

## Financial Realities

*from the desk of David M. Touchstone*

All of my previous articles have been written about legal issues that affect how you do business. This article will be a little different. This time I'm doffing my lawyer hat and donning my businessman hat. I want to share with you some of the financial realities of the title business and how those realities affect you and your clients.

In 1980, the going rate for a residential closing in this market was \$350.00. Today, the going rate is either \$250.00 or \$350.00, depending on the deal and which title company you are going to. Think about that a minute. Over the last 25 years, the closing fee has actually gone *down* in this market. What other industry can say that? How can this be?

First, this market has tremendous competition, perhaps too much competition. You might be asking yourself at this point: how can there ever be too much competition? Well, imagine needing a tumor removed from your brain and the brain surgeon telling you that although the surgery you need customarily requires 4 hours, he'll have to do yours in 1 hour because that's all he's being paid for based on the going rates. In some ways that's where our market has gone in the last 10 years – short cuts. More about that in a minute. I have looked at settlement statements from all over the country. I haven't been able to find even one market where the rates are even close to being as low as they are in this market. That includes the rest of



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Louisiana. Title company rates in the rest of Louisiana are lower than in most of the U. S., but are still significantly higher than Northwest Louisiana. Outside our market, I find that closing rates in the rest of the State are running from \$500.00 to \$1000.00 (when you total up the closing fee, notary fee, title search fee, underwriting fee, etc.).

Louisiana is blessed with a set of laws good for the public and good for the title industry. Of particular note is our public records doctrine. Under this legal doctrine, if a document isn't filed with the parish clerk of court, it can be disregarded, even if (in most cases) the parties are aware of the document's existence. The effect of this is that one need go to one place only, the parish clerk of court, to research a title. And unlike our sister state, Texas, no private individual can get a monopoly on the use of the public records. This opens up competition and low-

ers capital barriers to engaging in the title business.

Another distinguishing feature of the title industry in Louisiana is the “everybody-sits-down-together-at-one-time” closing. In many states, sellers come in at one time and buyers come in at another time. In some states, such as California, there is a fancy two step closing process that starts with “putting the deal into escrow”. Louisiana is one of the few states in which closings are table-funded. Our system is not only more convenient for the parties, but it cuts down on how many times the file has to be handled. And in our business, just like any other, the fewer the times the file is handled, the less it costs to process the transaction.

I entered the practice of law in 1977. At that time, there was only one title company in our market. Probably 80% of closings took place in law offices. Today, there are umpteen title companies in our market. Probably no more than 20% of transactions take place in law offices, and most of those are conducted in pretty much the same fashion as the closings that are performed in the title companies. What’s the difference between lawyer closings and title company closings? Well, in the old days, the lawyer probably did lots of other stuff; he might have done some divorces, some personal injury cases, maybe some business litigation. In the old days, the lawyer’s employees generally did other stuff too. In the old days, only a small percentage of the people working on closing files were *specialists*. Today, almost everybody in the process is a specialist. In the larger title companies, there are many sub-specialists in the same way that persons on assembly lines have one job that they do very well and very fast. There has been a great deal of streamlining in the last 25 years.

Add to that computers. I still grit my teeth when I think about the cases of white out we used to purchase in 1980. The mortgage companies’ loan closing instructions forbade us to white out errors on the promissory notes; we threw away a lot of promissory notes and started over. It just took a lot longer to type loan packages and check them for corrections. Title searches have been revolutionized by computers. When I started as a lawyer, in performing a title examination, I had to review years and years of hand written indices. If the seller was named James Smith, oh my gosh, I had to read through every entry for which the person’s last name was Smith. Bottom line is that from 1980 to 2006, the amount of time required to perform residential title searches has been reduced from an average of approximately 5 hours to approximately 2 hours. This is a substantial savings in abstractor labor expense.

But folks, I doubt that there is going to be much more increment of production due to organizational streamlining and technological innovation. We might get a little more improvement on technology, but my guess is that we are pretty close to cutting all the fat that’s ever going to be cut.

One other thing that’s made a big difference in keeping title fees down is title insurance. In 1980, title insurance was a very common feature in closings, but nowadays a much higher percentage of transactions require title insurance. Since a substantial portion of the title insurance premium is paid to the title agent, this has helped title companies maintain a healthy bottom line.

On the other side of the equation, we are required by law and by our title insurance underwriters to do and maintain a substantially greater amount of record keeping. This adds a significant increment of expense. For

instance, we have to send 1099's out and report this information annually to the IRS. I would estimate that for our company the expense burden of just this one requirement is \$30,000.00 per year. There are many other similarly onerous burdens that have been thrust upon us since 1980. In 1980, the annual malpractice premium hovered in the \$1,000.00 - \$2,000.00 zone. Last year we paid \$17,000.00 for an annual malpractice policy.

But the real cost of the title business is the labor cost. I'm not kidding – labor costs have approximately tripled per employee in the last 25 years. Probably 2/3rds of this expansion has been due to the normal increase of wages. The other 1/3<sup>rd</sup> is due to the shift from lawyer closings to title company closings. In the old days, the lawyer personally reviewed *everything*. Today, like the ophthalmologist, the lawyer just looks at the stuff that really requires a lawyer. For everything else, he relies on non-lawyer specialists. Example: in 1980, approximately 95% of the closings would have been personally conducted by a lawyer; nowadays, I estimate only about 30% of the closings in our market are personally conducted by a lawyer. Non-lawyer specialists are expensive. You simply have to pay more bucks to the kind of person who can *take care of it* as opposed to the kind of person you have to micromanage.

Specialization has resulted in significant increments in per employee production. The growth of title companies (at the expense of law offices) has resulted in greater and greater focusing of closings. In 1980, 80% of closings of the closings in our market would have been performed in perhaps 100 different places. Today, 80% of the closings are performed in approximately 15 different places.

With rapid wage expansion, there are only three ways for title companies to stay in the black. First, and most obviously, is to increase prices. That will come in time, but not just yet; because there are a sufficient number of title companies in this market, we are all still beating each other's brains out in a price war. The second method is to increase volume; the difficulty here from the title company perspective is that nearly all the business is already in the hands of title companies (and a handful of law offices that specialize in real estate and function pretty much the same as the title companies). The only wiggle room here is greater consolidation; that's coming too whether in the form of some of the competitors losing their chair in "musical chairs" or merger (or buyout). The third thing title companies can do is cut expenses.

It's this third approach that you ought to be giving your serious consideration. This is what I see: more and more and more corner cutting. Many title companies are cutting abstractor labor costs by doing abbreviated title searches; often this consists of a "two links back" title search. Folks, "two links back" title searches don't cut it. We've come behind many of these title searches and found serious defects. Some title companies are using abstractors that just aren't trained. They're cheap, but they aren't trained. Bad abstracting poses a serious risk to your client. This is compounded by the fact that some of the light weight title companies aren't going to be here in a couple of years. Guess how malpractice insurance works; you buy it one year at a time. So here's a scenario for you: you direct your client to Fly By Night Title Company. Fly By Night's abstractor just started last week; but, darn, he's cheap, and that's how they pass on that \$25 savings to your client. Two months after your closing,

Fly By Night has, well, flown by night. Two years after the closing, a serious title defect is discovered, threatening your client with many thousands of dollars of exposure. Fly By Night's malpractice policy expired eight months after your closing. Well, anyway, you helped your client save \$25 at the closing.

Lots of title companies around here are cutting corners on their post-closing work. One of the things we are all supposed to do is to get all the liens cleared off the title. Many of the title companies in this area are collecting the release fees at closing but aren't taking care of business. Now, this isn't the end of the world, but sometimes it really inconveniences your clients when they are ready to refinance or resell the property. Besides, it just isn't right. In the benign cases, this is happening because the title company is skimping on labor cost and not paying for enough hours for their post-closing employees to stay on top of things. In the non-benign cases, the title company is simply pocketing the release money and letting somebody else foot the bill of clearing things up.

There are many other areas of corner cutting with which I could terrorize you, but I think you get the picture.

We are blessed in this area with five or six high quality title companies and real estate law offices. Make sure you are referring your client to one of the better companies, even if there's somebody else out there who will do it for \$25 less. And for heaven's sake, don't refer your client somewhere because somebody has given you something or promised to give you something. Taking referral fees (bribes) is illegal; in fact it's a serious felony. But also think about this: what kind of company has to pay bribes to get business? Obviously, a company that can't make it in a straight up competition. And here's another rhetorical question for you: do you think that a company that will pay bribes might be willing to cut a few corners on the work?

Good title companies are good because they have good employees. It costs more to hire and train good employees than to hire bad employees and not pay for their training. If you starve the good companies out of business, you'll end up with what you deserve.