

***HOMEOWNERS RIGHTS IN TEXAS:  
WHAT THE LEGISLATURE MUST DO***

**By Jeff Brooks and Alex Winslow**

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Homeowners for Better Building

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*“Yes, as through this world I’ve wandered  
I’ve seen lots of funny men;  
Some will rob you with a six gun,  
And some with a fountain pen.”*  
-Woody Guthrie (1912-1967)

Texas was founded by brave men and women who dreamed of building new homes for themselves. They were willing to leave the lands of their birth and travel great distances in pursuit of this dream. They hacked out a precarious existence in the midst of an unknown wilderness and waged a revolution to protect their newfound freedom. They were willing to endure these trials because they wanted a place they could call *home*.

Today, nearly two hundred years later, millions of Texans still strive to achieve the dream of owning their own homes. But for far too many people, the dream of owning their own home is becoming a nightmare.

Too many Texas homebuyers are forced to deal with incompetent or unscrupulous builders, who do substandard or incomplete work. When the consumers attempt to hold the homebuilders accountable, they find themselves confronted with the Texas Residential Construction Commission (TRCC), a governmental bureaucracy which seems more interested in protecting the builders than in protecting the consumers.

In addition, Texas homeowners are faced with insurance rates that are the highest in the nation. Insurance companies are routinely overcharging Texas consumers, using justifications which seem incredibly flimsy upon examination.

Finally, many Texans who achieve full ownership of their homes find themselves victimized by unscrupulous lenders pushing predatory mortgage loans. Consequently, many consumers are finding their credit ruined and their financial independence in tatters.

These three issues: the TRCC, exploitative homeowners’ insurance and predatory mortgage loans, are hurting millions of Texans. They are taking away the freedom of our citizens, they are robbing our citizens of their hard-earned money and they are negatively impacting our state’s economy. Many of the worst violations of homeowners’ rights are inflicted upon the most vulnerable members of our society, especially low-income earners and the elderly.

The people of Texas have a right to be protected from these abuses. It is vital that the legislature enact measures to curb these abuses as soon as possible.

## The Texas Residential Construction Commission

The Texas Residential Construction Commission (TRCC) was created by House Bill 730 in 2003, during the 78<sup>th</sup> Session of the Texas Legislature.<sup>1</sup> Ostensibly, the job of the TRCC was to help mediate disputes between homebuilders and homeowners, thus averting expensive and time-consuming legal battles. In practice, however, the TRCC has functioned as a bureaucratic brick-wall, shielding the homebuilding industry from consumers who try to exert their rights to hold incompetent or unscrupulous builders accountable.

Lobbyists for the homebuilding industry were instrumental in drafting the legislative language of HB 730. According to media accounts, one of the major players in the writing of the legislation was John Krugh, general counsel for Perry Homes.<sup>2</sup> Perry Homes is the Houston-based building company of Bob Perry, the largest political donor in Texas. Many of the legislators who supported the bill were major recipients of campaign contributions from Perry and other homebuilders.

There are many ways in which the TRCC harms consumers and all demand corrective legislative action at the earliest possible moment.

First, and most important, is the mandatory nature of the TRCC dispute resolution process, known as State-Sponsored Inspection and Dispute Resolution Process (SIRP). If a homeowner wishes to take legal action against a negligent homebuilder, he or she is *legally required* to go through the SIRP first. This deprives consumers of the ability to bring legal action against those who have injured them, which has been a basic constitutional right of American citizens since the founding of the republic. The state has no right to hinder the ability of a citizen to make full and fair use of the legal system, yet that is precisely what the TRCC does.

The mandatory nature of the SIRP is also an affront to the notion of consumer choice. If the process really were fair and useful, the citizens of Texas would choose to participate in it on their own and they would not have to be forced to do so. The fact that the process is mandatory rather than voluntary is evidence that it is something the citizens of Texas would ordinarily avoid if given a choice.

Adding insult to injury, consumers are required to pay fees of \$250 in order to begin the TRCC dispute resolution process in the first place. Only two other states (New Jersey and Rhode Island) require consumers to pay fees in order to file complaints against homebuilders. It is unseemly to require the citizens of Texas to pay the state to protect them, when it is already the state's responsibility to do so.

Involuntary participation in the dispute resolution process is made worse by the fact that, once the process begins, the deck is firmly stacked against the consumer and in favor of

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<sup>1</sup> The text of the bill can be found at:

<http://www.capitol.state.tx.us/tlodocs/78R/billtext/html/HB00730F.htm>

<sup>2</sup> Mann, David. "The Agency that Bob Perry Built." The Texas Observer. 4 February, 2005.

the homebuilding industry. Of the nine seats on the TRCC, four are legally reserved for members of the homebuilding industry. Three are reserved for “representatives of the general public.” Because the law fails to specify the latter definition, however, these three seats have also been filled by persons with strong ties to the homebuilding industry. The remaining two seats are filled by an inspector and an engineer.

Because of the disparity between representatives of the building industry and representatives of the general public, even if the “representatives of the general public” were devoted defenders of consumer rights, they could be outvoted by the representatives of the building industry. Since, in practice, those three seats are also filled by persons linked to the building industry, Texas consumers effectively have no one representing their interests on the TRCC.

It is imperative that legislation be enacted to ensure proper equality between industry representatives and representatives of the general public on the Commission. Furthermore, the representatives of the general public must be persons with a strong background in consumer protection. Only then can it be truly said that the consumers of the state of Texas have a proper voice on the Commission.

It is also worth noting the troubling fact that, according to a report released last year by the Comptroller’s office, HB 730 contains legislative language which allows the TRCC to circumvent the standard conflict-of-interest provisions of the Sunset Commission. While no major charges of impropriety have yet been made public, one must wonder why basic conflict-of-interest provisions were omitted from the legislation which created the TRCC.

Even in those cases where the TRCC dispute resolution process results in decisions favorable to the consumer, the negligent homebuilder usually escapes any penalty. This is because the TRCC lacks any power to enforce its rulings. If the TRCC instructs a homebuilder to make necessary repairs to a consumer’s home, the homebuilder can simply ignore the ruling and suffer absolutely no penalty. According to the Comptroller’s office, homebuilders failed to make required repairs a whopping 86% of the time.<sup>3</sup>

One may reasonably ask whether the taxpayers of Texas are getting a good deal by paying for the business and operations of a state agency which does not even have the power to enforce its own rulings.

In investigating the TRCC, the Comptroller’s office also collected personal testimony from citizens who had endured the SIRP process. Here is a sampling of what ordinary consumers had to say:

- “The builder has not been seen or heard. TRCC doesn’t seem to care that the builder didn’t become involved.”
- “Builder completely ignored inspection results.”

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<sup>3</sup> Strayhorn, Carol Keeton. “The Texas Residential Construction Commission.”  
<http://www.window.state.tx.us/trcc/trcc.pdf>

- “[T]he builder was not willing to agree that problems existed in our house, even after the inspector verified the conditions existed.”
- “The inspection process is a joke.”
- “The inspector was for the builder all the way.”
- “The experience with TRCC was terrible.”
- “It appears [the TRCC’s] purpose is to protect the builder, not the guy paying the bills.”<sup>4</sup>

Far from benefiting consumers, the activities of the TRCC actually seem to hurt consumers. Its mission is ostensibly to streamline relations between builders and homebuyers, but the TRCC seems to be effectively controlled by the very industry it is supposed to regulate. Legislation to enact serious reforms to the TRCC will be necessary if the agency is ever to fulfill its stated purpose of protecting the interests of Texas consumers.

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<sup>4</sup> Strayhorn, Carol Keeton. “The Texas Residential Construction Commission.”  
<http://www.window.state.tx.us/trcc/trcc.pdf>

## Homeowners' Insurance

Texans pay the highest insurance premiums in the nation.<sup>5</sup> According to the most recent national study by the National Association of Insurance Commissioners (NAIC) of our country's insurance market, Texans pay roughly twice the national average on their homeowners insurance.<sup>6</sup>

Homeowners insurance premiums in Texas skyrocketed earlier in the decade and have never returned to Earth. Meanwhile, losses experienced by insurance companies have reached historical lows, resulting in massive overcharges and price gouging for policyholders. Since passage of Senate Bill 14 in 2003, a clear trend has developed. Homeowners continue to pay inflated premiums while insurance losses have dropped dramatically:

- In 2003, the top homeowners insurance companies in our state reported a loss ratio<sup>7</sup> of 58%, according to TDI.<sup>8</sup> TDI also noted that this 58% figure is “within a percentage point of the figure the Texas Department of Insurance has used in setting the benchmark rates in the past,”<sup>9</sup> meaning that these carriers had what was effectively an ideal year.
- In 2004, insurance carriers enjoyed what TDI described as “[r]ecord low loss ratios”<sup>10</sup> with an average loss ratio of just 27.6%.<sup>11</sup> This means that for every dollar of premium collected from Texas homeowners, insurance companies only had to pay out approximately 28 cents in losses, an incredibly miniscule amount.
- In 2005, Texas took a direct hit from Hurricane Rita. Despite having a catastrophic Category 3 hurricane devastate part the Texas coast, homeowners insurance companies posted just a 56.9% loss ratio, which is their second most profitable year of the decade.<sup>12</sup>

Data compiled by the Office of Public Insurance Counsel (OPIC) graphically illustrates the troubling phenomenon of excessive premiums during a time of falling losses (*see chart below*). **According to OPIC's most recent data, premiums dropped by a paltry 4.8% between January 2003 and September 2005.<sup>13</sup> Meanwhile industry losses have fallen by a whopping 85.2% over the same time period.<sup>14</sup>**

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<sup>5</sup> National Association of Insurance Commissioners, *2003 Homeowners Insurance Report*, January 5, 2006; *see* [http://www.naic.org/documents/research\\_2003\\_homeowners\\_prem\\_by\\_state.pdf](http://www.naic.org/documents/research_2003_homeowners_prem_by_state.pdf).

<sup>6</sup> *Id.*

<sup>7</sup> *Merriam-Webster* defines an insurance loss ratio as “the ratio between insurance losses incurred and premiums earned during a given period.” *See* <http://www.m-w.com/dictionary/loss%20ratio>.

<sup>8</sup> Texas Department of Insurance, *New Data Shows Improvement in Homeowners Insurance Market*, NEWS RELEASE, March 15, 2004; *see* <https://wwwapps.tdi.state.tx.us/inter/asproot/commish/news/clips2004.asp?id=1347>.

<sup>9</sup> *Id.*

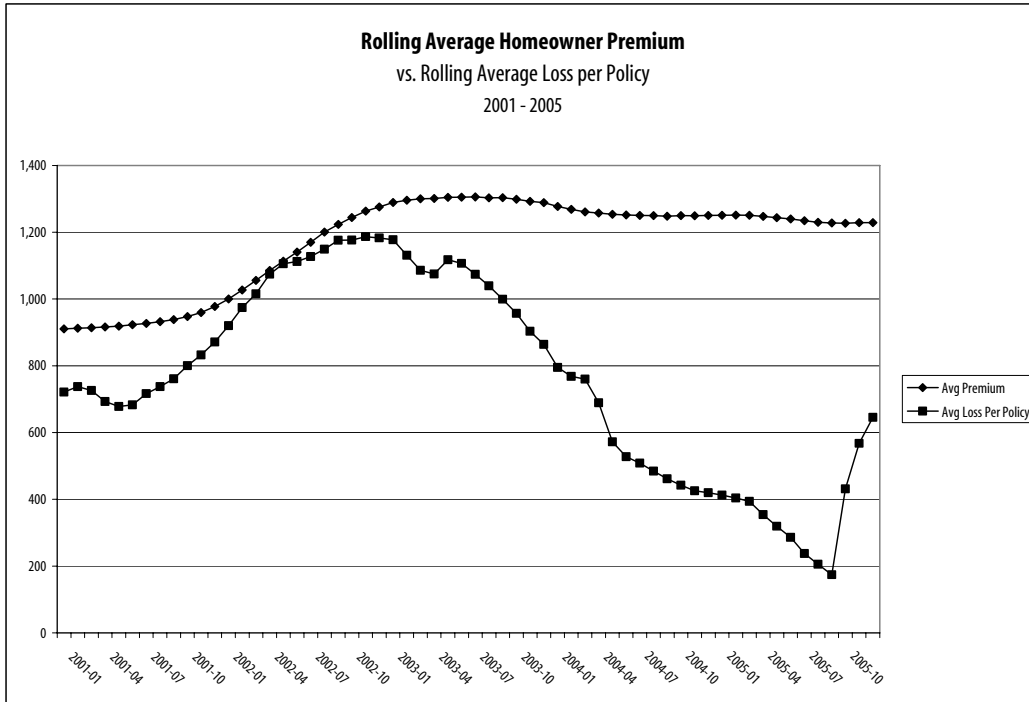
<sup>10</sup> Texas Department of Insurance, *TDI Orders Homeowners Insurers to File Rates with Department*, NEWS RELEASE, March 16, 2005; *see* <https://wwwapps.tdi.state.tx.us/inter/asproot/commish/news/clips2005.asp?id=19>.

<sup>11</sup> *Id.*

<sup>12</sup> Terry Stutz, *'05 Good for Texas Insurers*, DALLAS MORNING NEWS, March 22, 2006.

<sup>13</sup> Office of Public Insurance Counsel, *Rolling Average Homeowner Premium vs. Rolling Average Loss per Policy, 2001-2005*.

<sup>14</sup> *Id.*



In real dollars, premiums have essentially remained flat, only moving slightly from \$1,290 per policyholder in January 2003 to \$1,228 in September 2005. During that same period, losses plummeted from an average of \$1,177 to just \$174.<sup>15</sup>

OPIC’s data shows an increase in losses after Hurricane Rita, which is to be expected. However, note that this increase still results in a low loss ratio for insurers. We expect the overall trend to continue with premiums remaining high and losses falling until our lawmakers and regulators force the insurance companies to change their ways.

The ongoing overcharges have occurred as TDI has been soft with most of the major insurance carriers, including the top three companies, State Farm, Allstate, and Farmers, which together make up 55% of the current market.

- State Farm has refused to reduce their rates after a years-long court dispute. Meanwhile, the company’s policyholders have been forced to endure overcharges that grow by \$1.29 million every month.<sup>16</sup> State Farm’s recent attempt to increase its premiums in Texas prompted the *Dallas Morning News* editorial board to describe the company’s behavior as “bewildering” and “not in the spirit of market competition.”<sup>17</sup>

<sup>15</sup> *Id.*

<sup>16</sup> Calculated by dividing 10 percent (the interest penalty sought by TDI) by 12 months, giving a monthly interest rate of 0.8333%. Multiply this interest rate by \$155 million (the amount by which State Farm was ordered to reduce its rates in August 2003), and you get \$1.2916 million per month.

<sup>17</sup> *Not in the Insurance Spirit*, DALLAS MORNING NEWS, June 5, 2006.

- Allstate struck an agreement with TDI that has allowed the company to continue charging excessive premiums by ordering a one-time refund rather than an overall rate reduction.<sup>18</sup>
- Farmers negotiated a deal with TDI that has allowed the company to pocket \$101 million in overcharges and interest.<sup>19</sup>

The insurance crisis began in 2001 and yet much work remains to be done in order to bring balance to our state's insurance marketplace. Insurance was an emergency issue leading up to the 78<sup>th</sup> Session and it continues to be an emergency for millions of Texans as we approach the 80<sup>th</sup> Session.

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<sup>18</sup> *Homeowners Insured by Allstate to Get Policy Refunds*, THE ASSOCIATED PRESS, August 17, 2004; Purva Patel, *Firm Lowers Cost to Insure Homes*, HOUSTON CHRONICLE, August 17, 2004, *also see* Texas Watch materials on this settlement: <http://www.texaswatch.org/media/allstatesettlement.htm>.

<sup>19</sup> For more information on TDI's deal with Farmers, please see Texas Watch's memorandum to the Legislature of December 8, 2004: <http://www.texaswatch.org/media/farmerssettlement.htm>.

## **Predatory Mortgage Lending**

For many Americans, their home is their most valuable financial asset. Indeed, buying a home is often done as much for financial reasons as for the simple desire to own a house. This is particularly important for citizens who are close to retirement.

Unfortunately, unethical and unscrupulous mortgage lenders and brokers have become quite adept in recent decades at depriving people of this source of wealth. Predatory mortgage loan brokers cheat homeowners out of huge amounts of money, leaving the credit of the homeowner in ruins and often forcing them to foreclose on their homes.

A typical mortgage loan involves a person who owns their home and who needs a large amount of money for an immediate expense, such as making substantial repairs or renovations to the house itself. In order to borrow this amount, they use their homes as collateral to finance a mortgage loan. In a predatory mortgage lending scheme, however, the lender exploits the borrower through the use of various deceptive tricks.

Among the deceptive practices used by predatory mortgage brokers and lenders are:

- Persuading the homeowner to take out mortgage loans which the lender knows the homeowner will be unable to repay.
- Including “yield spread premiums” in the loan, which in fact are kickbacks to the broker for steering the loan to the lender with the highest interest rate.
- Requiring the borrower to pay high fees if he/she pays off the loan early, thus keeping them trapped in a high-cost loan even if they have improved their credit.
- Using a practice called “flipping,” in which the loan is refinanced more than once, thus generating additional fees without providing any benefit to the borrower.
- Including charges for insurance and other financial items which are of no benefit to the borrower.

Through the use of these and other methods, predatory mortgage lenders and brokers siphon millions of dollars out of the bank accounts of consumers every year. This not only harms consumers, but does considerable damage to the Texas economy.

The harmful effects of this practice are made worse by the fact that those who are most commonly targeted by predatory mortgage lenders are among the most vulnerable members of our society. Predatory mortgage lenders often go after elderly Texans, who tend to be equity rich but cash poor. 80% of Americans over the age of 50 own their homes free-and-clear of any liens, but a large number live on fixed incomes.<sup>20</sup> A common tactic of predatory lenders preying on the elderly is to convince the consumer that a repair needs to be made to their home and that the best way to finance such a repair is to take out a mortgage loan.

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<sup>20</sup> National Consumer Law Center. “Predatory Mortgage Lending.”  
[http://www.consumerlaw.org/initiatives/seniors\\_initiative/topics\\_predlending.shtml](http://www.consumerlaw.org/initiatives/seniors_initiative/topics_predlending.shtml)

Predatory lenders also target low-income Texans, whose credit ratings are often low and who therefore have difficulty obtaining conventional mortgage loans. This hinders low-income earners from building their assets and thus helps perpetuate the cycle of poverty in poor communities.

The state of Texas has taken some steps to combat predatory mortgage lending. For example, the state has banned the practice of negative amortization, by which the lender convinces the borrower to agree to a loan in which he or she would pay less than the interest rate owed every month, thus making the loan larger over time.

Despite some positive steps, much more needs to be done if this practice is to be stamped out for good. Legislation must be enacted to block the use of the various stratagems used by predatory lenders. Consumers should have access to credit counseling from a third-party non-profit organization before engaging in a non-conventional mortgage loan.

Many other professions, such as real estate agents and financial planners, are required to meet certain standards of fiduciary responsibility to their clients. If they fail to live up to those standards, the injured party has solid grounds for a lawsuit. Mortgage loan brokers should be subject to the same requirements.

## **Recommendations**

### *The Texas Residential Construction Commission:*

We believe that steps must be taken to:

- Eliminate the requirement that a consumer participate in the TRCC dispute resolution process before undertaking legal action against a negligent, incompetent or unscrupulous homebuilder. The process should be voluntary rather than mandatory.
- Ensure proper equality between industry representatives and representatives of the general public on the Commission, as well as ensuring that the representatives of the general public have a background of consumer protection.
- Mandate the standard conflict-of-interest provisions for members of the TRCC, as defined by the Sunset Commission.
- Give the TRCC effective enforcement powers, particularly the authority to levy financial penalties against homebuilders who fail to meet proper standards and who refuse to make necessary repairs as determined by the TRCC.
- Eliminate the requirement that consumers pay fees before lodging a complaint with the TRCC.

### *Homeowners' Insurance:*

We believe that steps must be taken to:

- Mandate a comprehensive marketwide review of Texas rates by the Texas Department of Insurance. Any identified overcharges should be promptly returned to policyholders.
- Have the Texas Department of Insurance develop a “one-stop-shop” where policyholders can make side-by-side comparisons of different insurance policies and companies.
- Guarantee living expenses for victims of catastrophes by requiring insurance companies to pay the living expenses of displaced policyholders.
- Have the Texas Department of Insurance regularly report the most current data regarding homeowners insurance rates.
- End the flawed and potentially discriminatory practice of credit scoring.
- Prohibiting insurance companies from varying homeowners' insurance rates by more than 15% within a county, except for legitimate weather-related reasons.

### *Predatory Mortgage Lending:*

We believe that steps must be taken to:

- Ban the practice of “yield spread premiums” and other such deceptive tactics.
- Ensure that all consumers who sign “non-conventional” mortgage loans should take a credit counseling session run by a third-party, HUD-approved non-profit group.
- Ensure that mortgage loan brokers are required to meet the same standards of fiduciary responsibility that apply to other professions, such as real estate agents and financial planners.

## **Conclusion**

For too long, the homeowners of Texas have been denied their basic rights and have endured unfair financial burdens. It is time for the state government to live up to its responsibility to protect the homeowners of our great state.

Legislation must be enacted to reform the TRCC so as to make it the friend, not the foe, of consumers. Steps must be taken to ease the burden of exploitative homeowners' insurance rates. Finally, measures must be taken to protect the citizens of Texas from predatory mortgage lending.

We are calling on the state to take the necessary measures to protect the rights of homeowners by acting on the recommendations we have outlined in this paper.