Fannie Mae®

Barriers to Entry:

Closing Costs for First-Time and Low-Income Homebuyers

Nuno Mota and Mark Palim

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Findings*

Closing costs tend to be regressive. In a sample of approximately 1.1 million conventional home purchase loans acquired by Fannie Mae in 2020, median closing costs as a percent of home purchase price were 13% higher for low-income first-time homebuyers than for all homebuyers, and 19% higher than for non-low-income repeat homebuyers.

Reducing closing costs for low-income first-time homebuyers could boost post-purchase reserves, making homeownership more sustainable. For instance, in our sample, if low-income first-time homebuyers' median closing costs as a percent of purchase price had been equal to the median closing costs paid by all buyers, their costs would have been reduced by $616. Given that the median post-purchase reserves for low-income first-time homebuyers in the sample was $2,598, this savings would be meaningful. For low-income first-time homebuyers of color, who tend to have lower reserves, the benefit would be greater.

If Black and white Hispanic low-income first-time homebuyers' median closing costs as a percent of purchase price had been equal to those of their white non-Hispanic counterparts in our sample, their costs would have been reduced by $180 and $379, respectively.

Within the low-income first-time homebuyer population, 21% of Black homebuyers and 19% of white Hispanic homebuyers paid closing costs equal to or greater than their down payment, compared with 6% and 14% of Asian and white non-Hispanic homebuyers, respectively.

Lender and loan origination costs plus title and settlement costs represent up to 75% of all closing costs — with low-income first-time homebuyers paying the highest costs relative to the purchase price of the home.

Black and white Hispanic low-income first-time homebuyers on average paid higher closing costs relative to purchase price than their white non-Hispanic or Asian counterparts.

For some low-income first-time homebuyers, closing costs can be particularly onerous. For example, more than 14% of these homebuyers had closing costs equal to or exceeding their down payment. If this group of homebuyers had median closing costs as a percent of purchase price equal to the median for all buyers, their closing costs would have been reduced by $3,580.

Closing cost burdens are significantly higher in some states. Depending on the state in which the buyer is purchasing a home, average closing costs relative to purchase price can vary by almost 400%.

Consumer disclosure forms allow for inconsistent or opaque descriptions of closing costs. In a 10% random sample of purchase mortgages acquired by Fannie Mae in 2020, 32% of entries, representing 40% of the closing fee dollar amount, had a fee type of "other" and had a fee description that allowed for free-form text input.

* It is important to emphasize that some of the differences in costs across homebuyer groups are a function of borrower or loan attributes, which are not controlled for in this paper. In a related working paper, we will control for these attribute differences and assess their impact on the magnitudes of cost differences across groups.

Introduction

Homeownership has proven to be one of the most effective ways to improve the financial, social, and generational well-being of individuals, their families, and their communities, particularly for those without the means or savings to engage in other wealth-building activities, such as investing in stocks. However, for decades, low- and moderate-income families in the United States — a group overrepresented by minorities and people of color — have struggled to make gains in homeownership.

> Most notably, the difference in the homeownership rates between Black and white households is not only about the same as it was in 1968, when the Fair Housing Act was signed into law, but in 1900, too, when explicit segregation was legally protected.

To make the transition into homeownership, a prospective owner must have sufficient savings at the time of purchase for a down payment, closing costs, and so-called reserves (a level of savings often required by lenders that is net of the down payment and projected closing costs). Having sufficient reserves is considered prudent underwriting, ensuring the borrower has sufficient savings to cover home repairs, unexpected expenses, or loss of income that may occur during the first few years of ownership. Any homebuyer funds used for closing costs diminish the savings that a new homeowner will have when the transaction is complete. A lower level of savings post-transaction increases the chances that they will lose their home when adverse economic or other life events occur. Furthermore, higher closing costs diminish the pool of prospective renters who could transition into homeownership.

This paper focuses on transaction costs associated with obtaining a mortgage and purchasing a home. As the analysis below demonstrates, closing costs are especially high for first-time,[1] low-income,[2] and minority homebuyers relative to their home purchase price and savings committed to the transaction. We conclude with a discussion of ways closing costs can be reduced as part of broad national efforts to expand sustainable homeownership, particularly for low-income households.

1 Defined using Internal Revenue Service rules, a first-time homebuyer is an individual who is purchasing a property as their principal residence and had no ownership interest (sole or joint) in a residential property during the three-year period preceding the date of the purchase, the standard approach for mortgage market analysis.

2 Under the Federal Housing Finance Agency's Housing Goals, low-income homebuyers are those whose disclosed income on their mortgage application places them at, or below, 80% of the Area Median Income (AMI) for the location of the property.

Transaction costs associated with buying a home with a mortgage

While every transaction is unique, services paid for at closing would typically include lender fees, a pass-through of the cost of items required for the mortgage — such as an appraisal and lender title insurance — and various fees charged by the settlement agent or attorney conducting the closing. In addition to these fees, a buyer must pay taxes, fund escrow accounts for future taxes and insurance, and prepay various other charges.

Once the loan is closed, if the lender subsequently opts to sell the loan in the secondary mortgage market, the lender no longer retains the entire monthly interest payment from the borrower. Instead, the interest payment is used to pay the servicer for administrative activities (sending out statements, collecting monthly payments, and making disbursements); the investor who purchased a bond that contains the mortgage (the MBS investor who now assumes the interest rate risk previously held by the lender); and the entity that guarantees the timely payment of principal and interest on the mortgage to the MBS investor, thereby relieving the lender and the MBS investor of borrower credit risk. (In most cases, this entity is a GSE, such as Fannie Mae or Freddie Mac.) Any remaining part of the borrower's interest payment goes to the lender who sold the loan (either as an excess interest strip or as a gain on sale booked by the lender at the time the loan is sold).

If a fee is due at the time the loan is delivered to a GSE, such as a loan-level price adjustment (LLPA) charged by Fannie Mae for certain loans, the lender pays that fee; both the borrower's interest payment and the closing costs agreed to with the borrower remain unchanged, as those were set prior to closing the loan and well before sale to a GSE. That being said, the agreed-upon closing costs and interest rate will likely reflect any LLPA payments the lender expects to make. To encourage lenders to originate loans to lower-income and first-time homebuyers on products such as housing finance agency loans and HomeReady®, lenders are eligible for LLPA credits (i.e., negative LLPAs) from Fannie Mae at time of loan delivery. For instance, the published LLPA grid for Fannie Mae's HomeReady® loans shows these loans are subject to an LLPA cap, as well as a lender credit if the borrower completes a housing counseling course.

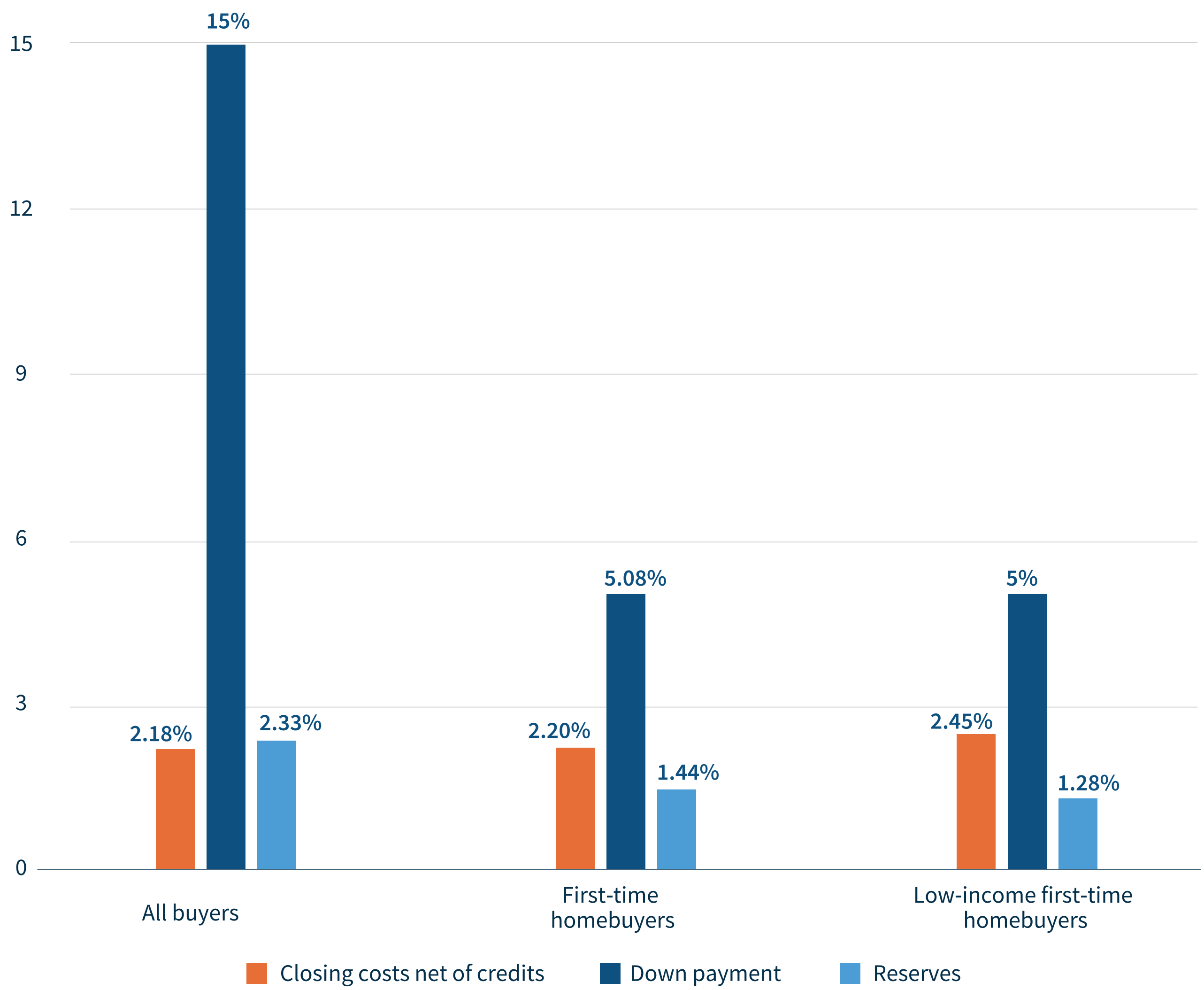
Services paid for at closing would typically include:

- Lender fees.
- A pass-through of the cost of items required for the mortgage — such as an appraisal and lender title insurance.
- Various fees charged by the settlement agent or attorney conducting the closing.

Unless otherwise noted, the analysis in this paper is based on a sample of approximately 1.1 million owner-occupied single-family conventional purchase mortgages acquired by Fannie Mae in 2020. Researchers relied upon the Uniform Closing Dataset (UCD) as well as borrower and property characteristics obtained by Fannie Mae in the ordinary course of business. UCD XML file data is provided by lenders based on information from final Closing Disclosure (CD) forms.

To begin, as shown in Figure 1, we examine how closing costs compared to down payments and reserves for different groups of buyers, specifically: all buyers; first-time homebuyers; and low-income first-time homebuyers.

Figure 1: Median closing costs, down payment, and reserves as a percent of sale price



As shown in Figure 1, median closing costs net of credits as a percent of sale price for home purchase mortgages ranged across the three groups from 2.18% for all buyers to 2.45% for low-income first-time homebuyers.[3]

> **So, we see that as a share of sale price, closing costs net of credits are more burdensome for first-time homebuyers and low-income first-time homebuyers, even though in dollar terms the median closing costs net of credits are lower for these two groups than for all buyers.**

This is a theme that we will see throughout our analysis; namely, that closing costs tend to be regressive in nature. Even though they mostly decrease with sale price, the rate at which they decrease is slower relative to that of loan amounts, hence they account for a larger share relative to sale price as we move down the sale-price range.

Note that we focus on closing costs net of credits, instead of gross closing costs. This is done so that we accurately capture the charges that buyers had to pay, not necessarily what was charged. Lenders and sellers can provide credits for individual charges or an overall credit at the end. Capturing these credits is important in accurately gauging how much money homebuyers need to "bring to the table" to complete the transaction. In a subsequent section of this paper, we will delve deeper into the various components of total closing costs, net of credits, and assess differences across buyer groups.

If median first-time homebuyer closing costs net of credits as a percent of sale price had been equal to those of all homebuyers, their closing costs would have been reduced by 0.28% of sale price, or $616. Considering that the median charge for an appraisal in our sample was $475, reducing or crediting this cost alone — if this savings was passed through to the borrower — could have a meaningful impact in terms of equalizing closing costs as a percent of sale price across homebuyer groups.[4]

3 The closing costs net of credits measure includes all charges paid by the homebuyer, thus excluding any charges paid by the lender, seller, or a third party. Furthermore, it accounts for any seller or lender credits in addition to individual charges paid for by these entities. As such, we control for any seller concessions that come in one of these forms. Concessions in any non-monetary form, such as fixing issues with the property or the conveyance of any assets, are not accounted for in our measure.

4 The statistic on median appraisal charge was obtained from a 10% random sample of the main analysis dataset.

Table 1: Comparison of closing costs, down payments, and reserves

	All buyers	First-time homebuyers	Low-income first-time homebuyers
Total closing costs net of credits			
Median ($)	$6,400	$5,939	$5,159
Mean ($)	$6,693	$6,228	$5,298
Coefficient of variation	0.59	0.63	0.63
5th / 95th percentiles ($)	$711 / $13,787	$488 / $13,323	$379 / $11,172
Median (% of price)	2.18%	2.20%	2.45%
Mean (% of price)	2.38%	2.38%	2.59%
Coefficient of variation	0.63	0.65	0.65
5th / 95th percentiles (% of price)	0.27% / 5.14%	0.19% / 5.18%	0.18% / 5.58%
Down payment			
Median ($)	$36,600	$18,750	$12,500
Mean ($)	$59,297	$37,697	$28,502
Median (% of price)	15%	5.08%	5%
Mean (% of price)	18.63%	12.95%	12.82%
Reserves			
Median ($)	$6,254	$3,545	$2,598
Mean ($)	$34,428	$18,004	$11,690
Median (% of price)	2.33%	1.44%	1.28%
Mean (% of price)	10.75%	5.96%	5.11%
Mean loan amount at origination ($)	$258,984	$253,442	$193,741
Mean sale price ($)	$318,281	$291,139	$222,243
Share of all sample loans	100%	45%	17%

> Within groups, we see there is greater variation in closing costs net of credits for first-time homebuyers and low-income first-time homebuyers.

This is evident in their larger coefficients of variation and ranges from the 5th to 95th percentile relative to all buyers, seen in Table 1.[5] The preceding statement is true both in dollar terms and as a percent of sale price.

5 Both the coefficient of variation (calculated as the standard deviation divided by the mean) and the 5th to 95th percentile range are distributional measures. The coefficient of variation is useful, since we can compare dispersion across different measures, which may have very different means.

Table 1 shows the variation across homebuyer groups and for homebuyers within a given group, yet meaningful variations also exist by the states and local jurisdictions in which the properties are located. These differences come about primarily due to differences in government taxes and property transfer fees, title insurance, settlement laws, and other local practices. In fact, state median total closing costs, net of credits, for all buyers ranged from $4,316 to $10,416 (1.17% to 4.06% as a percent of sale price). For first-time homebuyers, the range of medians across states was $3,472 to $10,359 (1.34% to 4.32% as a percent of sale price). For low-income first-time homebuyers, the range of medians across states was $2,993 to $9,860 (1.39% to 4.72% as a percent of sale price). So, depending on the state in which a homebuyer is purchasing a home, their closing costs relative to purchase price can vary almost four times.

Table 1 also allows us to compare the relative importance of closing costs net of credits, down payment amounts, and reserves. As we move from all buyers to first-time homebuyers and low-income first-time homebuyers, we see that down payments tend to be smaller (both in dollar terms and as a share of sale price). However, closing costs relative to price grow as we move left to right across the groups in Table 1, indicating that closing costs become an even more significant portion of the total amount of money needed to close the loan if you are a first-time homebuyer or a low-income first-time homebuyer.

Another data point further illustrates this dynamic. For all buyers, only 5.2% had closing costs greater than or equal to their down payment amount. The equivalent statistic for first-time homebuyers was 9.5% and for low-income first-time homebuyers was 14.5%. If low-income first-time homebuyers with closing costs greater than or equal to their down payment had median closing costs net of credits as a percent of purchase price equal to those of all buyers, their median costs would have been reduced by $3,580.[6]

Contrasting the median level of reserves for first-time homebuyers and low-income first-time homebuyers relative to all buyers also reveals that these groups tend to have lower levels of reserves post-closing. As such, a reduction in closing costs can have a more meaningful impact on these buyers' levels of reserves and, therefore, could place them in a better position to sustain homeownership in the face of future financial shocks. Unsurprisingly, our data shows that borrowers with higher reserves are less likely to default, all else equal.

5.2%
of all buyers
have closing costs that are greater than or equal to their down payment amount.

9.5%
of first-time homebuyers
have closing costs that are greater than or equal to their down payment amount.

14.5%
of low-income first-time homebuyers
have closing costs that are greater than or equal to their down payment amount.

6 Low-income first-time homebuyers with closing costs greater than their down payment had median closing costs net of credits as a percent of purchase price of 4.27%, which is 2.09 percentage points higher than for the all-buyers group displayed in Table 1.

Relative importance of different categories of closing costs

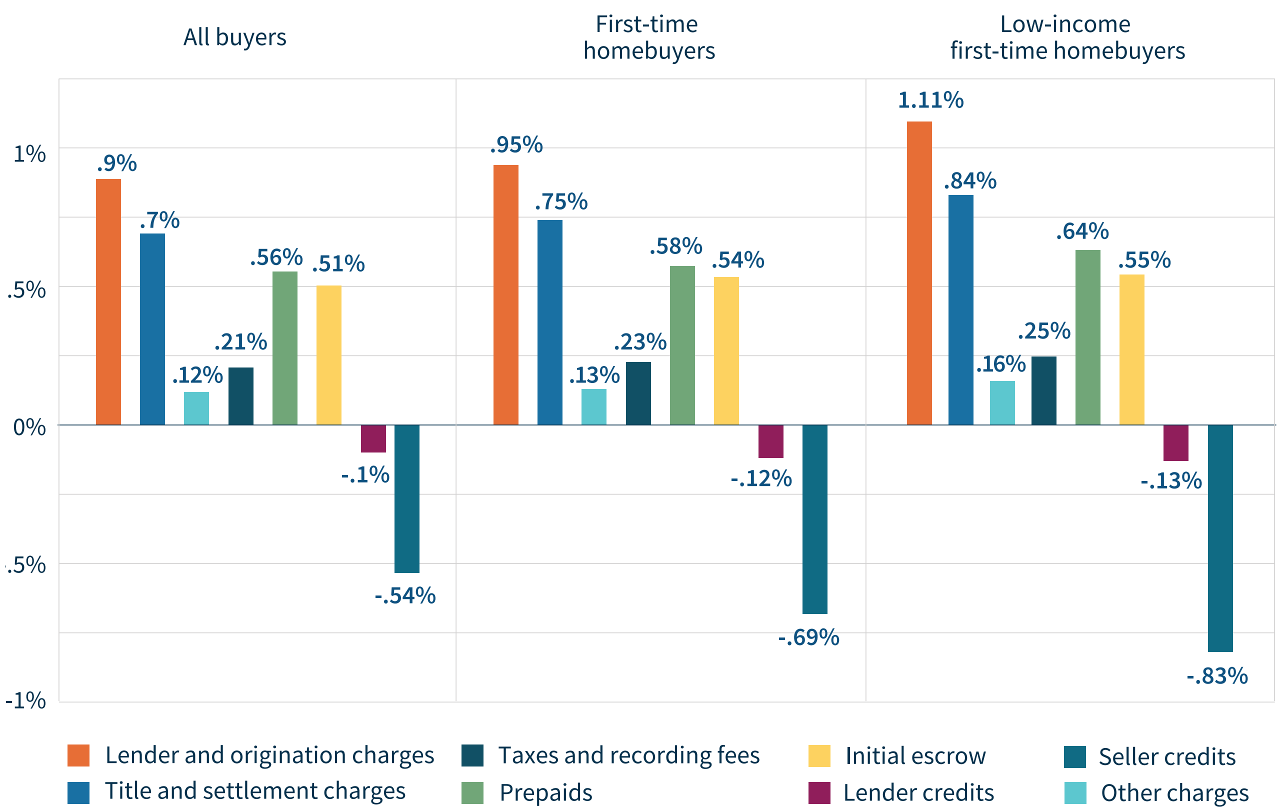
There are undoubtedly several ways one could measure the relative burden of distinct closing costs to homebuyers. For this part of our analysis, we re-categorized the fees into three distinct groups: lender and origination; title and settlement; and other charges. Examples of the types of charges in each category are shown in Table 2. Note that Table 2 displays the most common entries in the dataset by each category. These entries are unedited, hence multiple descriptions of similar charges being within the top 10, e.g., "HOA dues" and "homeowners association dues." This occurrence of multiple spellings for the same fee is a theme we will return to at a later point in the analysis, where we stress the large number of fees entered with a fee type of "other."

Table 2: Top 10 most common items in each category of closing costs

Lender and origination charges	Title and settlement charges	Other charges
Appraisal fee	Title lender coverage premium	Home warranty fee
Credit report fee	Title owner coverage premium	HOA transfer fee
Flood certification fee	Settlement fee	HOA dues
Processing fee	Title endorsement fee	Homeowners association dues
Automated underwriting fee	Title closing fee	Pest inspection fee
Loan origination fee	Courier fee	Homeowners dues
Property tax status research fee	Title examination fee	Home warranty
Document preparation fee	Title closing protection letter fee	HOA capital contribution
Application fee	Wire transfer fee	HOA special assessment
Tax-related service fee	Survey fee	Attorney fees

Having categorized the data into different groups based on who introduces the expense or who it benefits, next we look at how those charges affect different types of homebuyers. Table 3 presents a detailed breakdown of total charges for the three categories presented in Table 2. Note that the total closing costs net of credits measure presented in Figure 1 and Table 1 includes all charges in these three categories displayed in Table 2, in addition to items not in Table 2, namely: taxes and recording fees; prepaids (such as home insurance premiums); initial escrow amounts; lender credits; and seller credits.

Figure 2: Mean charges as a percent of sale price for different components of closing costs



> Figure 2 displays the mean values for all these components as a percent of sale price. It shows that lender and origination and title and settlement charges were the largest individual components of total closing costs, a point we will delve further into in analyzing the statistics displayed in Table 3 below.

Although prepaids and initial escrow amounts may not be considered a true cost of the purchase transaction, they are a component of the funds needed at closing, on average as a group representing more than 1% of sale price. Taxes and recording fees are a component we delve further into below. Last, seller credits and lender credits are also included when calculating total closing costs net of credits and displayed in Figure 1. Seller credits are a larger share of costs (in this case credits) for low-income first-time homebuyers.

Table 3: Comparison of components of closing costs

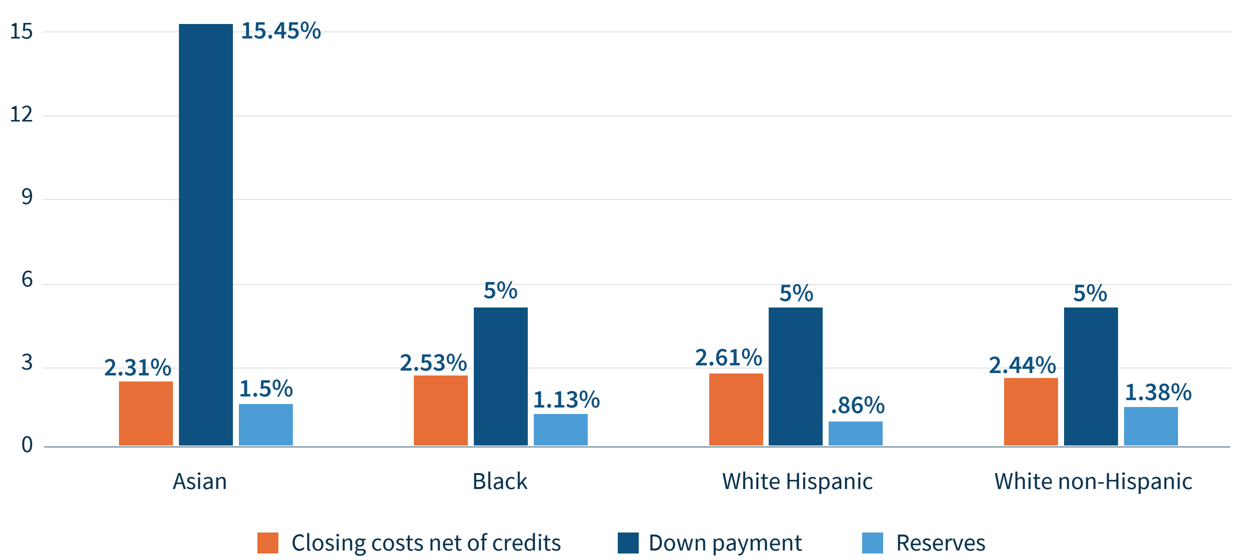
	All buyers	First-time homebuyers	Low-income first-time homebuyers
Lender and origination charges			
Median ($)	$1,964	$1,962	$1,914
Mean ($)	$2,406	$2,363	$2,207
Coefficient of variation	0.66	0.65	0.58
5th / 95th percentiles ($)	$536 / $5,695	$531 / $5,515	$562 / $4,727
Median (% of price)	0.73%	0.80%	0.98%
Mean (% of price)	0.90%	0.95%	1.11%
Coefficient of variation	0.73	0.68	0.60
5th / 95th percentiles (% of price)	0.16% / 2.22%	0.18% / 2.23%	0.26% / 2.41%
Title and settlement charges			
Median ($)	$1,901	$1,893	$1,681
Mean ($)	$1,961	$1,946	$1,723
Coefficient of variation	0.49	0.50	0.49
5th / 95th percentiles ($)	$475 / $3,631	$425 / $3,610	$445 / $3,174
Median (% of price)	0.67%	0.72%	0.82%
Mean (% of price)	0.70%	0.75%	0.84%
Coefficient of variation	0.53	0.52	0.51
5th / 95th percentiles (% of price)	0.15% / 1.33%	0.16% / 1.39%	0.21% / 1.56%
Other charges			
Median ($)	$65	$70	$50
Mean ($)	$342	$339	$324
Coefficient of variation	1.73	1.71	1.77
5th / 95th percentiles ($)	$0 / $1,500	$0 / $1,456	$0 / $1,385
Median (% of price)	0.02%	0.02%	0.02%
Mean (% of price)	0.12%	0.13%	0.16%
Coefficient of variation	1.91	1.87	1.85
5th / 95th percentiles (% of price)	0% / 0.54%	0% / 0.56%	0% / 0.68%

The statistics in Table 3 show that lender and origination charges and title and settlement charges together account for the bulk of closing costs, on average representing between 67% and 75% of total closing costs net of credits across homebuyer groups. For low-income first-time homebuyers these charges accounted for a larger share of total closing costs net of credits and were larger relative to sale price. This shows that these two components of closing costs are regressive in nature, as is the case for closing costs overall. Lender and origination charges tend to be the larger of these two components, with the median for low-income first-time homebuyers being 0.98% of sale price, whereas the median title and settlement charges for low-income first-time homebuyers were 0.82% of sale price. The variation in lender and origination charges within each homebuyer group also tended to be larger than title and settlement charges, with a coefficient of variation for low-income first-time homebuyers of 0.60 compared to 0.51 for title and settlement charges.

The third component of closing costs displayed in Table 3 are the other charges. Although these tended to account for a smaller share of total charges (median for low-income first-time homebuyers of 0.02% of sale price), there was significantly more variation in these charges. The coefficient of variation in these charges as a percent of sale price ranged from 1.85 to 1.91 across homebuyer groups. This is meaningfully larger than the variation in the other two components of closing costs displayed in Table 3 and reflects the fact that other charges can include a variety of charges with a wide range of charged dollar amounts.

Having shown the variation in total closing costs net of credits and the various cost components across buyer groups, we next focus specifically on low-income first-time homebuyers and assess differences in total costs net of credits by race and ethnicity, as shown in Figure 3.[7]

Figure 3: Median closing costs, down payments, and reserves as a percent of sale price for low-income first-time homebuyers by race and ethnicity



7 The borrower race and ethnicity categorization used in this paper is adapted from Fannie Mae's 2020 Annual Housing Activities Report and Annual Mortgage Report (see pp. 49 – 50). If a borrower or co-borrower identifies as Hispanic or Latino, they are classified as "white Hispanic." If the borrower or co-borrower both identify as "not Hispanic or Latino" or if ethnicity is missing for both, they are classified as "white non-Hispanic."

> Figure 3 shows that closing costs net of credits for Black and white Hispanic homebuyers represented a larger share of sale price than for Asian and white non-Hispanic homebuyers; the medians for Black and white Hispanic low-income first-time homebuyer were 2.53% and 2.61% of sale price, respectively.

If median Black and white Hispanic first-time homebuyer closing costs net of credits as a percent of sale price were equal to those of their white non-Hispanic counterparts, their closing costs would have been reduced by 0.09% and 0.17% of sale price, respectively. This equates to a $180 reduction in costs for Black homebuyers and $379 for white Hispanic homebuyers. If we again consider that the median charge for an appraisal in our data set of 2020 purchase mortgages was $475, we see that if an appraisal credit were passed on to a segment of buyers, this could potentially eliminate the disparities in closing costs as a percent of sale price across homebuyer groups. It is important to emphasize that some of the differences in costs across homebuyer groups are a function of borrower or loan attributes, which are not controlled for in the summary statistics presented in this paper. In a related working paper, we will control for differences in observable borrower or loan attributes and assess their impact on the cost differences discussed in this paper. We note that this pending analysis suggests the magnitude of the differences presented above does change, but the differences in homebuyer cost remain significant.

Black and white Hispanic low-income first-time homebuyers tend to have smaller down payment amounts than their white non-Hispanic counterparts (see difference in mean down payments in Table 4), and so the share of homebuyers for whom closing costs were greater than or equal to their down payment amount was also larger for these two groups. Specifically, among low-income first-time homebuyers in our sample, 21% of Black and 19% of white Hispanic homebuyers had closing costs greater than or equal to their down payment. The equivalent statistics for Asian and white non-Hispanic homebuyers was 6% and 14%, respectively. As shown in Table 4, Black and Hispanic homebuyers also tend to have smaller levels of reserves post-loan closing. Hence, changes that lead to lower closing costs for these groups could have a significant impact on their ability to sustain homeownership.

In addition to showing that costs tend to be larger as a share of sale price for Black and white Hispanic homebuyers, Table 4 also shows that the variation in total costs net of credits is larger for these two groups of homebuyers than for their Asian and white non-Hispanic counterparts. This indicates that there is a greater share of homebuyers in these groups for whom costs can be significantly larger.

Table 4: Comparison of closing costs, down payments, and reserves for low-income first-time homebuyers by race and ethnicity

		Low-income first-time homebuyers by race and ethnicity			
	Low-income first-time homebuyers	**Asian**	**Black**	**White Hispanic**	**White non-Hispanic**
Closing costs net of credits					
Median ($)	$5,159	$6,199	$4,938	$5,432	$4,985
Mean ($)	$5,298	$6,340	$5,262	$5,588	$5,087
Coefficient of variation	0.63	0.57	0.66	0.64	0.63
5th / 95th percentiles ($)	$379 / $11,172	$606 / $12,591	$416 / $11,457	$419 / $11,709	$359 / $10,667
Median (% of price)	2.45%	2.31%	2.53%	2.61%	2.44%
Mean (% of price)	2.59%	2.46%	2.70%	2.74%	2.57%
Coefficient of variation	0.65	0.62	0.66	0.64	0.64
5th / 95th percentiles (% price)	0.18% / 5.58%	0.24% / 5.15%	0.2% / 5.87%	0.19% / 5.82%	0.18% / 5.5%
Down payment					
Median ($)	$12,500	$35,100	$8,550	$10,000	$12,800
Mean ($)	$28,502	$54,798	$17,381	$22,250	$28,037
Median (% of price)	5%	15.45%	5%	5%	5%
Mean (% of price)	12.82%	19.11%	8.35%	10.11%	13.04%
Reserves					
Median ($)	$2,598	$3,781	$2,063	$1,755	$2,717
Mean ($)	$11,690	$13,923	$8,445	$8,537	$12,344
Median (% of price)	1.28%	1.50%	1.13%	0.86%	1.38%
Mean (% of price)	5.11%	4.70%	4.08%	3.84%	5.54%
Mean origination UPB ($)	$193,741	$232,499	$190,685	$197,926	$187,156
Mean sale price ($)	$222,243	$286,747	$208,158	$220,017	$214,962
Share of LI FTHB sample loans	100%	6.4%	5.8%	12.6%	62.6%

We considered the possibility that differences in points paid (the one-time fees paid to a lender in exchange for a lower interest rate) across homebuyers may be leading to some of the differences in total closing costs net of credits. Specifically, the concern would be that some homebuyers may have higher closing costs net of credits, but that those are offset by lower interest rates on the loan (because they paid for points). To check for this possibility, we incorporate the dollar cost of a loan's interest rate relative to the market par interest rate into the total closing costs. In that manner, we have a full view of the cost of the loan incorporating both dollar costs and the interest rate paid. Those results are being incorporated in a related working paper. However, at this point, that analysis indicates that while controlling for points and fees partially offsets the difference in closing costs for Black and white Hispanic homebuyers, closing costs as percentage of prices remain statistically significantly higher for Black and white Hispanic homebuyers in that analysis.

Closing costs: Consumers pay, but who benefits?

The CD form gives lenders and settlement companies significant latitude in how to categorize fees, leading to a large variability in fee coding. The range of possible fees is well-illustrated by the fact that the data standard governed by the Mortgage Industry Standards Maintenance Organization for the CD form includes 220 different types of fees, of which 71 are lender fees and 35 are title fees.[8]

Even with this large number of fee types, in practice there is an extensive use of the catch-all type "other." In a 10% random sample of the main analysis dataset, 32% of entries, representing 40% of closing fee dollar amount, had a fee type of "other" and had a fee description that allowed for free-form text input. Note that this means the fee itself was labeled as "other," not that our categorization of the fee placed it in the "other charges" category. Based on the free-form text description, we were able to identify them as lender and origination charges or title and settlement charges, while those not identifiable into these two groups entered the "other charges" category in our analysis (Table 5).

Table 5: Top 10 most common "other" items by category of closing costs

Lender and origination charges	Title and settlement charges	Other charges
Credit monitoring fee	Recording service fee	HOA working capital
Lender fees	E-recording fee	Condo questionnaire
Verification fee	Technology platform service fee	Compliance or admin fee
Undisclosed debt report	Chain of title	Builder fee
Verification services	Guaranty fee	Transaction coordinator fee
Borrower identity validation	Loan tie-in	Invoice
Flood life of loan coverage	Estoppel fee	HOA proration of dues
Natural hazard disclosure	Municipal lien search	Property disclosure report fee
MERS fee	Overnight mail	Miscellaneous
VOE fee	Messenger/carrier fee	Move-in fee

An outside observer might question if this framework creates too many potential entrance points to add costs based on a mortgage or real estate professional's assessment of what the buyer will tolerate — not what is necessary. Given how infrequently individuals purchase a

8 The remaining fee types are distributed as follows: commissions, 2; HOA, 9; inspections and utilities, 22; insurance, 14; offsets, 5; payoffs/liens, 17; recording and taxes, 28.

home, the complexity of the transaction and the financial interests of closing agents, loan officers, and others to maximize their revenues, the results above are disquieting.

Adding to this peculiarly consumer-unfriendly dynamic is a bigger question: How much should consumers pay for services they do not directly benefit from?

Services in the mortgage process such as lender title insurance, appraisals, and credit reports help lenders and investors measure, manage, and price the risks inherent in mortgage lending. This benefits mortgage investors, lenders, the GSEs, and other mortgage market participants directly, allowing for the sound and liquid operations of the mortgage market. But in the main, borrowers bear the cost of this benefit, and, as shown above, that cost is regressive: First-time and low-income homebuyers pay more on a relative basis than existing or higher-income homeowners.

Furthermore, some of these services may no longer be as necessary as we have come to believe. Technology-driven risk management and valuation techniques could even make many of them obsolete, or at least far less costly. The industry must confront the fact that some services associated with closing costs may not contribute meaningfully to either the quality of the mortgage or the likelihood a borrower will succeed at homeownership.

Finally, taxes and recording fees can be a significant part of closing costs in many jurisdictions. Table 6 displays the information on taxes and recording fees across the three homebuyer groups in our analysis.[9] One can observe that the coefficient of variation in these charges is significantly larger than for the lender and origination and title and settlement charges. In fact, it has a degree of variation similar to that of the “other” charges group, which, as we noted above, can include very disparate charges with large differences in dollar amounts. Furthermore, there is a large heterogeneity across states and jurisdictions, as made evident in Appendix Table 1, which contains information on average taxes and recording fees by state for first-time and low-income first-time homebuyers, as well as the distribution of such charges within each state.

These government taxes and recording fees in many jurisdictions are significant, and they are typically levied at the same rate regardless

9 Note that the $0 displayed as the 5th percentile of taxes and recording fees for all buyers and first-time homebuyers are not instances of no fees being charged. Instead, these are cases where all taxes and recording fees were paid by someone other than the buyer.

of income or homeownership transition status. Thus, they too represent a significant barrier to becoming a first-time homeowner. In 18 states, median taxes and recording fees are larger than either the national medians of lender and origination charges or title and settlement charges. Additionally, there is a large variation both within and across states in the levels of taxes and recording fees.

Table 6: Statistics for taxes and recording fees

	All buyers	First-time homebuyers	Low-income first-time homebuyers
Taxes and recording fees			
- Median ($)	$176	$181	$180
- Mean ($)	$604	$594	$538
- Coefficient of variation	1.49	1.48	1.45
- 5th / 95th percentiles ($)	$0 / $2,628	$0 / $2,575	$25 / $2,270
- Median (% of price)	0.07%	0.07%	0.09%
- Mean (% of price)	0.21%	0.23%	0.25%
- Coefficient of variation	1.44	1.42	1.38
- 5th / 95th percentiles (% of price)	0% / 0.89%	0% / 0.93%	0.01% / 1.04%

A homebuyer-centered approach to reducing closing costs

Homeownership, in addition to providing a roof over one's head, can be powerful tool for wealth creation and a safeguard against rent inflation, both for an individual as well as their families and subsequent generations. Reducing closing costs for first-time homebuyers could significantly increase the numbers of successful homeowners, potentially increasing both the likelihoods of transitioning into homeownership and the likelihood of sustaining that homeownership. This is especially true for low-income borrowers, because for many of these would-be homeowners, having enough money for a down payment, closing costs, and reserves remains among the chief barriers to homeownership.[10] With the wide availability of low- or no-down payment loan programs, the reduction or in some cases elimination of closing costs could expand opportunities for first-time homebuyers.

10 See, for example, the National Housing Survey Q4 2020 data, p. 46, showing that borrowers below the AMI are more likely to cite "affording the down payment or closing costs" as the chief barrier to homeownership than borrowers with incomes at or above the AMI.

Based on Fannie Mae's ongoing research into this topic, we believe there are several areas where policymakers, regulators, and the mortgage industry could work together to reasonably reduce origination costs for first-time homebuyers without adding undue credit risk.

1. **Cap closing costs for qualifying first-time and low-income homeowners on a dollar-cost basis.** This would allow first-time homeowners to know at the outset what their closing costs would be, to budget appropriately, and to enhance their ability to shop for the lowest-cost mortgage based on the mortgage terms.

2. **For mortgages to first-time and low-income homebuyers, require lenders, investors, insurers, the GSEs, and other mortgage-market participants — not borrowers — to pay for services needed to manage risk.** These could include credit reports, appraisals, and title insurance. For instance, in some of its low-income mortgage programs, Fannie Mae provides an appraisal credit to lenders. If these costs can be reduced or eliminated for consumers, it would be critical to ensure that other fees were not introduced to take their place.

3. **Local jurisdictions could explore ways to expand existing programs** that waive or reduce one-time taxes and government fees borne by first-time and low-income homebuyers.

4. **Federal, state, and local efforts to fund closing cost assistance programs,** particularly in jurisdictions with high relative closing costs, could be expanded to help first-time and low-income first-time homebuyers.

5. **Renew the effort to make the forms consumers receive, the Loan Estimate and Closing Disclosure, simpler and more transparent.** This could include efforts to create new tools and homebuyer education resources to help borrowers compare and shop for services based on price.

6. **Permit greater flexibility in how certain credit-risk management, title insurance, and settlement services are performed.** For instance, Fannie Mae has allowed for automated valuation models to be used in lieu of a formal appraisal for many of its refinance loans for low-income borrowers — an example of how technology and improved use of data can reduce or eliminate the need for a traditional appraisal. Alternative paths to achieving the proper levels of risk management should be explored, particularly those that reduce costs to consumers.

Many mortgage and housing market participants have a financial interest in the status quo. But this interest should be balanced against the real (if longer-term) benefits of expanding opportunities for people of color, low-income families, and others whose pathway to wealth creation through homeownership is difficult at best. Stable, affordable housing is linked to a whole range of positive life outcomes, yet barriers exist to achieving it. Closing costs should not be one of them.

A collaborative effort by all market participants should explore ways to reduce or eliminate closing costs and open the door to homeownership for more families by reducing the often-regressive financial burdens faced by first-time homebuyers. Fannie Mae believes that enabling and leading this multi-stakeholder effort would be consistent with its mission and its ongoing efforts to help people overcome barriers to homeownership.

Appendix Table 1: State variation in taxes and recording fees as a percent of sale price for low-income first-time homebuyers

State	Median	Mean	5th percentile	95th percentile	Coefficient of variation
Alaska	0.03%	0.03%	0.00%	0.06%	2.86
Alabama	0.19%	0.18%	0.00%	0.23%	0.32
Arkansas	0.23%	0.23%	0.19%	0.28%	0.24
Arizona	0.02%	0.02%	0.00%	0.04%	0.92
California	0.05%	0.09%	0.00%	0.28%	1.39
Colorado	0.05%	0.05%	0.01%	0.10%	1.09
Connecticut	0.14%	0.16%	0.06%	0.29%	0.83
District of Columbia	0.77%	0.68%	0.06%	1.16%	0.48
Delaware	0.92%	1.08%	0.20%	2.19%	0.48
Florida	0.59%	0.59%	0.09%	1.23%	0.43
Georgia	0.41%	0.36%	0.02%	0.44%	0.31
Hawaii	0.03%	0.04%	0.01%	0.14%	0.92
Iowa	0.05%	0.06%	0.03%	0.10%	0.54
Idaho	0.03%	0.03%	0.02%	0.05%	0.40
Illinois	0.09%	0.20%	0.04%	0.85%	1.32
Indiana	0.06%	0.06%	0.00%	0.10%	0.43
Kansas	0.16%	0.17%	0.03%	0.30%	0.45
Kentucky	0.10%	0.11%	0.05%	0.18%	0.39
Louisiana	0.18%	0.18%	0.00%	0.33%	0.49
Massachusetts	0.15%	0.17%	0.08%	0.33%	0.50

Maryland	0.90%	0.86%	0.07%	1.26%	0.37
Maine	0.27%	0.27%	0.24%	0.31%	0.16
Michigan	0.04%	0.08%	0.02%	0.10%	2.18
Minnesota	0.26%	0.26%	0.15%	0.33%	0.31
Missouri	0.06%	0.06%	0.03%	0.10%	0.38
Mississippi	0.04%	0.04%	0.00%	0.07%	0.59
Montana	0.06%	0.07%	0.03%	0.13%	0.46
North Carolina	0.05%	0.06%	0.02%	0.23%	0.91
North Dakota	0.04%	0.04%	0.00%	0.08%	0.46
Nebraska	0.06%	0.07%	0.03%	0.11%	0.54
New Hampshire	0.81%	0.81%	0.78%	0.88%	0.13
New Jersey	0.15%	0.19%	0.07%	0.64%	0.79
New Mexico	0.03%	0.03%	0.01%	0.06%	0.50
Nevada	0.06%	0.14%	0.02%	0.54%	1.14
New York	0.89%	0.77%	0.01%	1.21%	0.50
Ohio	0.12%	0.12%	0.05%	0.22%	0.56
Oklahoma	0.13%	0.13%	0.04%	0.17%	0.32
Oregon	0.11%	0.12%	0.06%	0.21%	0.42
Pennsylvania	1.14%	1.26%	0.24%	2.51%	0.42
Rhode Island	0.07%	0.08%	0.04%	0.12%	0.70
South Carolina	0.02%	0.08%	0.01%	0.39%	1.77
South Dakota	0.03%	0.04%	0.02%	0.08%	0.64
Tennessee	0.52%	0.50%	0.44%	0.56%	0.20
Texas	0.06%	0.06%	0.00%	0.11%	0.55
Utah	0.03%	0.03%	0.02%	0.05%	0.40
Virginia	0.69%	0.66%	0.37%	0.77%	0.23
Vermont	1.10%	1.03%	0.52%	1.25%	0.22
Washington	0.08%	0.10%	0.04%	0.16%	1.56
Wisconsin	0.04%	0.05%	0.02%	0.10%	1.13
West Virginia	0.04%	0.11%	0.00%	0.81%	1.98
Wyoming	0.03%	0.03%	0.01%	0.06%	0.51