STATEMENT OF
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2003 PRESIDENT
THE NATIONAL ASSOCIATION of REALTORS®
Before the
Committee on Small Business
U.S. House of Representatives
Hearing on HUD's RESPA Reform Proposal
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Introduction

Good afternoon Chairman Manzullo and members of the Committee. My Name is Cathy Whatley and I am the broker-owner of Buck & Buck Inc., a residential real estate brokerage firm in Jacksonville, Florida. I am also the 2003 President of THE NATIONAL ASSOCIATION of REALTORS®

On behalf of THE NATIONAL ASSOCIATION of REALTORS® (NAR), I appreciate the opportunity to appear before this committee to present our thoughts on HUD's proposed rule to reform the Real Estate Settlement Procedures Act (RESPA). NAR is America's largest trade association, representing more than 880,000 members involved in all aspects of the residential and commercial real estate industries. While our membership is large, the typical real estate brokerage is small, operating just a single office, serving a local market. Sixty-seven percent of residential brokerages have a sales force of five or fewer agents. REALTORS® work in every community across the country. When it comes to the home purchase transaction, we hold the position closest to the consumer. From the very early stages of the home search to closing day, the REALTOR® is involved and acts as an advisor in the process. It is because of this very important role that we feel we can offer valuable insight into how these proposed changes may impact the consumer as well as the small business community.

NAR has long supported efforts to improve RESPA and the home mortgage transaction experience for consumers. We admire Secretary Martinez's dedication to this initiative and we appreciate and agree with the stated goals of reform as set forth by the Department:

1. To simplify and improve the process of obtaining home mortgages, and
2. To reduce settlement costs for consumers.

However, we feel the proposal before us will not achieve those goals and has the potential to result in significant negative consequences.

As you know, the HUD proposal overhauls the current process for disclosing the costs necessary to obtain a mortgage. It replaces the current Good Faith Estimate (GFE) disclosure requirements with two new options:

1. An Enhanced Good Faith Estimate, and
2. The Guaranteed Mortgage Package (GMP).

The following is a summary of our overall reaction to the proposal:

- HUD proposes two new disclosure methods, the Guaranteed Mortgage Package (GMP) and the Enhanced Good Faith Estimate (GFE). We believe the goals of reform can be achieved by improving the current Good Faith Estimate (GFE). While the proposal before us has serious flaws, we support the concept and recommend that further analysis and development of this concept be conducted. It makes more sense to build on a model that we know rather than one that is untested relative to consumer and/or industry benefit.

- The Guaranteed Mortgage Package (GMP) represents a radical departure from today's rules. There is not enough evidence of consumer and industry benefit to move forward with this at this time. Additional data collection, research and analysis need to be conducted to provide evidence of significant benefits. There are risks inherent in this proposal and until more is known about the likely impacts, HUD should postpone advancing this kind of significant regulatory change.
- Congress should address many of the changes to RESPA in this proposal. To propose a repeal of Section 8 or to require providers to fix their fees requires oversight by the body that created RESPA.

HUD's Economic Analysis and the Regulatory Flexibility Act

In its economic analysis, HUD assumes that both the GFE and GMP proposal will yield substantial benefits to consumers. These benefits are largely due to cost transfers that HUD assumes will result from the new process. However, they come to these conclusions without the benefit of analyzing the underlying cost structure of the industry or the profit margins that exist today. For example, HUD forecasts a consumer savings in third party services of ten percent. We have to question these findings given the lack of national data on the distribution, the composition, and even the average level of closing costs. What we do know is that under the GMP method, third parties could be forced to offer deep discounts if they want to be included in lender packages. However, the Section 8 safe harbor removes the current requirements that these discounts be passed along to the consumer. The lender will now be free to charge the consumer whatever they want.

As you know, the Regulatory Flexibility Act requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Since HUD's GMP proposal provides lenders with the very strong incentive of a Section 8 safe harbor for the packaging of settlement services, it is likely the market will move in this direction. This proposal thus poses a serious threat to the settlement service industries that may already be offering a form of bundling or one stop shopping to their customers. These companies will not be able to compete with the large lenders who will now be offered a huge incentive to package.

HUD assumes a savings of $1.8 billion dollars in third party settlement costs. NAR believes HUD should conduct additional analysis to more fully quantify and qualify this benefit relative to the loss in the marketplace of third party settlement providers. An abundance of providers creates a healthy and competitive market where the consumer has choices and can base their choices on both price and quality. To create incentives that merely encourage consolidation without regard for the quality of services being provided by the small businesses in today's competitive environment should be reviewed more closely.

Industry and Consumer Reaction

It became increasingly clear at a recent congressional hearing on this issue, that both industry and consumer groups are splintered on the proposal. It appears HUD is facing a new challenge, to accommodate all of the conflicting recommendations without introducing an entirely new set of issues or unintended consequences. This underscores our belief that this proposal is so broad and complex that it deserves additional analysis to truly assess the benefits and/or negative consequences.

As you know, the Small Business Administration (SBA) Office of Advocacy submitted comments to HUD. They encouraged HUD to issue a revised initial regulatory flexibility analysis (IFRA) that takes into consideration the comments of affected small entities and develops regulatory alternatives to achieve HUD's objectives while minimizing the impact on small business. They are of the opinion that further economic analysis prepared by HUD, in a revised IRFA, would improve the Final Rule. This is consistent with our belief that additional analysis is needed before moving forward with this proposal.

REALTOR® Impact: Real estate brokers cannot package under the GMP

While HUD maintains that anyone can package, the requirements of the packaging make it impossible for anyone other than a lender to package, i.e. the packager must also guarantee an interest rate. The only participants in the marketplace that can offer a guaranteed interest rate are lenders. Further, by granting a Section 8 safe harbor, lenders are placed in a preferred position to control the entire settlement service industry.

In addition to effectively prohibiting real estate brokers and others from participating in this new business, it will also disrupt the existing business models real estate brokerages have carefully developed through the years in full compliance with RESPA and other state and local laws. Many real estate brokerages have expanded their business beyond the basic home buying and selling transaction to providing other real estate related goods and services. By expanding their services they can establish and maintain a long-term relationship with their customers and build consumer loyalty. In an increasingly competitive marketplace, the value of retained customers is tremendous. Twenty seven percent of NAR member firms with 1-20 agents provide ancillary services, such as mortgage, title insurance, home warranties, etc.

These businesses are subject to current RESPA restrictions that prohibit compensated referral activity. Quality of service is what induces a consumer to use these services or an agent to refer their clients to them. These models will be at risk under the GMP approach where large lenders will have the benefit of a Section 8 safe harbor. These lenders will seek providers willing to discount their services enough to be included in a lender package. Quality providers such as those affiliated with real estate brokerages will simply not be able to remain in the business.

Other Settlement Providers at Risk

Industry groups representing mortgage brokers and title agents continue to raise concerns about the adverse affects of the proposal on their members, which are largely small businesses. To the extent this proposal removes these players from the industry, the real estate brokerage community suffers as well. The real estate transaction is dependent on a healthy competitive environment for settlement services. Today, a real estate agent has unlimited choices of service providers to recommend to clients whether it be a mortgage broker, a closing agent or a home inspector. These choices in the marketplace ensure a smooth transaction for the homebuyer, the goal of every REALTOR®. To enact rules that can result in the removal of these choices will directly impact the kind of service a real estate professional can provide to their clients. This in turn will impact the consumer who relies on the expert advice of their agent to guide them through this complex transaction. HUD's analysis suggests that if a significant portion of the settlement service industry goes away, it will result in benefits to the consumer in the form of lowers costs. We believe there is much more at stake here that HUD should consider before moving forward.

Impact on Consumers

While HUD projects cost savings of $10.3 billion under their GMP proposal, they either dismiss or ignore some of the risks that are inherent in the GMP proposal. In an economic analysis written by Ann Schnare, PhD., *The Downside Risks of HUD's Guaranteed Mortgage Package*, (copy attached and submitted for the record) some of the potential negative outcomes of granting a Section 8 exemption are identified. The paper challenges HUD's assumptions about the market reaction to the GMP and identifies the key uncertainties associated with it.

Consumer impact will be felt in many ways, a loss of transparency in the process, an increase in the cost of the transaction, and a loss of quality services. Borrowers will shop for a loan based on an interest rate and a "black box" of settlement costs, making it impossible to comparison shop. The safe harbor from Section 8 will permit a lender to mark up third party services and keep the entire markup as profit, rather than pass along any discount to the consumer. Also, as pressure mounts on settlement providers such as appraisers, title companies, pest inspectors to drastically cut their prices to ensure inclusion in a lender package, quality of service could deteriorate. These potential consequences of the GMP should be more carefully considered.

Other Alternatives Should be Considered by HUD

We strongly believe there are serious flaws in the GMP proposal and believe they should instead pursue changes to the GFE that will provide some certainty about costs and simplify the process. However, if HUD is committed to moving forward with a Guaranteed Packaging rule as outlined in their proposal, we recommend a restructuring of the GMP. If the intent is to promote competition among non-lender packagers, a mechanism must be designed that will truly allow anyone to package independent of the loan. If designed correctly, it may offer opportunities for non-lender packagers, such as real estate brokers, title companies and others to provide alternative choices for the consumer, which do not exist under this proposal.

To date it appears the only alternative that would meet this objective is to split HUD's GMP into two independent guaranteed packages:

1. Lender Service Package: This package would include the lender services and perhaps the appraisal and credit report (800 series services on the HUD-1), and
2. Closing package: This package would include all of the other services such as title, inspections, surveys, government fees, etc. (1100, 1200, 1300 series services on the HUD-1).

Under the two-package system, a lender could offer a lender package along with a guaranteed interest rate. Anyone, including non-lenders, such as real estate professionals could offer the closing package. The conditions for receiving the Section 8 safe harbor would have to be carefully defined. Some minimal requirements would include:

- A lender could not require a borrower who is obtaining the lender's loan and lender package to also purchase the lender-closing package. In other words, the lender cannot tie their loan to a particular closing package.
- The services within the packages, both the lender and closing cost packages, would be itemized. Upon request of the borrower, the service providers should also be disclosed.
- Lenders should provide copies of all reports to borrowers, i.e. credit report, appraisal, etc. Lenders should also disclose to borrowers the type of appraisal used by the lender, i.e. Automated Valuation Model (AVM), a drive-by, or a full appraisal.
- HUD should move toward adopting and requiring uniform service fee descriptions so borrowers can make apples to apples comparisons.

  Under this proposal, large lenders will still have a competitive advantage with the Section 8 exemption. However, it is anticipated the lender tying prohibition of the closing package will provide a non-lender some opportunity to compete in this market by offering these services directly to the consumer. The details of such a proposal requires further development and analysis to ensure it creates adequate opportunity for other market players to compete. Further, if HUD pursues this disclosure track, then it would be appropriate to delay implementation of the Enhanced Good Faith Estimate.

- **Conclusion**

This proposal is extremely complex and represents a radical change in the way a borrower will obtain a mortgage. If the GMP provision is enacted, it will dramatically alter the lending and settlement services industries. Additional analysis as directed by the SBA should be conducted before moving forward with this proposal to more fully ascertain the impact. A reform effort focused on incremental changes such as improving the GFE is a more attractive option for satisfying HUD's stated goals for reform. By simplifying the GFE and clarifying that volume discounts are not violations of RESPA, HUD has created the necessary environment for packaging to occur.

I thank you for this opportunity to present the views of the Association and will be happy to work with you and your staff to more fully develop some options to reform.

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RESPA Reform

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