One street's story

The residents of Aquila Lane could have saved thousands in closing fees by shopping around.

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Money

NEW YORK (MONEY Magazine) - Many problems with "sham" title insurance companies -- companies set up to hide illegal rebates to banks, builders and realtors in exchange for steering business their way -- might have been fixed by now, except for this: No one knows the scope of the fees that home buyers pay -- or who profits most from them.

A tiny agency called the Federal Housing Finance Board is the only entity that tracks closing costs. But it doesn't collect data to break down numbers between realtors, lenders and title companies.

And lenders aren't required to file HUD-1 forms at all -- not even with HUD itself. The only place HUD-1s get filed away, if at all, is in basements, attics and home offices across the country.

So that's where MONEY went -- specifically, to the basements, attics and home offices on a single street, Aquila Lane, in a popular suburb just west of Minneapolis called St. Louis Park.

Why there? Because residents of the entire Minneapolis/St. Paul region pay more when buying a house than residents of any other metro area in the country, a MONEY analysis of Federal Housing Finance Board data shows. Brokerage commissions there are as high as 7 percent, while typical pretax closing fees, at about 1.1 percent of loan amounts, are more than double the national average. And folks in St. Louis Park are hammered harder than those in just about any other zip code in the Twin Cities region.

As part of a four-month investigation, MONEY went door to door on Aquila Lane, asking people about their home-buying experiences. Forty-two houses there have changed hands since 2000; 20 of the new owners talked to MONEY, and of those, 12 shared their financial documents. Most residents never knew that their closing costs were exorbitant or negotiable or even avoidable.

Based on our reviews of their HUD-1s with industry experts, the 12 Aquila homeowners would have saved an average of 23 percent on their closing costs if they'd shopped around, which in many cases would have amounted to thousands of dollars.

What brokers don't do

Freight trains ran alongside Aquila lane, shuttling goods into downtown Minneapolis, until 1984, when the rail line was abandoned. Now bike paths wend where tracks once lay. The adjacent park boasts softball fields, tennis courts and a popular sledding hill. Even in this up-and-coming bedroom burb, Aquila Lane stands out as highly desirable.

So when a two bedroom house on the south end of the street went on sale for $165,000 in 2003, Nikole and Josh Didier stretched for it. On the advice of their real estate agent, Edina Realty's Chuck Skolnick, they sought a loan through Edina's affiliated mortgage brokerage.

"Chuck was phenomenal in working with us," says Nikole. "We used Edina for everything."

That proved to be expensive. The couple's pretax closing costs came to $4,565, including at least $2,125 in up-front fees that went directly to their mortgage broker. At 2.7 percent of the loan, that pretax total is nearly seven times the national average.

Worse, the Didiers ended up with a two-year ARM at a high 8 percent. The Didiers figured at the time that it was the best their broker could get them, given some credit problems they'd had.

Turns out they almost certainly could have done better. Mortgage brokers have no obligation to get their customers the best deal.

On the contrary, they have an incentive to push them toward a mortgage with an unnecessarily high rate. That's because the bank's payment to the mortgage broker, called a yield spread premium, compensates the broker for the spread between the lowest rate at which the lender will make the loan and the rate the borrower ends up with.

In other words, the higher the rate, the more money the broker makes.

Based on the large referral payment of $3,398 by lender First Franklin to the Didiers' mortgage broker with Edina, they probably signed up for an interest rate between one and two percentage points higher than the best rate the bank was offering at the time, calculates Wharton's Guttentag.

A shocked Josh Didier says today that he didn't even know the bank was rewarding his broker. "We thought we had paid our mortgage broker up front."

An Edina spokesman calls its payment from the lender on the Didier loan "customary compensation," adding, "We'd be losing money on this mortgage" without it. "This loan was compliant within our company guidelines on responsible lending. It was competitive in the marketplace."

Next: The bunk behind junk fees