

Statement of the National Association of Home Builders

“The State of the Nation’s Housing Sector: An Examination of the First Time Buyer’s Credit and Future Policies to Sustain a Recovery”

House Small Business Committee

October 7, 2009

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement to the House Small Business Committee on the current state of the nation’s housing sector, the impact of the first time home buyer’s credit established as part of the American Recovery and Reinvestment Act (ARRA) and other measures to continue a recovery in real estate markets. Home building is an industry dominated by small businesses. Approximately sixty percent of NAHB’s 200,000 members build less than 25 homes per year and eighty percent of them have less than \$5 million in annual receipts. These small businesses are at the leading edge of the housing downturn.

Home Builders Ineligible for ARC Loans

Before addressing the primary issues of concern for this hearing, we want to raise a recent development having to do with the Small Business Administration’s (SBA) America’s Recovery Capital (ARC) Program, established as part of the ARRA legislation.

As you know, the ARC program guarantees interest free, deferred payment loans of up to \$35,000 from participating lenders to help existing small businesses meet their current obligations. When the ARC program was rolled out on June 15, we were hopeful that this program would help many of NAHB’s members to stay afloat through these tough economic times. Unfortunately, our hopes have been dampened as we received feedback from members who are being told by their bankers and SBA field staff that their businesses are apparently not eligible for this assistance.

SBA has long held the position that the business of home building is *always* speculative; however, NAHB disagrees. During times of strong home sales, many home builders constructed homes speculatively so they would have homes available on short notice to satisfy the demands of prospective home buyers. Few home builders have engaged in speculative activities since the beginning of the current economic downturn. Unfortunately, because of changing conditions in the mortgage markets, some homes that were originally being built under contract became “spec” homes when the purchasers discovered they no longer qualified for a mortgage. In these situations, the builders have been stuck with the responsibility to pay their subcontractors and suppliers.

SBA’s Standard Operating Procedures¹ separate home builders’ activities into 1) building of a speculative nature, and 2) building under contract with an identified purchaser. These descriptions of the nature of home builders’ activities are greatly oversimplified and fail to recognize the costs that are associated with keeping a company – any company – afloat, such as

¹ Small Business Administration SOP 50 10 5(A), Subpart 2, Chapter 2 (III)(D)(s)(2)(e), page 110

the need to pay utilities and other overhead necessary to maintain an office or vehicles or to safeguard tools and inventories of materials that are used in the normal course of business. These are the types of expenses that home builders, the vast majority of whom operate small businesses, could offset if ARC loans were readily available.

We urge the committee to encourage the SBA to revisit that way it views home builders and to reconsider the eligibility requirements for ARC program loans.

Housing Conditions and Outlook

The current housing recession is the worst since World War II. Total starts fell 80 percent from their peak in January 2006-- from 2.3 million starts to a low point of 479,000 starts in April. Virtually every housing indicator (starts, permits and sales) reached all time record lows within the past two quarters. The drop in single-family construction alone has resulted in more than 3 million lost jobs in construction and the related industries supplying materials and goods to housing construction.

Glimmers of hope, however, suggest that the three plus year decline in housing may have stabilized. Existing and new home sales appear to have bottomed. Existing single-family home sales hit a low of 4.05 million in January 2009 improved to 4.61 million sales at a seasonally adjusted, annual rate in July, but slipped down to 4.48 million in August. Meanwhile, new home sales bottomed in January 2009 at 329,000 and have since shown a modest recovery to 429,000 in August.

The inventory of unsold new homes continues to fall from a peak of 572,000 in July 2006 to 262,000 in August 2009. The decline has reduced the month's supply of unsold homes, but not as dramatically because sales continue at a very slow pace. The NAHB Housing Market Index (HMI) languished at a single digit rate for five straight months from late 2008 through the first quarter 2009, but has since picked up to 19 at the latest reading in September. Single-family housing starts have shown strength recently, likely in response to the first-time home buyer tax credit enacted as part of the economic stimulus legislation enacted in February 2009. Multifamily starts have been very weak and will likely continue to fall in the face of a large overhang of apartments and single-family homes on the market. Also, obtaining financing for multifamily projects has become virtually impossible.

These "buds" of growth notwithstanding, a number of housing specific headwinds will continue to buffet any significant housing recovery:

- A large inventory of vacant homes and apartments on the market
- A pipeline of foreclosures feeding the inventory
- Continuous downward price pressures from too much supply and not enough demand
- Tight mortgage underwriting and low appraisals making it difficult for a willing buyer to complete the sale
- Extremely difficult financing terms and availability for builder AD&C credit

All of this suggests that residential construction is now bouncing along a bottom. We forecast that housing starts face a long, slow recovery that will take several years. NAHB forecasts 568,000 housing starts for 2009 and 716,000 for 2010.

The First Time Home Buyer Tax Credit

The ARRA legislation improved the home buyer tax incentive enacted in 2008 by establishing a refundable tax credit for 10 percent of the purchase price of a home, up to \$8,000 for first-time buyers of a principal residence in 2009. The law defines a first-time home buyer as a buyer who has not held an ownership stake in a principal residence in the three years prior to the sale. To claim the tax credit, the taxpayer must complete the sale of the home before December 1, 2009. The credit is subject to an income phase-out that begins at \$75,000 modified adjusted gross income for single taxpayers and \$150,000 for married taxpayers. Partial credits are available for some taxpayers with incomes above those amounts.

The tax credit is having a demonstrable positive effect on housing demand. NAHB estimates conservatively that approximately 200,000 additional home sales are attributable to the tax credit. Of these, 121,000 are first-time buyers induced to buy homes because the credit makes the purchase more affordable. As well, 71,000 are a ripple effect of repeat buyers who were able to sell their existing homes because of the credit. NAHB further estimates that the increase in sales stimulated by the credit has resulted in the absorption of about 50,000 vacant and rental units. Recent data from the National Association of Realtors indicates that 40 to 50 percent of recent home sales are due to first-time buyers, and this increase in demand is in part responsible for recent declines in housing inventories.

The positive impact of the credit is also seen in the job market. NAHB calculates that the credit has resulted in a net increase of 187,000 jobs, measured in full-time equivalents. Some of the jobs are attributable to existing home sales; some are attributable to new construction; and some are the result of extra consumption spending by first-time home buyers with extra after-tax income as a result of the credit.

An important element to maximizing the economic impact of the home buyer tax credit is the ability to apply the proceeds of the tax incentive to the actual purchase of the home; that is, to monetize the tax credit. At NAHB's urging, the ARRA legislation removed certain tax law obstacles that prevented almost all monetization programs. As a result, and with the blessing of the Federal Housing Administration, more than 18 state housing agencies have established tax credit loan or grant programs that monetize the tax credit for home buyers needing the tax credit to fund a down payment on the purchase of a home.

However, as the deadline for the tax credit program approaches, NAHB supports extending and enhancing this important housing demand stimulus program. In particular, NAHB recommends extending the sunset date until December 1, 2010, and expanding the eligible buyer definition to include all purchasers of a principal residence. We estimate that these enhancements would increase home purchases by 383,000 in the next year; increase housing starts by 82,000; create more than 347,000 jobs; generate \$16.1 billion in wages and salaries; \$12.1 billion in business

income and tax income of \$8.4 billion for the federal government; and \$3.2 billion for state and local governments.

The increased home purchase generated by the above proposal will help soak up the excess supply and push house prices back in a positive direction. The economic stimulus created by established households moving into new homes and the added construction necessary to answer demand where there is no excess supply generates jobs, wages, salaries, business income and tax revenues. As well, these economic impact estimates do not include the larger macroeconomic benefits that would result from the stabilization of housing prices and the housing market in general.

Real Estate Appraisals

There are increasing complaints of real estate appraisers using foreclosure or other distressed sales as comparables in determining values of single family homes without properly adjusting the comparable property values to reflect the relative condition of the properties. If foreclosed and/or distressed property sales are used as comparables, appropriate adjustments must be made to reflect the condition of such properties as compared to the subject property. Improper or insufficient adjustments to the comparable values of foreclosed and/or distressed homes results in the undervaluation of new sales transactions. Such practices contribute to a continuing downward spiral in home prices and forestall economic recovery.

Often, properties that have been subject to foreclosure or distressed sales have issues relating to deferred maintenance or internal damage that an external inspection simply cannot reveal. A prospective purchaser would most assuredly recognize the differences in the value proposition between a well-kept home and a distressed property that is damaged or not properly maintained and the same should be true of an appraiser.

The Federal Housing Administration and Fannie Mae and Freddie Mac, which are regulated by the Federal Housing Finance Agency and the federal financial institution regulators, establish appraisal requirements for most of the home mortgages written in today's marketplace. NAHB is proposing that members of Congress urge these agencies and organizations to issue and enforce guidance that instructs appraisers on the proper procedures for the use of distressed and/or foreclosed properties as comparables. Any such guidance should encourage appraisers to expand the area and/or the time frame from which comparable properties are selected if a sufficient number of properties that have not been subject to foreclosure or distressed sales are not available in the area of the subject property. In addition, the guidance should emphasize that an appraiser should further investigate and consider the overall condition of a property and the specific factors related to a foreclosure or distressed property sale in determining value when a foreclosed property is used as a comparable.

NAHB believes the federal agencies and organizations that establish appraisal requirements for home mortgages should immediately issue and enforce guidance requiring appraisers to obtain sufficient information and make appropriate adjustments in the prices of comparable sales ("comps") in order to bring those comps to the level that represents a reasonable alternative to the home they are appraising.

Further, NAHB recommends the establishment of a required appeals process for Fannie Mae, Freddie Mac, and the Federal Housing Administration similar to that used for appeals of appraisals that are performed with the Department of Veterans Affairs (VA) Loan Guaranty Program. The VA instituted a policy in 2003 to reduce the number of requests for reconsideration of property values by facilitating improved communication between appraisers and lenders before appraisal assignments are completed.

In situations where an appraiser believes an appraisal would result in a value less than the sale price of a property, VA instructs the appraiser to contact the lender and allow two working days for the lender to provide additional information. In addition, the lender can specify another point of contact for the appraiser, such as a builder or Realtor, at the time the appraisal is ordered. By specifying a third party as a point of contact, a lender can reduce delays in getting additional information to the appraiser.

Appraisal problems have been exacerbated due to unintended consequences that resulted from the implementation of the Home Valuation Code of Conduct (HVCC) earlier this year. The HVCC was put in place by Fannie Mae and Freddie Mac, as the result of a settlement with New York State Attorney General Andrew Cuomo, to insulate appraisers from inappropriate influence from parties at interest in a home sales transaction.

Two immediate problems were confusion over what degree of communication is allowed between home sellers/lenders and the appraiser, and an increase in the use of out-of-area appraisers not familiar with the market. Fannie Mae and Freddie Mac, along with their regulator, the Federal Housing Finance Agency, attempted to address these issues through publication of a Frequently Asked Questions (FAQ) document on the HVCC. The FAQ makes clear that it is appropriate for sellers and other parties to the transaction to contact the appraiser to provide relevant information. The FAQ also states that sellers can insist on use of an appraiser that is familiar with the market under evaluation. Hopefully, these clarifications will be broadly disseminated and accepted so that the current confusion on these questions is eliminated.

However, NAHB's members are reporting other problems related to implementation of the HVCC. These issues are related to the experience and qualifications of appraisers and the time allowed for completion of appraisals. With the implementation of the HVCC, many lenders have begun using appraisal management companies (AMCs) to ensure they are meeting the requirement for appraiser independence. We are hearing that appraisal management companies are tending to reduce compensation for appraisers and are allowing only two days or less for completion of an appraisal. While such actions obviously reduce AMC costs and increase their profit margins, we feel they are having an adverse impact on the quality of appraisals.

This is a major problem in markets where a high portion of sales activity is made up of foreclosure or other distressed sales. A widespread failure to appropriately adjust the value of distressed sales used as comps is not surprising if less qualified appraisers are doing the work and appraisers are not given sufficient time to collect information on the condition of the homes used as comparable sales.

NAHB strongly supports the intent of the Home Valuation Code of Conduct and we are not among the groups calling for a repeal or suspension of the HVCC. However, NAHB also strongly believes that additional clarifications and implementation reforms are needed in order for the HVCC to work effectively without causing serious market disruptions. NAHB recently convened an Appraisal Summit involving representatives of major housing and financial institution stakeholders, appraisal organizations, and federal housing and banking regulators to discuss appraisal problems and solutions. There was strong sentiment at the Summit that clearer information on what the HVCC allows, requires and prohibits should be widely disseminated. There were also calls for reforms to establish a system where participants can be confident that appraisers have the training and experience needed to make valuations in complex markets and that appraisers are required (and are given enough time) to collect the information needed to make the appropriate adjustments to distressed sales used as comparables. NAHB urges members of Congress to reinforce the need for such changes.

Availability of Credit for Acquisition, Development and Construction Loans

Another persistent problem in the home building industry that is blunting the recovery of the housing market is the available of credit for Acquisition, Development and Construction (AD&C) loans. Banks are increasingly refusing to extend new AD&C credit or to modify outstanding AD&C loans in order to provide builders more time to complete their projects and pay off these loans. Often this is being forced by examiners demanding that banks shrink their AD&C loan portfolios. On outstanding loans, examiners are requiring banks to obtain new appraisals on properties for fully performing loans, which can result in the banks having to downgrade those loans, turning them into troubled “non-performing performing loans.” Once a loan is classified as such, the institution must hold more capital against the loan. As a result, an increasing number of builders are being required to put up additional equity or collateral due to reappraisal of collateral or revaluation of their loan.

Since most home building companies are small businesses and do not have the capacity to meet significant equity calls, the result is often foreclosure on a loan that had been performing. NAHB is proposing that members of Congress urge the federal banking regulators to put a halt to these shortsighted practices that are adversely affecting the financial condition of the banking industry as well as having devastating impacts on home building companies. Instead, financial institutions should be encouraged to fund viable new projects and to take steps to avoid foreclosure on AD&C loans by accommodating loan modifications and workouts. This would provide relief for a major sector of the economy that has suffered because of regulatory overkill and the inability of banks to provide the necessary funding and flexibility that would otherwise keep loans performing as scheduled.

Banks that have received funds from the Troubled Asset Relief Program (TARP) should be required to account for how these funds are being used in financing and / or working out loans on acquisition, development and construction (AD&C) projects. In many instances, banks that have received TARP funds are letting projects fail rather than pursuing workouts with the original developer and builders. This questionable action, which imposes serious hardship on home builders, often putting them out of business, should not be condoned or subsidized by the federal government.

Congress should direct the banking regulators to require banks that have received TARP funds to account for how these funds are being used in lending on new projects. Further, they must demonstrate how the institution is working out the restructuring of existing loans and providing more flexible terms to facilitate continued funding and eventual repayment of performing AD&C loans.

Green Building and the Incentives for Energy Efficiency in New Home Construction

According to the most recent NAHB/Wells Fargo Housing Market Index survey, energy efficiency is significantly more atop the minds of customers interested in building a new home. When asked if their buyers were willing to pay extra for green amenities, fifty-six percent responded that at least some of them were willing. However, cost and maximizing value for the dollar are critical drivers of potential buyers' decision-making, especially in the current economic downturn. Most consumers are not willing to pay extra for a more efficient home unless they are likely to see the benefit of their investment within a reasonable length of time. If we can maximize the cost/benefit for consumers in this area, we can enable substantial growth in this sector of the market with significant positive economic impacts for the nation.

On the supply side, programs like the Energy Star New Home Certification Program continue to gain ground. According to estimates by the Department of Energy and the Environmental Protection Agency, who together administer this program, as many as 25 percent of the homes built in 2009 will be Energy Star compliant. The difficulty for homebuilders, however, is that the current depressed housing market makes it difficult to recoup the costs of Energy Star certification in the final price of a home. This undermines the incentives to pursue this certification and increases the importance of federal programs for increasing energy efficiency in the built environment; discussed later in this statement.

In 2005, NAHB published the National Green Home Building Guidelines (the Guidelines) as the first step towards creating a consensus on residential green building that could be implemented nationally on a voluntary basis. The use of the Guidelines flourished, along with the burgeoning green movement, and its success led to even greater calls for a national consensus standard that could offset growing attempts to mandate privately-developed rating systems. Thus, in 2007, NAHB partnered with the International Code Council (ICC) and the NAHB Research Center (as Secretariat) to convene a consensus group of 42 industry, environmental, and government stakeholders to develop the National Green Building Standard™. After two years, thousands of public comments, and countless input from technical experts, the National Green Building Standard™ was approved by the American National Standards Institute (ANSI) on January 29, 2009, as the *first and only* ANSI-approved national green building standard.

NAHB is working hard to promote green building within the Congress and the Obama Administration. The ability to offer an ANSI-approved green building standard as an alternative to private programs is an important first step. The new standard, along with NAHB's multi-million dollar national green building program, confirms the home building industry's commitment to promoting green building for every aspect of residential construction – single family, multifamily, remodeling, and site development.

Congress must avoid green building mandates, especially for private rating systems, while better alternatives are available for affordable green building. Many state and local programs are having great success with green building and these strides should not be sidelined by overly aggressive federal action. The industry voluntarily initiated the effort to create the first national green building standard and invested time, money and expertise to ensure its integrity and its ability to be constantly improved going forward. Mandating a privately-developed program would have stifled such innovation and Congress must allow for further advancement in green.

In 2005, the *Energy Policy Act* was passed creating several critical energy efficiency incentives in the tax code to do this, including the section 45L, New Energy Efficient Home Tax Credit (New Homes Credit). This credit provides a \$2,000 credit to builder of new home that is 50 percent above 2003 International Energy Conservation Code with supplements. The credit is presently subject to basis adjustment and the Alternative Minimum Tax (AMT) and expires December 31, 2009.

All tax incentives like the 45L credit play a unique and critical role in the marketplace for increased energy efficiency. The New Homes Credit is of particular interest to many NAHB members and has seen a three-fold increase in usage since its creation in 2005. It stands alone as the only incentive in the tax code for energy efficiency in single family home construction. This incentive will help to insure that new homes built today and going forward are highly energy efficient and carry that efficiency for their full usable life.

NAHB believes there are several ways to substantially enhance the impact of the New Homes Credit. They include increasing credit amount to \$5,000 and making it permanent, allowing internal components of a house (heating, ventilation and/or air conditioning equipment), in addition to building envelope, to be eligible for reaching the 50 percent efficiency threshold, make the credit permanent, eliminate the basis reduction that comes with the credit and allow it to be used against AMT. This last recommendation is especially important because most home builders pay their taxes under the individual tax system and frequently get caught up in the AMT which limits their ability, and incentive, to use the New Homes Credit.

NAHB strongly urges the Congress to make 45L credit permanent. Having to be continually extended blunts its take-up in the market, which needs as much certainty as possible in making investment decisions along these lines. Efforts are underway now in the Senate to expand and extend these energy efficiency tax incentives. In particular, NAHB applauds the work of Senators Olympia Snowe (R-ME), Jeff Bingaman (D-NM) and Diane Feinstein (D-CA) for introducing S. 1637, the *Expanding Building Efficiency Incentives Act*. We urge the House to follow a similar course to ensure the continued availability of these critical programs.

Conclusion

NAHB appreciates the opportunity to share our views on the current state of the nation's housing sector, the impact of the first time home buyer's credit established as part of ARRA and other measures to continue a recovery in real estate markets. We are ready to work with the Committee and the Congress on ways to restore the housing market and hasten the overall economic recovery.