



# What is Title Insurance?

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A home's title may be a lesser-known detail of the real estate transaction, but it can cause a home sale to fall apart. Ask any real estate agent whose client has tried to close on a home without a "free and clear" title—meaning the property doesn't have any liens or other ownership disputes. As the American Land Title Association points out, even President Abraham Lincoln's family lost two homes due to title issues.

It can happen to anyone.

Title insurance is like an extra safety net protecting homeowners from potential property issues that could arise over the course of ownership. This could include claim disputes or unpaid liens from previous owners, or even clerical errors in public property records.

Title companies estimate that 36% of real estate transactions involve complex title issues that need to be resolved prior to closing, according to NDP Analytics, an economics research firm.

Real estate professionals can play a critical role in educating their clients about what title insurance is and why it's essential to a smooth and secure transfer of a property.

## How Much Does Title Insurance Cost?

Lenders typically require a buyer to purchase title insurance during the mortgage process. Title insurance protects the lender's investment in case any issues arise that could affect their ability to collect on the loan later.

Title insurance is often an added cost when purchasing a home, and real estate professionals can help their clients plan ahead. Title insurance costs can vary, but the average is 0.42% of the property's purchase price, according to Fannie Mae. (To estimate costs, First American Title offers a title insurance calculator.) This one-time payment can typically be rolled into closing costs.

In some areas, it may be customary for home sellers to pay for title insurance on the buyer's behalf. Title insurance can be a point of negotiation in a real estate transaction.

Real estate professionals should be prepared to respond to buyers' questions and present title insurance as an important financial piece of a secure real estate transaction, which also includes managing escrow accounts, earnest money deposits and more.

#### How to Shop for Title Insurance:

- Gather quotes from multiple companies. There are several websites to begin a search for title insurance, including Closing.com, EasyTitleQuote.com and FreeTitleQuote.com. Also, buyers may ask their lender or real estate agent for recommendations.
- Ask about any extra fees as well as discounts that may be offered. Companies may offer discounts if the home has been resold within only a few years of the last purchase.
- Check that the title insurance company has a favorable Financial Stability Rating® with Demotech, Inc., the leading title insurance rating company.

## Understanding Title Insurance: What It Is and How It Works

Title insurance is a key component of a real estate transaction, and it's important to be aware of common terms.

#### Title Insurance Glossary

- **Abstract of Title:** This is a summary of the public records detailing the property's ownership history. It could include past owners, mortgages, liens and any legal issues attached to the property over the years.
- **Chain of Title:** This shows the sequence of ownership for the property, tracing the transfer of title from the original owner to the current owner.
- **Title defect:** Also called "cloud on title," this refers to any issue or problem uncovered in the property's ownership records that could potentially impact the buyer's right to purchase the home. Title defect issues could include unsettled claims from previous owners, forged signatures on documents, or unresolved liens and unpaid taxes.
- **Lien:** This refers to a claim or legal right that is brought against the property. It's often used to describe a collateral for a debt. A lien can delay a home sale if it isn't paid off to settle the previous debt prior to closing.
- **Title search:** This is the process of examining public records to verify the chain of title and identify any potential ownership issues, claims or disputes against the property. This will be conducted prior to a home sale.
- **Escrow account:** This is a neutral third-party account where funds—such as the buyer's earnest money deposit, closing costs or loan funds—are held during a real estate transaction. The escrow account helps ensure all the finances involved in the transaction are securely handled before the property's title is transferred to a new owner.

- **Indemnity:** This is a legal agreement that protects the title insurance policyholder from financial loss if title defects are found. Indemnity could be for the buyer or the lender, depending on the type of title insurance.
- **Survey:** This is a formal measurement of a property's boundaries. A survey of the property can uncover issues like encroachments on property lines or easements (rights others have to use part of the property). Boundary disputes can lead to title issues.

## Types of Title Insurance

There are two main types of title insurance: Owner's title insurance and lender's title insurance. They offer two distinct benefits that home buyers should carefully consider before purchasing.

### Lender's Title Insurance

Lender's title insurance protects the lender—the bank or financial institution that is funding the buyer's mortgage—in case any title disputes or defects are discovered after a transaction closes. It's a way for lenders to protect their investment. Lenders typically require buyers to purchase this type of title insurance when approving a mortgage.

Lender's title insurance only covers the lender's financial interest in the property (aka the loan balance); it does not cover the homeowner's full investment. Lender's title insurance gives the lender the ability to recover the balance of the loan or extra costs when resolving title disputes.

Benefits of lender's title insurance:

- Protects the lender's investment from any potential title disputes for the duration of the loan;
- Safeguards the lender's investment up to the loan amount;
- Allows the lender to proceed with foreclosure more easily if needed. If the borrower defaults on the loan, the lender may proceed without title issues getting in the way.

### Owner's Title Insurance

Owner's title insurance protects the buyer of the home from possible title issues or disputes that could arise after the home purchase. It protects the owner's financial investment for the entire length of ownership. Owner's title insurance, however, will not cover issues that buyers were aware of prior to the sale.

Owner's title insurance is optional in a real estate transaction. But buyers may opt to purchase it for greater protection from financial losses if title issues arise. Owner's title insurance also

provides coverage to the homeowner for as long as they own the home, unlike lender's title insurance—which will last only for the duration of the loan.

Benefits of owner's title insurance:

- Provides assurance that homeowners are protected from financial losses if title issues surface, including potential legal costs;
- Protect owners if issues arise from previous owners, such as unpaid liens or hidden ownership claims;
- Offers coverage from title issues for the duration of ownership.

## What Does Title Insurance Cover?

Title defects can surface years after completing a home purchase, and they tend to be complex and costly to resolve. A title search prior to closing doesn't always uncover every potential problem. Therefore, title insurance provides extra assurance that if any future claims arise, homeowners are still protected. It's also added protection for the lender's investment, particularly if the borrower has a large loan and high loan-to-value ratio that could expose them to added risk.

### Coverage Details

If a title defect or claim arises after the buyer purchases the property, title insurance typically will pay for any legal costs and financial losses that owners could face in resolving the issue and clearing the title.

Whether obtaining owner's title insurance or lender's title insurance, policies typically cover some of the following scenarios:

#### Unpaid liens or mortgages

- **Example:** A new owner learns that the previous owner failed to pay a contractor's lien for remodeling work that was completed on the home years ago. The contractor now approaches the new owner trying to collect on the debt.
- **What is typically covered:** Title insurance would cover the cost of resolving the lien as well as any legal actions needed to clear the title.

## Forged documents

- **Example:** A seller forges a signature on the deed of the home when selling it to a buyer. The fraud is discovered years later, and it is determined that the property has been sold illegally.
- **What is typically covered:** Title insurance would help resolve any claims if the deed, powers of attorney or other documents involved in the property's transfer are found to have been forged or altered. Forged documents could make the transfer of property invalid. Title insurance would cover the legal costs to resolve the dispute and correct or clear the title. In some cases, title insurance may even compensate the owner for financial losses from the dispute.

## Claims from missing or unknown heirs

- **Example:** A seller inherits a property from a relative, unaware of a distant uncle who also has been named the heir to the property. After the home is sold, the uncle claims ownership of the property.
- **What is typically covered:** Title insurance protects against claims by missing heirs or relatives who weren't previously uncovered during the title search. The title insurance policy will protect the new owner from legal and financial burdens in clearing the title.

## Clerical errors in public records

- **Example:** The wrong address, 5383 Main Street, is recorded instead of the correct address, 5388 Main Street. The inaccurate property description is included in the deed. The error is discovered after the sale is completed.
- **What is typically covered:** Mistakes and clerical errors in public records—such as misspelled names, incorrect property descriptions or deeds, and data entry errors—are covered in most title insurance policies. Title insurance will cover the owner's legal and financial costs to correct the error and defend the owner's title.

## Boundary disputes

- **Example:** A new homeowner builds a fence on what they believe is their property line, but a neighbor later says the fence is on their side of the yard.
- **What is typically covered:** Title insurance can cover legal and other financial costs in resolving boundary disputes. For example, many policies will cover any needed surveys to determine the property's boundaries as well as legal fees and the potential financial impact of relocating a fence if it's found to be encroaching on the neighbor's property.

## Benefits of Title Insurance

Title insurance is a one-time cost in a real estate transaction, but it provides coverage for as long as the buyer owns the property or the length of the lender's loan. Title insurance protects policyholders from problems that could surface years later on claims of ownership.

### For Buyers

Title insurance can offer extra assurance about a home buyer's ownership rights while helping to avoid costly legal battles if title disputes ever arise. Title insurance benefits buyers in the following ways:

- Protects them against title defects, like hidden liens or ownership disputes made by previous owners.
- Covers title issues later discovered, like fraud or errors in public records.
- Fulfills the mortgage lender's requirement. Most lenders require title insurance in approving a mortgage.
- Provides assurance that ownership rights are protected for the duration of ownership or the loan.

### For Sellers

Sellers may consider paying for title insurance for buyers in a real estate transaction, which helps lower costs for the buyer and makes the property more attractive.

Here are some potential benefits for sellers in paying for title insurance in a transaction:

- Provides assurance that the home has a clear title and all issues have been resolved before the home sale;
- Reduces legal risk by protecting the seller from potential future legal claims against the property after the sale;
- Helps expedite closing. Clearing the title may give lenders and buyers greater confidence to proceed with the sale;
- Increases the marketability of the home. Sellers can offer title insurance to make their listing more appealing and avoid closing delays from ownership disputes.

Title insurance is an important element in a transaction—but it's only one financial piece of a home purchase. Title insurance will not help with the immediate financial costs buyers may face when purchasing a home, like the down payment, closing costs or monthly mortgage payments. Loan and grant options for first-time buyers can help make homeownership more affordable.



## Common Myths About Title Insurance

Real estate professionals can be an important information source on title insurance for their clients, helping to clear up confusion or misperceptions.

**Myth: Title insurance is unnecessary because any issues will be discovered during a title search prior to a home sale.**

**Reality:** A thorough title search often is conducted prior to a home sale, but it doesn't always turn up every issue. Title searches are based on public records, which could be missing hidden liens or contain fraudulent information or unnoticed clerical errors. Title insurance can protect new owners from issues that could surface years following a home sale.

**Myth: Title insurance is too expensive.**

**Reality:** Title insurance is a one-time fee paid at closing, which can be negotiated with a seller or rolled into a buyer's mortgage with other closing costs. The cost typically ranges from 0.5% to 1% of the property's purchase price. That could amount to anywhere from \$2,000 to \$4,000 for title insurance on a \$400,000 home. While it is an added expense, home buyers may find that it's a small price to pay for the long-term protection from financial losses if title issues are ever found. Without title insurance, homeowners could be on the hook for paying tens of thousands of dollars to resolve title claims on their own.

**Myth: Title insurance only benefits the lender, not the owner.**

**Reality:** Lenders typically require buyers to purchase what's known as "lender's title insurance" to protect the loan amount the lender has invested in the home. But it also can provide some protection to the buyer if hidden liens from the previous owner or other ownership disputes arise. Buyers may wish to purchase "owner's title insurance" to protect their full investment for the entire length of ownership. Lender's title insurance coverage will last as long as the buyer has the loan.

**Myth: Title insurance is the same as homeowners insurance.**

**Reality:** These provide two different types of coverage and protection for homeowners. Homeowners insurance protects against risks to the home's physical structure, such as in the case of a fire or theft. Title insurance, on the other hand, protects against problems related to the home's ownership, such as undiscovered liens from previous owners.

**Myth: The seller is responsible for paying for title insurance.**

**Reality:** In some areas of the country, it may be customary for sellers to pay this cost for the buyer—but not always. Who pays for title insurance can be negotiated between the buyer and seller in the real estate transaction. In some cases, both parties may end up chipping in: The buyer may pay for owner's title insurance while the seller pays for lender's title insurance.

**Myth: Title insurance is not needed for newly built properties.**

**Reality:** Just because a home is newly built doesn't mean it's clear of all title issues. Problems can still surface, like if the land the house was built on has unpaid liens from contractors or subcontractors, encroachments on easements, or even fraud or forged documents.

**Myth: Title insurance policies are all the same.**

**Reality:** Not all title insurance policies are identical. Specific terms, coverage and exclusions can vary from company to company. Home buyers are urged to shop around to compare premium rates and policy terms, like exclusions, endorsements and coverage limits.

**Myth: Title insurance only protects you before the sale is finalized.**

**Reality:** Title insurance is a one-time fee but can provide coverage as long as the buyer owns the property or the length of their mortgage (depending on whether they have owner's or lender's title insurance). So, if an issue pops up years after closing—say, a long-lost heir suddenly makes a claim of ownership on the property—title insurance will still protect the owner.

## Ensuring Smooth Transactions With Title Insurance

Home buyers may be quick to dismiss the importance of title insurance in a real estate transaction and brush it off as an unnecessary extra cost. Here's how real estate agents can help educate them:

- Explain how title insurance is part of the real estate process and its purpose.
- Point clients to educational materials and resources to learn more about title insurance, such as consumer-oriented sites like [Homeclosing101.org](http://Homeclosing101.org), produced by the American Land Title Association.
- Make clients aware of the added expense of title insurance, along with other closing costs. This may be a point of potential negotiation between the buyer and seller in a transaction. (First American Title offers an online title insurance calculator to estimate costs.)
- Build relationships with local title companies that can respond to clients' questions.