S. HRG. 112–24

THE STATE OF THE HOUSING MARKET

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

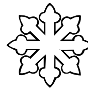
FIRST SESSION

ON

EXAMINING THE STATE OF THE HOUSING MARKET

MARCH 9, 2011

Printed for the use of the Committee on Banking, Housing, and Urban Affairs



Available at: http://www.fdsys.gov/

U.S. GOVERNMENT PRINTING OFFICE

66–724 PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

TIM JOHNSON, South Dakota, *Chairman*

JACK REED, Rhode Island
CHARLES E. SCHUMER, New York
ROBERT MENENDEZ, New Jersey
DANIEL K. AKAKA, Hawaii
SHERROD BROWN, Ohio
JON TESTER, Montana
HERB KOHL, Wisconsin
MARK R. WARNER, Virginia
JEFF MERKLEY, Oregon
MICHAEL F. BENNET, Colorado
KAY HAGAN, North Carolina

RICHARD C. SHELBY, Alabama
MIKE CRAPO, Idaho
BOB CORKER, Tennessee
JIM DEMINT, South Carolina
DAVID VITTER, Louisiana
MIKE JOHANNS, Nebraska
PATRICK J. TOOMEY, Pennsylvania
MARK KIRK, Illinois
JERRY MORAN, Kansas
ROGER F. WICKER, Mississippi

DWIGHT FETTIG, *Staff Director*
WILLIAM D. DUHNKE, *Republican Staff Director*

ERIN BARRY, *Professional Staff Member*
BETH COOPER, *Professional Staff Member*

MICHAEL PIWOWAR, *Republican Chief Economist*
JIM JOHNSON, *Republican Counsel*

DAWN RATLIFF, *Chief Clerk*
LEVON BAGRAMIAN, *Hearing Clerk*
SHELVIN SIMMONS, *IT Director*
JIM CROWELL, *Editor*

C O N T E N T S

WEDNESDAY, MARCH 9, 2011

	Page
Opening statement of Chairman Johnson	1
Opening statements, comments, or prepared statements of:	
Senator Shelby	2
Senator Reed	4

WITNESSES

Susan M. Wachter, Richard B. Worley Professor of Financial Management, Professor of Real Estate and Finance, The Wharton School, University of Pennsylvania	6
Prepared statement	25
Mark A. Calabria, Director of Financial Regulation Studies, Cato Institute	7
Prepared statement	26
David Crowe, Chief Economist, National Association of Home Builders	9
Prepared statement	31
Ron Phipps, President, National Association of REALTORS®	10
Prepared statement	36
Jeffrey Lubell, Executive Director, Center for Housing Policy	12
Prepared statement	38

THE STATE OF THE HOUSING MARKET

WEDNESDAY, MARCH 9, 2011

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 2:32 p.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. Good afternoon. Thank you, everyone, for being here. I call this hearing to order.

The housing market is in an incredible period of transition. Families are reeling from the impact of a bubble that burst several years ago. In many regions, prices have yet to stabilize. Realtors are struggling to find the appropriate balance between adequate credit availability and improving underwriting standards. It is clear that the current housing market is fragile, and a strong recovery in housing is not yet underway. And as we begin debating the future of housing in America, it is important for the Committee to understand the challenges our Nation faces.

Today's hearing is part of that process. We will explore various aspects of the housing market, including the impact of foreclosures on the single-family market, site built and manufactured housing, multifamily rental housing, and the availability of workforce housing.

The housing sector remains in turmoil. Today we see decreasing property values eroding homeowners' equity, rapid foreclosures, devastating neighborhoods, and a fall in home ownership rate that threatens to place the option of home ownership out of the reach even for qualified borrowers.

According to the Case-Shiller Housing Index, home values have fallen to their 2003 levels. That has put record numbers of homeowners underwater on their mortgages, effectively trapped in homes they cannot sell. Meanwhile, widespread foreclosures compound the problem by driving down the value of other homes in neighborhoods. Losing one's home to foreclosure often means the loss of the largest part of a family's wealth and can create further instability in communities. Last but not least, an unemployment rate that remains near 9 percent has contributed to home ownership falling to a level last seen in 1998.

The housing bubble peaks in 2006 and its aftermath left millions of American families underwater and struggling to cover their mortgage each month.

I look forward to hearing from our witnesses regarding how changes in foreclosure trends, the housing supply, and falling home values are interacting to affect the housing market and economic recovery.

Today's hearing will also explore the state of the housing market for middle- and lower-income households. The recession appears to have worsened the affordable housing crisis that already existed for so many Americans. A recent HUD study found that the number of very low income renters with worst-case housing needs increased by 20 percent from 2007 to 2009, the largest 2-year increase in the past 25 years.

Finally, homelessness increased by 4 percent from 2008 to 2009, and the number of people doubled up in temporary arrangements, unfortunately a common occurrence in many Native American communities, increased by 12 percent.

In the last 3 years, we have seen that no segment of the population is immune to problems in the housing sector, and it is clear that addressing these problems is an urgent need for Americans of all economic backgrounds. We hope to examine these trends and the causes today.

As my colleagues know, we have noticed a hearing for next week with Secretary Geithner and Secretary Donovan. This will begin the long-term discussion regarding housing finance reform, and I anticipate many future hearings on this topic. I ask my colleagues to reserve specific questions on that topic for next week.

Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you. Thank you, Mr. Chairman, for calling this hearing.

I hope this, Mr. Chairman, will be the first of many hearings by the Committee on the housing market and the housing policy. The well-known problems in the housing market deserve the Committee's full attention.

Over the past 3 years, national home prices have declined sharply from the unprecedented levels reached at the height of the housing bubble. Not since the Great Depression has our housing market experienced such a severe correction. Today we hope to learn the present state of the housing market and what the future may hold.

How close is the market to bottoming out, for example? What will it take for home sales to reach normal levels? How does the housing market vary by region? And what factors account for the differences? What is the appropriate level of home ownership and why?

In addition, it is my hope that today's hearing will set the stage for a discussion of the future of housing finance. Without question, our housing finance system is broken. The Federal Government now backs approximately 97 percent of all new mortgages. Our once thriving private markets have been largely replaced by Government programs. I believe this is a dangerous situation that will not only erode innovation and competition, but ultimately reduce the availability of housing and expose taxpayers to future bailouts.

The Banking Committee should fully examine our housing markets with the goal of promptly adopting any needed reforms. I be-

lieve we will soon be upon the third anniversary of the American taxpayers' bailout of Fannie Mae and Freddie Mac. If ever history provides a clear lesson on the importance of Congress acting in a timely manner, it is this Committee's failure, I believe, to address the GSEs.

The demise of Fannie and Freddie could have been prevented had the Committee acted sooner. Unfortunately, the GSEs were a very powerful political force right up until the time that they collapsed. Fannie and Freddie's disproportionate influence on this Committee and Congress ultimately cost the taxpayers billions and should be long remembered as a major, major policy mistake.

Finally, Mr. Chairman, I would like to take a moment to discuss recent news reports about a proposal that has been described as a "global mortgage servicing settlement." Based on the facts reported, I have serious concerns not only about the substance of the proposal, but also about the process. What is occurring appears to be nothing less than a regulatory shakedown by the new Bureau of Consumer Financial Protection, the FDIC, the Federal Reserve, certain Attorneys General, and the Administration, led by Elizabeth Warren.

The proposed settlement appears to be an attempt to advance the Administration's political agenda rather than an effort to help homeowners who were harmed by servicers' actual conduct.

Just last year, I warned that the new Bureau of Consumer Financial Protection would prove to be an unaccountable and unbridled bureaucracy. I did not expect to be proven correct so quickly. Under the guise of helping homeowners hurt by improper foreclosures, regulators are attempting to extract a staggering payment of nearly $30 billion for unspecified conduct. The $30 billion would most likely fund a new slate of housing programs long sought by the Administration but previously rejected by the Congress.

Setting aside for a moment the attempt to end-run Congress, I question whether removing $30 billion in capital through a backdoor bank tax is the best way to jump-start lending in today's recession.

The long-term consequences of this settlement could be even more serious. It would politicize our financial system. For example, the proposed settlement requires the appointment of third-party monitors, paid for by the banks. Mr. Chairman, I thought our financial regulators monitored our banks. Under this incredible proposal, however, those days would be over. Who might these third-party monitors be? ACORN or other community organizers, or perhaps other special interest allies of the Administration? I believe we need to know; the American people need to know.

As troublesome as the substance of the settlement is, the process by which it is being imposed is potentially far more concerning. The proposed settlement would fundamentally alter the regulation of our banks, yet this would be done without congressional involvement by this Committee. Instead, it would be done by executive fiat through intimidation and threats of regulatory sanctions. The Administration and our financial regulators are clearly hoping the banks will consent to these new regulations.

The precedent these strong-arm tactics could set, however, should be of concern to all citizens, especially Members of this

Committee. If these tactics can be used successfully on financial institutions, they can be used on any business.

I want to be very clear. If any person was harmed by the actions of these banks, I believe they should be compensated to the full limits of the law. As everyone knows, I did not vote to bail out the banks, and I strongly opposed TARP because I believe banks should be responsible for their actions. They should be held accountable here as well. However, efforts to help homeowners who were legitimately harmed by the banks should not be hijacked for the purpose of imposing a regulatory agenda the American people clearly rejected in the last election.

Because of the longer-term consequences of the proposed settlement and the serious due process issues involved, I am requesting that this Committee begin an immediate inquiry into the facts and circumstances surrounding this effort. I am also requested that the Administration and our financial regulators refrain from entering into any settlement agreement until Congress, the Congress of the United States, has had an opportunity to conduct appropriate oversight on this matter. I think this is too important for Congress to sit on the sidelines.

I hope you will heed this, Mr. Chairman.

Chairman JOHNSON. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Well, thank you very much, Mr. Chairman, and thank you, Ranking Member Shelby, for inviting Ron Phipps of Rhode Island to join us today. Ron is the president of the National Association of REALTORS®, and he along with his colleagues in Rhode Island are a mainstay not only of our economy, but all of our communities, so thanks, Ron, for being here, and gentlemen and ladies, thank you also for being here today.

We all understand that a sustainable economic recovery has to depend on a healthy housing economy, and we have seen great turmoil in the housing market over the last 2 years. I have looked at the testimony of our witnesses. Each one of them notes the fact that the swollen inventory of housing, made worse by homeowners facing foreclosure, is dragging on the economy. So the issues that have been discussed by the Chairman and by Senator Shelby about how do we resolve these foreclosure issues, how do we get these houses back on the market, how do we put a floor into our housing markets to begin to grow again is central not just to the housing sector but to our overall economic development.

We also understand that this foreclosure crisis has grown with great complexity because of the allegations of robo-signing, illegal behavior of financial institutions, and poor supervision by regulators. We also understand, as alluded to by Senator Shelby, that the Attorneys General of each State have banded together and have taken the lead to protect their constituents and their neighbors and to provide them satisfaction. This effort was theirs, and it has been supplemented by the activities of the Federal regulators to try to develop a proposal that will deal with several intersecting and complicated situations:

Were there illegalities with respect to foreclosure procedures? Simple issues about who holds title to homes, that is in doubt now,

which upsets the ability to grow the economy once again. The status of bond holders in these mortgage-backed securities, do they have an ability to sue for billions of dollars for breaches of representations and warranties?

Until we try to resolve this, frankly, in a comprehensive way, there is going to be a drag on the economy, a reluctance to move forward, not just simply because of homeowners and financial institutions, but also a whole array of financial actors.

In that spirit, I propose—and I am sure there will be other proposals—S. 489, the Preserving Homes and Communities Act of 2011, to try to address some of these issues. I believe there should be a comprehensive solution. Legislatively, we should recognize that it will take probably—let me say it will not happen tomorrow because things do not happen around here tomorrow. And I think in substance and in fairness, there should be pursuit of some type of comprehensive solution, voluntary because that is the nature of the solution in which the financial institutions feel that it is in their interests as well as Federal regulators, State Attorneys General, bond holders, to come to conclusion and to do it rapidly.

I think time is wasting. I think we should approach this with the view that every homeowner deserves to be treated fairly. Some may not be able to maintain their homes, but they deserve a fair evaluation of whether their home arrangement, their mortgage, could be modified and that they can get on with their lives either in their home or at least knowing that a fair effort was made to help them.

With that, I thank you, Mr. Chairman.

Chairman JOHNSON. Senator Vitter.

Senator VITTER. Thank you, Mr. Chairman. I am going to pass for now. I look forward to the testimony of the witnesses.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Mr. Chairman, I am going to defer. I know we are going to have a vote shortly. I would like to hear the testimony. And I was unaware that the Chair was going to permit opening statements, but I really want to hear the testimony. I have read some of it already. But since we are going to have votes, I will defer.

Chairman JOHNSON. Does anyone have an opening statement to give?

[No response.]

Chairman JOHNSON. Well, then, two votes are scheduled for 3 o'clock, and we should get going.

I would like to introduce our first witness, Dr. Susan Wachter. Dr. Wachter is the Richard B. Worley Professor of Financial Management and Professor of Real Estate and Finance at the Wharton School. Dr. Wachter is the author of over 150 publications and is frequently called upon to testify before the U.S. Congress on mortgage markets and the financial crisis.

Our next witness is Dr. Mark Calabria, who, in addition to being the director of financial regulation studies at the Cato Institute, is also a former staffer for this very Committee. Dr. Calabria has also served as Deputy Assistant Secretary for Regulatory Affairs at the U.S. Department of Housing and Urban Development prior to his work on Capitol Hill. We welcome you back to the Committee.

David Crowe, Ph.D., is chief economist and senior vice president at the National Association of Home Builders. Dr. Crowe is responsible for NAHB's forecast of housing and economic trends, research and analysis of the home building industry, and consumer preferences as well as macroeconomic analysis of Government policies that affect housing. Welcome, Dr. Crowe.

Our next witness is Mr. Ronald Phipps. Mr. Phipps is the president of the National Association of REALTORS®, representing 1.1 million members involved in all aspects of the residential and commercial real estate industries. Mr. Phipps has previously served in many senior leadership positions within NAR. Welcome to the Committee.

Jeffrey Lubell has been executive director of the Center for Housing Policy since 2006 and is the recognized expert in housing and community development policy. He has previously served as Director of the Policy Development Division in HUD's Office of Policy Development and Research. Thank you for being here, Mr. Lubell.

Dr. Wachter, will you proceed?

STATEMENT OF SUSAN M. WACHTER, RICHARD B. WORLEY PROFESSOR OF FINANCIAL MANAGEMENT, PROFESSOR OF REAL ESTATE AND FINANCE, THE WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA

Ms. WACHTER. Chairman Johnson, Ranking Member Shelby, and other distinguished Members of the Committee, thank you for the invitation to testify today. It is my honor to be here to discuss the current state of the Nation's owner-occupied housing markets.

At this time, housing markets for single-family owned homes are fragile. The most recent data available from Radar Logic's Residential Price Index show that home prices continued their decline in January 2011, with prices down over 34 percent from peak values. For the fourth quarter of 2010, again, the most recent data available, the Census Bureau reports homeowner vacancy rates have increased, now at 2.7 percent, up from 2.5 percent in the third quarter of 2010. This is nearly 50 percent higher than the historical average vacancy rate for single-family homes. The consensus estimate is that home prices will continue to decline in the range of 5 percent to 10 percent in the coming months. This is due to unsold inventory plus remaining so-called "shadow" inventory.

The expectation of continued price declines will in itself deter home buying. Thus, the most pressing issue in the housing market today is how and when the excess inventory of homes will be resolved.

Although the supply overhang threatens to depress home prices further, national housing prices may not be far from reaching a bottom based on fundamentals. The national house price-to-rent ratio, as calculated by Case-Shiller, is near the level observed in 2002 and 2003, which, given the low interest rates then prevailing, was not, I believe, significantly inflated. At today's even lower interest rates, the current rent-price ratio, which is near that, is not inconsistent with a bottoming of housing prices nationally. Homes today are also affordable relative to income. According to the National Association of REALTORS'® Housing Affordability Index, a family earning the median income has 185 percent of the income

needed to purchase a median-priced home. Of course, that leaves aside major issues of ability to qualify.

But, nonetheless, in the short and intermediate run, the big threat facing the housing market is the uncertainty surrounding the supply overhang. Assuming household formation rates do return to their historic levels—and they are way beneath that as of now—the excess vacancy could be absorbed—and I emphasize "could be"—in 3 years so that it is possible that by 2014 markets could reach equilibrium, nationally. But in the short and intermediate run, a slowing of job growth, a rise in interest rates, or a decline in the availability of credit would delay this and could cause further price declines or even a spiral of price declines.

With or without stabilization of prices, distressed properties will continue to account for a large proportion of total sales in the markets. Recovery will depend upon continued strengthening of job markets and increased consumer confidence. For the incipient recovery to take hold, the availability of financing is also crucial.

Given the policy questions before this Committee, it may be useful in ending to comment briefly on the broader issue of housing finance. Borrowers who qualify for home loans are able to access historically low mortgage rates for 30-year, fixed-rate loans, which is helping to shore up the market. Questions about whether such mortgages will be available or what will replace them are likely to be an additional and, going forward, increasingly important factor creating uncertainty in housing markets. The housing finance system in the future that is yet to be created will be less vulnerable to economic disruptions affecting the ability to refinance if borrowers continue to have access to the standard fixed-rate mortgages that are not subject to refinance risk.

With that, I thank you and I am open for questions. I appreciate it.

Chairman JOHNSON. Thank you, Dr. Wachter.

Dr. Calabria.

STATEMENT OF MARK A. CALABRIA, DIRECTOR OF FINANCIAL REGULATION STUDIES, CATO INSTITUTE

Mr. CALABRIA. Chairman Johnson, Ranking Member Shelby, and distinguished Members of the Committee, I want to thank you for the invitation, and it really is a pleasure to be back here at this side of the table for a change.

I want to start with saying you are going to hear a lot of predictions about and a lot of discussions about where the housing market is at and where it is going, and I largely agree with those. I think there is a consensus about where the market is at. I think there is a consensus about the fragilities, and I think there is some consensus about direction of prices. I have touched on that in my testimony, so rather than repeat what everybody else will say, I think I will spend my time talking about my points of departure with other witnesses, and that is not to minimize the points of agreement.

First, I think we need to keep in mind you cannot fight fundamentals. I think to a large degree we spent the last 4 years trying to keep prices above what they should be in terms of market clearing levels. Ultimately prices will get to where they are going,

and that is driven by households and it is driven by income more than anything else, and we are seeing it get there.

I want to see if I can submit for the record an article that was in Bloomberg yesterday, and I think the title says it all: "U.S. Home Sales Accelerate as Price Decline Rebound." And I think the point that I would like to make is housing markets work like every other market. If you want to clear excess inventory, prices have to come down, and that is the way we need to do it.

A point I also want to make as well is while we have seen stabilization at the national level, there are tremendous differences across localities. While again we see median homes prices to median incomes around three, that is a historic trend, and that is, I think, a healthy trend, and that is where a healthy market is at. In San Francisco, that multiple is still eight. So there are a number of markets that are still relatively unaffordable, and the importance, I think, of this is that almost all the Federal policies we have, whether it is Federal Reserve interest rate policy, whether it is homebuyer tax credits, act through the demand side of the market. And the reason that this is important is that in markets with very rigid supply if you think back to your Econ. 101, essentially an inelastic supply curve, the demand forces prices up, and markets where you can bring supply on quite easily, you end up having excess supply. I think this is best illustrated—I talk about this in my testimony. Phoenix and San Diego are essentially the same size, yet San Diego over the last year has seen price increases, a bit minor, whereas Phoenix has seen an 8-percent decline. Part of that is driven by, despite the similar population and migration trends, the number of building permits in Phoenix is over twice that in San Diego. So local conditions very much matter. We cannot lose sight of that. And I am concerned that what looks like a stabilization at the national level is really just an offsetting of what is going on in very different markets, and that is something to keep in mind.

The other point I want to make in terms of the foreclosure crisis is we need to keep in mind negative equity alone is not the cause of most delinquencies. It is almost always coupled with a life event, like a job loss, or health care costs. Yes, there is some degree of strategic defaults which are those that just simply walk away because the house price has declined. I think those are under 25, 20 percent, and I do not think this should necessarily be the focus of policy. So I do think we need to be concerned about solutions that focus solely on negative equity.

I think we need to be worried about impacts of our housing policies and our home ownership on labor markets. It is well appreciated that the higher your home ownership rate, usually the higher you have structural unemployment. So I think about a percentage point of the unemployment rate we are seeing today is a direct result of the high home ownership rate we had going into this crisis combined with the foreclosure assistance programs and the other things in the marketplace that delay this.

I would also say in terms of a balancing of it, I think the risks are much greater if we keep prices above market clearing levels than they are if we allow prices to overshoot on the way down. And there are certainly risks if we allow them to overshoot on the way

down. But I want to echo something that Dr. Wachter said, which is the expectation of further price declines can have a considerable impact on keeping homeowners on the sidelines. We are far better in terms of turning the market around if we get to the point where buyers believe prices can go no further down. In my opinion, we are not there yet.

I want to close with saying I am greatly concerned, as I am sure Members of the Committee are, that the taxpayer stands behind almost all credit risk in the mortgage market. We are potentially looking at further bailouts. I think this is incredibly unhealthy. I think we recognize under all the Administration's three proposals, interest rates will go up. And they will, of course, go up because of inflation and Federal Reserve policy. We need to prepare for that now, and I think we need to move away from the sense of having the market not take this risk and pass it on to the taxpayers. As I note in my testimony, there is a tremendous amount of capacity outside of the GSEs in the rest of the financial services industry, and I am happy to go into further detail on that in Q&A.

With that, I thank you again, and I look forward to the discussion.

Chairman JOHNSON. Thank you, Dr. Calabria.

Dr. Crowe.

STATEMENT OF DAVID CROWE, CHIEF ECONOMIST, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. CROWE. Thank you, Mr. Chairman. My name is David Crowe. I am the chief economist for the National Association of Home Builders, a trade association of roughly 160,000 members who work in the residential construction industry. I appreciate the opportunity to testify today on the condition of the Nation's housing markets and the prospects for recovery in the housing sector.

The state of the Nation's housing market is improving but fragile. While the bottom of the market is behind us, the road to a robust recovery for housing remains a long and difficult path. High unemployment, unavailable buyer and builder financing, and consumer uncertainty are challenges for the home building sector.

A weakened housing sector will hold back economic growth. Traditionally, housing has led the U.S. economy out of recessions. In previous recoveries, housing grew at 28 percent in the first year of the recovery. In this recovery, housing has grown at less than 5 percent.

Construction unemployment remains the highest of any major area of the economy, with more than 1.4 million jobs lost in residential construction and an equal amount lost in the building supply sector.

National housing prices stabilized in early 2010, but have weakened due to the elevated share of distressed sales. However, in many areas the ratio of house prices to income has returned to historic levels, and on a national basis, the price-to-income ratio has returned to its historic average. I think Dr. Calabria mentioned the same.

Currently housing production is running around 600,000 units a year, well below the long-run trend of about 1.7 million new homes,

that are necessary to accommodate population growth and replacement of older housing stock.

The gap between current production and trend housing construction is a result of multiple factors. First, the excess existing home inventory has held back prices and construction of new homes. Nevertheless, the inventory of existing homes has fallen from over a year's supply to about an 8-month supply. Inventories of new homes for sale are at a 42-year low, and the ready-to-occupy new homes stand at an all-time record low of 78,000.

Foreclosures remain a drag on prices and demand and are likely, not unlikely, to fade. However, foreclosures remain concentrated with very high rates in six States that hold almost half of the foreclosure inventory. One promising sign is the pent-up demand from delayed household formations. Young people in particular have not moved out of their parents' home or have remained as roommates. NAHB estimates that approximately 2 million household formations have been delayed. These households constitute a shadow demand that will be unlocked as the economy improves.

Finally, and most importantly, in terms of the long-run health of the home building industry, lack of financing available to small builders is holding construction back where demand exists. Small businesses are at the heart of the residential construction sector who typically rely on debt financing. For such firms, the credit crunch persists and lending conditions are as tight as ever. As a result of these factors, near-term outlook for new construction remains cloudy.

These sobering signals have persisted despite record high housing affordability and historically low mortgage interest rates. Yet tight buyer finance and challenges with appraisals means housing demand remains at low levels.

NAHB forecasts that new home sales and housing production will remain weak in the first half of 2011, pick up slightly in the second half of the year, and build some momentum into 2012. Given this weak but improving market environment, NAHB urges Congress to approach housing policy issues with caution. For builders, these policy issues include providing a secondary mortgage market that ensures a reliable and uniform credit for homebuyers, preservation of the mortgage interest deduction and other housing tax rules, and unblocking the AD&C lending channels to permit home builders to contribute to the economy where and when demand exists. NAHB will soon present legislative proposals to ensure adequate credit availability to builders.

Thank you for the opportunity to testify, and I look forward to your questions.

Chairman JOHNSON. Thank you, Dr. Crowe.

Mr. Phipps.

STATEMENT OF RON PHIPPS, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

Mr. PHIPPS. Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for inviting me to testify today regarding the current state of the Nation's housing market.

My name is Ron Phipps. I am the 2011 president of the National Association of REALTORS®, and I am proud to be part of a four-

generation family owned residential real estate business based in Rhode Island. My passion is making the dream of home ownership available to American families. I am proud to testify today on behalf of the 1.1 million REALTORS® who share that passion, but also the 75 million Americans who own homes and the 310 million Americans who require shelter.

Most Americans understand the value of home ownership and aspire to it. They measure their personal financial wellness in large part in terms of home ownership and the equity they have within that home. Owning one's home is the first commandment of self-reliance for most families.

So what is the state of housing? In a word, a word you have heard repeated, it is fragile. The housing climate continues to be erratic. Mortgage rates have jumped from the exceptionally low rates of last year and have risen slightly, and we expect them to go a little bit further.

But the consumer malaise continues to prevail in the overall economy, effectively retarding the housing recovery. NAR believes that the economy may not be able to rely heavily on those consumers with stable jobs to help the overall economic recovery.

Thanks to some job creation, existing home sales will likely see improvement in 2011. However, changes in the median home price will be determined by how fast the inventory is worked off. Assuming that the pace of home sales can hold at near 5.3 million units this year, then the industry absorption rate of inventory should keep home values broadly stable. This should help absorb some of the distressed shadow inventory that will be coming to the market.

As we consider the future of Federal housing policies, we must keep in mind the immense value that sustainable home ownership provides to our country. Aside from the financial benefits gained over many years, home ownership improves communities, increases civic participation, and improves student test scores. These are benefits that make home ownership a pillar of society.

What makes home ownership a pillar of our economy is its ability to create jobs. Our research suggests that 1 million additional home sales in 2011 can create 500,000 additional private sector jobs. So while housing alone may not pull us out of this stalled economy, hampering its recovery will severely negatively impact the overall economic recovery.

REALTORS® believe that the pendulum on mortgage credit has swung too far in the wrong direction, and it is hurting consumers and the economy. The harmful products that led to the bubble and the crash are gone, and no one wants those to be brought back. But it is making it harder right now for those who can afford to obtain safe mortgages to further the recovery.

Let us be clear. REALTORS® agree that reforms are required to prevent a recurrence of the housing market meltdown, but unnecessary raising of down payments and other mortgage costs will have stark ramifications for the overall economy. REALTORS® believe that Federal regulators should honor the congressional intent by crafting a qualified residential mortgage—that is, QRM—exemptions that include a variety of traditional safe, well-underwritten products for 30-, 15-, 10-year fixed rates and 7–1 and 5–1 ARMs, those loans with flexible down payments, and they would require

mortgage insurance. It is likely to shape housing policy for the future. It is very important.

The QRM is also a precursor for the future of GSEs and is likely to be eligible for securitization. A poor QRM policy that does not heed the congressional intent will displace a large number of potential homebuyers, which in turn will slow economic growth.

Further, increases in fees from both FHA and the GSEs and credit overlays will make it more difficult for people to finance. Ten to 15 percent of qualified purchasers are being precluded from obtaining mortgages. And, remember, every two additional closed transactions generates 500,000 additional sales and can actually produce 250,000 jobs.

During World War II, President Franklin Delano Roosevelt said that a Nation of homeowners is unconquerable. In the 1980s, President Ronald Reagan advocated the need to preserve the mortgage interest deduction in order to promote the most important aspect of the American dream—home ownership. America's realtors agree. We see a bright future for housing with America. We ask you, Congress, to maintain a positive, aggressive, forward-looking approach to overcome the obstacles we currently face and ensure that housing and the national economic recoveries are sustained.

I thank you for the opportunity to speak today. As always, the National Association of REALTORS® is ready, willing, and able to work with Congress to create a bright future for our children and grandchildren.

Thank you.

Chairman JOHNSON. Thank you, Mr. Phipps.

Votes have just been called. Because we have two votes, the Committee will recess for a short time and resume the hearing after the votes.

[Recess.]

Chairman JOHNSON. Mr. Lubell, will you please proceed?

STATEMENT OF JEFFREY LUBELL, EXECUTIVE DIRECTOR, CENTER FOR HOUSING POLICY

Mr. LUBELL. Thank you, Chairman Johnson, Ranking Member Shelby, and distinguished Members of the Committee, for the opportunity to testify. My name is Jeff Lubell. I am the Director of the Center for Housing Policy, a research organization based in Washington, DC. We are the research affiliate of the National Housing Conference, a nonprofit policy organization dedicated to helping ensure safe, decent, and affordable housing for all Americans.

I have been asked to focus on the state of the housing market faced by working and lower income Americans. I am going to try to do it with the aid of some illustrations here. The bottom line is that despite the housing market decline, in terms of home prices, housing affordability for low and moderate income families has actually worsened.

So I know it is counterintuitive, but I will explain why basically lower home prices primarily benefit those Americans who have bought a home in recent years. If you have stayed where you are, or if you are a renter, things have actually gotten worse, and the reason is that incomes have gone down, home prices have only gone

down slightly, about 1 percent for working families, whereas rents have gone up.

So costs go up, incomes go down, the number of Americans with severe cost challenges increases. I have here a figure from HUD's Worst Case Needs Report, which Chairman Johnson cited in his testimony, his opening statement.

As of 2009, 7.1 million renter households have worst case needs for housing. That means they spent more than half their income for housing, lived in severely substandard housing, and had very low income rents and did not receive rental assistance. That is an increase of 20 percent in just 2 years, and an increase of 42 percent since 2001.

The primary factors are falling incomes, increased competition for affordable units, along with limited availability of rental assistance. But housing affordability challenges are not confined to renters and not confined to the very lowest income families. Next slide, please.

We recently released a study looking at working households. These are households working at least 20 hours or more per week with incomes up to 120 percent of the area median income. This is a group of Americans, more than 40 million households. It is 40 percent of the market.

Nearly one in four paid more than half of their income for housing costs. One in four working families spent more than half of their income for housing costs in 2009. That is 10.5 million households nationwide, an increase of 600,000 households in just 1 year.

As this table shows, there were increases in the share of working households with severe housing cost burdens throughout the country. Basically, costs went up by a statistically significant amount in 25 States. Those are the States that are shaded blue. They include Alabama, New Jersey, North Carolina, and Tennessee. There were——

Senator SHELBY. Say that again about my State and others.

Mr. LUBELL. Sure, sir. The share of working families who spent more than half of their income for housing went up by a statistically significant amount in those States, 25 States. They went down by a statistically significant amount in no States. So there were increases in other States, like in Hawaii, but because the numbers were not large enough, they were not statistically significant.

Senator SHELBY. And why did they do that?

Mr. LUBELL. Why did they go up?

Senator SHELBY. Lack of income, lack of opportunities?

Mr. LUBELL. So the reason that those numbers went up is that incomes went down, people had less opportunity for work, and rents went up. And owner costs went down only slightly, only 1 percent. So you have to distinguish. We talk about affordability in the market. That is for new housing. Very few people are moving. Most people are staying where they are. And for them, the problem has actually gotten worse.

As shown in the next chart, the housing cost challenges affect a broad range of family types. They are split almost evenly between renters and owners. So basically, we have housing cost challenges among owners as well as among renters. They are most prevalent

among families at the bottom of the income scale, but they are experienced by families across the spectrum, including families with incomes between 80 and 120 percent of the median income. So we have problems across our income spectrum.

My testimony includes some specific numbers about rural communities. We have very significant housing challenges in rural communities, and we had an increase of about 3 to 4 percent in the number of homeless families between 2008 and 2009.

I do want to make a really quick point in my last 20 seconds about the impact of rising energy prices. The cost of living in a place is affected not just by your shelter costs, but also by your utility costs and also by your transportation costs. As energy prices rise, affordability is going to get worse, and there is a huge connection between housing and transportation costs. They are related. Families think about them and treat them as a single budget item. If we want to address this, we are going to have to think about how to improve our coordination of housing and transportation policy to try to reduce the combined costs and improve overall affordability. I will look forward to your questions, and thank you for the additional time.

Chairman JOHNSON. Thank you, Mr. Lubell.

Dr. Wachter, can you discuss the structural barriers to the housing recovery that may exist in the financial system?

Ms. WACHTER. There is, right now, of course, a great deal of uncertainty about the future structure of the housing finance system. While that may not be weighing on housing prices at this moment, as we go forward, that is likely to be an increasingly important factor in the uncertainty of the future of housing prices.

I would like to reiterate that housing is different from most commodities and goods in that it is an asset. This price is determined by households' expectations of the future. So, for example, future scarcity of housing finance would impact housing prices today.

Chairman JOHNSON. Mr. Lubell, are there barriers to financing affordable rental housing in the current market? If so, how can these be overcome?

Mr. LUBELL. The short answer is yes, there are barriers to financing affordable housing, particularly affordable rental housing, but also, owner-occupied housing. To some extent, they are starting to resolve themselves. The market for equity, for example, in low-income housing tax credits has rebounded, but there continues to be difficulty on the debt side.

One of the things that is really helping is the availability of credit through Fannie Mae and Freddie Mac. I know it is not popular these days to talk about the benefits of those entities, but one of the things that those entities are doing is helping to ensure the availability of credit for affordable rental housing, particularly at a long-term fixed rate of interest, which is extremely important for financing and affordable property.

And those entities and their lending has actually, on the multifamily side, on the multifamily side has not incurred the same losses that we have seen on the single family side. So it is just important to understand that.

I do think that one of the problems we have is that the number of families that need assistance, in terms of affordable housing, has

gone up, as shown by these charts, and there is just not enough subsidy available to fill the gap between what the market can pay and the cost of actually building those homes. And so, that is something that I think is of continued interest as we think about how are we going to meet the growing challenge of affordable housing in America.

Chairman JOHNSON. Dr. Crowe and Mr. Phipps, you discuss the idea that potential homeowners are not entering the market and are creating a shadow demand. Would you explain what factors would bring that demand out of the shadows to help absorb the excess housing supply? First, you, Dr. Crowe.

Mr. CROWE. OK, thanks, Senator. Several things. One is jobs. Young people who have not yet moved out of their parents' home or have remained as roommates are unable to because either they do not have a sufficient income or they have no income. And so, return of consistent job growth will be the first thing.

And the second thing is some clarity about where the housing market is going. I think Jeff is correct that we are going to continue to see rent increases because we are not building enough rental units to keep up with the demand, so rents are going to go up. That is going to retard the continued delay in household formations. And as house prices remain uncertain, that is going to retard those folks from moving into a home because they do not want to buy a home, as Susan mentioned, until they are sure of the long-term sustainability of that house price.

Chairman JOHNSON. Mr. Phipps.

Mr. PHIPPS. Senator, the interesting thing to me when we testified is that four of us used the word "fragile" to describe the market. I am struck by the part where we say handle with care. The problem is, is that media treats real estate as a single market across the country. It is all local. One of the things we need to get back to is what is really going on in the local market and understand that the financing sources are, in fact, national.

But the challenge that we are faced with right now is a lot of people who should be able to obtain financing are not able to. When Fannie and Freddie now have credit scores that average 60 up from 720, we have got 15 percent of the market that could help absorb that shadow inventory.

There is a second piece of the shadow inventory—in some ways, we would like to get it out there and resolve it so we can go back to a normal, stable, dynamic market, but there is an opportunity for short sales in the market which just has not been realized in an effective way, that is clearly better for the investor and actually, in most instances, better for the family. The investor ends up losing 37 percent of principal on average versus 50 percent. But the process of getting a short sale approved in a timely, human fashion is just nonexistent.

The final point I would make is that we need understanding of mortgages and finance universally. It needs to be something people understand, and I believe the consumer understands their house and understands what they are buying, but they still have great difficulty understanding what the 100 or 150 pages of documents they sign at closing, which, by the way, you need to sign these now or you will not get the house.

That process of understanding and comprehending what happens is really important in order for us to get back to a normal, informed market. At the end of the day, we need to get through the overhang, we need to have that excess inventory resolved so the market does what markets do, and frankly, there will be price stabilization when we get beyond that.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman. Dr. Calabria, some housing interest groups have called for more regulations to govern the foreclosure process which would lengthen the time to complete foreclosures. Some have even called for a foreclosure moratorium. What would be the consequences, in your opinion, of these policies on the housing market and the economy.

Mr. CALABRIA. In the aggregate, we would be delaying the adjustment of the housing market to reaching an equilibrium of getting the inventory out of there. So I am very concerned that while we need to deal with those who can be helped, the vast majority of those who cannot be helped, we need to move that quicker. It is also important to keep in mind that somewhere from 30 to 40 percent of the foreclosures are on vacant properties, so those properties do not do anybody any good sitting there in those neighborhoods vacant.

So I would actually say what we need to have is more of a two-track approach where we focus on families that can be helped, but those who we know who are not going to be able to be helped and stay in the unit they are in, are the units vacant, that needs to be sped up and that process needs to be quicker.

I also want to comment very quickly on a couple of things that the Chairman mentioned, which is, we need to keep in mind that we all want to get back to a normal market, but we need to remember 2005 and 2006 were not normal markets and we do not want to go back to that.

Senator SHELBY. They were housing bubbles, were they not?

Mr. CALABRIA. They were housing bubbles and I believe Professor Wachter mentioned and I agree with this, that about 2002–2003, that was more like a normal market except for the massive refinance boom in 2003.

Senator SHELBY. And the chances of us going back to that are pretty slim, I hope.

Mr. CALABRIA. In the short term, yes, but this is a country where we have had a long history of housing bubbles, every 10 to 15 years, so I hope that we have learned something this time around, but I am not convinced of it.

Senator SHELBY. Dr. Calabria, has the force of the prospective homeowner been lost in the discussion of what the Government can do in mitigating mortgage foreclosures?

Mr. CALABRIA. I think that this is an important point. I certainly have friends who tried to buy short sales and homes that were in foreclosure and had those transactions fall through. This is an important thing to keep in mind, which is, any time we try to push up prices artificially, we are simply transferring wealth from potential buyers to sellers, and I certainly do not think that is a legitimate process.

Senator SHELBY. And we are interfering in the market, aren't we?

Mr. CALABRIA. We are, we are. We have to have the market find a price. I would reiterate, to me, the fundamental way of getting that pent-up demand out there is to get prices to a point where buyers just do not believe they can go any further down.

Right now I would have concern that potential buyers feel like if they buy something today, they will lose money on it, so there is a little bit of wait-and-see. We need to get past that point where the only direction for prices to go is up and we are not there yet.

Senator SHELBY. Dr. Crowe, in your testimony, you state that the National Association of Home Builders urges Congress to agree to definite solutions regarding the future of the Government-sponsored enterprises. Except in the need for a reasonable transition period and understanding the deliberative nature of Congress that we are a part of, would you agree that Congress needs to begin considering how to reform our housing finance system now?

Mr. CROWE. Senator, the simple answer is yes, we do need a solution to this. However, we do need to understand the fragile nature of our housing market and have the transition. And I would also say that the NAHB also supports some ultimate backstop by the Federal Government in order to maintain a 30-year, fixed rate mortgage in this country.

Senator SHELBY. I want to get into the HAMP program. The HAMP program was promoted by President Obama as a way to help 3 to 4 million struggling homeowners. To date, the program has put only 522,000 people in permanent loan modifications. By contrast, nearly 800,000 people have dropped out of the program.

This is significant, I think, and it is disturbing because as Special Inspector General Neil Barofsky of TARP recently pointed out in testimony before the House Financial Services Committee, and I quote, he says, "Failed trial modification often leave borrowers with principal outstanding on their loans and less home equity, depleted savings, and worst credit scores."

Dr. Calabria, do you agree with Mr. Barofsky's analysis there?

Mr. CALABRIA. I think Inspector General Barofsky is 100 percent correct in this, and I think we do need to be concerned that many of the people who have been through these modification programs come out worse than they have gone in. I think it is also important to keep in mind that we simply have not, and the Administration or even the last Administration, either has not put forth a baseline—we do not have a discussion over who should we be helping, what is a reasonable number, what is a reasonable expectation.

Senator SHELBY. Is that a good use of taxpayers' money?

Mr. CALABRIA. I question whether it has been used effectively.

Senator SHELBY. OK. Mr. Phipps, in your testimony you stated that frequent increases in fees from both FHA and the GSEs and credit overlays from lenders will unnecessarily increase the cost to home buyers and discourage these consumers, who can otherwise afford the mortgage, from participating in the housing market.

In both cases, these were existing fees designed to protect the taxpayer. If these reasonable fee increases deter a consumer from buying a house, does this not indicate that the person is better off renting, perhaps, and do you support charging actuarially sound

fees at FHA and the GSE to prevent further Government bailouts, in other words, the hit on the taxpayer?

Mr. PHIPPS. Senator, the short answer is that we believe the FHA serves a specific purpose and it is to fill a void in the market that is a larger percentage than it has historically. There have been actually several increases recently on FHA. Each time the increases for the threshold becomes higher.

There has to be a balance between cost and benefit, and we actually welcome that conversation and that analysis. But in the short answer, we think that the stepping up of cost needs to really reflect the demand that the market will support. And if you raise that first level of the ladder too high and people do not get on it, then we have further comprising of overall value.

So it is woven. It is absolutely woven. We would like to get back to a normal market where people who can sustain the mortgages have access to mortgage money to enjoy the gift, the benefit of home ownership.

Senator SHELBY. Mr. Chairman, I have one last question, if you will indulge me.

Dr. Calabria, in your testimony you state, and I will quote, "Unemployment is the primary driver of mortgage delinquency." Previously this Committee heard testimony from Dr. Paul Willen of the Federal Reserve stating, and I will quote him, "When home prices fall, some bars can no longer profitably sell and then the income disrupting life events really take a toll."

One of the life events Dr. Willen referenced that day was unemployment. Does this analysis mean that the best way—and there are other ways—but the best way to help homeowners is to spur economic growth?

Mr. CALABRIA. I would absolutely agree with that. I think a significant amount of the problems in our housing and mortgage markets would go away if we brought unemployment down significantly.

Senator SHELBY. Do you disagree with that, Dr. Crowe?

Mr. CROWE. No, Senator.

Senator SHELBY. What about you, Dr. Wachter?

Ms. WACHTER. Employment growth is a major driver and, in fact, we need it to strengthen in order to have a housing market recovery.

Senator SHELBY. OK. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. And thank you all for your testimony. I want to talk about liquidity in the marketplace. It seems to me, and I would like to get your perspectives on this, how do we get banks to commit to lending for real estate projects again? Particularly, you know, right now it seems to me that except for a very high asset class, for example, which attracts institutional investors in like the luxury high rental markets, certainly in our area in New Jersey, other than that, you have underwriting criteria on lenders where projects that are performing, borrowers that, in fact, have current debt service, fully current, and have not had a blip in that process, ultimately finding themselves, because they do not appraise today at the level of the loan closing

totally stopping projects in the midst of a project, even though the loan is performing.

So I look at that liquidity issue and I look at the flip side of the liquidity issue on the consumer side and see the changes in the underwriting criteria. We certainly understand legitimate changes to ensure that we do not have people buying homes they cannot afford.

But by the same token, you know, if we have had a 25 percent drop in real estate values, but you could get 10 percent down, based upon your income, and that would be, you know, take whatever price level you want of a $400,000 home, which is $40,000. Now you have to put 25 to 30 percent down, so that is anywhere, you know, nearly $100,000. I do not know how many people have $100,000 to put down on a home.

So I am wondering, from your perspective, how do we deal with this challenge of the liquidity crisis both for the actual movement forward in the market by those who develop it and on the consumers who seek to purchase it?

Mr. CROWE. I would like to take the first stab at that, Senator. I appreciate the question. On the production side, on the builder's side, the builders are having that difficulty. We have been surveying builders for 6 or 7 years, through the boom and into the bust, and what we find is a greater and greater percentage of them are being turned down at financial institutions, and that is their source of loanable funds.

Builders are small companies and they go to small banks to borrow the money to build the houses to sell to their customers, and they cannot get that money. We have gone to the regulators and we say, "There is something strange here." We do not see any differentiation in banks' response between the markets that are in good shape and the markets that are not. We understand why the bank might say no in the market that is overgrown with excess inventory, but we do not understand why they are saying no in a market that is showing some signs of recovery and people want to buy a house.

And we do not get satisfactory answers from the regulators. So, in fact, NAHB will be presenting legislation that we hope you will consider that speaks to some of these regulatory overreactions, things like making guidelines absolutes so that the regulator has guidelines and yet they have turned them into absolutes so there is no breaking those barriers.

Or evaluating properties, developed properties at their distressed level instead of at their build-out level. There will be that build-out level eventually, but we cannot seem to convince examiners that that will correct itself as that market corrects.

Requiring a payoff of a loan when it is current, but the sell rate has not been the same as it should have been, and therefore, the bank has suddenly decided that they want their money back even though the builder is making regular payments. They just do not have the same sales rate as they promised.

And then finally, we would like to see the SBA loan system more friendly to home builders. It is not a useful program to home builders right now.

Senator MENENDEZ. Anyone else? Mr. Phipps?

Mr. CALABRIA. If one starts with the observation that many banks tend to essentially be spread lenders, you know, we all recall the sort of borrow at three, lend at six, and be on the golf course at three. Well, that is no longer really the case, but there is a degree of truth to it. My point being is that if we also start with the observation that despite the financial crisis, insured depositories, their balance sheet has actually increased throughout this crisis, and insured deposits actually increased.

What they have done, however, is greatly change what they are holding on their balance sheet, and part of this is their incentive. We have set up a situation where you could essentially borrow from the Federal Reserve at near zero, put it in treasuries, earn a very nice spread that is absolutely risk-free. Part of that, if you look at the decline in small business lending and commercial bank, it almost exactly equals the increase in bank lending in terms of Government debt. So we have swapped who we have lent to.

What I think is important here is we need to change the incentive system of banks, and I think we do need to question as well, while the Federal Reserve has paying interest on reserves as a way to get us out of this crisis, it does not make sense in a situation where there is not a lot of liquidity actually getting out to the economy to pay interest on reserves. We are encouraging banks to hold excess reserves.

It is important to keep in mind, commercial insured depositories have a trillion dollars in cash just sitting around. So there is not a lack of capacity. It is really, how do we change the incentive system so that they put those funds into risk-making, like construction, but also into small business and other things. And I really think we need to look at monetary policy as a component of this and what the Fed is doing.

Mr. PHIPPS. Senator, the only thing I would add is on the consumer side, your FICO scores become the equivalent of your SAT score, and if the FICO score is below a certain threshold, the lender really does not look at you in a holistic approach. We need to get back to common sense, holistic lending where they take the amount down, the whole financial profile of the potential borrower, when analyzing whether to give them financing or not.

You do not need 760 as a minimum credit score to be credit-worthy and to be honorable in terms of repaying back the mortgage. The pendulum has swung so far that the rate of default over the 2009 instruments, mortgages that were issued, is about 1.2 percent, which is well-below the normal we would have seen in the early 2000 range. So getting it back to medium is important.

We have been meeting with the lenders, meeting with Fannie, Freddie, FHA to say, Please bring it back to a centrist, commonsense, sustainable criteria. We are just not seeing that impact as quickly as we would like it because at 15 percent of the market, if we move from 5 to 5.75, that is a lot of transactions and a lot of jobs. But the problem still is very, very much present in the marketplace.

Senator MENENDEZ. Thank you, Mr. Chairman. I have questions for the record for Mr. Lubell, but my time is over on affordable housing, which I would love to see your answer on, and we look forward to seeing your legislation and working on trying to change

this dynamic, because I do not think we are going to move the housing market until we get the regulators moving in a different direction. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and I want to continue on in the conversation about credit, and specifically, Mr. Crowe, in your testimony, you noted, "Most importantly for the Nation's small home builders, Congress, regulators, and financial institutions must work to unblock acquisition development and construction lending channels."

I think you mentioned that you may, in the near future, have a legislative proposal. I just wondered if there were some points you would like to preview for us.

Mr. CROWE. Thank you, Senator. I was given an opening by Senator Menendez, and so I took it. In summary, what we are looking for is the Congress to throw its weight around, if you will, because we have not had any success in convincing the regulators that there seems to be one systematic regulation concerning home builders throughout the country, even though, as I think you have heard in testimony today, the markets are dramatically different across the country.

And so, we have recovering markets in Texas, for instance, and some other States, and not so recovering in other States; and yet, we see no differentiation in the ability for builders to borrow. So what we are looking for is a little more sanity to the regulatory oversight that would allow financial institutions, who tell us they are perfectly comfortable with lending to real estate in certain markets, but are being told no by the regulators.

Senator MERKLEY. And so essentially, is it a cap on the percentage of the loan portfolio that can go to homes?

Mr. CROWE. Thank you. Yes, it is several points, but one of them is a guideline of no more than 100 percent of capital going to real estate. It is a guideline, nevertheless being used as a hard and fast rule. So if an institution has that much loan on its balance books already, it can no longer add any even though there is another good one out there.

Senator MERKLEY. An individual was actually telling me, as the owner of a commercial building, where he went to get a real estate loan for that building, and in the end, the bank did it as a nonreal estate loan, essentially foregoing the collateral, which was an insane decision from a common-sense point of view, but as a result of these type of caps that you are referring to.

Mr. Phipps, I really appreciated your point about the intangible value of home ownership. It is certainly something that I feel strongly about. Do you want to mention some of what you consider to be the intangible benefits?

Mr. PHIPPS. At the end of the day, we all need shelter, so we need a place to live, and when you look at the benefits, when people—we keep talking about skinning the game, Senator, and I get entertained by that, that skinning the game is a down payment. Skinning the game is my name on that deed saying I own that property, that I have an investment for my family.

Now, we got away from the discipline of taking out a 30-year mortgage and paying it off. But that is the concept that worked for

my parents, it worked for my grandparents. We need to go back to that, but that is an asset that really has a lot to do with my sense of place, accomplishment, and self-worth, and benefit to society.

We as realtors are committed to the concept of self-reliance. We believe that home ownership is a prerequisite for that. When you look at the benefits for neighborhood, for community, for test results, *et cetera,* they are all plus. We watch it with great caution because this Government has made a historic commitment to home ownership.

We think, in the highest purpose for over a hundred years, and the game has been played this way for a hundred years, so we are very anxious about any effort to reduce the number of baseball bases on the diamond or change the number of innings or change the number of outs, because we think home ownership, at the end of the day, is right for our children and grandchildren.

Senator MERKLEY. Well, thank you very much, and I really echo that. I certainly saw in my work with Habitat for Humanity and then other work in home ownership that the fact that one has the ability to have the freedom of choosing to do what you want on that property. No longer is there a rule about what color you can paint the house, no longer is there a landlord to call when something is broken, you have to take the responsibility for that.

A huge positive influence on the children. The stability. You mentioned test results. Study after study is showing children do far, far better with the stability when the family is in home ownership and more likely to graduate from high school, more likely to go to college, more likely to have higher incomes, more likely to have lower dependence on any future payments, which saves—is not just intangible. That is tangible. That is a real, real benefit.

It bothers me to hear folks saying that we should not press for home ownership in our society, especially because what they are responding to is the impact of predatory mortgages. If a family was unsuccessful on a predatory exploding interest rate mortgage, that does not mean they would not have been successful if they had been offered a straight-forward prime fully amortizing mortgage.

I wanted to, in that sense, one of our major programs for home ownership is the home mortgage interest deduction and it is a very valuable program over the long term to reduce the size of payments. One thing that I have been interested in is more help at the front end, and that is, for working families, often the home mortgage interest deduction provides only a modest amount of assistance, especially when interest rates are low.

Just a crude example, a $200,000 house, 10 percent down would be $180,000 mortgage, 5 percent, that would be $9,000 a year in interest, and your first year, which is the highest interest, and $9,000 for a couple is less than the standard deduction. So that couple would not actually get any benefit from the home mortgage interest deduction unless they had additional itemizable expenses. And if they did, it would probably be a modest amount.

And so, I have been floating the idea, not of a temporary down payment tax credit, or better yet, ability to use those funds at closing, but of a permanent. And I realize permanent may be too expensive and too hard for people to seize on, but really what I am saying is, we used a down payment credit as a short-term stimulus,

but in terms of working families having matching assistance to get into a home to begin with, spending a little bit of money on the front end is highly valuable.

We are spending around $100 billion a year on the home mortgage interest deduction. For somewhere around $5 billion a year, we could help a whole lot of families make that transition into home ownership, and in the short term, my sense has been that it would help absorb this excess inventory that several folks have mentioned. So I just thought I would invite you to share any thoughts about that.

Mr. PHIPPS. Senator, we actually have studied the proposal and we are very intrigued by it. The experience of the tax credits before we thought were very effective in stabilizing the market. In Australia right now they have exactly that type of program and it is working extremely well.

You prefaced the conversation with the mortgage interest deduction and we believe that life is choices, and we are very sensitive that that, for us, is the penultimate thing that we will defend. But we certainly support and encourage programs that provide for home ownership and opportunities for that.

Senator MERKLEY. Thank you. And, Mr. Crowe, from the home builders' point of view, any thoughts about that?

Mr. CROWE. I think a similar comment. Down payment is the single biggest retardant for a first-time home buyer to get into a home. So any assistance. In fact, we still favor a higher loan to values, lower down payment mortgages with the appropriate premiums paid for the risks. So if there is another way to subsidize that down payment through some tax credit, we would certainly be supportive of that, certainly with the caveat that we still believe to be that the mortgage interest deduction is very important to the broad base of households.

Senator MERKLEY. Yes.

Mr. PHIPPS. Senator, if I may, there is one other thing that is a little bit disturbing for me in the conversation about down payments. The assumption is that if someone puts 5 percent down, that is all they are putting down. The closing costs typically run between 3 and 5 percent additional. So when we talk about the down payment, we really need to add the real cost that the homeowner has to bring to closing in order for that to happen. It is more than 5 percent or 10 percent or 20 percent. It is that amount plus the related closing costs.

Senator MERKLEY. Point very well taken. And, Mr. Chair, I am over my time so I will follow up with additional comments you all have. Thank you.

Chairman JOHNSON. Thank you, Senator Merkley. The housing market has several challenges to overcome. We took the initial steps in Dodd-Frank by strengthening underwriting standards and risk retention, but we still have work to do. I will look forward to continuing the discussion about the future of housing in America in the coming weeks and months.

I am hopeful that as we explore the path forward, we will find more areas of agreement than disagreement. It is essential that we get this right for a sustainable housing market for American fami-

lies. Thanks again to my colleagues and our panel for being here today. This hearing is adjourned.

[Whereupon, at 4:26 p.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF SUSAN M. WACHTER

RICHARD B. WORLEY PROFESSOR OF FINANCIAL MANAGEMENT, PROFESSOR OF REAL ESTATE AND FINANCE, THE WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA

MARCH 9, 2011

Chairman Johnson, Ranking Member Shelby, and other distinguished Members of the Committee, thank you for the invitation to testify at today's hearing. It is my honor to be here to discuss the current state of the Nation's owner-occupied housing markets.

At this time, housing markets for single-family owned homes are fragile. The most recent data available from Radar Logic's Residential Price Index show that home prices continued to decline in January 2011, with prices down over 34 percent from peak values. According to the S&P/Case-Shiller Home Price Index, the U.S. National Home Price Index declined 3.9 percent during the fourth quarter 2010 and is down 4.1 percent for the year. In the most recent data, for the fourth quarter of 2010, the Census Bureau reports homeowner vacancy rates at 2.7 percent, up from 2.5 percent in the third quarter of 2010. This is nearly 50 percent higher than the historical average vacancy rate for single-family homes. Looking ahead, the size of the current inventory of unsold homes and the so-called 'shadow' inventory will likely depress the price of homes further before prices stabilize. Industry estimates predict that housing prices will fall 5 percent to 10 percent more this year. The expectation of continued price declines will in itself deter home buying. Thus, the most pressing issue in the housing market today is how and when the excess inventory of homes will be cleared.

Existing single-family home sales have increased in recent months. The National Association of REALTORS® reports an annualized rate of 5.36M in January, which is significantly higher than the 5.09M level of January 2009. Over a quarter of these homes sold in 2010 were distressed (including those in default, scheduled for foreclosure auction, and REO) according to RealtyTrac. Homes in process of foreclosure sell for a 28 percent discount in RealtyTrac's most recent data. Not only do distressed homes sell for less, but with many homes still potentially in the foreclosure pipeline, an estimated 4 million homes—approximately 2 million in the foreclosure process and 2 million in default—this potential additional supply suppresses expected home prices. Homes with mortgages that are currently underwater may add to this potential excess supply. According to CoreLogic's report of March 8, 2011, 23.1 percent of all residential properties with a mortgage were in negative equity at the end of the fourth quarter of 2010, up from 22.5 percent in the third quarter, resulting in an aggregate level of negative equity of $751 billion.

Although this supply overhang threatens to depress home prices further, national housing prices may not be far from reaching a bottom. The most important factors affecting the fundamentals of demand for owner-occupied housing are employment, income, interest rates, and the availability of financing. These factors impact demand for owner-occupied homes through household formation and the desired rate of home ownership. Household formation in particular depends upon job growth and is critical for the growth in demand for housing whether rental or owner-occupied. The recovery of housing markets requires that underlying fundamentals continue to improve. This includes critically that jobs continue to grow and that interest rates remain stable or increase within limited bounds as the economy gains strength.

Today the national housing price-to-rent ratio, as calculated by Case-Shiller, is near the level observed in 2002–2003, which, given the low interest rates then prevailing, was not, I believe, significantly inflated. At today's lower interest rates, the current rent/price ratio is not inconsistent with a bottoming of housing prices nationally. Homes today are affordable relative to income. According to the National Association of REALTORS'® Housing Affordability Index, a family at the median income has 185 percent of the income needed to purchase a median-priced home.

Nonetheless, in the short run and intermediate run, the big threat facing the housing market is the uncertainty surrounding the supply overhang. The glut of foreclosed and delinquent homes currently sitting on the market could take years to work through. How long might it take to absorb the excess housing inventory? According to the Census Bureau, the total U.S. housing stock consisted of 130 million units in 2010. It is generally estimated that average population growth requires approximately 1.5 million housing units to be constructed annually. Combining this number with the number of units that need to be replaced due to deterioration, 0.4 million according to the Congressional Budget Office, results in demand for approximately 2 million units annually. Housing starts are at historic lows, approximately 500k units annually, thus far from the historic average demand, and the current overall vacancy rate is approximately 10 percent or 13 million units. To reduce over-

all vacancy to historic norms of approximately 7 percent requires the absorption of 3 percent (or 4 million) homes. Assuming household formation rates return to their historic levels, the excess vacancy could be absorbed in as little as 2 to 3 years so that by 2014, markets could reach equilibrium, on a national basis. However, the threat to this scenario is the supply of homes waiting on the sidelines. We run the risk of overshooting on the downside and falling beneath the price level justified by fundamentals—just as we far overshot equilibrium prices on the way up to the peak in 2006.

Thus pending foreclosures and potential future foreclosures from the shadow supply weigh heavily on the housing market. This potential additional supply of unsold homes suppresses home prices today and adds to uncertainty in the future. Last year, over a quarter of homes sold were foreclosures and short sales. If prices increase, underwater homeowners will be made whole as the market restores their equity, thus over time reducing the number of homes sold in distressed sales. If the share of distressed sales rises, housing prices will fall further. A reentry into a vicious cycle of house price declines could push more homeowners underwater, precipitating more defaults, which will drive prices lower again. I am not predicting this, but it is a possible outcome.

Distressed home sales and underwater mortgages are concentrated regionally. According to RealtyTrac, in January 2011, five States—California, Arizona, Florida, Michigan, and Nevada—accounted for over half of the Nation's foreclosure filings. The differences in job growth and inventory across States add to the regional disparate housing outcomes.

In addition to regional differences, national uncertainty remains. In the short and intermediate run, a slowing of job growth, a rise in interest rates, or a decline in the availability of credit would cause further price declines on a national scale. In any case, distressed properties will continue to account for a large proportion of total sales in the coming months, although defaults appear to be diminishing with the overall increased stability of markets. We may be at a turning point or may shortly be in the second half of 2011. But a recovery will depend upon continued strengthening of job markets and increased consumer confidence. For an incipient recovery to take hold, the availability of financing and, given the policy direction of moving away from Federal support of mortgage markets, the availability of private capital to finance mortgages is crucial. Uncertainty affecting the housing market includes the availability of financing, the terms under which loans will be made, as well as the path of disposition of mortgages that are currently in distress.

Today approximately 90 percent of housing finance is federally supported. Borrowers who do qualify for home loans are able to access historically low mortgage rates for 30-year, fixed-rate loans. During the housing bubble, the market abandoned the 30-year, fixed-rate mortgage. Instead of long-term, fixed-rate, amortized mortgages, the bubble featured the wild growth of nonamortized, adjustable-rate mortgages with short, introductory teaser periods. They were designed to be refinanced upon the expiration of a short 2–3 year teaser period, as the promotional interest rate expired. The 30-year, fixed-rate mortgage has served American homeowners well; it was a source of tremendous stability for consumer finance and the national economy. Questions about whether such mortgages will be available or what will replace them are likely to be an additional and increasingly important factor creating uncertainty in housing markets. Private markets have now recognized the instability that can be a feature of housing finance, especially with volatile capital flows and potential interest rate rises with global capital market disruptions. Going forward, the housing finance system will be less vulnerable to economic disruptions affecting the ability to refinance if borrowers continue to have access to standardized fixed-rate mortgages.

PREPARED STATEMENT OF MARK A. CALABRIA

DIRECTOR OF FINANCIAL REGULATION STUDIES, CATO INSTITUTE

MARCH 9, 2011

Chairman Johnson, Ranking Member Shelby, and distinguished Members of the Committee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a nonprofit, nonpartisan public policy research institute located here in Washington, DC. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official policy positions of the Cato Institute. In addition, outside of my interest as a citizen, homeowner, and taxpayer, I

have no direct financial interest in the subject matter before the Committee today, nor do I represent any entities that do.

State of the Housing Market

The U.S. housing market remains weak, with both homes sales and construction activity considerably below trend. Despite expected increases in mortgage rates, many forecasters are projecting increased housing activity in 2011. Although activity will likely be above 2010 levels, 2011 is expected to fall below 2009 levels and is unlikely to reach levels seen during the boom for a number of years. As other witnesses are likely to provide their economic forecasts of housing activity, which are generally within the consensus estimates, I will not repeat that exercise here.

As in any market, prices and quantities sold in the housing market are driven by the fundamentals of supply and demand. The housing market faces a significant oversupply of housing, which will continue to weigh on both prices and construction activity. The Federal Reserve Bank of New York estimates that oversupply to be approximately 3 million units. Given that annual single family starts averaged about 1.3 million over the last decade, it should be clear that despite the historically low current level of housing starts, we still face a glut of housing. NAHB estimates that about 2 million of this glut is the result of "pent-up" demand, leaving at least a million units in excess of potential demand. [1]

The Nation's oversupply of housing is usefully documented in the Census Bureau's Housing Vacancy Survey. The boom and bust of our housing market has increased the number of vacant housing units from 15.6 million in 2005 to a current level of 18.7 million. The rental vacancy rate for the 4th quarter of 2010 declined considerably to 9.4 percent, although this remains considerably above the historic average. The homeowner vacancy rate actually increased from the 2nd and 3rd quarters to the 4th quarter of 2010, reached 2.7 percent, a number almost twice the historic average.

The number of vacant for sale or rent units has increased, on net, by around 1 million units from 2005 to 2010. Of equal concern is that the number of vacant units "held off the market" has increased by about 1.5 million since 2005. In all likelihood, many of these units will reenter the market once prices stabilize.

The fourth quarter 2010 national home ownership rate fell to 66.6 percent, just above the 1998 figure of 66.5, eliminating almost all the gain in the home ownership rate over the last 12 years. Declines in the home ownership rate were the most dramatic for the youngest homeowners, while home ownership rates for those 55 and over were stable or saw only minor declines. This should not be surprising given that the largest increase in home ownership rates was among the younger households and that such households have less attachment to the labor market than older households. Interestingly enough, the percentage point decline in home ownership was higher among households with incomes above the median than for households with incomes below the median.

Homeowner vacancy rates differ dramatically by type of structure, although all structure types exhibit rates considerably above historic trend levels. Single-family detached homes displayed an owner vacancy rate of 2.3 percent, while owner units in buildings with 10 or more units (generally condos or co-ops) displayed an owner vacancy rate of 10.7 percent in the 4th quarter of 2010. Although single-family detached constitute 95 percent of owner vacancies, condos and co-ops have been impacted disproportionately.

Owner vacancy rates tend to decrease as the price of the home increases. For homes valued under $150,000 the owner vacancy rate is 3.1 percent, whereas homes valued over $200,000 display vacancy rates of about 1.5 percent. The vast majority, almost 75 percent, of vacant owner-occupied homes are valued at $300,000 or less. Owner vacancy rates are also the highest for the newest homes, with new construction displaying vacancy rates twice the level observed on older homes.

While house prices have fallen considerably since the market's peak in 2006—over 23 percent if one excludes distressed sales, and about 31 percent including all sales—housing in many parts of the country remains expensive, relative to income. At the risk of oversimplification, in the long run, the size of the housing stock is driven primarily by demographics (number of households, family size, *etc.*), while house prices are driven primarily by incomes. Due to both consumer preferences and underwriting standards, house prices have tended to fluctuate at a level where median prices are approximately three times median household incomes. Existing home prices, at the national level, are close to this multiple. In several metro areas, however, prices remain quite high relative to income. For instance, in San Fran-

[1] Denk, Dietz, and Crowe, "Pent-up Housing Demand: The Household Formations That Didn't Happen—Yet", National Association of Home Builders. February 2011.

cisco, existing home prices are almost eight times median metro incomes. Despite sizeable decline, prices in coastal California are still out of reach for many families. Prices in Florida cities are generally above four times income, indicating they remain above long-run fundamentals. In some bubble areas, such as Phoenix and Las Vegas, prices are below 3, indicating that prices are close to fundamentals. Part of these geographic differences is driven by the uneven impact of Federal policies.

Household incomes place a general ceiling on long-run housing prices. Production costs set a floor on the price of new homes. As Professors Edward Glaeser and Joseph Gyourko have demonstrated,[2] housing prices have closely tracked production costs, including a reasonable return for the builder, over time. In fact the trend has generally been for prices to about equal production costs. In older cities, with declining populations, productions costs are often in excess of replacement costs. After 2002, this relationship broken down, as prices soared in relation to costs, which also included the cost of land.[3] As prices, in many areas, remain considerably above production costs, there is little reason to believe that new home prices will not decline further.

It is worth noting that existing home sales in 2010 were only 5 percent below their 2007 levels, while new home sales are almost 60 percent below their 2007 level. To a large degree, new and existing homes are substitutes and compete against each other in the market. Perhaps the primary reason that existing sales have recovered faster than new, is that price declines in the existing market have been larger. Again excluding distressed sales, existing home prices have declined 23 percent, whereas new home prices have only declined only about 10 percent. I believe this is pretty clear evidence that the housing market works just like other markets: the way to clear excess supply is to reduce prices.

Mortgage Markets and Mortgage Policies

For those who can get a mortgage, rates remain near historic lows. These lows rates, however, are not completely the outcome of the market, but are driven, to a large degree, by Federal policy interventions. Foremost among these interventions is the Federal Reserve's current monetary policy. Of equal importance is the transfer of almost all credit risk from market participants to the Federal taxpayer, via FHA and the GSEs. Given massive Federal deficits as far as the eye can see, and the already significant cost of rescuing Fannie Mae and Freddie Mac, policymakers should be gravely concerned about the risks posed by the current situation in our mortgage markets. Immediate efforts should be made to reduce the exposure of the taxpayer.

In transitioning from a Government-dominated to market-driven mortgage system, we face the choice of either a gradual transition or a sudden "big bang." While I am comfortable with believing that the remainder of the financial services industry could quickly assume the functions of Fannie Mae and Freddie Mac, I recognize this is a minority viewpoint. Practical politics and concern as to the state of the housing market point toward a gradual transition. The question is then, what form should this transition take? One element of this transition should be a gradual, step-wise reduction in the maximum loan limits for the GSEs (and FHA).

If one assumes that higher income households are better able to bear increases in their mortgage costs, and that income and mortgage levels are positively correlated, then reducing the size of the GSEs' footprint via loan limit reductions would allow those households best able to bear this increase to do so. As tax burden and income are also positively correlated, the reduction in potential tax liability from a reduction in loan limits should accrue to the very households benefited most by such a reduction.

Moving beyond issues of "fairness"—in terms of who should be most impacted by a transition away from the GSEs—is the issue of capacity. According to the most recent HMDA data (2009), the size of the current jumbo market (above $729k) is approximately $90 billion. Reducing the loan limit to $500,000 would increase the size of the jumbo market to around $180 billion. Since insured depositories have excess reserves of over $1 trillion, and an aggregate equity to asset ratio of over 11 percent, it would seem that insured depositories would have no trouble absorbing a major increase in the jumbo market.

Given that the Mortgage Banker Association projects total residential mortgage originations in 2011 to be just under $1 trillion, it would appear that insured depositories could support all new mortgages expected to be made in 2011 with just

[2] Edward Glaeser and Joseph Gyourko, "The Case Against Housing Price Supports", *Economists' Voice* October 2008.

[3] *Also see,* Robert Shiller, "Unlearned Lessons From the Housing Bubble", *Economists' Voice* July 2009.

their current excess cash holdings. While such an expansion of lending would require capital of around $40 billion, if one is to believe the FDIC, then insured depositories already hold sufficient excess capital to meet all new mortgage lending in 2011.

Moving more of the mortgage sector to banks and thrifts would also insure that there is at least some capital behind our mortgage market. With Fannie, Freddie, and FHA bearing most of the credit risk in our mortgage market, there is almost no capital standing between these entities and the taxpayer.

The bottom line is that reducing the conforming loan limit to no more than $500,000, if not going immediately back to $417,000, would represent a fair, equitable and feasible method for transitioning to a more private-sector driven mortgage system. Going forward, the loan limit should be set to fall by $50,000 each year. As this change could be easily reversed, it also represents a relatively safe choice.

Reducing the competitive advantage of Fannie Mae and Freddie Mac via a mandated increase in their guarantee fees would both help to raise revenues while also helping to "level the playing field" in the mortgage market. Given that the Federal taxpayer is covering their losses and backing their debt, along with the suspension of their capital requirements, no private entity can compete with Fannie Mae and Freddie Mac. We will never be able to move to a more private market approach without reducing, if not outright removing, these taxpayer-funded advantages.

An increase in the GSE guarantee fee could also be used to recoup some of the taxpayer "investment" in Fannie Mae and Freddie Mac. Section 134 of the Emergency Economic Stabilization Act of 2008, better known as the TARP, directed the President to submit a plan to Congress for recoupment for any shortfalls experienced under the TARP. Unfortunately the Housing and Economic Recovery Act of 2008, which provided for Federal assistance to the GSEs, lacked a similar requirement. Now is the time to rectify that oversight. Rather than waiting for a Presidential recommendation, Congress should establish a recoupment fee on all mortgages purchased by Fannie Mae and Freddie Mac. Such a fee would be used directly to reduce the deficit and be structured to recoup as much of the losses as possible. I would recommend that the recoupment period be no longer than 15 years and should begin immediately. A reasonable starting point would be 1 percentage point per unpaid principal balance of loans purchased. Such as sum should raise at least $5 billion annually and should be considered as only a floor for the recoupment fee.

In any discussion regarding costs in our mortgage market, we must never forget that homeowners and homebuyers are also taxpayers. Using either current taxes or future taxes (via deficits) to fund subsidies in the housing market reduces household disposable income, which also reduces the demand for housing. None of the subsidies provided to the housing and mortgage markets are free. They come at great costs, which should be included in any evaluation of said subsidies.

Contribution of Federal Policy

Federal Government interventions to increase house prices, including Federal Reserve monetary and asset purchases, have almost exclusively relied upon increasing the demand for housing. The problem with these interventions is they have almost the opposite impact between markets where supply remains tight and those markets with a housing glut. In areas where housing supply is inelastic, that is relatively unresponsive (often the result of land use policies), these programs have indeed slowed price declines. Areas where supply is elastic, where building is relatively easy, have instead seen an increase in supply, rather than price. For these areas the increase in housing supply will ultimately depress prices even further.

A comparison of San Diego, CA, and Phoenix, AZ, illustrates the point. Both are of similar population (2.5 million for Sand Diego, 2.2 million for Phoenix), and both witnessed large price increases during the bubble. Yet the same Federal policies have drawn different supply and price responses. In 2010, about 8,200 building permits were issued for the greater Phoenix area; whereas only about 3,500 were issued for San Diego. Existing home prices (2010) in Phoenix fell over 8 percent, whereas prices in San Diego actually grew by 0.6 percent. This trend is compounded by the fact that prices are almost three times higher in San Diego than in Phoenix. The point is that Federal efforts to "revive" the housing market are sustaining prices in the most expensive markets, while depressing prices in the cheapest markets, the opposite of what one would prefer. As home prices are correlated positively with incomes, these policies represent a massive regressive transfer of wealth from poorer families to richer.

Among policy interventions, the Federal Reserve's interest rates policies are perhaps having the worst impact. It is well accepted in the urban economics and real estate literature that house prices decline as distances from the urban core increase. It is also well accepted that the relative price of urban versus suburban house prices

is influenced by transportation costs. For instance, an increase in the price of gas, will, all else equal, lower the price of suburban homes relative to urban. If loose monetary policy adds to increases in fuel prices, which I believe it currently is, then such monetary policies would result in a decline in suburban home prices relative to urban. One can see this dynamic play out in California. In general, prices in central cities and urban cores, have witnessed only minor declines or actual increases over the last year. According to the California Association of Realtors, overall State prices are down just 2 percent from January 2010 to January 2001. Yet prices in the inland commuting counties—Mariposa (-27%), San Benito (-14%), Butte (-29%), Kings (-16%), Tulare (-16%)—are witnessing the largest declines, in part driven by increases in commuting (gas) costs.

Foreclosure Mitigation and the Labor Market

There is perhaps no more important economic indicator than unemployment. The adverse impacts of long-term unemployment are well known, and need not be repeated here. Although there is considerable, if not complete, agreement among economists as to the adverse consequences of jobless; there is far less agreement as to the causes of the currently high level of unemployment. To simplify, the differing explanations, and resulting policy prescriptions, regarding the current level of unemployment fall into two categories: (1) unemployment as a result of lack of aggregate demand, and (2) unemployment as the result of structural factors, such as skills mismatch or perverse incentives facing the unemployed. As will be discussed below, I believe the current foreclosures mitigation programs have contributed to the elevated unemployment rate by reducing labor mobility. The current foreclosures mitigation programs have also helped keep housing prices above market-clearing levels, delaying a full correction in the housing market.

First we must recognize something unusual is taking place in our labor market. If the cause of unemployment was solely driven by a lack of demand, then the unemployment rate would be considerably lower. Both GDP and consumption, as measured by personal expenditures, have returned to and now exceed their precrisis levels. But employment has not. Quite simply, the "collapse" in demand is behind us and has been so for quite some time. What has occurred is that the historical relationship between GDP and employment (which economists call "Okun's Law") has broken down, questioning the ability of further increases in spending to reduce the unemployment rate. Also indicative of structural changes in the labor market is the breakdown in the "Beveridge curve"—that is the relationship between unemployment and job vacancies. Contrary to popular perception, job postings have been steadily increasing over the last year, but with little impact on the unemployment rate.

Historically many job openings have been filled by workers moving from areas of the country with little job creation to areas with greater job creation. American history has often seen large migrations during times of economic distress. And while these moves have been painful and difficult for the families involved, these same moves have been essential for helping the economy recover. One of the more interesting facets of the recent recession has been a decline in mobility, particular among homeowners, rather than an increase. Between 2008 and 2009, the most recent Census data available, 12.5 percent of households moved, with only 1.6 moving across State lines. Corresponding figures for homeowners is 5.2 percent and 0.8 percent moving across State lines. This is considerably below interstate mobility trends witnessed during the housing boom. For instance from 2004 to 2005, 1.5 percent of homeowners moved across State lines, almost double the current percentage. Interestingly enough the overall mobility of renters has barely changed from the peak of the housing bubble to today. This trend is a reversal from that witnessed after the previous housing boom of the late 1980s burst. From the peak of the bubble in 1989 to the bottom of the market in 1994, the percentage of homeowners moving across State lines actually increased.

The preceding is not meant to suggest that all of the declines in labor mobility, or increase in unemployment, is due to the foreclosure mitigation programs. Far from it. Given the many factors at work, including the unsustainable rate of home ownership, going into the crisis, it is difficult, if not impossible, to estimate the exact contribution of the varying factors. We should, however, reject policies that encourage homeowners to remain in stagnant or declining labor markets. This is particularly important given the fact that unemployment is the primary driver of mortgage delinquency.

Conclusion

The U.S. housing market is weak and is expected to remain so for some time. Given the importance of housing in our economy, the pressure for policymakers to

act has been understandable. Policy should, however, be based upon fostering an unwinding of previous unbalances in our housing markets, not sustaining said unbalances. We cannot go back to 2006, and nor should we desire to. As the size and composition of the housing stock are ultimately determined by demographics, something which policymakers have little influence over in the short run, the housing stock must be allowed to align itself with those underlying fundamentals. Prices should also be allowed to move towards their long-run relationship with household incomes. Getting families into homes they could not afford was a major contributor to the housing bubble. We should not seek to repeat that error. We must also recognize that prolonging the correction of the housing market makes the ultimate adjustment worse, not better. Lastly it should be remembered that one effect of boosting prices above their market-clearing levels is the transfer of wealth from potential buyers (renters) to existing owners. As existing owners are, on average, wealthier than renters, this redistribution is clearly regressive.

PREPARED STATEMENT OF DAVID CROWE

CHIEF ECONOMIST, NATIONAL ASSOCIATION OF HOME BUILDERS

MARCH 9, 2011

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement to the Senate Committee on Banking, Housing, and Urban Affairs on the current state of the Nation's housing markets, prospects for the future, and housing policy implications. NAHB represents over 160,000 member firms involved in home building, remodeling, multifamily construction, property management, housing finance, building product manufacturing and other aspects of residential and light commercial construction.

The state of the Nation's housing markets is improving but fragile. While the bottom of the market in terms of housing production and significant price declines is behind us, the road to a robust recovery for housing remains a long and difficult path. High unemployment, housing policy uncertainty in terms of buyer and builder finance, and long-term fiscal issues are challenges for the housing construction sector as it struggles to return to its long-run trend, with the job and economic benefits that such a development would bring. NAHB estimates that the construction of each single-family home creates three jobs, $90,000 in Federal, State, and local tax revenue, $145,000 in wage income, and $86,000 in net business income.

NAHB urges Congress to agree to definite solutions regarding the future of the Government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac that ensure a functioning housing finance system that provides credit to homebuyers on reasonable terms, protect the housing tax incentives, including the deduction for home mortgage interest, and unblock the obstacles to acquisition, development, and construction (AD&C) lending for builders.

In normal times, housing's total contribution to Gross Domestic Product (GDP) is approximately 18 percent. Today it stands at a diminished 15 percent, with home building's direct component down from a normal of 5 percent of GDP to 2.4 percent of GDP. In the first year of all post-World War II economic recoveries, except for the most recent cycle, housing averaged a 28 percent increase in production. In this recovery, housing construction has grown less than 5 percent. As a result, unemployment in the construction sector remains the highest of any major area of the economy.

General Economic Conditions

A recovery in the housing market is dependent on strong economic performance by the economy as a whole. The Commerce Department's second estimate of growth in real GDP for the final quarter of last year, released on February 25, showed a downward revision from 3.2 percent to 2.8 percent; a revision that dropped growth for 2010 as a whole from 2.9 percent to 2.8 percent. This surprising development primarily reflected downward revisions to spending by consumers and State and local governments, along with a reduction in net exports.

Last week's job market data suggested an improving labor market. Total nonfarm payroll employment increased by 192,000 in February, a marked improvement after the weak performance in January. Job gains occurred broadly across sectors of the economy. Year-over-year, total payroll employment has grown by 1.3 million, or an average of 106,000 per month. The unemployment rate decreased to 8.9 percent, but the number of unemployed is still high at 13.7 million.

Residential construction employment increased slightly in February, up 0.66 percent (13,200 jobs) to 2.024 million. Conditions are improving in the sector, as this is the fourth consecutive month of growth. However, year-over-year, the sector is

still down 65,800 jobs (-3.15%). Total construction unemployment continued to improve, falling to 16.39 percent on a seasonally adjusted basis, from 18.65 percent in January. Nonetheless, total loss in residential construction employment since its peak in April 2006 is 1.426 million (-41.3%).

While it is positive that overall job creation is occurring, the economy in general, and the housing markets in particular with respect to the demand side of the market, require much more robust employment growth. In the 1990s, the labor force grew at a rate 139,000 a month, and in the prerecession 2000s this rate was 122,000. To accommodate population growth and replace the more than 8 million jobs lost in the Great Recession, the economy needs to generate at least 300,000 jobs a month.

With respect to regional economic conditions, unemployment rates are declining and jobs are being created, but there remains significant variation across States. Nevada's total job losses exceed 14 percent of its employment force, and Michigan, Florida, and Arizona have recorded job losses of more than 10 percent of their labor forces. Nevada has the top unemployment rate, as of December 2010, at 14.5 percent, with the States of California, Florida, Michigan, Rhode Island, South Carolina, Oregon, Kentucky, Georgia, and Mississippi possessing rates greater than 10 percent. Nonetheless, all States have posted reductions in unemployment rates since their respective maximum rates, with the largest point declines reported in Michigan, Illinois, Washington, DC, and Alabama.

Credit conditions remain tight. The Federal Reserve's January Senior Loan Officer Opinion Survey indicated that, after easing slightly in the third quarter of 2010, banks resumed tightening their lending standards in the fourth quarter and the tightening continued in January 2011. Over the past 3 years the major banks have ratcheted up their credit standards to a point that it is very difficult for homeowners without superior credit standards to access loans for housing.

Further, builders are finding access to credit even more difficult, with very few banks willing to provide AD&C loans. In the fourth quarter of 2010, NAHB survey data confirmed that few builders are even seeking loans given existing tight credit conditions. Only 17 percent of builders sought land acquisition loans in the fourth quarter, down 92 percent in the final quarter of 2005. Similarly, only 20 percent attempted to secure land development loans, down from 89 percent in 2005. For the single-family market, 40 percent of builders sought construction financing in the fourth quarter of 2011, down from 96 percent for the same period of 2005. Multifamily tells a similar story as well, with 19 percent of surveyed membership seeking construction financing, down from 82 percent in 2005.

Data from the fourth quarter of 2010 indicates that of those builders reporting tighter conditions 77 percent noted lenders require lower loan-to-value ratios, 76 percent indicated that lenders were not making new loans at all, 69 percent reported reduced lending amounts, 59 percent responded that lenders required personal guarantees or collateral not connected to the project, and 51 percent indicated higher interest rate requirements. Overall, these very tight credit standards are holding back housing demand and restricting supply.

Taken together, NAHB expects above-trend growth of GDP over the 2011–2012 period, with a modest slowdown in 2012 as fiscal stimulus to the economy fades away. NAHB is forecasting year-over-year GDP growth of 3.1 percent and 3.5 percent in 2011 and 2012, respectively. With respect to home construction, NAHB expects year-over-year growth in residential fixed investment to reach 12 percent in 2011 and 26 percent in 2012, performances that will contribute about 0.3 and 0.7 percentage points to GDP growth in these 2 years.

Current Housing Market Conditions

House prices have declined in recent months, falling with the end of the home buyer tax credit program. All major house price measures turned down in the third and fourth quarter of 2010, taking back some but not all of the gains achieved since early 2009. However, some of the price decline was related to the elevated share of the existing home sales market that was attributable to distressed sales. Data from RealtyTrac indicates that for 2010, 26 percent of home sales were distressed sales, and that homes in the foreclosure process on average sold for a 28 percent price discount. Bank-owned homes sold for an even deeper discount, a 36 percent reduction on average.

Despite these recent declines, NAHB expects house prices to stabilize in the near term and to post slow growth later this year and in 2012 as economic growth produces jobs and improves consumer confidence. In many areas, house price-to-income ratios have returned to historical levels. On a national basis, the home price to income ratio has reached 3.2 (the level it approximately tracked from 1991 to 1999) after peaking at 4.7 in late 2005.

As of January 2011, private housing starts totaled 596,000 at an annualized rate. This is well below the long-run trend of approximately 1.7 million new homes that are necessary to accommodate population growth and replacement of older housing stock. The gap between current production and potential housing construction is a result of multiple factors, including builders dealing with excess housing inventory, deferred household formations, and lack of AD&C financing.

Inventories of new and existing homes continue to fall as a result of significant declines in housing construction. The National Association of REALTORS® estimates that the national inventory of existing homes for January 2011 stands at 3.38 million homes, a 7.9 months supply of homes at current sales rates. This is significantly lower than the 12.5 months supply that was recorded in July 2010. In contrast to existing homes, newly constructed inventories represent a very small share of total housing inventory. As of January 2011, the Census reports 188,000 newly constructed homes for sale, a 7.9 months supply. This is also much reduced from the 11.2 months supply level reported in 2008. Such inventory numbers reflect homes that are completed, are underway, or not yet under construction. Inventories of completed constructed for-sale homes stand at an all-time low: 78,000 in January 2011, down from 199,000 in January 2009. The homebuyer tax credit program was effective in reducing these inventories, and we thank the Congress for its support of this important program during the Great Recession.

On the negative side, the inventory of foreclosed homes rose in the fourth quarter of 2010, matching the peak level set at the start of the year. The foreclosure crisis is unlikely to fade in the near-term, with delinquency rates remaining high, providing a steady flow of foreclosure starts. While the rate of foreclosures declined in the fourth quarter of 2010 to 1.27 percent of all loans outstanding, it was only a modest improvement from the peak level of 1.42 percent in third quarter of 2009. The foreclosure problem is concentrated however, with very high rates of foreclosures started in Nevada (2.95 percent of loans outstanding in Q4 2010), Arizona (2.29%), Florida (2.21%), Illinois (1.55%), Michigan (1.55%), and California (1.41%). These six States also hold almost half of the foreclosure inventory. The large number of foreclosed properties on the market will continue to exert downward pressure on house prices and stifle demand in these States through 2012. In other States less burdened by foreclosures, the housing market is likely to be more responsive to the improvement in economic activity and declines in the unemployment rate that is expected in the near term.

While much has been made of the excess supply of homes, the demand side of the housing market has also contributed to recent weakness. Due to high unemployment rates and economic uncertainty associated with the aftermath of the Great Recession, many households that were expected to form due to simple population growth have not in fact materialized. Such individuals may represent children living with parents, roommates doubling up, or even divorce-related. NAHB estimates that approximately 2.1 million household formations have been delayed as a result of recent economic conditions. These potential households constitute a "shadow demand" for the Nation's housing markets. As the economic picture improves, we expect this demand to be unlocked, helping to reduce housing vacancy rates.

Finally and most importantly in terms of the long-term health of the home building industry, low levels of housing construction activity, and its spillover economic benefits and job creation, are also due to lack of financing available to small- and medium-sized builders across the Nation.

Small businesses are the heart of the residential construction sector, which includes single-family and multifamily construction, land development and home remodeling. Overall, approximately one-third of NAHB's membership is made up of dedicated builders. The remaining share of its membership consists of associate members who also work within the residential construction sector.

As measured by workers, 80 percent of NAHB builder members have less than 10 employees, with the average member having approximately 11 employees. Only 1 percent of NAHB builder members have more than 100 employees. For NAHB's associate members, nearly 90 percent have less than 50 employees.

Approximately 50 percent of NAHB builder members have less than $1 million in gross receipts, and 86 percent have less than $5 million in gross receipts. Approximately 80 percent of NAHB builder members built 10 or fewer homes in 2010. NAHB's associate members are very similar to its builder members with respect to dollar size of business, with 77 percent having less than $5 million in gross receipts.

These kinds of small businesses typically rely on debt financing, often from regional and community banks. For such businesses, the credit crunch persists, and lending conditions are as tight as ever. Builders who have local demand to build often cannot access AD&C financing, thereby preventing business activity and job creation.

Housing Market Outlook

The near-term outlook for new housing demand remains sluggish, with the NAHB/Wells Fargo Housing Market Index (HMI) for February failing to gain ground. The HMI remains at a level of 16, with any reporting less than 50 indicating ongoing weakness on the demand side of the new-home market and suggesting low levels of single-family production for some time.

These sobering signals have persisted despite record-high readings regarding the affordability of home purchases. NAHB's housing opportunity index (HOI) reached a new high in the fourth quarter of 2010. Similarly, consumers' view of the buying conditions for homes from the University of Michigan consumer sentiment survey is also very high. However, while consumers are aware of the very favorable affordability conditions and continued low interest rates (30-year, fixed-rate mortgage rates have hovered around 5 percent since mid-December 2010), other factors, such as concerns over their employment situation and income growth, tight buyer credit conditions, and inaccurate appraisals, are holding back prospective home buyers.

Despite some recent downward revisions, NAHB expects slowly improving economic and financial market conditions, along with great affordability conditions, to support moderate increases in new single-family home sales and housing production in 2011–2012.

New single-family home sales and housing production are expected to remain weak in the first half of 2011, but will pick up in the second half of the year, with momentum building through 2012. NAHB's forecast of new home sales shows a modest gain of 8 percent in 2011, before a more substantial 49 percent increase in 2012.

After recent gains, the rate of increase in existing single-family home sales is expected to slow in the first quarter of 2011. However, we expect that it will return to its strong rate of growth in the second quarter, which will carry through to the end of 2012. This will return existing single-family home sales to their long-term sustainable trend level by the end of 2012.

Single-family housing starts will follow a similar trend to new single-family home sales with an increase of 15 percent in 2011 and 47 percent in 2012. This will raise the level of single-family starts to 900,000 units by the end of 2012. While a substantial gain over current depressed levels, this is still 40 percent below NAHB's estimate of the long-term sustainable trend, based on demographics, replacement needs, and second-home demand.

Multifamily housing starts have experienced great volatility in recent months, rising from 89,000 in June 2010 to 182,000 in August, back down to 93,000 in November then up to 183,000 in January 2011. This variation is expected to continue, with a sharp rise in multifamily housing starts expected in the first quarter of 2011, a modest decline in the second quarter, before resuming steady growth through the end of 2012. Overall multifamily housing starts are projected to increase 21 percent in 2011 and 40 percent in 2012, rising to 210,000 units in the fourth quarter of 2012, which is still 38 percent below NAHB's estimate of the long-term sustainable level.

Residential fixed investment (RFI) experienced only moderate growth in the fourth quarter of 2010, with the gains in existing home sales (*i.e.,* increase in brokers' commission) countered by weak housing production (single-family and multifamily housing starts). Increases are expected over the next few years, with the forecasts for housing production and home sales generating year-over-year growth in real RFI of 12 percent in 2011 and 26 percent in 2012. However, coming from an extremely low level in 2010, these gains in RFI will provide only a modest contribution to GDP growth, about 0.3 and 0.6 percentage points respectively, in those 2 years.

Policy Implications

Given housing's ongoing weakness in the economy, NAHB urges Congress to approach housing policy with due caution. Several housing policies loom on the horizon, and if treated inappropriately, they have the potential to harm the housing sector, thereby hurting the savings of the Nation's 75 million homeowners, as well as the ability of the residential construction and real estate industry to contribute to the economic recovery.

First, NAHB urges Congress to agree to definite solutions to the issue of the GSEs that ensure a functioning housing finance system that provides credit to home buyers on reasonable terms. The housing market faces a strong possibility of a double dip characterized by strong price declines and significant declines in sales volumes if homebuyers do not have reasonable access to credit. In the short-term, the conforming loan price limits for mortgages will adjust downward, which could place downward price pressure on affected, high-cost markets. It is useful to remember

that FHA and GSE guarantees currently cover approximately 90 percent of mortgages issued today.

Second, there has been increased attention paid to the Federal Government's budget situation. The state of the Nation's public finances is critical for homebuyers and home builders. A large Federal deficit can absorb savings that might be used for investment in housing, thereby leading to higher interest rates, increasing borrowing costs for small businesses and crowding out potential homebuyers. However, most economists believe the state of the Federal Government's fiscal path is unsustainable, prompting cries of reform, both for Government spending and tax policy. And a target for some within this debate is the mortgage interest deduction (MID), arguably the most important tax rule for homebuyers and homeowners in the U.S.

It is important to keep in mind that the deduction for mortgage interest is solidly a middle class tax break. Nearly 70 percent of the benefits of the MID is collected by homeowners with less than $200,000 in income. In 2012, the tax expenditure for the MID—roughly its budget size—is estimated by the Joint Committee on Taxation as $94 billion. While a large number—not surprisingly as more than 35 million homeowners will benefit from the MID directly in 2012—this amount totals to only 3.7 percent of expected tax collections in that year. Under realistic policy estimates, a total repeal of the MID would likely collect $75 million or less, as homeowners restructure their finances, increasing tax collections by only about 3 percent (or half a percentage point of GDP). This is not responsible for, nor can it fix, the Nation's fiscal challenges.

Other housing tax rules, such as the capital gain exclusion, the real estate tax deduction, and the Low-Income Housing Tax Credit (LIHTC), are well-established housing policies, which if eliminated or weakened would result in wealth losses for homeowners (in the case of the gain exclusion) or the abandoning of a successful policy that facilitates the production of affordable housing (in the case of the LIHTC).

Regulators should also proceed with caution as they implement last year's financial reform legislation (Dodd-Frank). A determination needs to be made regarding what constitute a qualified residential mortgage (QRM) that would be exempt from the law's risk retention rules. An excessive down payment requirement, such as 20 percent, would squeeze first-time homebuyers out of the housing market for years to come, preventing household formations and producing economic damage to the overall economy.

Finally, and most importantly for the Nation's small home builders, Congress, regulators, and financial institutions must work to unblock the AD&C lending channels, to permit home builders to contribute to the economy where and when housing demand emerges as the economy improves. Without access to credit, the residential construction industry will lose more small businesses and experience more job losses, with these impacts being widely spread across the Nation.

With this in mind, NAHB has presented banking regulators with specific instances of credit restrictions; provided data showing no difference in credit access across market conditions and requested specific changes to current regulatory guidance. To date, these efforts have not produced any tangible results. With the spigot for housing production loans cut off, and threat that the uncertainty from Dodd-Frank rulemaking will further affect the ability of small community lenders to service the credit needs of the home building industry, it is clear that Congressional action is needed to help open the flow of credit to home builders. Without such action, there can be no housing recovery, which has major implications for our Nation's ability to recover from the current economic downturn. NAHB has outlined a formal legislative blueprint to Congress detailing key legislative elements critical to help ensure adequate credit availability to home builders. Three of these key elements focus on fixing specific instances of regulatory excess, while the final element aims to address the ability of the Small Business Administration (SBA) to meet the credit needs of small home builders. In the coming weeks and months, NAHB will be working with Congress to address these critical issues and seek congressional action to address each specific concern.

PREPARED STATEMENT OF RON PHIPPS

PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

MARCH 9, 2011

Introduction

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, on behalf of more than 1.1 million REALTORS® who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry, thank you for inviting me to testify today regarding the current state of the Nation's housing market. I am also speaking on behalf of the 75 million American families who own homes and the 310 million Americans who require shelter.

My name is Ron Phipps. I am a 3rd generation member of a 4 generation family tradition in the Rhode Island residential real estate industry. My passion is making the dream of home ownership available to all American families. As direct result of my passion, I have become very active within the National Association of REALTORS® (NAR); holding significant positions at both the State and national levels. Since 2000, I have been President of the Rhode Island Association, a NAR Regional Vice President, and a member of the NAR Executive Committee. Currently, I am the 2011 NAR President.

Most Americans understand the value of home ownership. They measure their financial wellness in large part with home ownership and with the equity they have in that home. Home ownership provides them with shelter. Owning one's home is the first commandment of self-reliance for most families. Most Americans understand the value of buying a home and over time paying the mortgage off. More Americans rely on this tangible asset for their confidence in their own financial situation, the overall financial well-being of the country, and the strength of these United States: "Life, Liberty, and the Pursuit of Happiness" was Life, Liberty and Property in the first draft by Jefferson.

Current Housing Trends

The housing climate continues to be erratic. Mortgage rates have jumped from their exceptionally low levels of last year, and are likely to rise even further. Of course, REALTORS® expected mortgage rates to increase—that is not unusual as an economy comes out of recession and moves into recovery.

However, consumer malaise continues to prevail in the overall economy, effectively retarding the housing recovery. NAR believes that the economy may not be able to rely heavily on those consumers with stable jobs to help with economic recovery. A solid stock market recovery has lifted wealth for some, but many consumers historically have relied on the wealth tied to their housing equity for confidence. These consumers are now staring at a much lower household net worth in the aftermath of a painful housing market bust. Furthermore, many homeowners who refinanced last year into historically low rates interestingly brought more cash to the table, thus lowering their overall mortgage debt—perhaps to further increase their ability to repay their obligation and/or to improve their equity position. The lowering of debt is a healthy trend for the long-haul, but it also means less money available for current spending and current economic growth.

Historically, the housing market has been a major power engine for economic growth, particularly coming out of a recession. This does not seem to be the case this time. Additional foreclosures and a shadow real estate owned (REO) inventory loom. As a result, housing starts may only reach 700,000 units in 2011—half the normal historical annual production, though an improvement from the 554,000 and 586,000 starts, respectively, in the past 2 years. That implies little addition to economic growth. It also implies a potentially faster than expected "cleaning up" of what has been a bloated housing inventory, particularly as existing-home sales pick up.

Since jobs are now being created, albeit at a slower than desired rate, existing-home sales will likely see some improvement in 2011. Changes in median home prices will be determined by how fast the inventory is worked off. Assuming that the pace of home sales can hold at near 5.3 million units, as occurred in the final month of last year and in January (with swings in home sales induced from the existence and absence of the homebuyer tax credit largely over), then the inventory absorption rate should keep home values broadly stable. This, combined with the continued reduction in builder activity—resulting in a 40-year low on newly constructed inventory—should help absorb some of the distressed shadow inventory that will be reaching the market.

NAR expects local housing market recovery paths in terms of both sales and prices to follow in the footsteps of local job market conditions. Those metros with reasonably healthy job creating markets have so far been Washington, DC, Boston, Minneapolis, and Seattle. The local economies with energy exposures such as those of Alaska, North Dakota, Oklahoma, and Texas are also doing relatively well. Improvements to jobs are helpful for home sales. We also need to be mindful that improved home sales help create jobs. Research suggests that one million additional home sales in 2011 over 2010 will mean 500,000 private sector jobs created in the country. Meaning, jobs and the housing market go hand-and-hand.

The housing bust of recent years has unfortunately forced as many as 11 million homeowners in to underwater situations and the aggregate homeowner wealth has declined. The median net worth—the value of everything owned minus everything owed—for a homeowner is estimated to have fallen from $230,000 in 2007 to about $170,000 in 2010. However, the net worth of homeowners still outpaces that of a typical renter, which is only $4,000 to $5,000. That is a testament to long-term benefits for homeowners who steadily pay down mortgage.

Aside from the eventual financial benefits gained over many years for homeowners, let's not lose sight of the intangible societal benefits of home ownership: better communities, higher civic participation, lower juvenile delinquency, higher pupil test scores, and higher voter participation rates among home-owning families versus tenant (rental) households. As we continue to discuss the future of housing finance, we must consider the intangible social stability that arises from having a super majority of the population that are property owners. REALTORS® are not suggesting that home ownership will cure society's ills, but the U.S. has seen the benefits of home ownership and private property rights that are protected by our Constitution.

Housing Recovery Impediments

The belief in home ownership as a pillar of American society is why REALTORS® are reaching out, with great concern, to the national association to better understand the intentions of the Administration, Congress, and numerous regulatory bodies that are perceived as actively working to devalue, or place severe obstacles in the path of, home ownership. REALTORS® agree that reforms are required to prevent a recurrence of the housing market meltdown, but unnecessarily raising down payment will have ramifications for the overall economy, as well as housing. According to Exhibit 5-3 from NAR's 2010 Home Buyer and Seller Profile (released November 2010), 41 percent of repeat buyers and 70 percent of first-time homebuyers had down payments of 10 percent or less of their home's purchase price (see chart below).

Exhibit 5-3 **PERCENT OF HOME FINANCED BY FIRST-TIME AND REPEAT BUYERS, AND BUYERS OF NEW AND PREVIOUSLY OWNED HOMES**

(Percentage Distribution)

				BUYERS OF	
	All Buyers	First-time Buyers	Repeat Buyers	New Homes	Previously Owned Homes
Less than 50%	8%	6%	12%	9%	8%
50% to 59%	3	1	5	4	3
60% to 69%	4	2	6	5	4
70% to 79%	10	7	14	11	10
80% to 89%	19	16	23	16	20
90% to 94%	12	14	10	11	12
95% to 99%	30	39	21	29	30
100% – Financed the entire purchase price with a mortgage	14	17	10	15	13
Median percent financed	92%	96%	86%	92%	92%

Congress intended to create a broad exemption from risk retention for historically safe mortgage products. REALTORS® believe that Federal regulators should honor Congressional intent by crafting a qualified residential mortgage (QRM) exemption that includes a wide variety of traditionally safe, well underwritten products such

as 30, 15, and 10 year fixed rate loans, 7–1 and 5–1 ARMs, and loans with flexible down payments that require mortgage insurance. The QRM is likely to shape housing finance for the foreseeable future and is therefore very important. Another reason QRM is important is that it serves as a precursor for what the future GSE is likely to be eligible to securitize. A poor QRM policy that does not heed the Congressional intent will displace a large portion of potential homebuyers, which in turn will slow economic growth and hamper job creation.

Furthermore, frequent increases in fees from both FHA and the GSEs and credit overlays from lenders will unnecessarily increase the costs to homebuyers and discourage these consumers, who can otherwise afford a mortgage, from participating in the housing market. By some estimates, 10–15 percent of otherwise qualified buyers with a demonstrable ability to repay will be turned away due to the overly stringent requirements. This represents approximately 500,000 home sales that won't happen, further dragging out the housing and economic recovery. (Every two additional closed real estate transactions can create one job, 500,000 sales can produce 250,000 additional jobs.)

REALTORS® believe that the pendulum on mortgage credit has swung too far in the wrong direction and it is hurting consumers and the economy. The harmful products that led to the bubble and crash are gone and no one is looking to bring them back, but making it harder for those who can afford a safe mortgage does not further the goals of recovery.

As we have mentioned in prior testimony before this Committee and the House Financial Services Committee, reduced home buying activity hurts numerous businesses that are part of the housing industry (*e.g.,* home renovation, remodeling, furnishing, *etc.*) and our State and local governments through reduced tax revenues. So, even though it is our belief that housing will not pull us out of this recession alone, the hampering of its recovery will severely, negatively impact any recovery that is, or soon to be, underway.

Conclusion

President Thomas Jefferson dreamed of a well-functioning and self-governing democratic society evolving from a Nation of agrarian land-owning families. During the World War II era, President Franklin Delano Roosevelt said that a Nation of homeowners is unconquerable. President Ronald Reagan advocated the need to preserve the mortgage interest deduction in order to promote the one important aspect of the American Dream—home ownership.

The idea of home ownership has been attacked from many quarters because of the housing bubble and subsequent bust. Many mistakes were made during the cycle. However, as the country takes a critical look at Federal housing policy, let's not lose sight of the immense intangible value of home ownership—sustainable home ownership—to our country.

The National Association of REALTORS® sees a bright future for the housing market and the overall economy. However, our members are well aware that the future we see rests on the industry's and the economy's ability to successfully navigate some significant obstacles. Congress and the housing industry must maintain a positive, aggressive, forward-looking partnership if we are to ensure that housing and national economic recoveries are sustained.

I thank you for this opportunity to present our view of the state of the Nation's housing market. As always, The National Association of REALTORS® is at the call of Congress, our industry partners, and other housing stakeholders to help facilitate a sustainable housing and national economic recovery.

PREPARED STATEMENT OF JEFFREY LUBELL

EXECUTIVE DIRECTOR, CENTER FOR HOUSING POLICY

MARCH 9, 2011

I am the Executive Director of the Center for Housing Policy, a research organization based in Washington, DC, working to expand awareness of the Nation's housing challenges and to identify proven and promising strategies for meeting those challenges. In addition to analyzing relevant and timely data, we draw on the expertise of the broad range of practitioners that belong to our affiliate, the National Housing Conference.

My testimony this afternoon will focus on housing affordability trends. The bottom line is simple and perhaps counterintuitive: despite several years of falling home prices, housing affordability has worsened for low-and moderate-income households. In 25 States, the share of working households severely burdened by their housing costs rose significantly between 2008 and 2009, while no State saw a statistically

significant decline. Lower home prices primarily benefit those in the market for a new home, and renters face steady or rising costs and more competition for low-cost units. For both owners and renters, falling incomes and a grim employment picture have contributed to the erosion of housing affordability.

Worst Case Housing Needs

Housing affordability is often a concern for renters with the lowest incomes. There were approximately 17.1 million very low-income renters in 2009, and a recent study by the U.S. Department of Housing and Urban Development (2011) found that:

- 7.1 million (41 percent) had worst case needs, spending more than half of their income on housing costs, living in substandard housing, or both, without receiving Government rental assistance.
- The number of renters with worst case needs has increased by nearly 42 percent since 2001. (*See,* Figure 1 in the Appendix.) Between 2007 and 2009, the number rose by 1.2 million households—or 20 percent. A 2-year increase of this magnitude is unparalleled in at least the last 25 years.
- Only 60 affordable and adequate units were available for every 100 very low-income renters in 2009.
- Increased competition for affordable units, falling incomes, and a shortage of rental assistance are the primary factors driving the recent increase in worst case needs.
- In 2009, families with children made up 39 percent of all renters with worst case needs, representing the most common household type. However, renters with worst case needs are far from homogenous, representing all household types, races/ethnicities, and residential settings.

Low- and Moderate-Income Working Families

But housing affordability concerns are not limited to very low-income renters. Another recent study—this time by the Center for Housing Policy—found high levels of severe housing cost burden among working families—both renters and owners—spanning a broad income range. In 2009, there were 46.2 million households in the United States that averaged at least 20 hours per week in the workplace and earned no more than 120 percent of the area median income. Our study (Wardrip 2011) found that:

- Nearly one in four working households had a severe housing cost burden in 2009, spending more than half of their income on housing. More than 10.5 million working households experienced this cost burden—an increase of 600,000 households in only 1 year.
- The share of working households with a severe housing cost burden increased significantly in 25 States between 2008 and 2009, while no States saw a statistically significant decrease. (*See,* Figure 2 in the Appendix.)
- Roughly 80 percent of working households with extremely low incomes (below 30 percent of the area median income) had a severe housing cost burden. However, housing costs burden working households of all incomes and tenures, from coast to coast. (*See,* Figure 3 in the Appendix.)
- Working renters reported working fewer hours in 2009 than in 2008, and nominal household incomes declined by 4 to 5 percent for working renters and owners.

Rural Housing Challenges

Housing issues in rural America are often over-shadowed in policy discussions, but one-fifth of all U.S. households live in rural communities. Many of the same housing concerns associated with urban areas are also of concern in rural areas.

- Roughly 3.4 million households in nonmetropolitan areas spent half or more of their income on housing in 2009. Approximately 40 percent were renters. [1]
- Although housing quality in rural areas has improved markedly during the last several decades, it remains an issue for many. According to data collected in 2009, approximately 1.5 million rural households lived in substandard housing (Housing Assistance Council 2010).
- Among the 3.1 million very low-income renters in nonmetropolitan America, some 1.1 million—or 36 percent—had a worst case need in 2009, either spend-

[1] Housing Assistance Council's tabulations of the 2009 American Housing Survey public use files.

ing more than half of their income on housing costs or living in severely inadequate conditions. This rate is close to that of renters with similar incomes in central cities and the suburbs (42 to 43 percent) (HUD 2011).

- Despite lower housing costs generally, rural areas lack a sufficient number of units for their very low-income renters. Fewer than 73 units were affordable, available, and adequate for every 100 very low-income renters in nonmetropolitan areas in 2009 (HUD 2011).

Homelessness

Even in the best economic times, a substantial number of families and individuals go to bed each night without a permanent roof over their heads. The sagging economy and persistently high unemployment rate have not only eroded housing affordability for those with homes of their own but also made it increasingly difficult to address homelessness.

- The number of people who were homeless on a given night in 2009 increased by 3 percent from 2008 to 2009, rising to approximately 656,129.[2] The homeless population increased in 30 States and the District of Columbia (Sermons and Witte 2011).
- Over 1.5 million people used the shelter system during the 12 months ending September 30, 2009 (HUD 2010). Although the number of people seeking shelter has inched down over the last 2 years (-1.9 percent), the number of households with children doing so has increased from 131,000 to 170,000 over the same time period (HUD 2010).
- The population living in doubled-up situations for economic reasons—a common living arrangement prior to homelessness—rose to over 6 million people in 2009, an increase of almost 12 percent in 1 year (Sermons and Witte 2011).

Multifamily Housing Markets

Much of the Nation's affordable housing (whether assisted or unassisted by Government subsidies) is in multifamily properties. This sector is still recovering from the effects of the recession and the capital market disruptions, so affordability challenges will persist. The lack of financing and uncertainty about future demand greatly slowed the pace of new apartment construction, the effects of which will persist for at least 1–2 years. A recent Marcus & Millichap (2011) report expects only 53,000 new apartment completions in 2011, down 46 percent from last year and far less than the expected 158,000 new units demanded. In general, the renting of foreclosed single-family homes does not significantly offset the shortage of new apartments—these houses are priced higher, more costly to maintain, in inconvenient locations for renters, and difficult to manage efficiently as rental properties.

Reliable capital flows are still a barrier to sustained multifamily production as well. Debt capital is still primarily Government backed, with the GSEs and FHA providing more than 90 percent of new originations. Equity investment interest is once again growing due to projections of rising demand and stronger yields. Demand for Low Income Housing Tax Credits (LIHTC) has rebounded somewhat from the devastating retreat of equity capital in 2008–9, although demand and pricing are generally substantially below their peak. Properties in stronger, mostly coastal housing markets command far more investor interest than other areas.

Impact of Rising Energy Prices

Living costs are not limited to the costs of shelter. Families also must pay for utility costs as well as the transportation costs of getting to and from work and around town. Research conducted by the Center for Housing Policy and the Center for Neighborhood Technology found that moderate-income working families (incomes of $20,000 to $50,000 in 2000) in the 28 metro areas studied actually spent slightly more for transportation (30 percent of income) in 2000 than their combined housing and utility costs (28 percent of income), with the costs for both heavily dependent on how close they lived to jobs and public transportation (Lipman 2006). Cities like New York City, with high housing costs, often had comparatively low transportation costs, while cities like Houston and Cincinnati, with low housing costs, often had comparatively high transportation costs.

---

[2] HUD (2010) reported to Congress that there were 643,067 homeless persons in January 2009, a decrease of 3.2 percent from 2008. These estimates include three communities with which HUD expressed some methodological concerns. Sermons and Witte (2011) adjust the counts from these communities and make other adjustments to arrive at their estimate of over 656,000 homeless persons and an increase of 3 percent. HUD notes that removing the three problematic estimates suggests that homelessness rose by 2.1 percent, a finding more closely in-line with Sermons and Witte (2011).

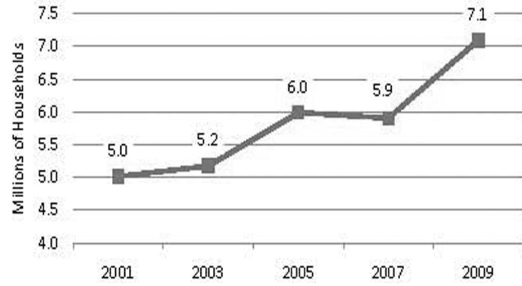
While updated data on the combined burden of housing, transportation, and utility costs will not be available until next year, one thing is clear: Low-and moderate-income families are highly vulnerable to rising energy prices. Everyone will pay more in utility costs as energy prices rise, reducing affordability even further. Families that live far from their places of employment and in auto-dependent communities will bear a double burden as their transportation costs rise along with their utility costs.

Conclusion

Housing prices have fallen sharply over the past several years. For those buying a home today, affordability has certainly improved. However, affordability has not improved for America's renters and owners more generally. For renters as well as homeowners who stay in place, monthly housing costs have largely remained stable or risen, while unemployment and under-employment have reduced incomes for many. The rising demand for low-cost units and the sharp drop-off of multifamily production in recent years have exacerbated the already significant shortage of affordable and available units. In short, far from improving it, recent economic and housing market trends have significantly worsened housing affordability for America's low-and moderate-income households. Rising energy prices will likely further exacerbate families' affordability challenges in the years to come.

Appendix

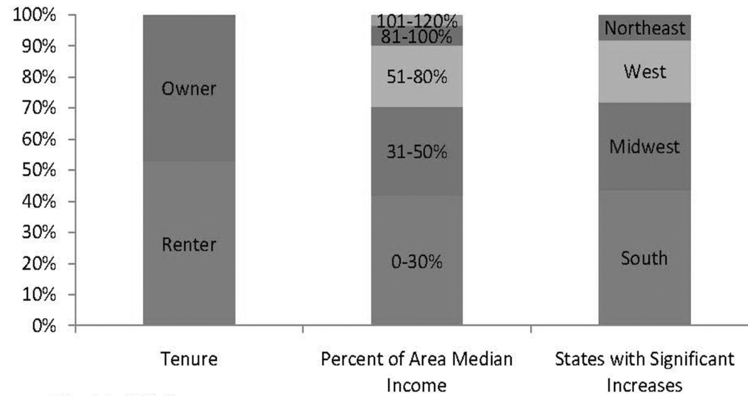
Figure 1: Very Low-Income Renters with Worst Case Needs



Source: Exhibit 1-1 in HUD (2011)

Figure 2: Percentage of Working Households with a Severe Housing Cost Burden in 2009

Source: Figure 4 in Wardrip (2011)



Works Cited

Housing Assistance Council, "Housing in Rural America", Washington, DC: Author, 2010.

Lipman, Barbara, "A Heavy Load: The Combined Housing and Transportation Burdens of Working Families", Washington, DC: Center for Housing Policy, 2006.

Marcus & Millichap Real Estate Investment Services, "Real Estate Investment Research: National Apartment Research", Phoenix, AZ: Author, 2011.

Sermons, M. William, and Peter Witte, "State of Homelessness in America: A Research Report on Homelessness", Washington, DC: National Alliance To End Homelessness and Homelessness Research Institute, 2011.

U.S. Department of Housing and Urban Development, Office of Policy Development and Research, "The 2009 Annual Homeless Assessment Report to Congress", Washington, DC: Author, 2010.

U.S. Department of Housing and Urban Development, Office of Policy Development and Research, "Worst Case Housing Needs 2009: Report to Congress", Washington, DC: Author, 2011.

Wardrip, Keith, "Housing Landscape 2011: An Annual Look at the Housing Affordability Challenges of America's Working Households", Washington, DC: Center for Housing Policy, 2011.

I am pleased to acknowledge the assistance of Keith Wardrip, a senior research associate at the Center for Housing Policy, and Ethan Handelman, Vice President for Policy and Advocacy at the National Housing Conference, in preparing this testimony.