

Modernizing Home Buying

How IT Can Empower Individuals, Slash Costs, and Transform the Real Estate Industry

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The e-commerce revolution has begun to transform a host of information-based service industries—including travel services, banking, and securities trading—bringing new efficiencies, reduced costs, and more consumer choice. A number of industries, however—including health care, education, legal services, entertainment, some segments of the retail industry (such as auto sales), and residential real estate—have made little progress on the path to e-transformation.

Given their size, the slowness of e-transformation in these and related industries is troubling and suggests that the overall digital transformation of the U.S. economy and the attendant productivity gains are likely to be slowed considerably. It is not enough to just hope, as many free-market purists do, that somehow market forces alone will lead to rapid and broad-scale transformation. There are a number of market or political failures that stand in the way, including active political resistance to change by entrenched actors; lack of incentives by middlemen to develop digital transformation tools; producers who are too dispersed or small to drive e-transformation; and lack of key government investments, standards, or regulations to support private sector transformation. In order to better understand the barriers to transformation in lagging sectors and public policy's role in accelerating it, PPI chose to examine in detail one such industry—the residential real estate industry—focusing on the current state of IT usage, the barriers to faster and deeper transformation, and most important, what public policymakers can do to spur e-transformation.

The residential real estate industry has lagged behind many other industries in e-transformation, still relying largely on face-to-face transactions, paper-intensive processes, and middlemen to

negotiate the myriad and complex facets of a typical purchase. We find that information technology has the potential to streamline processes and empower consumers to engage in real estate transactions with less reliance on expensive intermediaries. We estimate that residential real estate transaction costs can be cut in half, saving American homeowners tens of billions of dollars every year. Such efficiencies will not only boost productivity and economic growth, they will also play a key role in helping to expand homeownership, as one of the barriers to first-time home purchases is the large amount of money needed to cover transaction costs.

It should be stressed, however, that the goal of transformation is not merely to disintermediate particular players in the industry, even if doing so would boost productivity. Rather, the goal is to enable buyers and sellers to make choices for themselves, instead of having those choices dictated to them by powerful forces in the industry. Once consumers are empowered with technology tools to take more control over their real estate transactions, market forces and competition will determine the degree of disintermediation that occurs.

While e-transformation of the real estate industry will cut the costs of buying a home and boost economic growth, there are three reasons why we believe the industry is unlikely to make this transformation absent public policy intervention. First, middlemen (e.g., mortgage brokers, Realtors, and title companies) exercise control over large parts of the real estate transaction, either through favorable laws and regulations or control of key assets such as the Multiple Listing Service (MLS), the computerized database of homes for sale. Their efforts to protect their roles in the transaction make it more difficult for consumers to have other choices,

including self-service enabled by e-commerce. Second, unlike industries such as travel or securities trading where producers are relatively concentrated (for example, the online travel site Orbitz was initially established by the five largest airlines¹), the real estate industry is highly dispersed. There are millions of “producers” (home sellers) who sell perhaps once per decade. Because home sellers are a disorganized “industry,” the pressures to build IT systems that streamline transactions and reduce the need for middlemen are virtually nonexistent. Finally,

transformation of at least one part of the industry—title search and insurance—is held back by the lack of government effort, in this case the establishment of electronic “recording” systems for real property records.

For these reasons we believe that absent smart, new public policies, e-transformation of the real estate industry will be extremely slow, costing consumers hundreds of billions of dollars. This report outlines a strategy by which public policy can spur e-transformation of the industry. It focuses on five key aspects of the

Table: Typical Transaction Costs and Potential Savings From E-Transformation to Average Home Buyer (\$150,000 Purchase Price)

Transaction Item	Typical cost under current system	Potential cost after e-transformation	Potential savings
Credit Report	\$30	\$10	\$20
Real Estate Agent ²	\$4,500	\$2,000	\$2,500
Mortgage costs (loan origination, application processing, underwriting)	\$3,800	\$500	\$3,300
Appraisal	\$300	\$100	\$200
Title search	\$350	\$50	\$300
Title insurance	\$800	\$400	\$400
Settlement fees	\$500	\$200	\$300
Fixed costs (taxes, survey, inspections, etc.) ³	\$3,220	\$3,220	\$0
Totals	\$13,500	\$6,480	\$7,020 (52 percent)
Nationwide totals (annually)⁴	\$75.1 billion	\$36 billion	\$39.1 billion

Source: Progressive Policy Institute estimates

home buying and selling process and discusses barriers to transformation and changes in law and regulations for each. These areas are:

1. **Improving computerized access to and accuracy of credit reports** by standardizing reporting data to allow for one-stop correction at all credit bureaus and requiring more accountability for accurate reporting of credit history;
2. **Facilitating computerized shopping for mortgage interest rates** by standardizing forms and eliminating protectionist rules that favor in-state bricks-and-mortar lenders;
3. **Unbundling the functions of real estate agents** by encouraging competition for brokerage and listing services and disclosing alternatives to buyers and sellers;
4. **Streamlining the recording process to cut costs and reduce risks associated with incomplete or inaccurate land records** by establishing electronic recordation systems;
5. **Reducing the costs and paperwork associated with the settlement process** by encouraging digital signatures and online settlements.

The Opportunity and the Challenge

Fostering e-transformation of the real estate industry is important for two reasons: economic efficiency and economic opportunity.

For a typical \$150,000 home with a 20 percent down payment, a home buyer can expect to pay about \$13,500 in transaction costs, including taxes, loan origination and approval, title insurance, and real estate agent commissions—costing home buyers nearly \$80 billion per year. A good portion of these costs—perhaps up to half—are generated simply because of insufficient information technology systems. Better technology could improve the efficiency of the process and empower consumers to make better choices without the assistance of fee-generating professionals—just as people who used to buy airline tickets and stocks through intermediaries increasingly do it themselves,

empowered by IT tools. An overall transformation of the residential real estate process, therefore, could eliminate nearly \$40 billion worth of costs from the system, making homeownership more affordable for thousands of families (see Table).

The real estate industry holds a special status in our society because it is the gateway through which we achieve one of our most important social goals: homeownership. Homeownership is a key factor in allowing Americans to build wealth, and in turn, helps to foster a “stakeholder society” with greater civic awareness and participation.⁵ The tax code has long encouraged homeownership, and the economic boom and federal policies of the 1990s have boosted it to record levels: two-thirds of Americans now own their homes.⁶

The record levels of homeownership, however, hide some troubling facts. They are significantly lower for some segments of society: only 41 percent of people under 35 years of age, 47 percent of African Americans, and 48 percent of Hispanics own their homes. Though e-transformation is not a “magic bullet” that will clear the obstacles to homeownership faced by lower-income and minority families, a significant reduction in transaction costs can be a key part of a comprehensive strategy to make the American dream a reality for more families.⁷ This can be accomplished through a comprehensive transformation of the industry based on modernizing the homebuying process with information technology.

1. Improving Credit Report Access and Quality

Evaluation of consumer credit reports issued by the three major credit reporting agencies (CRAs) have long been the critical first step in the home buying process.⁸ Credit reports contain detailed information about the consumer’s payment history, which helps mortgage lenders make a more accurate assessment of the risk of default. Two recent developments have made credit reports even more critical to home buyers.

The first is the growth of the “subprime” market, which makes mortgage loans to consumers with poor credit histories, but

typically with higher interest rates.⁹ Because subprime mortgages are available to all but the very worst credit risks, the fundamental question facing potential homeowners has changed from “Can I qualify for a mortgage?” to “What will my interest rate be?” In addition, since the accuracy of the credit report has a direct bearing on the cost of homeownership, it is important that potential home buyers ensure that their credit reports are completely accurate, rather than merely “good enough to qualify” for a mortgage.

The other factor raising the importance of credit reports is the growth of automated underwriting. In order to streamline the process of reselling mortgages in the secondary market, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)¹⁰ developed computerized systems that tell mortgage lenders if a potential loan would meet the criteria for resale. Though there are many advantages to automated underwriting—such as lower costs and the elimination of race as a factor in the loan decision—the underwriting systems rely heavily on the data in credit reports to make an evaluation. A negative result from the automated underwriting system will almost certainly send a lender to the subprime market for a loan.¹¹ Because the interest rates in the subprime market are higher—usually by several percentage points—lower-income buyers who would be stretching their finances to purchase a home in the first place might be priced out of the market.

The key to ensuring an accurate assessment of credit risk and the corresponding best interest rate is accurate information in credit reports. Inaccuracies in credit reports are notoriously difficult to correct for a number of reasons. First, though mortgage lenders and third-party providers can pull data from all three CRAs in a single report (known as an “infile” credit report), corrections to the data must be made by filing disputes with each individual CRA. If the disputes are more complicated, the consumer must get in contact with the original creditor to set the record straight, and then follow up individually with each CRA. Because many of these disputes must be resolved through a series

of correspondence sent via registered mail,¹² it is not unusual for a potential home buyer to spend weeks or months correcting errors in the credit reports before the home buying process can even begin. Unfortunately, this is necessary far too frequently; and the growing rate of identity theft, which usually results in damaged credit, is likely to exacerbate the problem.

To streamline the process of correcting credit reports:

- ▶ **Congress should encourage “single portal” online access to credit reports and online dispute procedures.** The three major CRAs have already developed web-based credit reporting and disputing services with tools to verify the identity of the requestor and assure privacy, but the hassle and expense of visiting each one is unnecessary. Moreover, many regional or smaller CRAs, such as Innovis, do not have websites for consumers to access and correct their data.¹³ The effort required to correct credit report inaccuracies in triplicate stands as a barrier to homeownership. To facilitate one-stop credit correction, Congress should facilitate the development of a standardized credit data reporting format. Once the data furnishers supply information in standardized form, it will be possible for websites to develop a single point of contact for consumers to correct information with all CRAs.¹⁴
- ▶ **Congress should increase accountability for reporting inaccurate information to CRAs.** The Fair Credit Reporting Act has a “hot potato loophole” for inaccurate information. The consumer can sue a CRA for failing to correct inaccurate information, but the CRAs are not responsible for determining whether information is accurate; they simply report what the data furnishers tell them. However, consumers cannot sue data furnishers for reporting inaccurate information.¹⁵ To ensure that data furnishers make their best efforts to report accurate data, Congress should grant a private right of action to sue data furnishers that continue to report inaccurate information as a last resort after the dispute process is completed.

- ▶ **The CRAs should ensure that shopping for a home does not hurt a home buyer’s credit rating.** Though raw credit data plays a larger role in mortgage lending decisions than in other lending decisions (such as auto loans or credit cards), the use of the credit score is still an important factor in the mortgage process. The prominent formulas to determine credit scores, such as the Fair Isaac Company (FICO) score, decrease a consumer’s creditworthiness if the account contains too many inquiries from other potential creditors. The reason for this is that inquiries could indicate the existence of outstanding credit lines that have not yet been reported, or a pressing need for credit on the part of the borrower. This inhibits potential home buyers from shopping for mortgages from many lenders over the course of months or years.¹⁶ Whereas 20 inquiries by credit card issuers might indicate a large number of cards recently issued, multiple mortgage inquiries are unlikely to have led to multiple mortgages. Fannie Mae and Freddie Mac should adopt the most accurate model for credit scoring and ensure that home buyers are not penalized for shopping for mortgage rates over extended periods.¹⁷
- ▶ **Lenders that participate in the credit reporting process should be required to report complete information on all of their customers.** In the vast majority of instances, lenders do not discriminate in the information they report. Some subprime lenders, however, may neglect to report the positive payment histories of their customers—although they do not hesitate to report defaults. This leaves some borrowers unfairly trapped in the subprime market because their credit scores cannot improve if no positive information is added to their files. The integrity of the credit reporting system depends on complete and accurate information. As previously suggested by PPI, Congress should require lenders to report all credit history information.¹⁸

2. Facilitating Online Mortgage Shopping

One of the most important tasks faced by potential home buyers is finding the best possible mortgage. Overpaying for a mortgage can cost the home buyer hundreds of dollars at closing and tens of thousands of dollars over the life of a loan. For lower-income Americans who are taking a bigger financial risk by becoming homeowners, it is not an exaggeration to say that finding the right mortgage can be as important as finding the right home. Because there are so many mortgage options and exploring all of them is difficult, a multi-billion dollar industry of middlemen—known as mortgage brokers—exists to match borrowers to lenders, typically at a cost of thousands of dollars to the borrower. Moreover, the paper- and person-intensive process of finding and applying for mortgages raises overall costs when compared to online mortgage services. Using technology tools to increase the efficiency of the mortgage industry will let buyers shop directly from lenders (or cheaper online brokers) and save much of the estimated \$13 billion in fees brokers collect each year on home sales.¹⁹ Bringing greater efficiency to online mortgage shopping will also help eliminate one of the frustrations faced by mortgage brokers in the Internet age: borrowers who seek out their professional advice, but then turn to online lenders to get a better rate, thereby “stealing” free advice from the professionals.²⁰

Many companies have started web-based services that can shop for loans from multiple lenders and return online comparisons of rates and fees from which borrowers can choose with the click of a mouse. Because mortgage capital has essentially become a commodity, getting the appropriate mortgage is a relatively simple matter of determining the needs of the borrower and finding lenders with products that match those needs, a process that websites can execute particularly well. By performing consumer education functions, substituting web-based self-service for paper and face-to-face transactions, and eliminating the need to have

brokers search for mortgage products, Internet-based mortgage companies can be far more efficient than traditional brokers.

Many players in the mortgage industry, however, would prefer to continue the traditional method of doing business, which mainly involves borrowers calling or visiting banks and brokers to discuss mortgage options. Personal contact allows for salesmanship to play a large role in closing deals—borrowers are frequently talked into accepting mortgages on terms less favorable than are available elsewhere. More important, the tremendous complexity of the transaction creates space in the market for mortgage brokers and originators who offer to steer borrowers through the process and take a hefty fee in return, sometimes as much as 2 percent of the total loan.²¹

There are several ways that mortgage brokers can add to the cost of a loan. One favorite method is locking customers into a higher interest rate in exchange for a yield spread premium (YSP). YSPs work as a form of reverse points; rather than the borrower paying points to the lender in exchange for a lower interest rate, the lender pays points to the borrower in exchange for a higher interest rate. By accepting a YSP, a borrower can get cash in hand to defray closing costs, and pay for it over the life of the loan. Many loan originators, however, simply present the higher interest rate to borrowers and pocket the YSP for themselves. This is not an isolated phenomenon: According to an economic analysis done by the Department of Housing and Urban Development (HUD), this pocketing of YSPs costs borrowers an estimated \$7.5 billion per year.²²

The addition of so-called “junk fees” is another obstacle that potential home buyers face when choosing a mortgage. The large number of parties involved in a mortgage transaction (broker or originator, lender, title company, closing agent, attorney, and others) leaves ample opportunity to add costs to the mortgage. Buyers are often bewildered by the difference between origination fees, application fees, and underwriting fees and often pay excessive junk fees for items like document preparation or third-party services such as couriers.²³ Of course, mortgage brokers do perform work that justifies

many of these fees, but technology can significantly reduce the amount of work necessary by automating processes, which would cut costs significantly.

The key to allowing consumers to get the best deal on mortgages and making it easier to find and purchase mortgages online is to empower them with effective information about the market. Most borrowers evaluate loans on a single key term: the interest rate, the monthly payment, the amount due at settlement, or whichever single factor concerns them most. Giving consumers a better understanding of the relationship between the variables in a mortgage will help them decide which package best suits their overall needs.

The Real Estate Settlement Procedures Act (RESPA) of 1974²⁴ sought to make it easier to compare costs of different mortgage offers on an “apples to apples” basis by creating standardized forms for settlement costs (known as the HUD-1) and requiring loan originators to give borrowers a standardized Good Faith Estimate (GFE) of settlement costs. Though well-intentioned, the detailed explanations required by RESPA have led to a proliferation of junk fees. Moreover, at times there is very little good faith in a good faith estimate, since the preparer of the estimate is not responsible for its accuracy. For example, one lender may provide an accurate estimate of the taxes due at settlement, while another lender inserts a lowball estimate or leaves the estimate blank. In that case, the bottom-line cost from the second lender may look better even if the first lender is offering a better deal. Because a GFE runs several pages, it is difficult to dig down into the line items to determine what discrepancies may account for differences between rate quotes. Standardizing the way bottom-line estimates are prepared is key to allowing borrowers to accurately assess the differences between lenders and mortgage products.

Shopping for mortgages is also difficult because borrowers have a hard time accessing all of the potential lenders. Most loan originators and brokers work with only a small group of lenders, and it is often difficult for consumers to find out which brokers they need to visit to access the widest number of mortgage offers. Online

mortgage shopping services work the same way; different services work with specific lenders or groups of lenders, but no service currently available allows borrowers to receive offers from all lenders.²⁵ Most egregious, many states—at the urging of bricks-and-mortar banks and mortgage companies—have passed laws requiring mortgage lenders or brokers to maintain a physical office in the state, effectively eliminating competition in these states from many nationwide Internet-based mortgage providers with lower costs due to the online nature of their business.²⁶ For these reasons, the ability to get the best available rate for a mortgage is often a matter of luck, even for the most informed and diligent shopper.

To help address this problem, HUD has proposed changes to the GFE to facilitate mortgage shopping.²⁷ The HUD proposal would create a new standardized GFE form that collapses the numerous fee categories into a few numbers and includes a table showing how changes to the interest rate (either by paying points or accepting a YSP) would affect monthly payments and the amount due at settlement. The proposal would also require the GFE to be accurate within 10 percent, provided that the borrower uses the settlement service providers recommended by the lender. HUD also proposes to relax regulations designed to prohibit kickbacks to lenders by third party service providers (such as appraisers and inspectors) which will allow lenders to negotiate bulk discounts and offer a total package of services at a guaranteed price.²⁸ A guaranteed price quote would constitute a contract offer and assure borrowers who are shopping for the best deal that they will not have to worry about unexpected charges at settlement. These changes are an important first step in facilitating mortgage shopping, including online mortgage shopping.

To further facilitate online mortgage shopping:

- ▶ **HUD should strengthen the proposed RESPA reforms by increasing disclosure and responsibility for all items in the GFE.** Though the HUD proposal is a step in the right direction, it still may be difficult for consumers to make informed decisions if

they do not fully understand the myriad ways fees can be disguised. More important, a true apples-to-apples comparison is impossible if the GFE preparers are bound by their cost estimates for settlement services but not for other costs due at closing, such as taxes and costs for hazard and lender-required title insurance. Given the wealth of information available online, getting accurate estimates of these costs (within 10 percent) is not difficult. Holding GFE preparers financially responsible for the accuracy of the estimates will ensure that buyers looking at the bottom line of the revamped GFE form will be making an accurate comparison across all offers, thereby capturing the full benefits of the streamlined mortgage shopping process.²⁹ Any RESPA reform should make clear that borrowers can shop for third party services on their own without changing the terms of the loan (though they would sacrifice the “guaranteed” settlement price).

- ▶ **HUD should create a standardized form for online mortgage shopping.** In order to receive offers over the Internet (known as online pre-approval), prospective home buyers must enter a tremendous amount of information about themselves, their financial situation, and the target property they wish to buy. The data entry is nearly doubled when a co-borrower is involved. Though the Internet is supposed to make mortgage shopping easier, the sheer effort involved in getting an online offer discourages extensive shopping. To facilitate this process, HUD should develop a standardized electronic form that mortgage shoppers could fill out once and then transmit to as many lenders or broker services as they wish (similar to the standard form used by college students applying for financial aid and student loans). This will allow prospective home buyers to seek offers from a large number of lenders with virtually no marginal cost.³⁰ This will also benefit lenders by reducing the costs associated with “dropouts,” borrowers who send the lender or mortgage brokers through the time-consuming application process and

then leave when they find a better deal. Pushing the price competition to the “front end” of the transaction eliminates risk for both lenders and borrowers.

- ▶ **States should eliminate “bricks-and-mortar” laws that require mortgage providers to maintain a physical office in the state.** Although state laws requiring financial services providers to maintain offices once protected consumers from shady operators who moved from town to town, they no longer make sense in the Internet era. The market for mortgage products is now a national one, and consumers using the Internet can often find the best deals either from out-of-state lenders or through brokers such as LendingTree.com who operate on the Internet only. Laws that require a physical presence (or place additional burdens on companies that do not maintain a physical presence) restrict consumer options without providing any significant consumer protections. States with such laws should repeal them.³¹
- ▶ **Congress should create national licensure for mortgage brokers and lenders as an alternative to state licensure.** Licensing mortgage providers is an important consumer protection requirement, but disparate and protectionist licensing requirements (such as the bricks-and-mortar regulations) and multiple licensing costs are significant barriers to online mortgage providers. While ideally states would eliminate restrictive and conflicting laws and regulations, political pressures from in-state mortgage brokers make it unlikely that this will happen. As a result, creating a national license that presumptively meets state requirements will protect consumers while giving them greater choice among mortgage services.

3. Promoting Choice in Real Estate Agency Services

When entering the real estate market, most buyers and sellers hire a professional agent as

their first step. Real estate agents perform a number of functions: advising sellers on how to make the house more marketable, assessing current market conditions, assisting with paperwork, negotiating the sale price, and steering their clients through the array of tasks that must be done before settlement. Though all of these tasks are valuable, the vast majority of both buyers and sellers say that finding the right house or finding a buyer are the primary reasons for hiring an agent.³²

For providing these services to buyers and sellers, real estate agents typically charge a commission on the sale, which by custom averages around 6 percent. Traditionally the seller pays the entire 6 percent to their agent, who in turn offers a portion of the commission to any agent that brings in a buyer. (If the buyer is not represented by an agent, the seller’s agent keeps the entire 6 percent.) On a home costing \$150,000 (the national average), the agents’ commissions add \$9,000 to the costs.³³ The value of existing home sales in 2001 was over \$800 billion.³⁴ At the traditional 6 percent fee for agents, those sales cost American homeowners as much as \$48 billion in 2001.

Information technology can dramatically cut these costs. Since the ultimate goal of e-transformation is to streamline the home buying process, the goal here should be allowing consumers to choose only those agent services they want and letting technology tools to handle the rest. Under the traditional system, the real estate agent offers a package of services: showing homes, providing information about home values and neighborhoods, matching buyers and sellers, negotiating and signing the contract, arranging for inspections, assisting with closings, and so on. Technology can disaggregate those services—Internet searches for listings, databases displaying home values, smart software for boilerplate contract language, personalized websites that manage the complicated transaction, and so on—and allow consumers to pay for only those that they want.

The Internet also increases the efficiencies of the home search process by lowering the amount of time spent physically searching for homes; buyers who use the Internet visit half as many homes before purchasing as buyers who

use an agent exclusively.³⁵ Greater use of IT will also bring greater price competition to the standard 6 percent commission, a fee that is set and enforced by culture and custom rather than by market logic. The services provided by agents are valuable, and some buyers and sellers will always prefer to pay for the assistance of a full-service agent. But consumers, not agents, should be able to decide which services will be purchased.

Though many buyers and sellers praise the utility of the Internet in educating them about the real estate transaction, most still hire an agent at full commission for one simple reason: It is extremely difficult to sell or buy a house for a fair price without access to the local MLS, which in most cases can be done only by hiring a full-service real estate agent.

The MLS is the gold standard for marketing a home for sale in every region of the country.³⁶ It is by far the easiest way to attract buyers to a home because 80 percent of buyers are represented by an agent and the MLS is the primary tool used by agents to find available homes. Agents search the MLS because each listing details exactly what their share of the commission will be if they bring a willing buyer and complete the deal. A listing in the MLS is also the only way for the home to appear on Realtor.com, the official commercial site of the National Association of Realtors (NAR) that aggregates local MLS data into a single searchable site. Though many For Sale By Owner (FSBO) websites have been launched, it is difficult to compete with the critical mass of the MLS system, and many sites have failed for that reason; the remaining sites are small and get very light traffic compared to Realtor.com. The massive “first mover” advantage³⁷ held by the MLS as the primary market-maker for residential real estate makes it a de facto monopoly controlled by distributors rather than producers (i.e, the home sellers).

The MLS system, in turn, supports the full-service model by enabling the full-commission system. The 6 percent commission is paid by the seller to the seller’s agent, and the MLS lists the compensation to a buyer’s agent (typically half the commission, or 3 percent of the contract

price). Buyers who are not represented by an agent but search for listings on Realtor.com will not realize any savings because the seller’s agent simply keeps the entire 6 percent commission. But buyers normally cannot get even this far. Because Realtor.com does not as a rule list street addresses, buyers who are not represented by an agent must contact the listing agent to do so much as drive by the house, giving the listing agent the opportunity to sign a new client rather than allowing buyers to search for homes on their own.³⁸ Many buyers would be more than willing to do all of the searching themselves, especially if it meant getting a rebate on the commission, but the conventional business model impedes this kind of self-service.

Given that there is no realistic alternative to the MLS for buying and selling houses, increased competition and pressures to facilitate self-service with technology must come from within. However, efforts to improve competition by offering reduced commission costs to consumers have been bitterly opposed by real estate agents. Reducing commission costs through rebates to buyers and discounts to sellers is an important competitive innovation fought by agents in the courts and through their trade association, the NAR.

Companies such as eRealty and ZipRealty act as agents for online buyers and give them access to MLS listings in several major cities, including address data.³⁹ Like any other agent, these sites are authorized to share full MLS data on their own website with to potential buyers.⁴⁰ They then offer to serve as the buyer’s agent and rebate one-third of the commission received from the seller’s agent, a rebate which typically amounts to one percent of the sale price. (These savings are possible because buyers who use the Internet consume so much less of the agents’ time by viewing fewer homes, using address information to do initial site visits, doing more independent research on neighborhoods and mortgages, and so on.) The sites also charge sellers less, as little as 4.5 percent to list the home, cutting the seller’s portion of the commission in half.⁴¹ These are savings that go directly to consumers, and can contribute thousands of dollars to defray settlement costs or reduce the

purchase price. This represents a good example of how the efficiencies gained by information technology can cut costs and promote competition among real estate agents.

This effort to streamline the process and pass the savings on to consumers has been met with fierce resistance by local Realtor associations and NAR.⁴² In an effort to limit competition from websites that offer commission rebates, last October NAR contemplated a change to MLS rules that would let listing agents withhold their listings from eRealty and other websites by allowing them to opt out of “electronic display” of their listing data.⁴³ This would mean that web-based brokerages would not be able to display every matching home when a buyer does a search.⁴⁴ (NAR delayed a final decision until at least May 2003.)

The buyer rebate model is also limited in several states by regulations that prohibit rebates to anyone who does not hold a real estate license. In some cases the prohibition is the result of unclear language in regulations designed to prevent undisclosed referral fees or other kickbacks to third parties, but some states, such as New York, explicitly prohibit the payment of rebates to buyers.⁴⁵ Another rule used to put discount brokers at a competitive disadvantage is a provision in the MLS rules that allows sellers’ agents to notify specific buyers’ agents in writing that they refuse to share commissions, allowing large brokerages to shut discounters out of the market.⁴⁶ Such legal restrictions constitute a serious barrier to improving consumer choice through e-transformation.

Another method of unbundling agent services is allowing sellers who want to sell their own homes—FSBOs, for For Sale By Owners—to list their homes in the MLS for a small fee rather than a full commission. Rather than participate in the marketing of the home (such as holding open houses), the agent charges the owner a flat rate of \$300 to \$600 to list the home in the MLS.⁴⁷ This offers a significant savings over the typical commission of the listing agent. However, because only NAR-affiliated agents⁴⁸ can search and see full MLS data, having access to the MLS will generally only work if the owner offers to pay a commission to the buyer’s agent, which is typically 3 percent of the sale price. A FSBO seller, therefore, does virtually all of the

work in marketing the home, but will save less than half of the typical commission.

This innovation (which, like the rebate model, reduces but does not eliminate commissions) has also been resisted by real estate agents. Agents in Texas convinced the state’s real estate regulatory panel to pass a rule requiring all real estate agents to assist with price negotiations, effectively eliminating the discount FSBO business model. This regulation has become the subject of a messy legal battle in that state, the outcome of which is still uncertain.⁴⁹

Both buyers and sellers will ultimately benefit from a transformation of the brokerage process using information technology. Unfortunately, it is unlikely that the industry will develop these tools on their own, since doing so would incur costs in both investment capital and a reduced number of working real estate agents. Expecting real estate agents to move forward with e-transformation is like expecting auto workers to design, build, and pay for the robots that will replace them on the assembly lines. The incentives in the current system are for agents to build technology tools that secure their role in the process and discourage competition; with regard to Realtor.com, that is exactly what has happened.

But it is not enough to develop technology tools for consumers, as so many Realtor.com competitors have learned. Educating consumers about the existence of those tools is also important. This education function has a strong precedent in residential real estate, and in every industry where the transaction is important and the consumer (by virtue of engaging in the transaction very rarely) cannot hope to have the same level of expertise as professionals. While grocery stores, for example, are not required to disclose that a store down the street has better prices, every state requires certain disclosures of real estate agents before an agreement is signed. Information about various transaction options rightfully belongs in the category of information to be disclosed.

To facilitate the unbundling of real estate agent functions and promote e-transformation of the transaction process:

- ▶ **The Federal Trade Commission (FTC) should monitor the residential real estate**

market to discourage anticompetitive business practices and regulations. Because real estate agents enjoy significant market power and political clout, they are able to discourage innovative business models that increase the efficiency of the residential real estate market. The efforts in Texas to stop eRealty, for example, were called a probable antitrust violation by a federal court.⁵⁰ The industry can be expected to resist changes, but the role of government is to ensure a fair and competitive market. The FTC has been effective in discouraging state laws and regulations that protect middlemen at the cost of economic efficiency. Continued examination of the industry, through public hearings and workshops, will help shed light on anticompetitive business practices and give innovators an opportunity to have a fair chance in the marketplace.

- ▶ **States should make explicit the fact that rebates to buyers and sellers are legal and can be advertised.** Although it is a legitimate public policy goal to protect home buyers and sellers from undisclosed financial agreements between their agents and third parties, it is inappropriate to extend such regulations to the buyers and sellers involved in the transaction. Because the current method for compensating buyer's agents is to share the commission paid by the seller, the primary way for buyer's agents to offer reduced prices is to offer rebates that sometimes run afoul of state regulations designed to prevent kickbacks. Ideally, the payment arrangements would be changed to allow the customer who receives a service to pay the service provider directly.⁵¹ Rebates, however, are an effective intermediate step toward that goal. States should repeal any laws or regulations that explicitly prohibit rebates to principals in the transaction, and should clarify any regulation that may prohibit the offering of rebates or other cash inducements as a marketing strategy.
- ▶ **In partnership with the states, HUD should develop tools to empower buyers and**

sellers to complete more steps of the transaction on their own. Real estate agents facilitate home purchase transactions in three primary ways: showing homes, negotiating prices, and arranging legally mandated purchase contracts and disclosures. Negotiating is a task that many consumers are capable of doing on their own, particularly with the ever-growing availability of data on home values.⁵²

The legal paperwork typically consists of boilerplate clauses and disclosures with easily understandable blanks to be filled in, usually written or approved by federal or state regulatory agencies. States should make these forms available online, along with intelligent systems that guide the completion of the forms, to allow consumers to do it themselves, perhaps with the involvement of an attorney or other expert who charges significantly less than 6 percent of the purchase price. The development of intelligent online systems for explaining and completing the necessary forms should be led by HUD, with an eye toward creating a generic system that states can customize to their particular needs. This governmental boost to the development of smart systems will help resolve the chicken-or-egg problem that makes it difficult for private companies to act because they cannot get a critical mass of customers to cover the high development costs.

- ▶ **HUD should develop a real-time list of residential real estate resources and listings.** One reason that Internet listing services have a difficult time competing is their inability to gain a critical mass of viewers. The failure of numerous websites with FSBO listings is a striking example of this. Informing consumers of alternatives to full-commission arrangements will help break the stranglehold the MLS has on the real estate listing business. This in turn will empower consumers to do work for themselves or hire other professionals, such as attorneys or mortgage lenders, that offer packaged settlement services.⁵³ HUD should therefore establish a comprehensive and unbiased list

of Internet resources that includes the MLS and its alternatives, as well as a list of agents who are willing to add FSBO listings to the MLS for a flat fee. Such a website would be comparable to the Free Internet Filing Consortium organized at the Internal Revenue Service website to bring low-income taxpayers together with companies providing free electronic tax return filing services.⁵⁴

- ▶ **States should add a “seller’s bill of rights” to the disclosures required before signing a contract with a full-service real estate agent.** In the rapidly changing business environment created by the Internet, many consumers choose full service agents simply because they are not aware of the alternatives. Mandating disclosures of the alternatives when the seller signs a contract with the agent will help inform consumers, and will encourage agents to unbundle their services so that the needs of buyers and sellers are met and transaction costs are reduced. The disclosures should include the following provisions:
 - sellers have additional options for listing their homes in addition to or in lieu of the MLS, and a list of those options is available at the HUD website;
 - sellers who wish to sell their home without an agent can add their homes to the MLS for a greatly reduced fee, and a list of agents who will insert the listing into the MLS is available at the HUD website;
 - seller’s agents traditionally split the commission with buyer’s agents, and the seller’s agent has the option of discounting the commission if the buyer is not represented by an agent; and
 - seller’s agents have the option of displaying the property address in the MLS listing and on various Internet sites to increase the odds that the buyer will not be represented by an agent as well as reduce the amount of time necessary to sell the home.

4. Streamlining the Recordation Process

Once a home is purchased, the deed indicating new ownership, as well as any encumbrances such as mortgages, must be recorded in a public records office. From the homeowner’s point of view, the maintenance of residential property records is particularly critical. Any doubt as to the ownership of the home can destroy the value of the asset. County recorders therefore play a vital role in protecting homeowners and buyers from “title defects” that could ruin their investments, such as encroachment across property lines or mechanic’s liens—claims against the value of the property filed by a someone who has done work to improve the property but has not received payment.⁵⁵

The risk that a title being transferred to a home buyer could have unknown defects that put true ownership of the property into question has given rise to the title insurance industry.⁵⁶

If a question of title defect comes up, the insurer agrees to defend against the claim or to pay off the claim. Home buyers have the option of buying title insurance to protect their personal interest in the property (the owner’s policy), but lenders invariably require title insurance as a condition of making the loan (the lender’s policy). Since the owner’s policy is a relatively small marginal cost, and is paid in a one-time premium at settlement, most owners opt to purchase it. Depending on the value of the property, this expense can add between several hundred and a few thousand dollars to the settlement costs.⁵⁷ The cost is particularly egregious on refinancing and home equity loans, where the homeowner is forced to pay the one-time lender’s premium all over again—albeit at a discount—even if the original title insurance policy was written only one year earlier.⁵⁸

To decrease the risk associated with title insurance (and therefore the premiums), a title search is conducted whenever a new policy is issued. The title search generally consists of sending a title agent or attorney to the local records office to search through property records and examine them for possible defects. This manual search is necessary even if a title search was recently completed, because there is no

other way to determine whether a mechanic's lien or other encumbrance has been filed since the last title search was conducted. Because the title search involves a physical visit sorting through stacks of papers, it is an expensive and labor-intensive process, and the home buyer is generally charged several hundred dollars for it. Finally, the simple process of filing and storing paper titles, as opposed to electronic ones, is inefficient and adds costs to buying a home or getting a loan.

Enabling electronic filing of and access to property records will cut expenses for home buyers in three ways: reducing the cost of title recordation, reducing the cost of title searches, and reducing the premiums for title insurance by decreasing the risk of undiscovered defects caused by faulty paperwork or searches. The key to streamlining the process is electronic recordation: paperless property records that can be filed and searched remotely.⁵⁹ In recent years, the advantages of electronic recordation have become more apparent, and the National Association of County Recorders, Election Officials, and Clerks (NACRC) has launched an aggressive program to study the issue.⁶⁰ The effort has spun off the Property Records Industry Association (PRIA), a non-profit organization working to develop XML-based web forms and other technology standards to facilitate electronic recording across the nation.⁶¹ Despite these efforts, only a few large counties have actually launched electronic recordation systems.⁶²

Unlike other technology changes to the real estate industry, which tend to be opposed by the players at risk of disintermediation when processes and information are improved, there is no serious opposition to electronic recording.⁶³ Rather, the true barrier to electronic recording is a matter of cost and priorities. Deploying secure systems for transmission and storage of some of the most important public records in the nation will require an investment in software, equipment, and training. Moreover, changing the centuries-old process of stamping and filing sheets of papers will require comprehensive assessments of state laws on property, taxation, and privacy to determine what changes are necessary to move to a fully paperless, remotely-searchable system. There is also a threshold

problem: Because an electronic system will work only if the paper system is eliminated, the shift to electronic filing will force recorders to carry the costs of two systems simultaneously for a period of time. As a result, the only counties making the investment in electronic recordation are those with adequate resources and sufficient populations to quickly recoup the investment through cost savings.⁶⁴ Though developing a unified system would be more efficient than developing thousands of proprietary systems, counties have not moved to do so.

Fortunately, the proliferation of firms providing application service provider (ASP) technology can reduce the costs. An electronic recordation ASP would develop the system and deploy the hardware to record documents for a number of counties, and then rent the application to the counties. The ASP would post a website for each client county with a customized form and instructions for electronic submission and searching of records; each county website would embody the rules, policies, and fee structure of the individual county. The ASP model allows for the development of a single back-end application and storage system rather than separate systems for each county. Since there are over 3,000 counties with populations less than 1 million, the market for such ASPs is likely to be large and competitive.⁶⁵

To speed the deployment of electronic recordation:

- ▶ **Congress should appropriate funds for grants to counties that adopt electronic recordation to defray the start-up and transition costs.** There are a number of industry players that are ready to develop electronic recordation ASPs, but reluctant to make the investment given the current business climate; companies are afraid to invest when counties are not likely to make electronic recordation a priority. Counties are unlikely to pursue this change aggressively due to budget pressures and the chicken-or-egg dilemma. To break this impasse, congressional appropriations could take the form of a HUD grant program, to give funds to counties to cover up to 80 percent of the cost of developing electronic

recordation themselves or contracting with an application service provider to do so. While counties should be free to develop proprietary electronic recordation systems, there is a risk that such systems will restrict consumer choice if the systems are developed only for “professional” access. It is conceivable that a county might launch a system that requires specialized software, direct dial-in, high subscription fees, local licensure, or other impediments that effectively limit system access to established players in the title industry.⁶⁶ Although it would be an improvement over the paper-based system, a restricted system would nevertheless squander an opportunity to bring greater competition to the title industry by lowering barriers to entry. Counties should keep in mind that the goal is not merely electronic recordation, but *simple and inexpensive* electronic recordation. Any federal funding should support only *open* web-based systems, so anyone with an Internet-connected PC and proper authority can have access.⁶⁷

- ▶ **States should provide incentives for electronic recording of mechanic’s liens.** A key risk for title insurers is an undisclosed mechanic’s lien, which in turn creates the expense of multiple and frequent title searches.⁶⁸ Once an electronic recordation system is up and running, the expense of discovering those liens—and the risk posed by undiscovered liens—can be reduced dramatically. Electronic recordation will make it possible for anyone to search the title history from any computer. By requiring all title encumbrances to be filed electronically going forward, a final search of the paper documents can mark a property as “clean” as of the transition date; all future electronic searches will be valid because the only additions to those records would be electronic additions. As long as paper-based liens are accepted, the risk of a title defect not appearing in the database is unacceptably high, and the costs of that risk will be passed on to the home buyer. Providing incentives for electronic filing,

such as fee discounts, will encourage filers to visit a website rather than use paper forms, which in turn will accelerate implementation of an electronic recordation system.

5. Enabling Electronic Settlement

After the lengthy process of house hunting, making an offer, obtaining a mortgage, and attending to myriad details of the purchase process, many home buyers consider settlement to be a tremendous emotional release. The sense of ceremony in signing the numerous pages of documents and disclosures, culminating in the keys being handed to a new homeowner, is undeniable.

There are, however, several downsides to settlement as it currently practiced. Many home buyers, particularly first time home buyers, do not realize that they are entitled to choose their settlement company and instead go with whichever company their agent recommends. This failure to shop around can cost the home buyer hundreds or thousands of dollars. Home buyers are also frequently surprised to find an extensive list of fees for services they did not know about in advance, many of which (such as courier fees) are listed at significant markups. The current process is also extremely paper- and labor-intensive.

Some states also add to closing costs by defining real estate closings as a practice of law, thereby requiring an attorney to be present at closing. Such requirements offer little additional protection to either buyers or sellers, because qualified lay professionals are just as capable of administering the signing of (largely boilerplate) documents at closing.⁶⁹ However, requiring attorneys to be present does add tremendously to the cost—in some cases nearly doubling the amount buyers pay for closing services, according to the Federal Trade Commission and the U.S. Department of Justice, both of which have been active in fighting these requirements at the state level.⁷⁰

Here, again, technology can help improve the home-buying process. Secure websites can create a virtual settlement table where all parties can peruse the documents at their convenience and leisure. Each of the documents can be

digitally signed and transmitted, saving the expense of the bringing the parties together in a meeting room.⁷¹ Moreover, placing digital signatures on electronic documents makes the process of electronic recordation much easier.

Realizing the savings and convenience to be gained by electronic closing, the mortgage industry has been very aggressive in their efforts to transform the process. The Mortgage Industry Standards Maintenance Organization (MISMO) was established in 1999 to develop a set of data standards to facilitate the e-transformation of the industry.⁷² The goal is to create industry-wide data standards that enable the mortgage industry to do their post-closing work (storage, servicing, secondary market reselling) in purely electronic format. MISMO's work is a model for industry e-transformation, but government needs to take steps to support their efforts.

To facilitate widespread adoption of electronic settlements:

- ▶ **States should not require that attorneys conduct residential real estate closings.** Though buyers and sellers are free to hire attorneys if they choose, the evidence indicates that making attorneys mandatory adds nothing but costs to the process. Yet, in response to pressure from real estate attorneys, some states (such as Rhode Island) have proposed or passed laws requiring their presence. Because electronic closing requires a leap on the part of consumers—who are likely to feel more comfortable conducting such a large transaction with traditional pen and paper—the savings of electronic closing are a vital part of the incentive to innovate. The higher fees associated with hiring an attorney could virtually wipe out the savings from electronic closing, thereby making the e-transformation of real estate settlements less likely.
- ▶ **All states should adopt a “clean” version of the Uniform Electronic Transactions Act (UETA),** the model legislation that gives legal force to digital signatures. President Clinton's signature of the E-Sign bill in 2000 gave a boost to widespread UETA adoption, which will be key to the development of electronic closing services by large nationwide mortgage lenders who are more likely to invest in the technology if UETA is adopted in every state. Several states, however, have yet to pass their versions of the legislation, and others have adopted UETA but altered the model legislation in ways that present problems for interstate commerce.⁷³
 - ▶ **Use state motor vehicle agencies to improve the capability of the government and the private sector to verify the identity of customers over the Internet using digital signatures.** The main obstacle to remote signature of settlement documents is verifying the identity of the home buyer when the documents are signed. It is widely known that driver's licenses and state-issued ID cards are the gold standard for identity verification, but they only work when the person presenting the card and the person verifying the card are in the same place. PPI has proposed two initiatives to allow driver's licenses to accurately verify identification in an online transaction rather than requiring a face-to-face presentation of the card. One calls for states to issue “smart” driver's licenses with onboard computer chips that carry biometric identifiers (such as thumbprints) and encryption.⁷⁴ The other calls for state motor vehicle agencies to issue digital signatures in conjunction with card issuance.⁷⁵ Taken together, these initiatives would allow home buyers to sign settlement documents with their driver's licenses, verified by a unique biometric identifier. This would vastly simplify the electronic settlement process.

Conclusion

In many industries—particularly those competitive industries where producers rather than middlemen drive the action—the market pressure for e-transformation and consumer empowerment through technology is irresistible. However, in some industries where producers and/or consumers are disorganized or uninformed and professionals and other middlemen exercise power over the market and

the political process, it is unreasonable to expect e-transformation to happen on its own in the foreseeable future. It is therefore incumbent on government to move forward with appropriate measures to encourage e-transformation, leading to greater competition, efficiency, and choice for consumers. In the residential real estate industry, the results of this transformation will have an important additional benefit: greater opportunities for homeownership, and all of the benefits that accompany it, for all Americans.

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Appendix: Summary of Recommendations

1. Improving Credit Report Access and Quality

- ▶ Congress should encourage “single portal” online access to credit reports and online dispute procedures.
- ▶ Congress should increase accountability for reporting inaccurate information to CRAs.
- ▶ The CRAs should ensure that shopping for a home does not hurt a home buyer’s credit rating.
- ▶ Lenders that participate in the credit reporting process should be required to report complete information on all of their customers.

2. Facilitating Online Mortgage Shopping

- ▶ HUD should strengthen the proposed RESPA reforms by increasing disclosure and responsibility for all items in the GFE.
- ▶ HUD should create a standardized form for online mortgage shopping.
- ▶ States should eliminate “bricks-and-mortar” laws that require mortgage providers to maintain a physical office in the state.
- ▶ Congress should create national licensure for mortgage brokers and lenders as an alternative to state licensure.

3. Promoting Choice in Real Estate Agency Services

- ▶ The Federal Trade Commission (FTC) should monitor the residential real estate market to discourage anticompetitive business practices and regulations.
- ▶ States should make explicit the fact that rebates to buyers and sellers are legal and can be advertised.
- ▶ In partnership with the states, HUD should develop tools to empower buyers and sellers to complete more steps of the transaction on their own.
- ▶ HUD should develop a real-time list of residential real estate resources and listings.
- ▶ States should add a “seller’s bill of rights” to the disclosures required before signing a contract with a full-service real estate agent.

4. Streamlining the Recordation Process

- ▶ Congress should appropriate funds for grants to counties that adopt electronic recordation to defray the start-up and transition costs.
- ▶ States should provide incentives for electronic recording of mechanic’s liens.

5. Enabling Electronic Settlement

- ▶ States should not require that attorneys conduct residential real estate closings.
- ▶ All states should adopt a “clean” version of the Uniform Electronic Transactions Act (UETA).
- ▶ Use state motor vehicle agencies to improve the capability of the government and the private sector to verify the identity of customers over the Internet using digital signatures.

Endnotes

¹ For more on Orbitz and the e-transformation of the travel industry, see the October 8, 2002 testimony by Rob Atkinson before the Federal Trade Commission, <http://www.ppionline.org>.

² As discussed later in this report, the real estate agent representing the buyer is typically paid by the agent representing the seller, generally by equally sharing a 6 percent commission. This payment scheme makes it difficult to assess who would benefit most from a reduction in agent commissions, but we will assume that the buyer and seller would benefit equally as the commission is typically split equally.

³ These costs must be paid in any event, and therefore will not be affected by e-transformation. Some third-party costs may be reduced slightly by the “guaranteed pricing” reforms proposed by HUD and discussed later in this report.

⁴ Based on 2002 existing home sales of 5.56 million, [http://www.realtor.org/Research.nsf/files/CurrentEHS.pdf/\\$FILE/CurrentEHS.pdf](http://www.realtor.org/Research.nsf/files/CurrentEHS.pdf/$FILE/CurrentEHS.pdf).

⁵ Some have also claimed that homeownership promotes self-esteem and improves family life, but the empirical evidence for such claims is considerably weaker. For a summary of research related to homeownership see <http://www.huduser.org/publications/txt/hdbrf2.txt>.

⁶ The national homeownership rate was 68.3 percent for the fourth quarter of 2002. For historical rates, see <http://www.census.gov/hhes/www/housing/hvs/q402prss.pdf>.

⁷ Some of the problems to be addressed by a more comprehensive strategy include improving financial literacy, improving access to mainstream banking and financial services, and improving the credit scoring models on which mortgage lending decisions are made. The homeownership rate, however, will never reach 100 percent because at any given time there will always be a portion of Americans for whom renting is a better option.

⁸ The three major CRAs are Experian (<http://www.experian.com>), TransUnion (<http://www.transunion.com>), and Equifax (<http://www.equifax.com>). Innovis (<http://www.innovis-cbc.com/>) is a minor CRA that primarily serves direct marketers by providing a “wash list” of consumers with negative credit histories so pre-approved credit offers are not extended to consumers who are bad risks.

⁹ The assessment of risk in mortgage underwriting is based on several factors in addition to credit history, such as job stability, current debt levels, and so on. Thus, even a borrower who does not have a poor credit history may be forced to borrow in the subprime market.

¹⁰ For a summary of how Fannie Mae and Freddie Mac work, see <http://www.bankrate.com/nsc/news/investing/20000802a.asp?prodtype=grn>.

¹¹ Automated underwriting systems either approve a loan or send it back to an underwriter for further processing, at which time extenuating circumstances can be taken into account. However, because buyers at the margin tend to buy lower-priced homes and therefore generate lower commissions, many mortgage lenders are reluctant to put additional effort into “massaging” the loan, particularly if the lender can refer the borrower to an affiliated subprime mortgage company.

¹² Correcting information in credit reports by telephone can be difficult; in 2000 the three major CRAs paid a \$2.5 million fine collectively because they did not maintain sufficient staff to answer all of the phone calls they received. Correction through CRA websites, while available at all times, is also limited either by a pre-set list of reasons for dispute or by the difficulty in submitting supporting documentation for the dispute. In practical terms, mail is still the only effective way to clean a credit report.

¹³ The Fair Credit Reporting Act requires data furnishers to supply corrected information to all CRAs, so in theory correcting information on one report will correct it on all three. However, it is necessary for the consumer to follow up with all three CRAs because some data is reported only to one CRA and because some corrections might not take place across all CRAs (if, for example, one CRA deleted a data line but the data furnisher did not correct it, the incorrect information could still appear on the other reports).

¹⁴ This may also require changes to privacy laws that currently require CRAs to deal directly with consumers, if third party websites become the preferred solution.

¹⁵ Section 623 of the Fair Credit Reporting Act (<http://www.ftc.gov/os/statutes/fcrajan2002.pdf>) limits the right of action for false reporting to state agencies, which generally sue only for pattern or practice of false reporting. Some consumers have been successful in suing data furnishers for defamation, but this is far from a settled legal principle.

¹⁶ Most credit scoring formulas—including the FICO model used exclusively by Fannie Mae and Freddie Mac—have been adjusted in recent years to recognize that a certain number of inquiries within a given time frame constitute a single inquiry, but home buyers who use the Internet often stretch their shopping across many months.

¹⁷ Fannie Mae and Freddie Mac have been under fire for being slow to accept a more accurate version of the FICO scoring model known as Next Generation FICO. Quicker approval of scoring models, as well as broader acceptance of alternate models generated by companies other than Fair Isaac, will facilitate e-transformation of the mortgage approval system.

¹⁸ This recommendation was originally proposed in PPI’s November 2002 policy report “Taken for a Ride: Lenders, Automobility, and the Working Poor,” by Anne Kim, http://www.ppionline.org/documents/Automobility_1102.pdf.

¹⁹ Based on transfers of existing homes only. The addition of new home sales and refinances of existing mortgages pushes the total above \$30 billion. For an alternate view on the role of mortgage originators, see the testimony of economist David Olson before the Senate Committee on Banking, Housing, and Urban Affairs (Hearing on “Predatory

Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums," January 8, 2002). Olson defends the role of mortgage originators and the practice of pocketing of YSPs rather than passing them through to the consumer, which makes up half of the money collected by mortgage originators for their services, and without which he contends mortgage originators could not survive in the marketplace.

²⁰ This phenomenon happens in other industries, from travel to retail, where customers seek free advice from storefront businesses and then make their purchases from online discounters.

²¹ Various analyses indicate that the total amount collected by a mortgage broker, in direct and indirect fees, totals slightly more than 2 percent, or more than \$3,000 on the average home price of \$150,000. For an extended discussion of the mortgage broker industry, including the various ways mortgage brokers can add to the cost of a mortgage without the borrower even realizing it, see the informational website posted by Wharton economics professor Jack Guttentag at <http://www.mtgprofessor.com>.

²² <http://www.hud.gov/offices/ogc/ea-chapters.pdf>.

²³ The fact that most mortgage brokers are paid in proportion to the loan amount encourages the proliferation of junk fees on lower income borrowers (who typically buy less expensive homes and require smaller mortgages) because there is very little correlation between the amount of the loan and the effort expended by the mortgage broker. Since smaller loans require just as much work as larger loans, brokers make up the difference with junk fees or by pocketing YSPs.

²⁴ P.L. 93-533.

²⁵ Lend-X (<http://info.lend-x.com>) offers online mortgage shopping on behalf of specific lender clients. Other services such as Lending Tree (<http://www.lendingtree.com>) introduce borrowers to multiple lenders, though still only a relative handful of the total available lenders. Some online services, such as Quicken Mortgage (<http://quickenloans.quicken.com>), work as direct Internet-only lenders, eliminating mortgage brokers from the process entirely.

²⁶ A list of state bricks-and-mortar laws can be found at http://www.ftc.gov/opp/e-commerce/anticompetitive/panel/buckley_cunliffe_attach_A.pdf.

²⁷ Though HUD's proposed reforms can operate only on a regulatory and enforcement level, Rep. John LaFalce (D-N.Y.) introduced the Mortgage Loan Consumer Protection Act in May 2002 (H.R. 4818). LaFalce's bill is similar to the HUD proposal in many respects, but it also includes an amendment to RESPA prohibiting lenders from marking up fees for third party services, such as charging a borrower \$50 for a credit report when the lender paid only \$20 and gave the borrower no option to shop around for a better price. While this goal is commendable, it may be unnecessary if consumers are able to shop based on guaranteed bottom-line prices.

²⁸ Such discounts are currently prohibited by the so-called "Section 8 Rule" because they are deemed to be kickbacks by third parties to the lenders or brokers who steered business to them. The HUD proposal offers safe harbor from Section 8 for packaged services with a guaranteed price under certain limited circumstances, but otherwise leaves intact the prohibition on kickbacks. This is a fair deregulatory tradeoff for increased regulatory burdens of the proposed RESPA requirements.

²⁹ Charging recording taxes on a per transaction basis rather than as a percentage of the loan amount, will make it much easier to give accurate estimates of the taxes due at settlement. However, database technology is more than powerful enough to accurately estimate the amount of tax due based on the zip code of the target property without such a change. This recommended policy change, therefore, should not be contingent on the change in recording tax policy.

³⁰ Of course, deployment of such a system represents considerable up front costs to lenders, but lenders ultimately benefit by streamlining their marketing efforts, reaching more customers, and eliminating brokers and originators from the process.

³¹ For more on bricks-and-mortar laws as inhibitors to e-commerce, see "The Best States for E-Commerce," by Robert D. Atkinson and Thomas G. Wilhelm at http://www.ppionline.org/documents/States_Ecommerce.pdf.

³² According to the 2002 National Association of Realtors Profile of Home Buyers and Sellers, 65 percent of first time buyers cite finding the right house to purchase as their main reason for hiring an agent, with negotiating and paperwork help tied for second at 9 percent each (Table III-4). For sellers, 55 percent cited finding a buyer or finding a buyer within a specific time frame as their primary concern, with help pricing the home following at 20 percent (Table VII-5). These numbers indicate that both buyers and sellers value agents primarily for their ability to *create* the transaction, and only secondarily for their ability to *assist* with the transaction.

³³ How the agent costs are allocated between buyer and seller is a theoretical matter, with some suggesting that the entire cost is borne by the seller because the buyer would be willing to pay the same price whether or not the seller is paying an agent. Others believe competition in an agentless market would lower housing prices by the full amount of the commission, meaning that buyers bear the entire cost. Because both parties pay more than they otherwise would, it is reasonable to say that both parties bear the expense of real estate agents equally.

³⁴ According to official NAR data, there were 5.4 million sales of existing homes at a median price of \$151,400 (<http://www.realtor.org/PublicAffairsWeb.nsf/Pages/DecEHS?OpenDocument>). There were also 908,000 sales of new homes at an average price of \$213,200 (<http://www.census.gov/ftp/pub/const/www/neuressalesindex.html>), but new home sales typically are handled directly by the developer and therefore do not generate commissions for real estate agents.

³⁵ According to the California Association of Realtors 2002 Internet vs. Traditional Buyers Study, traditional buyers look at an average of 15.2 homes, whereas Internet buyers look at an average of 7.5 homes before purchasing.

³⁶ Each region has its own local MLS, but all operate under rules established by the National Association of Realtors.

³⁷ As used here, “first mover” means a monopoly that exists not because of anticompetitive practices or government fiat, but because an organization was first to market with a good idea and gained such market share that it is virtually impossible for competitors to gain ground. This is most pronounced in services with strong network effects: the greater the number of participants, the greater the value of the service. Another frequently cited example of first mover advantage is the Internet auction site eBay, which thrives because of the network effects of its user base despite the entry of competing auction sites.

³⁸ The limited information on Realtor.com also serves to keep agents from accessing full listing data without paying membership dues to NAR. There are some local MLS websites that list address information, such as the Tucson MLS (<http://www.tarmls.com/>), but access to full listing data including commissions to buyers’ agents is restricted.

³⁹ <http://www.erealty.com> and <http://www.ziprealty.com>.

⁴⁰ In order to deliver MLS data, registration is required to certify that the individual is a bona fide shopper.

⁴¹ eRealty charges sellers a 4.5 percent commission because technically the seller pays the commission for the buyer’s agent and in order to bring in the maximum number of buyers it is necessary to pay the customary 3 percent to buyer’s agents. This leaves 1.5 percent for eRealty as the seller’s agent, half the customary commission.

⁴² For more information on the efforts of the Austin Board of Realtors to deny MLS data to eRealty, see “The Revenge of the Disintermediated: How the Middleman is Fighting E-Commerce and Hurting Consumers,” by Robert D. Atkinson at <http://www.ppionline.org/documents/disintermediated.pdf>.

⁴³ At the heart of the dispute is whether MLS data will be displayed under a “virtual office website” model (VOW) or an “internet data exchange” model (IDX). The VOW model treats website visitors as if they were customers sitting in a bricks-and-mortar office for purposes of determining the rules for distributing MLS data. The IDX model allows listing agents to opt out of Internet displays of their listings, though the listings could still be given to website visitors via fax or email.

⁴⁴ Depending on the wording of the final rule, it is possible that web-based brokerages would be able to deliver the “opt out” listings to buyers via email or fax, adding an unnecessary step to the process.

⁴⁵ Section 442 of New York’s Real Estate License Law states, “[N]o real estate broker shall pay or agree to pay any part of a fee, commission, or other compensation received by the broker, or due, or to become due to the broker to any person, firm or corporation who or which is or is to be a party to the transaction in which such fee, commission or other compensation shall be or become due to the broker,” <http://www.dos.state.ny.us/lcns/re-law.html>.

⁴⁶ This rule serves an important purpose: Because listing in the MLS constitutes a binding commitment to share the commission, this exception allows agents to refuse to do business with unethical colleagues (provided that refusal is made in advance). However, like so many other rules that began with a good purpose in the pre-Internet era, it can be twisted to serve protectionist goals.

⁴⁷ Most agents that offer flat fee services also rent lockboxes and yard signs for an additional fee. For an example of such a service, see <http://www.pmdrealty.com/page720793.htm>.

⁴⁸ Agents who pay dues to NAR may call themselves by the trademarked term Realtors, but the term is under challenge as being too generic to qualify as a trademark.

⁴⁹ For more on the legal twists in the Texas case, see http://realtytimes.com/rtnews/rtnapages/20021205_assistancerule.htm.

⁵⁰ Austin Board of Realtors, et al v. eRealty, Inc., Case No. A-00-CA-154 JN (Order filed March 30, 2000).

⁵¹ This would also address longstanding controversies about the inherent conflict of interest faced by buyer’s agents who are paid by individuals other than their clients, and the confusing web of fiduciary responsibilities involved when a single agent handles an entire transaction.

⁵² As more county recorders bring home value data online, it is easier for home buyers to search for “comps,” the prices of comparable homes, which was previously possible only by contacting an agent.

⁵³ Under the proposed RESPA reforms, the Section 8 regulatory relief will allow mortgage lenders and others to negotiate bulk rates with inspectors, appraisers, and other service providers. If this occurs, many consumers will find it more desirable to cut their real estate agent out of the process of finding these third-party service providers and accept the packaged services, making the 6 percent commission even less supportable.

⁵⁴ <http://www.irs.gov/efile/article/0,,id=101371,00.html>.

⁵⁵ Mechanic’s liens are most commonly filed by contractors hired by the homeowner (such as electricians or plumbers) or by subcontractors to property developers who are not paid for the work they put into building the house.

⁵⁶ The industry trade group is the American Land Title Association (<http://www.alta.org>).

⁵⁷ Title insurers and the premiums they charge are generally subject to heavy state regulation. The industry uses that regulated status to fight vigorously against lower cost alternatives to title insurance, such as the “undisclosed lien protection” offered by mortgage insurer Radian Guaranty Inc. For more on the battle to close down Radian’s lien protection program, see http://realtytimes.com/rtnews/rtnapages/20020819_titleprogram.htm.

⁵⁸ Most title insurance companies offer a discount ranging from 20 percent to 60 percent if the property does not change hands and the homeowner can produce a valid owner's policy written in the past several years.

⁵⁹ An alternative to paperless electronic recording preserves the paper copies of documents, but also files digital images of the document for online searches. This added functionality is useful, but in the end it adds costs rather than transforming the process, which should be the ultimate goal of any technology investment.

⁶⁰ <http://www.nacrc.org/interestgroups/LandPropRecordsAdmin/default.htm>.

⁶¹ NACRC began the effort in 1998 by starting the Property Records Industry Joint Task Force (PRIJTF). When the original three year tenure of PRIJTF expired, it transformed into PRIA (<http://www.pria.us>).

⁶² The counties include Fairfax County, Virginia; Maricopa County, Arizona; Orange County, California; and Wayne County, Michigan. For a comprehensive assessment of the current state of electronic recordation efforts, see the Electronic Document Recording State of the Industry Report 2002, <http://www.nacrc.org/presentations/2002/annual/INGEORReport.pdf>.

⁶³ Because title searches involved a physical visit to the courthouse or other records facility, competition among title agents is essentially local. An electronic system would bring competition to a national scale, and those title companies who are slow to adopt technology and compete on a national level are likely to oppose electronic recordation as the penetration rate increases.

⁶⁴ The median population of the 10 counties that have implemented electronic recordation is 1.4 million.

⁶⁵ The ASP model is likely to allow small counties to engage in electronic recordation for less than \$1 per document, with long-term storage costs that are comparable to or less than paper storage costs.

⁶⁶ One precedent for this is the development of online access to court records, which ranges from easy and inexpensive to difficult and costly depending on jurisdiction. For a comprehensive survey of state court record access, see <http://www.cdt.org/publications/020821courtrecords.shtml>.

⁶⁷ Since land records are public, the ability to browse the records should be available to anyone. Authority to add records, however, should be restricted and guarded by electronic signatures and other authentication technologies.

⁶⁸ Title insurance also covers other risks that cannot be eliminated by electronic recordation, such as encroachments across property lines (which are disclosed by surveys) and fraud (as when someone sells a house without the knowledge or consent of an estranged spouse).

⁶⁹ Of course, lawyers are necessary for the creation of boilerplate documents, and might be necessary in certain unusual situations to which boilerplate forms do not apply.

⁷⁰ For more on their efforts, and a summary of the data on costs to consumers, see <http://www.ftc.gov/opa/2002/04/riralestate.htm>.

⁷¹ Every year there are more than 10 million settlement meetings in the United States, each requiring a meeting room for approximately one hour. The cost of providing meeting space for those events is significant, and is rolled into settlement costs paid by the home buyer as overhead.

⁷² <http://www.mismo.org>.

⁷³ For current status on UETA adoption, see <http://www.bmck.com/ecommerce/uetacomp.htm>. For examples of states that passed altered versions of model legislation, see Thomas E. Crocker, "The E-Sign Act: One Year Later", *Electronic Banking Law and Commerce Report*, Vol. 6, No. 4, September 2001, pp. 11-14.

⁷⁴ "Modernizing the State Identification System," by Shane Ham and Robert D. Atkinson, February 2002, http://www.ppionline.org/documents/Smart_Ids_Feb_02.pdf.

⁷⁵ "Jump-Starting the Digital Economy (with Department of Motor Vehicles-Issued Digital Certificates)," by Marc Strassman and Robert D. Atkinson, June 1999, <http://www.ppionline.org>.