Barry Ritholtz: Crocodile tears from the real estate industry

By Barry Ritholtz Bloomberg
View

Starting Saturday, the real-estate industry became subject to new disclosure rules, courtesy of the Dodd-Frank law and the Consumer Financial Protection Bureau. Lenders will be required to make transparent and complete disclosure of the terms of mortgages – including all costs and fees.

This information was sorely lacking during the boom in the 2000s. Residential real estate peaked in the U.S. in 2006, and the housing bust that followed exposed the worst practices of the era. Common-sense disclosure could have curbed many of the more egregious and preventable abuses.

New lending disclosure rules are in effect beginning Oct. 3. Mark Humphrey The Associated Press

The new regs (details at the CFPB) also require a three-day grace period between the disclosure and the actual mortgage signing. In the past, closings were characterized by a flurry of signatures and initials – and it's safe to say that most home buyers had no idea what they were signing, even after the cursory explanatory from their real estate attorney.

The rules were finalized two years ago and initially were scheduled to take effect in August. In response to industry concerns that the change could cause confusion in the height of the summer selling season, the agency postponed implementation until Oct. 3.

Click here to learn more about the new rules on the Consumer Financial Protection Bureau blog.

We should remember why these rules became necessary: During the housing boom, mortgage underwriting became a mass-produced, nondisclosed, poorly originated free-for-all. Unqualified buyers purchased mortgages that, in many cases, they did not know they could not afford. Many people believed they had inexpensive fixed-rate mortgages only to be surprised when these reset two years later.

Stories of abuse were rampant. Mortgage brokers often filled out applications on behalf of home buyers, writing what they knew the underwriters wanted to see. Employees of JPMorgan Chase figured out how to work around "Zippy," the bank's own automated mortgage processing system. An internal document (circulated without official approval) titled "Zippy Cheats & Tricks" showed how to get questionable loans approved.

There were many other instances of poor judgment, unnecessary risk taking and bad behavior in the mortgage and financial industry. The net result was more than 8 million foreclosures, the collapse of the financial system and the worst banking crisis since the Great Depression.

It was an unholy mess, and it ended badly. (I look forward to emails repeating the thoroughly debunked claims that Fannie Mae and Freddie Mac were to blame for the mortgage crisis, so I can A) block your email address, and B) use them as an example of what happens when ideology compromises analysis.)

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Mortgage Bankers Association CEO David Stevens

Nonetheless, the mortgage and real estate industries are up in arms about the new rules. They have made the questionable claim that it is costing billions of dollars to prepare, even though they knew the changes were coming five years ago. And, of course, they are predicting Armageddon, warning in a Wall Street Journal article that “the rest of the year could be marked by delayed closings, frustrated borrowers and confused real-estate professionals as they adjust to the new rules.”

I went through the process just a year ago, and I can attest to the fact that the old system was an utter mess. After handing out mortgages to anyone who could fog a mirror, the pendulum has now swung too far in the opposite direction. The mortgage originators themselves have changed the required documentation from borrowers, which already is gumming up and slowing down the process. Blaming two disclosure documents and a three-day waiting period is simply foolish.

This isn’t the first silliness from the industry. The National Association of Realtors made some laughable assertions during and after the mortgage crisis. But the Mortgage Bankers Association had been usually fairly sober about things, so I was surprised by the hair-on-fire comments from David Stevens, the MBA’s chief executive. He told the Wall Street Journal that “lenders have spent billions of dollars in technology-system changes and training” – a number that appears to be a gross exaggeration. Stevens added:

“It is without question the single largest implementation challenge that the broad industry has faced since Dodd-Frank. It’s massive. It involves every real-estate agent, settlement-service provider, every consumer, mortgage originator, everyone.”

Filling out four documents instead of two and transparently disclosing the full costs of a mortgage doesn’t sound like an insurmountable problem to me. Quicken Loans CEO Bill Emerson claimed he had “350 employees working for 17 months to change over to the new federally mandated processes and forms.”

Let’s take him at his word: a year and half of people who likely make about $50,000 a year. Assuming they worked on that project exclusively for 17 months, Quicken, then the third-largest underwriter of mortgages, spent less than $25 million on this project. I suspect it was some fraction of that number. I doubt the industry-wide cost was one-tenth of the amount being claimed.

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I have been interested in real estate for as long as I can remember. My mother was a Realtor in the 1970s and 1980s, in the days of 14 percent mortgages. The excesses of that era were dinner-table fodder in my home.

The mess in real estate was created by the industry itself. Its reactions and overreactions to reasonable disclosure measures are typical. No wonder so few people take it seriously when it keeps crying wolf. One day, when it really needs relief, no one will be listening.

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