



AMERICAN
LAND TITLE
ASSOCIATION



TESTIMONY OF MIKE PRYOR
ON BEHALF OF
THE AMERICAN LAND TITLE ASSOCIATION

“The State of the Nation’s Housing Sector:
An Examination of the First Time Buyer’s Credit
and Future Policies to Sustain a Recovery.”

BEFORE THE
HOUSE SMALL BUSINESS COMMITTEE

WEDNESDAY OCTOBER 7, 2009

1:00 PM

Introduction

My name is Mike Pryor, and I am the President and Chief Executive Officer of Lenders Title Company, headquartered in Little Rock, Arkansas, with offices in Arkansas and Louisiana. I am both a licensed abstractor and licensed title agent in the state of Arkansas and a Past President of the Arkansas Land Title Association.

I am the 2009 President of the American Land Title Association (ALTA), which I am here today to represent. ALTA is the national association for the land title industry, representing nearly 3,000 member companies, including title insurers, title insurance agents, abstractors and attorneys – the majority of which are small businesses. Our members operate in every state and county throughout the country. Over 60 percent of title insurance premium revenue is derived from small businesses.

On behalf of ALTA, I appreciate the opportunity to appear before you today to discuss (1) the title industry's role in the nation's housing sector; (2) the current state of the housing sector and the title industry (3) the impact of additional federal regulation on the small businesses I represent and (4) additional thoughts on steps that can be taken to encourage a recovery in real estate markets. The title industry is critical to the stability of real estate in this country.

The title industry's role in the nation's housing sector

Nowhere else in the world is the creation and transfer of interests in real property accomplished more efficiently and securely than in the United States. Economic success in America grows out of a clear system of property rights. Because all of our citizens can own and sell property, there is available collateral to secure the lending necessary for a vibrant economy. This system was created during the times of the American frontier and remains the basis for entrepreneurship and the creation of wealth and capital in our country. Our property recording and title insurance system, served by local public officials and the land title industry, provides our economy with the legal underpinning that fosters the trust necessary for mortgage credit to flow which makes homeownership possible.

When an individual sits at a closing table to buy or sell a home or refinance their mortgage, the main reason such a complex real estate transfer can be quickly accomplished is because an independent, third party title professional has already scoured the public record (including property records, tax records, and court records) to ensure legal ownership of the property being sold. Before a transaction can occur, a title professional corrects any title or public record defects, accounts for and transfers all of the money intended to change hands, and insures the entire transaction against any known or unknown fraud, risk or defect. As a practical matter, this means that homes and property can be bought and sold with confidence and with reduced financial risk.

There are two concerns which must be addressed in any real estate transaction. First a consumer's primary concern, whether they are a buyer or seller should be that

they will ultimately transfer ownership of a property that is subject only to liens or encumbrances that they know about and are willing to accept.

Second, before providing financing for a transaction, a mortgage lender should be certain that the buyer will own the property and that the lender will obtain a valid and enforceable claim to the property as collateral for payment. Likewise, the lender should also be certain that the property is not subject to any other lien or claim that could adversely affect its investment. As a result, secondary financial markets can invest in Mortgage-Backed Securities without risk of losing the underlying asset (or property) as collateral for payment.

There are two types of title insurance: an Owner's Policy which protects the buyer's interests and a Loan Policy which protects the lender's interest. An Owner's Policy is typically issued in the amount of the real estate purchase price, and remains in effect for as long as the owner or their heirs retain an interest in the property. The Owner's Policy will pay valid claims and all defense costs against claims on the title. A Loan Policy assures the lender of the validity, priority and enforceability of its lien (or mortgage), is issued in the amount of the loan, and its liability decreases with each payment until it is exhausted when the mortgage is paid off by the borrower.

Title companies and their agents are involved in completing all aspects of the closing process, from preparation of documents and recording instruments, to preparation of closing forms, and collecting and disbursing funds. Before a transaction is completed, a title search of the records is made in an effort to locate potential problems so that they can be corrected and the transfer of ownership may proceed. Liens, easements, rights-of-way, life estates, air and subsurface rights, and future interests are also discovered in a title search and covered by a title insurance policy.

Because the history and current status of each parcel of property is unique, title insurance policies cannot be issued on a "casualty" basis – by making an actuarial judgment or determination of risk. Rather, title insurance policies should be issued on the basis of thorough underwriting, through a search and examination of the relevant public records pertaining to the ownership of each particular property to be insured according to the property laws in the jurisdiction in which the property is located.

This title search and exam is critical to reduce risk of loss, identify matters of public record and determine whether any action needs to be taken to eliminate possible defects in the public record.

The title industry has been so effective over time in identifying and correcting title that the integrity of the public records is so sound that it is extraordinarily rare for a property's title to be so defective as to be uninsurable or unmarketable. This fact keeps U.S. real estate markets exceptionally liquid.

The title search and examination provides additional benefits to the public as well. In fact, a 2008 ALTA study found that because of the industry's work:

- At no cost to taxpayers, the title industry collects \$1.75 billion per year in back income taxes.
- At no cost to taxpayers, the title industry collects \$3 billion per year in delinquent real estate taxes.
- At no cost to taxpayers, the title industry collects \$325 million per year in delinquent child support payments.
- The title industry spends \$225 million per year to correct errors in the public property records that otherwise would lead to serious impairment of the property rights of millions of Americans.
- The title industry is an important source of revenue for local governments, paying \$170 million per year to purchase copies of recorded documents.

In addition, a study by Association Research¹ found that if problems were not eliminated prior to closing, one in three consumers and their lenders would be subject to a claim due to an error in the public record. These claims cost time, money and great anxiety for consumers who otherwise would risk the loss of their homes and lenders who otherwise would risk loss of their investment.

The current state of the housing sector and the title industry

A vibrant and growing small business sector is critical to creating jobs in a dynamic economy. Across all sectors, small businesses employ half of the work force, produce 52 percent of private sector output, and provide significant ownership opportunities for women, minorities, and immigrants. Providers of settlement services ancillary to real estate transactions, such as title agents, abstracters, escrow officers, attorneys, and appraisers generally tend to be small businesses.

The title insurance industry is extraordinarily local and as a result there are small title agents in every county across the country. The majority of these businesses are Subchapter S corporations with 2 to 15 employees. There are approximately 50,000 of these brick and mortar small title businesses in the U.S., and each one has been impacted directly by the housing sector's collapse. Although there are signs of stabilization, the title industry is excessively pro-cyclical, which means that when times are tough for the housing sector, times are *very* tough for the small businesses that make up the industry.

¹ "2005 Abstracter and Title Agent Operations Survey," Association Research, Inc. (April 2006)

It is important to note that although small independent title agents did not cause the housing crisis, they have been severely impacted by the sector's downturn.

The title insurance industry is on the frontlines of the housing crisis every day. Declines in home values and increasing foreclosures have left consumers with shaken confidence in the real estate market, and the current recession has further discouraged consumer confidence in the housing sector.

Sales of new and existing homes, after reaching rock bottom in January, are slowly recovering, according to several reports. In July, for the fourth consecutive month, new home sales and existing home sales both increased. Since a bottom in January, new home sales are up approximately 32 percent and total existing home sales are up approximately 17 percent.

While this is good news, rising home sales are only half of the picture since title insurance premiums are directly tied to the sales price of a home. Unfortunately rising home sales are offset by continued declines in prices. This means that for small title insurance agencies revenue continues to decline as well. In July, the median price for new homes was down 11.5 percent from a year ago and the median price home for total existing homes fell 15.1 percent from a year ago. For the title industry this means that if even volumes were consistent, the same home sold today provides 15.1 percent less revenue for the small title agent than it would if the property were sold last year. It is important to note that revenue is a function of volume and price, therefore revenue is significantly less as a result of decreased volume.

All of this is occurring at a time when claims are spiking as a result of increased foreclosures, which generate less revenue, but often also require additional search and curative work and create an even greater likelihood of a title insurance claim on the property resulting in a loss for the industry. Foreclosures also bring higher instances of title defects and mortgage fraud. The title industry plays an even more important role in the mortgage transaction process when foreclosures flood the market by detecting and eliminating fraud and curing title defects to ensure the integrity of the transfer of property.

The statistics from a Midwestern title agency based in the Chicago suburbs demonstrate the drop-off in residential transaction activity between 2006 and 2008. The number of initial requests for title insurance policies fell 31 percent in those three years, with the most dramatic fall-off, 23.75 percent, occurring from 2007 to 2008. These figures reflect a high percentage of refinances. Purchase policies render much higher average revenue per order. However, since the housing market crashed, home purchases have been few and far between.

Due to the lack of liquidity, marginal costs are increasing at a time when orders are being placed for title insurance but deals are not closing. It has become common for a request or order for title insurance to be withdrawn by the consumer because the deal falls through. For the most part, the title industry can only charge for its services when a

closing occurs or a deal actually goes through, therefore title agents must cover the cost of the work completed without receiving payment. Over the same period of time at the suburban Chicago agency, the number of actual closings performed declined by 44.75 percent – an even faster rate of decline than the number of orders received.

To demonstrate further, the number of orders for title insurance at the agency that closed in 2006 was about 70 percent, and the work completed on the remaining 30 percent of transactions was funded by revenue generated when other deals closed. However, in 2008, only 55 percent of title insurance orders actually closed, which means this title agency was earning revenue on only about half of the transactions on which work was performed. Finally, while the average cost of providing title insurance services for a transaction has increased 27 percent, the average revenue generated per transaction has decreased 9 percent. The revenue generated per transaction has been calculated based on the number of orders received as opposed to orders closed which allows us to see the effect of order cancellations on revenue.

In addition, the agency's employment picture shows that between 2006 and 2008, the number of FTE's dropped from 46 to 37.5, an employment decrease of 19 percent. It should also be noted that these figures do not point only to the Chicago agency's specific performance. During this time, neither that title agency's market share nor comparative ranking changed, indicating that its entire market is experiencing similar challenges.

One title agency based in Indiana is typical of many across the country. It has gone from six full time employees before the real estate bust to one full time and two part time employees – a two-thirds drop in its Full-Time Equivalent (FTE) workforce. Real estate transactions for both sales and refinances have fallen to about 35 percent of what they were in 2006 driven by high unemployment and lack of credit availability. As the title agency's owner puts it, "There is simply very little business." In addition, the agency reports that home values are dramatically lower due to the number of foreclosure properties for sale.

In 2008, the title insurance industry generated \$10 billion or 40 percent less premium revenue than the \$16.9 billion generated in 2005 due to the real estate downturn. This revenue drop precipitates even further industry consolidation as companies react to lower returns and higher costs. While title insurance agencies continue to be the source of over 60 percent of premium revenue, they are writing policies for fewer companies.

According to ALTA's Quarterly Market Share and Financial Report, the second quarter of 2009 marked the 13th consecutive quarter in which title premiums declined from the prior year's equivalent quarter. While losses are moderating as a result of the significant rise in refinance activity, it is important to note that a refinance transaction produces much less revenue for the title agency per transaction than does a purchase transaction.

Year to year comparison of total premium revenue demonstrates this fact. Title insurance premiums generated during the first half of 2009 were \$4.53 billion, compared to \$5.42 billion during the first half of 2008. Despite an increase in refinance activity and the continued reduction of operating expenses, the title insurance industry posted an operating loss of \$68.8 million during the second quarter of 2009. While this contrasts favorably with an operating loss of \$264.4 million for the corresponding 2008 second quarter and an operating loss of \$711.9 million for the full year 2008, much of this cost savings is due to layoffs.

There are some bright spots depending upon where your small business is located. During the first half of 2009, according to industry-wide results, 10 states actually showed increases in title insurance premium revenues from the first half of 2008 with the highest being North Dakota up 29.1 percent; Alaska up 22.8 percent; Kansas up 14.7 percent; Oregon up 13.9 percent and Wisconsin up 9.6 percent.

Unfortunately, chances are that you are more likely to be the owner of a small business in one of the five largest states for premium revenue. If you operate in one of these states, you are faced with a very different operating environment. During the first half of 2009, according to the same industry-wide results, these states showed a starkly different results with California essentially unchanged; Texas down 26.7 percent; Florida down 35.3 percent; New York down 33.9 percent; and Pennsylvania down 9.2 percent.

We hope that the decline in title insurance premium revenue, which appears to be leveling off in 2009, demonstrates the market has begun a slow march to recovery. Leading indicators point to gradual recovery in several housing market projections. In August, the National Association of Home Builders' (NAHB) Housing Market Index rose one point to 18, more than double its record low in January. New permits for single-family homes, a leading indicator of single-family housing activity, rose for the fourth consecutive month in July up 5.8 percent. In addition, pending home sales have increased for seven straight months according to the National Association of Realtors (NAR) Pending Home Sales Index.

The impact of additional federal regulation on small businesses

Unlike many other small businesses, title insurance agencies cannot easily pass additional costs onto customers because rates and charges for title related services are regulated by state insurance departments. In addition to state regulation, the title industry is also regulated by the federal government through the Real Estate Settlement Procedures Act (RESPA).

Industry analysts believe regulatory limitations make the title insurance industry more susceptible to housing market volatility because title agents and insurers are often unable to increase revenue by means other than by increasing their market share. First, a title insurance policy is issued for a one-time premium. There are no recurring premiums which can be collected and increased to boost revenue. Simply raising rates cannot make up for losses. Second, title insurance's status as a monoline product limits

opportunities for growth into other types of insurance products, as it prohibits the provider from offering any line of insurance other than title.

Title insurance's monoline restriction was adopted following the collapse of the title insurance industry in New York during the Great Depression because title insurers had been allowed to issue mortgage guaranty insurance. During the Great Depression, extraordinary unemployment led to a collapse in home prices and a spike in foreclosures. The holders of mortgage guaranty insurance filed claims wiping out reserves and making the firms insolvent. Monoline restrictions were imposed in order to prevent this kind of disaster in the future and as a means of ensuring the safety and solvency of title insurers and protection for policyholders where policies remain in effect for indefinite periods of time, and they performed well during this economic crisis.

These thoughtful state regulations strike an appropriate balance between the need to protect consumers and the need to allow small businesses to innovate responsibly. Unfortunately, new regulatory proposals provide no such balance for the title industry and do not consider the ability of the regulated – especially small businesses – to comply much less be able to know if or when new rules require them to change their practices.

The proposed Consumer Financial Protection Agency (CFPA) would impose a third layer of regulation and an additional federal bureaucracy onto the title insurance and settlement services industry. This industry, which is already adequately regulated on the federal level through RESPA as well as by state insurance regulators, will face an additional federal regulator with broad powers to write new regulations.

This kind of structure, with a federal regulator overseeing small businesses operating in every county in the country will require the smallest of agencies – one and two person operations – to shift the focus of their time and resources in order to get into the habit of reading the Federal Register to check for new rulemaking intended for major bank and non-bank financial institutions, but which also applies to their work in searching local courthouse records. Today, our small business members are spending hours educating themselves to ensure they comply with new mandates required by HUD's new RESPA guidelines. RESPA intends to ensure consumers are fairly protected in local real estate transactions – exactly the work that we do. CFPA has no such focus, but will sweep small businesses into its purview.

Like many other small businesses which have been exempted from the CFPA, the title industry was not the cause of the problems that led to the push for the agency. Like many other small businesses which have been exempted from the bill, extending CFPA regulatory authority to the title industry has no measurable benefit in achieving the bill's purposes, but would add to it essentially needless regulation at a cost to small business owners.

Although some recent studies have looked at the impact of regulations on the relationship between government and private business in general, less attention has

been directed toward understanding precisely how government regulations have affected *small* businesses. There is good reason to believe that size matters. Precisely because of their smaller size, small businesses are likely to be less diversified and less able to leverage economies of scale or to access capital markets. As a result, small businesses might be more risk-averse and less able to react to unexpected events compared to larger businesses.

In addition, the cost of complying with a particular regulation may be roughly the same for smaller and larger firms, thus placing a disproportionate burden on the smaller firm. According to a 2001 study funded by the Small Business Administration's Office of Advocacy, small businesses spend \$6,975 each year per employee just to comply with current federal regulations and mandates.

New RESPA rules, which come into effect on January 1, 2010, as well as revisions to the Truth In Lending Act (TILA) drive up costs for title agencies even further and place additional stress on these small businesses' already strained resources.

The requirements imposed in the new RESPA rule will add an additional burden on title agents who perform real estate settlements. Along with the new requirements come new procedures, major software changes and training expenses for all title agents who perform closings, the expense of which was calculated by HUD for the title industry as a whole to be \$62 million for software expenses and training (\$46 million of which will be borne by small businesses), and \$37 million for legal consultation (\$18 million of which will be borne by small businesses).

While ALTA applauds the efforts of HUD to make the home buying and financing process clearer and more transparent for consumers, the responsibilities and liabilities placed on the title industry come at a great cost when our industry is already struggling. However, we will continue to work with HUD and stakeholders to implement the rule successfully.

Additional steps

Beyond an awareness of and sensitivity to the implications of federal regulatory burdens on small businesses, additional common sense steps can be taken to strengthen stability and even encourage a recovery in real estate markets. While none of us are particularly thrilled about increased government outlays, incentives to buy a home are key to purchase transactions.

The extension and expansion of the first-time homebuyer tax credit is the single greatest step Congress can take to stimulate the housing market. Making this tax credit available to all homebuyers, without restrictions on income or their status as a first-time homebuyer will continue to bring consumers back to the market, reduce inventories of unsold homes, and stabilize home prices.

ALTA members have already reported an increase in purchase transactions directly correlating to the \$8,000 tax credit enacted earlier this year. According to an ALTA survey conducted in June, 46 percent of land title professionals reported seeing an increase in purchase transactions associated with first-time homebuyers.

NAHB analysis indicates that extending the homebuyer tax credit a full year, through November 30, 2010, and expanding the credit to all buyers of principal residences would:

- Increase home purchases by 383,000 homes;
- Increase housing starts by 82,000 homes;
- Create more than 347,000 jobs;
- Generate \$16.1 billion in wages and salaries and \$12.1 billion in business income; and,
- Yield tax revenues of \$8.4 billion for the federal government and \$3.2 billion for state and local governments.

While a homebuyer tax credit with reduced barriers can help, it alone cannot reduce the excess housing inventory and stabilize home prices. The homebuyer tax credit has spurred some movement in the first-time homebuyer market but the move-up buyer is still hesitant to incur additional debt. First-time homebuyer transactions alone are not enough to clear the excessive amount of housing on the market.

The federal government continues to be the single largest source of mortgage credit, and as credit has become less available, borrowers continue to find it harder to qualify for loans. This is exacerbated by high unemployment, which is a major drain on the housing industry. Jobs are key to this industry's recovery. We also cannot assume interest rates will remain below historical averages indefinitely.

Other steps

Other steps can be taken to remove barriers to homeownership. First, Fannie Mae's charter was amended by the Housing and Economic Recovery Act of 2008 to expand the definition of a "conforming" loan. General conforming loan limits, and high-cost area conforming loan limits are now provided for first single-family mortgages. The standard conforming loan limit for single-family properties should be increased from \$417,000 to \$625,500 and high-cost area conforming loan limits should remain at 125 percent of the median home price for high-cost areas up to \$729,750. Permanently increasing the conforming loan limit would help spur recovery in real estate markets and increase lending to consumers, especially in jumbo markets where credit remains extraordinarily tight.

Second, in December 2008, Fannie Mae and Freddie Mac increased the presale eligibility requirement for new condominiums from 51 percent to 70 percent. This means Fannie Mae and Freddie Mac require at least 70 percent of the units in a multifamily project to be sold before they will back a loan. With the federal government serving as the largest source of mortgage credit, unless the developer has already sold 70 percent of the units, virtually no units are being removed from inventory.

Although the motivation to reduce potential loss exposure and combat mortgage fraud cited by Fannie Mae and Freddie Mac are valid, the consequences are crippling. Borrowers face extraordinary hurdles to purchase condo units in newer buildings. Condo markets in cities like Chicago have nearly come to a halt and many buildings remain vacant. A reduction in the presale requirement would give buyers additional options and help the recovery of condo markets across the country. The 70 percent presale eligibility requirement should be reworked.

Finally, when our real estate markets are restored to healthy levels, Congress will want to have taken steps necessary to prevent a collapse similar to the one which we have experienced. Too many homebuyers did not know what they were getting into when they signed their mortgage documents. Congress can confer significant benefits to consumers by requiring that borrowers be given their closing documents prior to closing to prevent confusion when borrowers are presented with myriad complex forms and are pressured to sign documents that may be incorrect or against their best interests – a consumer protection measure which is strongly supported by HUD.

Under current law, consumers currently have the right to request and review closing documents 24 hours before the closing. Few of us know or make use of this option, nor is there a corresponding requirement that the documents provided be complete. In many cases documentation is still being faxed to the closing agent while the borrower is seated at the closing table.

A Borrower Right of Inspection would remedy the plight that borrowers face at settlement and strengthen the remedial disclosure provision of RESPA by giving borrowers time to review their HUD-1 Settlement Statement, the promissory note, mortgage or deed of trust, and the final TILA disclosure which would be complete and finalized by their lender and settlement agent.

The consumer benefit conferred by the proposal is enormous: borrowers would be able to review the key documents, ask questions, obtain third party counseling and renegotiate terms during this period before the scheduled settlement. This would facilitate their understanding of the closing process and help to ensure that they do not enter to an unsuitable loan transaction that leads to non-performance down the road.

Conclusion

A fragile stability exists within the housing industry, but this stability is even weaker within the title industry, especially on small businesses. Incentives like low

interest rates and a limited, first-time homebuyer tax credit ensure that revenue and employment losses are not as bad as they could be. Congress should take simple, common sense steps to remove barriers to growth in the title industry and prevent additional barriers from being created. ALTA appreciates this opportunity to share the economic perspective of small businesses in the title industry and looks forward to a swift, stable and strong economic recovery.

I thank you for the opportunity to serve as a resource about the current state of the nation's housing sector.