (with a title insurance policy). Total estimated risk exposure is based on the historically observed First American propensity for the various title risks and average net claim severities aggregated with ALTA industry estimated market shares annually. The risk exposure mitigation cost is defined as the ALTA industry reported direct title premium written divided by the estimated industry total risk exposure each year.

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Samantha VanSchalkwyk and Kathryn Meehan contributed their talent and expertise in the data analysis for this paper.

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[iii] Based on ALTA analysis of National Association of Insurance Commissioners (NAIC) annual financial statements filed with state insurance commissioners. Available at https://www.alta.org/businessoperations/research-initiatives-and-resources/industry-financial-data/. See also, First American, The Value of Title Insurance page 8 (June 2024), https://apps.mba.org/pdf/Title%20Insurance%20Stats%20First%20American.pdf.

[iv] https://www.alta.org/file/2022-Economic-Contribution-Report

[v] Takeaways, K. (n.d.). More than pushing a button: Estimating the time and complexity of clearing title. Alta.org. Retrieved May 15, 2024, from https://www.alta.org/media/pdf/240506-ALTA-Curative-Study-Executive-Summary.pdf

[vi] Fleming, M. (n.d.). *Missing the Forest for the Fees - borrower life-of-Loan Costs*. First American. Retrieved April 16, 2024, from https://www.firstam.com/value-of-title/costs-and-fees-of-homeownership/.

Appendix

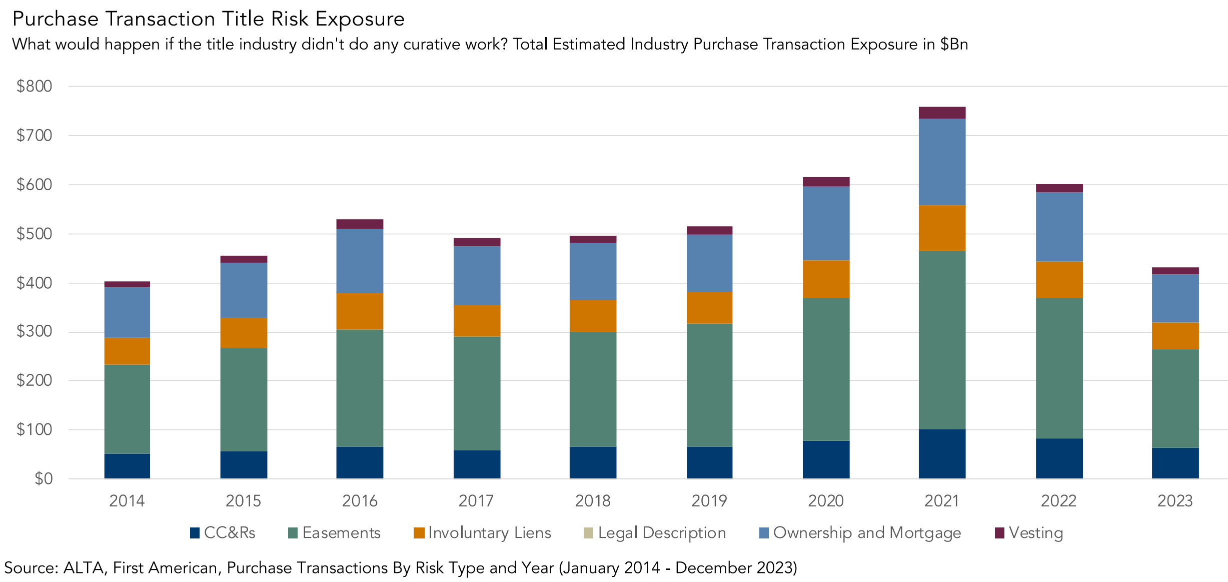

Figure 3 - Total Purchase Transaction Risk Exposure

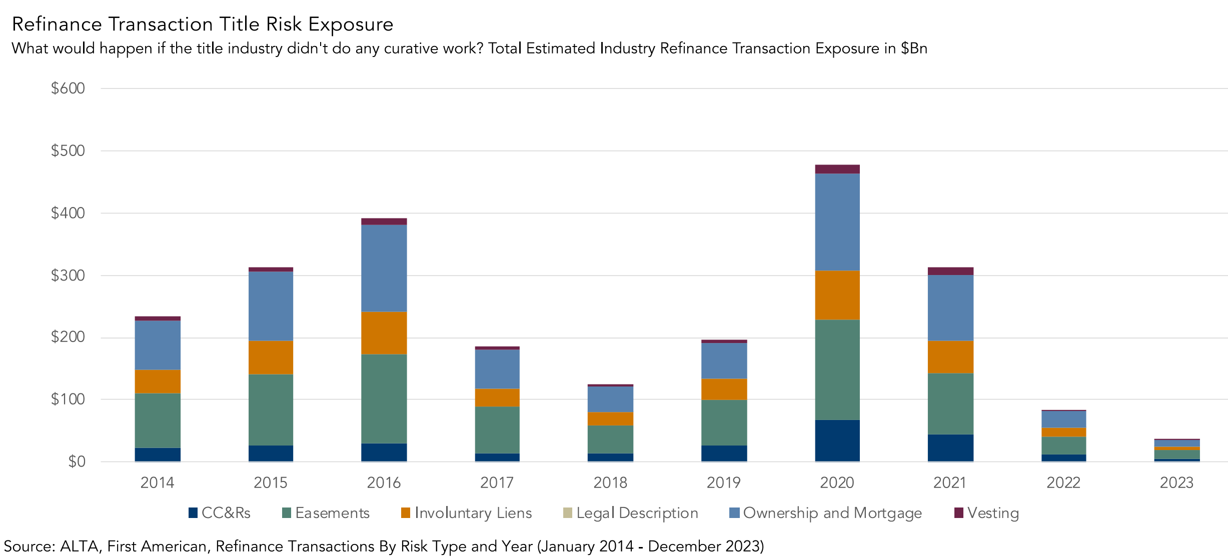

Figure 4 - Total Refinance Transaction Risk Exposure