PERSPECTIVES FOR THE NEW ADMINISTRATION

Helping Homebuyers and Housing

By John C. Weicher

Hudson Institute

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HUD has just completed a badly needed reform of the rules governing real estate settlements. The changes are consistent with President Obama's campaign pledge to mandate accurate loan disclosure. He can minimize the risk of a future subprime mortgage mess and stimulate the housing market by letting the new rules stand.

As he confronts the problems of the subprime mortgage market, there is one thing President Obama can do that will help homebuyers and homeowners, especially minority and lower-income buyers.

In mid-November, HUD issued new rules under the Real Estate Settlement Procedures Act (RESPA), so that homebuyers can better understand their mortgage: what it's going to cost at closing, what monthly payment will be, and how it can change over time. Those rules will help homebuyers and give some stimulus to the extremely depressed housing market, if President Obama and the new HUD leadership let them go fully into effect.

Under the new rules, homebuyers will have a clear explanation of the total cost they will pay at settlement; the various categories of closing costs are listed, and there are limits on how much most costs can change. The new rules will require lenders to provide a clear Good Faith Estimate (GFE) within three days after application (borrower provides all necessary information). The GFE shows clearly what the total costs will be and how much the homebuyer will have to pay at the settlement table. The homebuyer will know what he or she is paying, and can compare mortgages. There are limits on the extent to which closing costs can increase from this GFE; the homebuyer is not buying a pig in a poke.

These new rules have been badly needed. Consumers now don't know for sure until the actual settlement how much their loan will cost. Then they confront a bewildering array of charges for various services, often including "junk fees" for nothing in particular. They also often run up against last-minute surprises at the settlement table: if they refuse to pay an extra $500 or $1,000 for some not-very-clearly-specified service, they risk losing the loan and losing the house. At the root of these complaints is the fact that it is very difficult for homebuyers to shop for settlement services.

This is not the way RESPA was intended to work when Congress enacted it in 1974. Ironically, a statute intended to provide for more effective advance disclosure of settlement costs, and protect consumers from unnecessarily high costs, has instead made it harder for them to understand the settlement process and pushed up their costs.

The settlement process has become a standing joke. "Why do we need to reform RESPA?" a reporter for a major national newspaper once asked me; and then she immediately added, "besides the stories of everybody in our newsroom, of course."

This is one reason—not the only reason, but still an important reason—for today's mortgage mess: homebuyers are not able to look out for their own interests.

Indeed, those homebuyers who most need help are the most disadvantaged. A major study of closing costs by HUD last year found that African-American and Hispanic homebuyers pay about $400 more, on average, at the settlement table, than white borrowers obtaining similar loans.[1] Also, homebuyers who are less well educated pay more.

The study also showed the value of clarity. The simplest mortgage arrangement —rolling all the closing costs into the interest rate, as is commonly done now with home equity lines of credit—was the least expensive. Homebuyers with these "no-cost" loans pay about $1200 less than borrowers who pay cash at settlement, and minority borrowers with these loans pay no more than whites. The reason is clarity. When homebuyers only have to compare interest rates, they can easily choose the cheapest loan. When they have to choose between a loan with a high interest rate and low closing costs, and another loan with a low rate and high closing costs, it's much easier to make a mistake. When they really can't tell what they're paying because the forms are so confusing, mistakes are normal.

Reducing the complexity of settlement costs to a single number is very similar to a proposal advanced by President Obama during the campaign: mandating accurate loan disclosure by creating a simplified, standardized "borrower metric" that "will allow individuals to easily compare various mortgage products and understand the full cost of the loan." The President can take a significant step toward achieving that objective by simply letting HUD's new rules take effect.[2]

The new rules were issued on November 12, and generally go into effect on January 16. HUD's new, standard GFE will be required of all lenders on January 1, 2010, to allow time for changes to their computer software and other adjustments. When that happens, homebuyers will save about $700 in closing costs, on average —a welcome stimulus to homebuyers and the housing market.

Endnotes

1. Susan E. Woodward, *A Study of Closing Costs for FHA Mortgages,* U.S. Department of Housing and Urban Development, Office of Policy Development and Research, May 2008, available at http://www.huduser.org/Publications/pdf/FHA_closing_cost.pdf.

2. Mr. Obama's proposal is described at http://www.barackobama.com/issues/economy/index.php#home-ownership.

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