REAL ESTATE CENTER
TEXAS A&M UNIVERSITY

More Regulations, More Days to Close

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Given the importance of mortgage loans for Texas real estate markets and the state's banking industry, the Real Estate Center embarked on a research program to investigate the impact of the Dodd-Frank Act on the time it takes to sell a home. The Center leveraged its long-term time series data to investigate the length of time to complete home sale transactions in Texas after an offer is accepted.

Center researchers studied the impact of the Wall Street Reform and Consumer Protection Act on the length of time to sell homes and close transactions in Texas' two largest metropolitan housing markets, Houston-The Woodlands-Sugar Land (Houston) and Dallas-Fort Worth-Arlington (Dallas). The research found that:

- The length of time to sell homes in the two metro areas has trended downward in the aftermath of the recovery from the Great Recession (GR).
- The length of time to process home sale transactions after an offer is accepted has trended upward.

The Takeaway

Center research reveals that Dodd-Frank regulations extend the time from acceptance to closing by one week.

- Consequently, the percentage of time devoted to closing transactions has been trending upward to the extent that processing the transaction accounts for more than 40 percent of the time needed to sell a home.

Dodd-Frank Act Effects

Every U.S. economic recession has ended in a blame game between proponents and opponents of more or less government intervention and regulation. Among a long list of culprits blamed for nearly eight million foreclosed homes and the GR of 2007–09, subprime mortgage lending was the most prominent. Advocates for less government intervention blamed government policies

that overexpanded homeownership, Federal Reserve policies that engineered artificially low interest rates, government-sponsored entities (Fannie Mae and Freddie Mac) that subsidized risky loans, and so on.

Proponents of more government intervention blamed greedy bankers seeking quick profits, rating agencies (Moody's, Standard and Poor's, Fitch) colluding with bankers to defraud investors by giving misleading ratings to risky mortgage-related securities, borrowers who didn't understand what they were being offered by predatory lenders, and so on.

As Hubert Humphrey said, "To err is human, to blame is politics." In the immediate aftermath, advocates for more government intervention emerged victorious in the GR blame game. In response to widespread calls to learn from past mistakes, the administration passed the Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in 2010.

The 3,500-plus pages of rules targeted changes to all parts of the U.S. financial system to "promote the financial stability of the United States." An important part of the act was devoted to regulating mortgage loans on the presumption that loose mortgage loans were the real culprit behind the GR. The Mortgage Reform and Anti-Predatory Lending Act section of the Dodd-Frank Act has more than 200 pages of regulations to "assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive."

To fulfill these objectives, the act sets minimum standards for mortgage originators, appraisals, escrow accounts, title agents, and other players in the mortgage field. It prohibits "mortgage originators from steering any consumer to a residential mortgage loan that the consumer lacks a reasonable ability to repay."

To manage new loan regulations, the act created the Consumer Financial Protection Bureau (CFPB) to "promote fairness and transparency for mortgages, credit cards, and other consumer financial products and services." Since its creation, the CFPB has been busy issuing rules making the Dodd-Frank Act an ongoing work-in-progress. Lenders and borrowers now need to spend more time being aware of the latest rulings of CFPB to update their knowledge of mortgage lending regulations.

The key words in the act are "the ability to repay." The burden of verifying the ability of the borrower to repay the mortgage loan is on the lenders who are now required to check and document the borrowers' current employment, current assets and income, credit history, monthly mortgage payments and related payments (taxes, insurance expenses), other debts, and borrowers' debt-to-income ratios. Lenders should also determine how much income borrowers have left to pay for their living expenses after all housing costs are deducted from their incomes.

Since the passage of Dodd-Frank, there has been an ongoing debate between its advocates and opponents. Advocates argue that new mortgage regulations have prevented another nationwide mortgage default. Critics argue that the act and regulations have limited access to mortgage loans, particularly to first-time homebuyers and new retirees, resulting in fewer home sales. Banks spend millions of dollars to comply with the regulations. Compliance costs are especially important for small community banks. The increased costs have forced many of them to merge with larger banks or exit the mortgage lending business.

The debate regarding the impact of Dodd-Frank on finance and real estate markets has spurred research programs to quantify the impact of the act and empirically test the validity of various claims and counterclaims.

In a typical transaction, the time from offer acceptance to closing represents the time needed to prepare required documents, process the buyer's mortgage application, and comply with regulations. Obviously, the more regulations and the more documentation, the more time needed to complete a homebuying transaction, but how long?

Regulations and Days-to-Close

The Center compiled monthly computations of days-on-market (DOM), days-to-close (DTC), and days-to-sell (DTS) for the two largest Texas metropolitan areas, Houston and Dallas, to test whether increased regulation has lengthened homebuying transactions in Texas. The two metros normally account for more than 55 percent of homes sold in Texas. DOM represents the number of days a house has been on the market from when it was listed for sale until an offer is accepted by the seller through a signed purchase agreement. DTC reflects the number of days from the offer acceptance date until the transaction closed. DTS is the sum of DOM and DTC. The monthly data run from January 2003 to December 2016.

The blue line in Figure 1 shows the number of DOM for single-family homes in Houston and includes short-term fluctuations and seasonality. The red line represents the long-term trend in DOM extracted using the Hodrick-Prescott filter. The trend shows decreasing DOM before the GR of 2007–09 from 83 days in January 2003 to 80 days in November 2006. This was followed by an increase to 84 days during the GR and finally trending downward during the local economic recovery after the GR to 55 days in December 2016.

The number of DTC following the offer acceptance on single-family homes in Houston trended downward before the GR, decreasing to 31 days in February 2006, then trended upward, reaching 37 days in May 2012 and 38 days in December 2016 (Figure 2). Compared with the pre-GR era, Houston's homebuyers now need to wait one additional week to get the key for their purchased home.

The time series of DTS trended downward before the GR, decreasing to 111 days in September 2006, then trended upward to 119 days in March 2011 followed by a steep downward trend, falling to 89 days in September 2015 and ending at 91 days in December 2016 (Figure 3).

The percentage of time spent closing (mortgage application, appraisal, inspections, completing paperwork in compliance with Dodd-Frank regulations) after the offer is accepted can be calculated by dividing DTC by total DTS. The percentage of time spent closing the transaction in Houston was less than 28 percent before 2009. Since then it has risen, reaching 42 percent in December 2016 (Figure 4).

DOM for Dallas rose from 70 days in January 2003 to 82 days in September 2010. It fell during the local economic recovery after the GR to 34 days in December 2016 (Figure 5).

The DTC for Dallas trended downward before the GR, decreasing to 30 days in October 2007. Then it turned upward, reaching 36 days in December 2016, a 20 percent increase in time (Figure 6). Compared with the pre-GR era, Dallas homebuyers now also wait one more week to get the keys for their purchased home.

Dallas' DTS was trending upward before the GR, reaching 115 days in December 2010. Since then it has decreased, reaching 71 days in December 2016 (Figure 7).

The percentage of time spent closing the transaction in Dallas was less than 30 percent before 2011. In December 2016, it reached more than 50 percent—so, shorter absolute days but longer percentage of time in closing. Favorable market conditions shortened the DOM, but regulations lengthened the DTC (Figure 8).

Mortgage Borrowers Be Prepared

Maybe waiting one more week to close a homebuying transaction is not important for some buyers, but if it is important, gathering documents showing incomes, expenses, credit history, and so on can help homebuyers minimize the days needed to close.

So what does this all mean? First, it is clear that the regulations introduced with Dodd-Frank have had a measurable impact on time taken to close a home purchase. The extra safety checks created to protect buyers and prevent another financial crisis have extended the time for transactions in Dallas and Houston to close by one week.

Second, the significant decline in DOM in Dallas and Houston reflects the urgent shortage of housing supply in Texas. While the national economy struggled to recover after the GR, the Texas economy expanded strongly, creating new jobs and attracting millions of new residents to the state.

The Dodd-Frank regulations also tightened lending conditions for builders and construction loans, leading to lower supplies of new homes. The net result is a historically low housing inventory and rapidly rising prices, threatening the affordability of housing in Texas.

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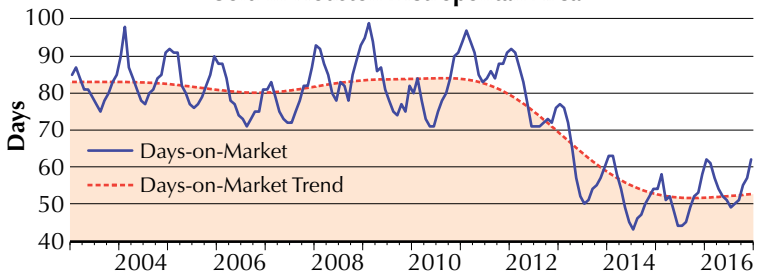
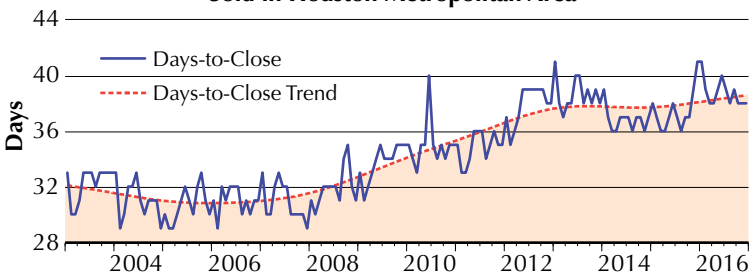
Figure 1. Days-on-Market for Single-Family Homes Sold in Houston Metropolitan Area



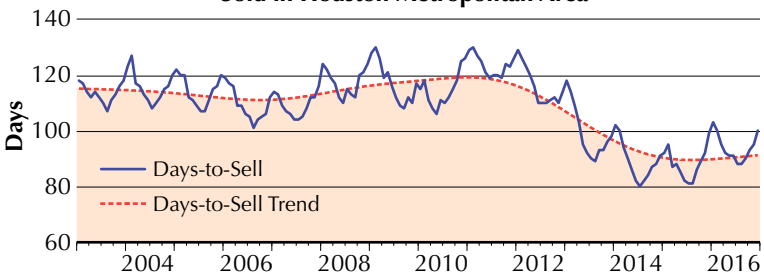
Source: Real Estate Center at Texas A&M University

Figure 2. Days-to-Close for Single-Family Homes Sold in Houston Metropolitan Area



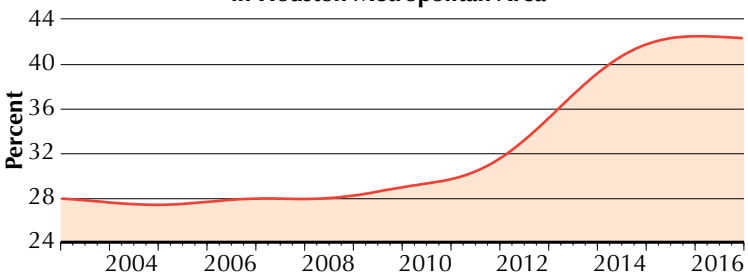
Source: Real Estate Center at Texas A&M University

Figure 3. Days-to-Sell for Single-Family Homes Sold in Houston Metropolitan Area



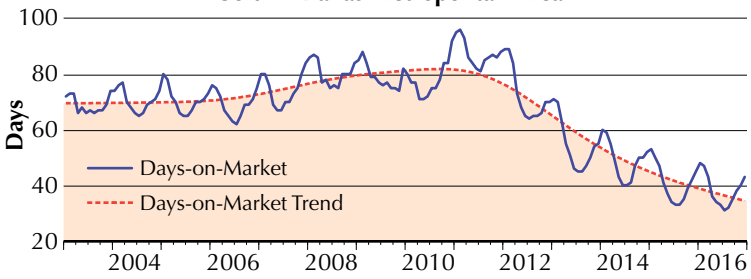
Source: Real Estate Center at Texas A&M University

Figure 4. Percentage of Time to Process Home Sales Transactions in Houston Metropolitan Area



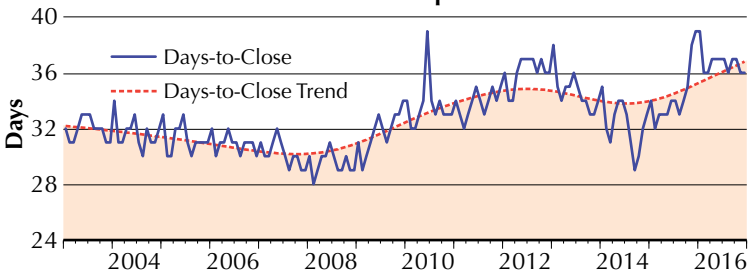
Source: Real Estate Center at Texas A&M University

Figure 5. Days-on-Market for Single-Family Homes Sold in Dallas Metropolitan Area



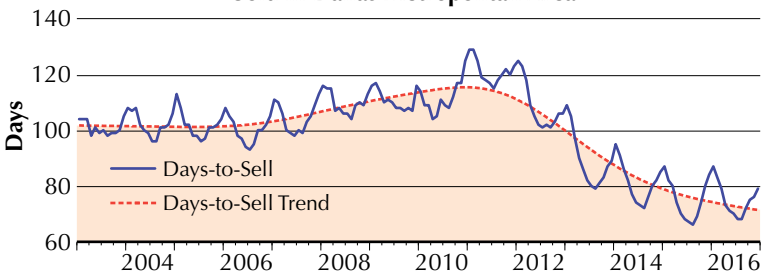
Source: Real Estate Center at Texas A&M University

Figure 6. Days-to-Close for Single-Family Homes Sold in Dallas Metropolitan Area



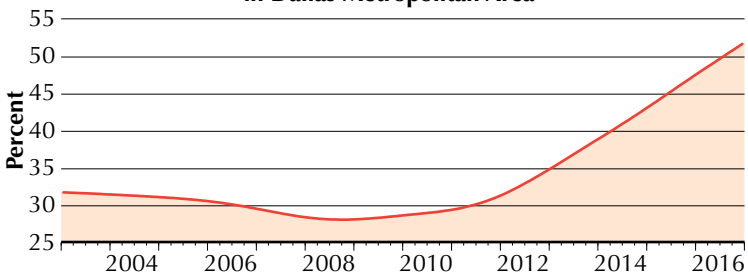
Source: Real Estate Center at Texas A&M University

Figure 7. Days-to-Sell for Single-Family Homes Sold in Dallas Metropolitan Area



Source: Real Estate Center at Texas A&M University

Figure 8. Percentage of Time to Process Home Sales Transactions in Dallas Metropolitan Area



Source: Real Estate Center at Texas A&M University

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