Written Statement of:

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Hearing: "New Ideas for Refinancing and Restructuring Mortgage Loans"

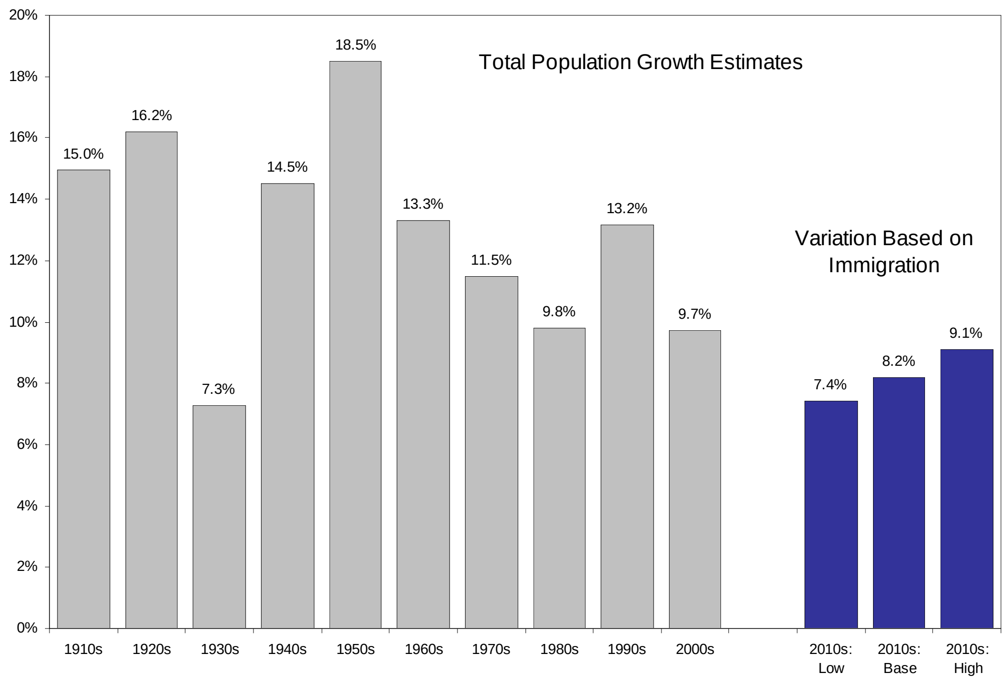
Wednesday, September 14, 2011

Thank you Chairman and Honored Senators for the opportunity to testify on the State of the Housing Market.

As we sit here today in the sixth year of the worst housing crash since the Great Depression, many have suggested that we have become a "Renter Nation" and the American Dream of homeownership is dead. I do not believe this to be the case. Our great nation is still forming new households and I expect population and household growth to support building activity at levels nearly triple the current pace.

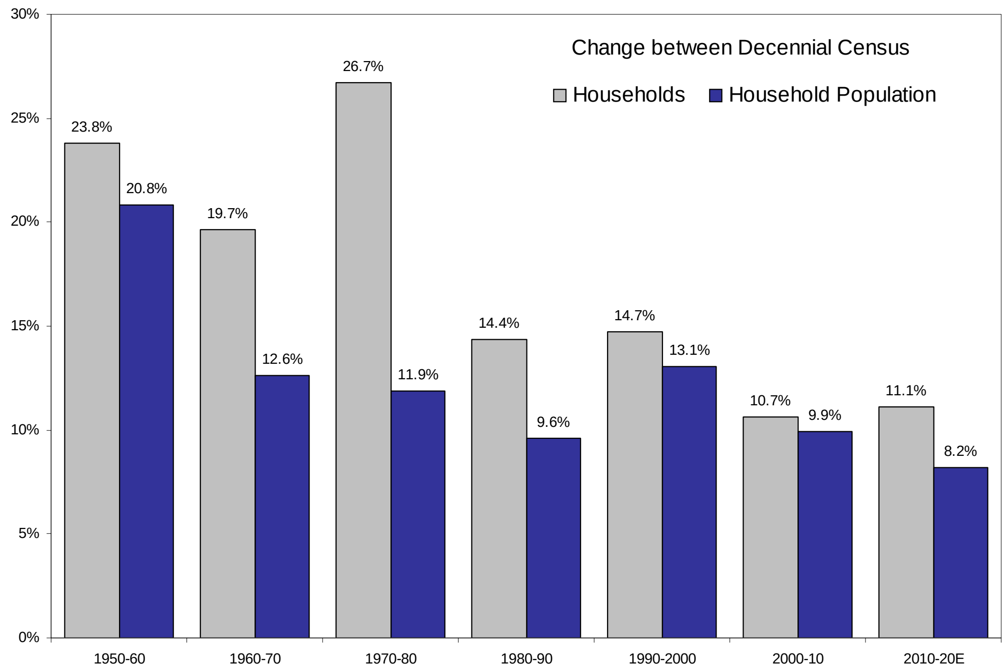
Currently, Zelman & Associates is forecasting 11% household growth for the current decade supported by 8% population growth, which I believe should eventually translate into a normal level of 1.4-1.6 million total housing starts per annum. For reference, in 2011, I estimate that total housing starts will be roughly flat from 2010 at 590,000 units. However, I expect single-family starts to hit a new post World War II low of 420,000 units, down 11% from 2010. To put today's depressed levels in perspective, the current level of total starts would compare to 1.06 million in 1982 when unemployment was as high as 10.8% and 30-year fixed mortgage rates were in the 16-18% range. I do not expect housing starts to get back to over one million units until 2014.

Exhibit 1: Population Growth Expected to Slow; However, Immigration is a Big Wildcard



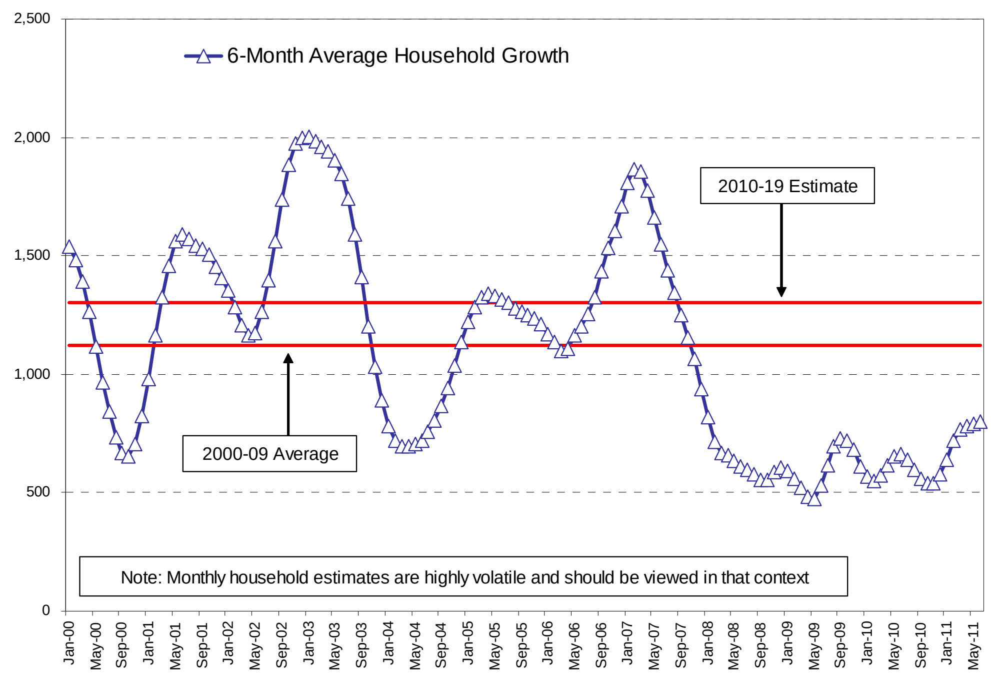
Source: Census Bureau, Zelman & Associates analysis

Exhibit 2: Demographics Drive Variance Between Households and Population Growth



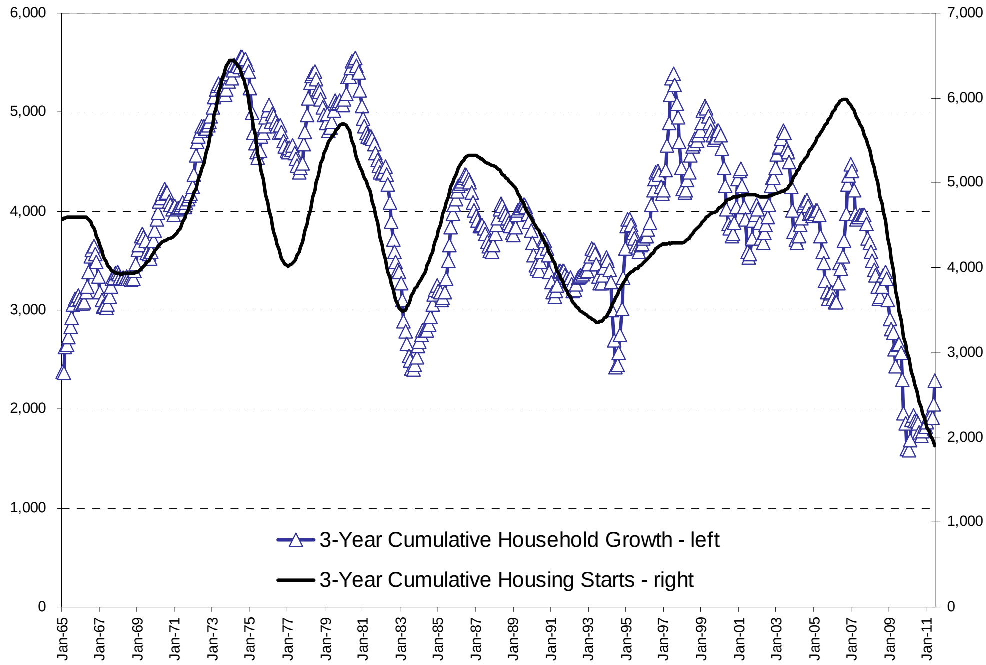
Source: Census Bureau, Zelman & Associates analysis

Exhibit 3: Depressed Household Formation Temporarily Reducing Need for New Stock



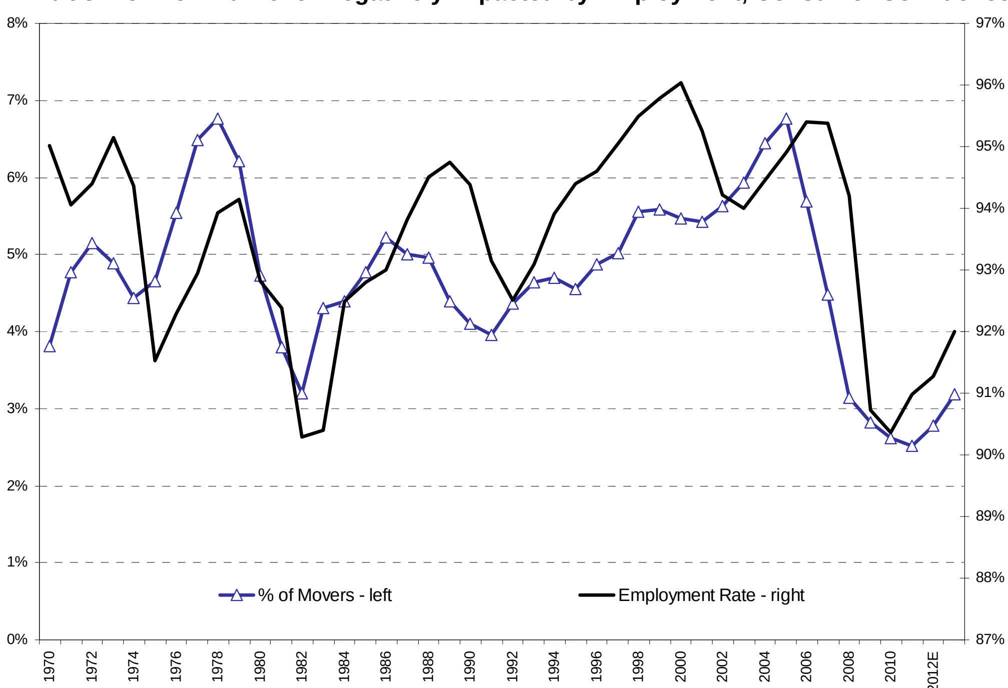
Source: Census Bureau, Zelman & Associates analysis

Exhibit 4: Eventually, Household Growth Should Drive Cyclical Recovery in Starts



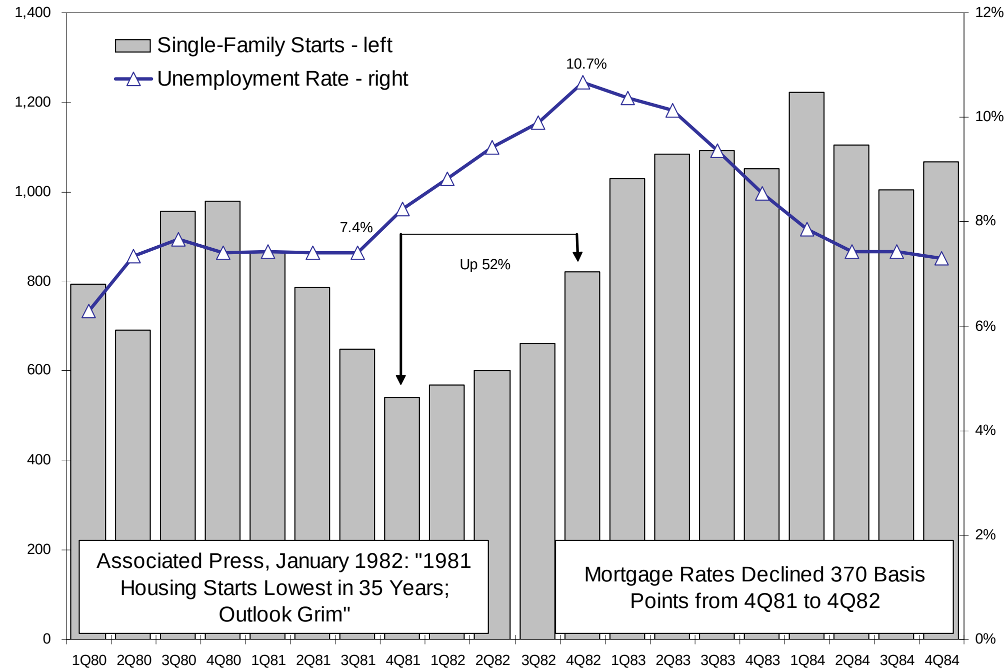
Source: Census Bureau, Zelman & Associates analysis

Exhibit 5: For Now Turnover Negatively Impacted by Employment, Consumer Confidence



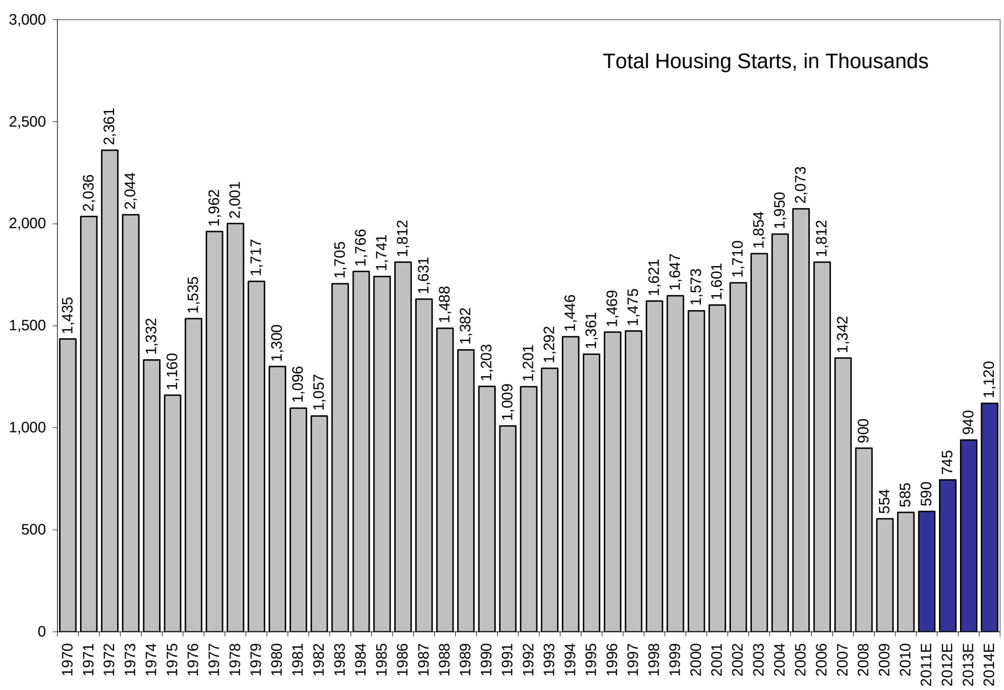
Source: BLS, Census Bureau, CoreLogic, NAR, Zelman & Associates analysis

Exhibit 6: However, Recovery Does Not Have to be Driven by Employment



Source: Census Bureau, Zelman & Associates analysis

Exhibit 7: Near-Term Starts View Absolutely Bearish, But Relatively Bullish

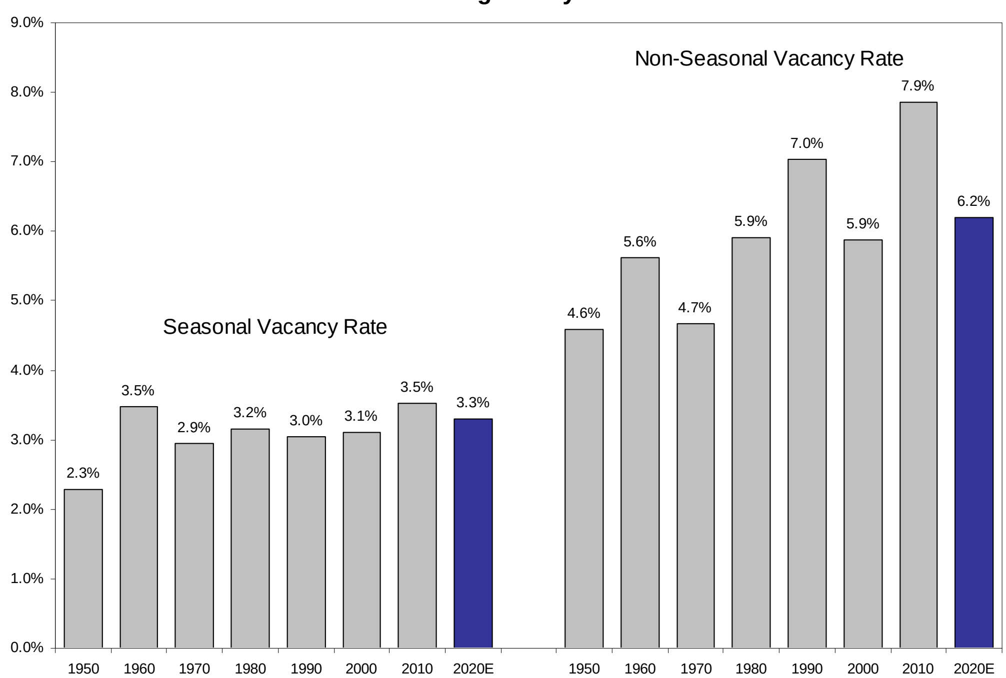


Source: Census Bureau, Zelman & Associates analysis

With that said, there has clearly been a disconnect between longer-term demographics and the near-term reality. I estimate there are currently 2.5 million “excess” vacancies that need to be absorbed before a return to “normal” building levels can be justified. For reference, seasonal homes accounted for only 14% of the excess while the other 86% is defined as for-rent, for-sale, sold, rented or the ambiguous catch-all category of “other”. These vacancies have to be absorbed before new construction returns to normalized levels.

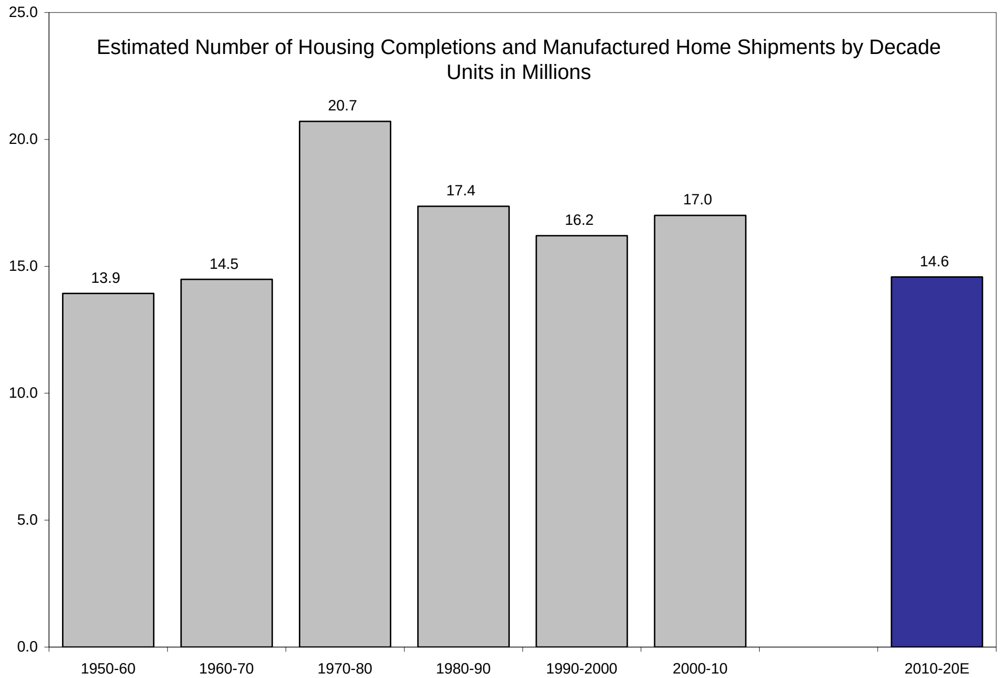
I expect seasonal vacancy rates to decline from the 2010 level, but remain slightly ahead of the 1990 and 2000 rates. For non-seasonal units, I expect a significant decrease in the vacancy rate to levels more consistent with the preceding 50 years as unoccupied, distressed properties transfer to more financially-sound investors that seek a rental yield and other household formations absorb the units. Our sustainable vacancy rate forecast of 9.5% in 2020 would compare to 9.0% in 2000 and 10.1% in 1990, and imply that 1.44 million units that are currently vacant would be occupied by the end of the decade, net of new intentional vacancies, partially satisfying incremental housing demand.

Exhibit 8: New Construction Forecast Mitigated by 2.5 Million Excess Vacancies



Source: Census Bureau, Zelman & Associates analysis

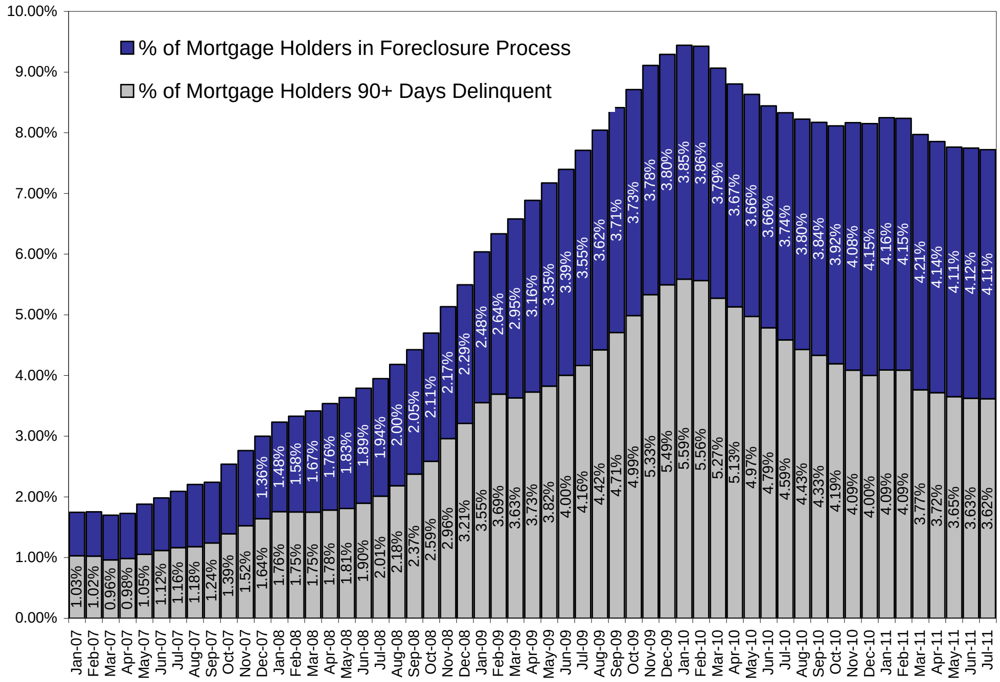
Exhibit 9: But We Will Have a Cycle Once Excess Supply Is Absorbed



Source: Census Bureau, Zelman & Associates analysis

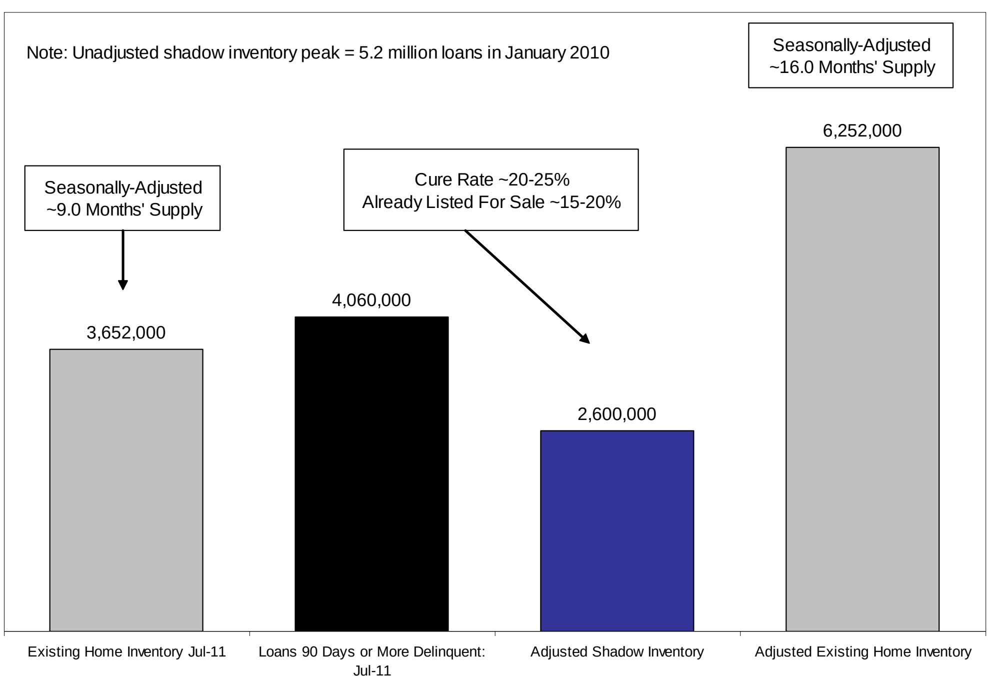
Furthermore, the number of excess vacancies has the potential to move even higher given the current pipeline of 4.1 million loans that are either in the foreclosure process or at least 90 days delinquent as of July 2011, according to Lender Processing Services. While some of these late-stage delinquencies and foreclosures in process would already be included as vacancies, many of the dwellings remain occupied by the delinquent borrower. It is worth noting that I do believe a material portion of these 4.1 million borrowers that are presently at least 90 days delinquent or in the foreclosure process will be “cured”, mainly through modification efforts. Specifically, when calculating today’s “shadow inventory”, I assume a 20-25% cure rate on these loans as the effectiveness and sustainability has continually increased on newer vintage modifications. On the other hand, I am not incorporating the 2.5 million loans 30-89 days delinquent, or any future early-stage delinquencies that will ultimately flow through the process.

Exhibit 10: 4.06 Million Borrowers Are at Least 90-Days Behind on Their Mortgage



Source: LPS Applied Analytics, Zelman & Associates analysis

Exhibit 11: Shadow Inventory Remains Significant and Adds to Excess Supply

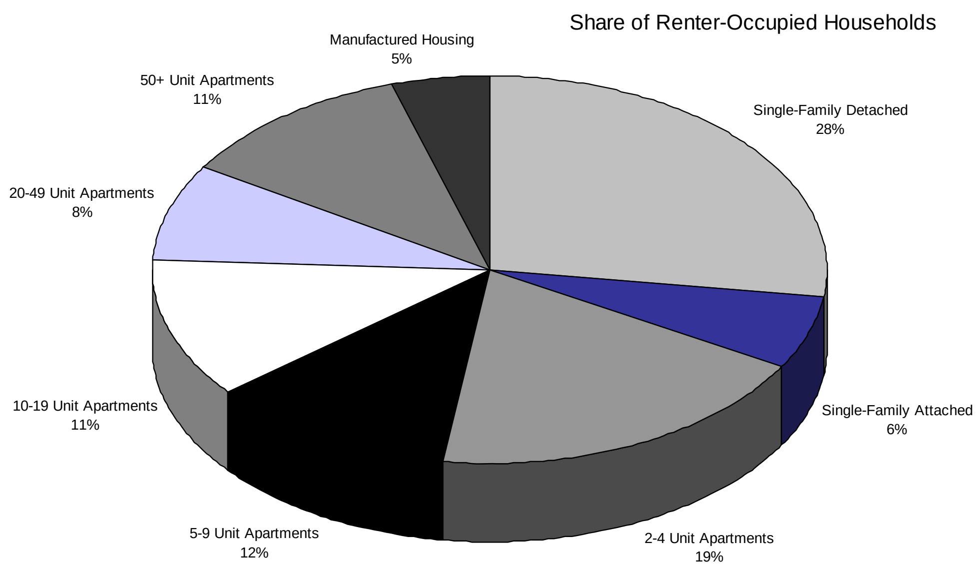


Source: LPS Applied Analytics, NAR, Zelman & Associates analysis

I believe the most powerful tool that Washington can provide is a rental program to dispose of these vacant REO and future foreclosures in an orderly manner. The most efficient and cost effective way to achieve this goal is for the GSEs to ease financing terms and expand financing options to investors that would purchase properties at low LTVs and pursue a single-family rental strategy.

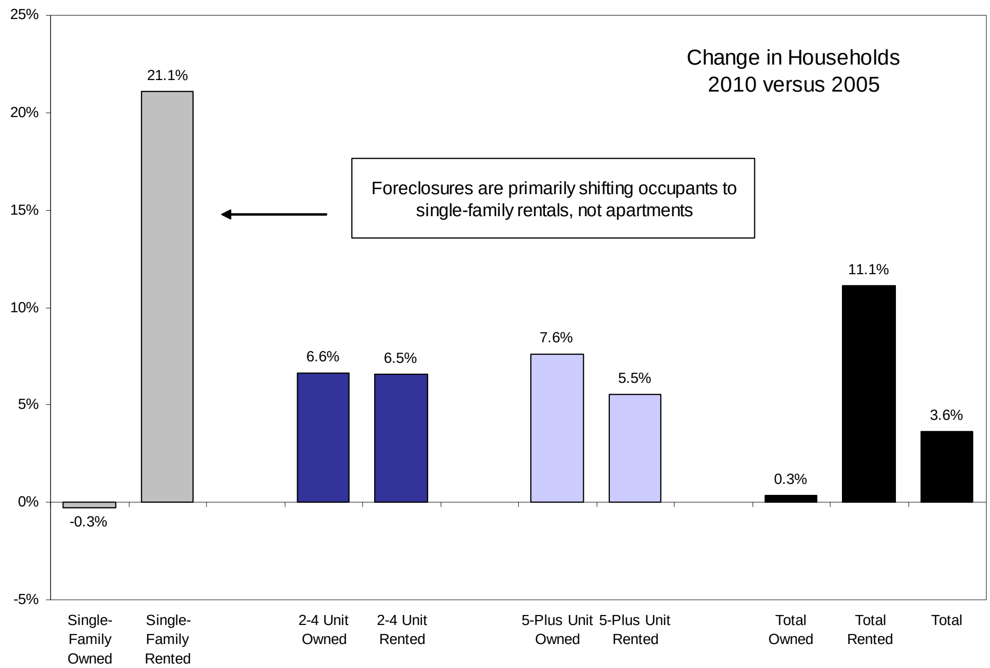
Over the past five years, single-family rental has been the fastest growing residential asset class. From 2005 to 2010, single-family rentals grew at 21% versus just a 4% increase in total housing units. In the hardest hit markets, such as Nevada, Arizona and Florida, single-family rental units increased 48%, while apartment units were virtually unchanged.

Exhibit 12: Do Not Underestimate the Single-Family Rental Market



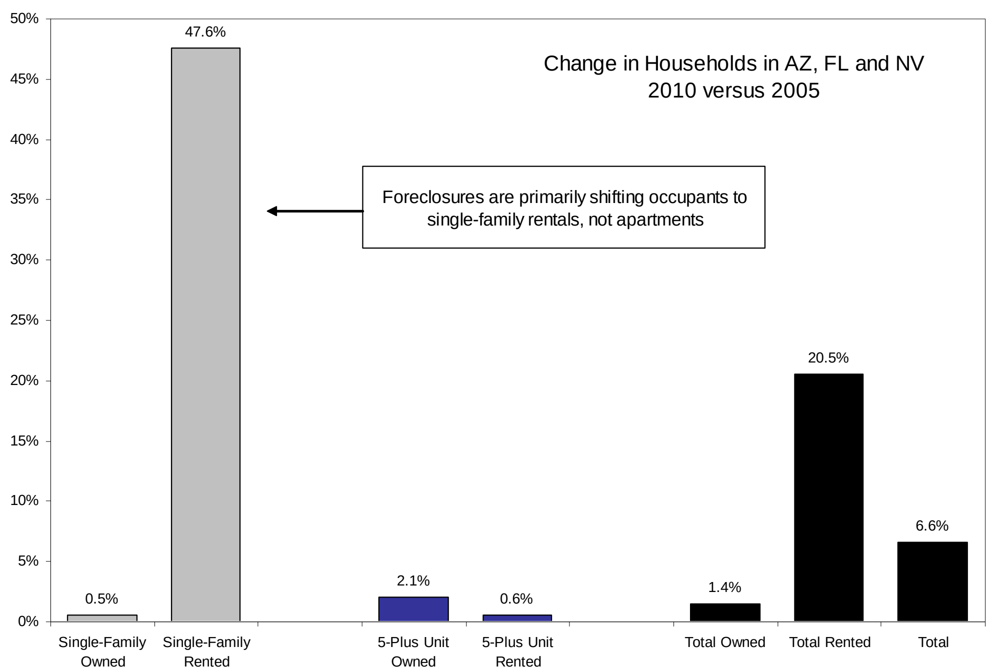
Source: Census Bureau, Zelman & Associates analysis

Exhibit 13: In Fact, SF Rentals Have Been the Biggest Beneficiary of Foreclosures



Source: Census Bureau, Zelman & Associates analysis

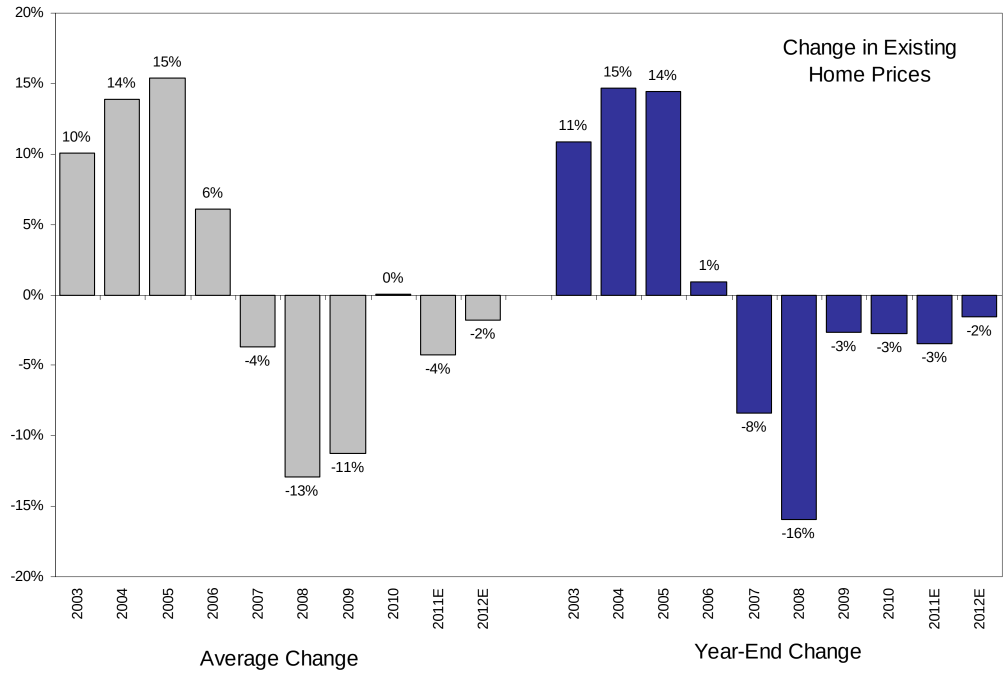
Exhibit 14: Apartments Seeing Virtually No Boost in Most Distressed Markets



Source: Census Bureau, Zelman & Associates analysis

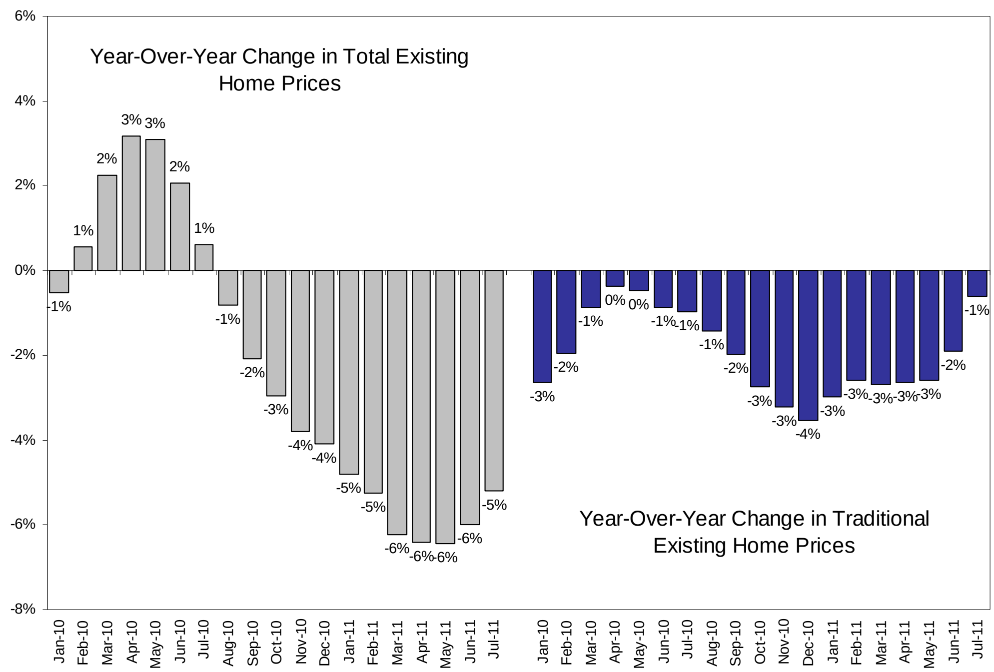
Facilitating an orderly transfer of these distressed units should also have a favorable impact on pricing. Given modest improvement in the economy, record levels of affordability and a reduction in inventory, through the first seven months of 2011 home price deflation has diminished. In fact, prices of traditional homes, excluding foreclosures and short sales, were down just 1% on a year-over-year basis in July according to CoreLogic versus a 5% decline for the total market, suggesting double-digit pressure for distressed sales, which currently account for approximately one-third of all transactions.

Exhibit 15: We Forecast 2011 Average Deflation of 4% and 2011 Year-End of 3%



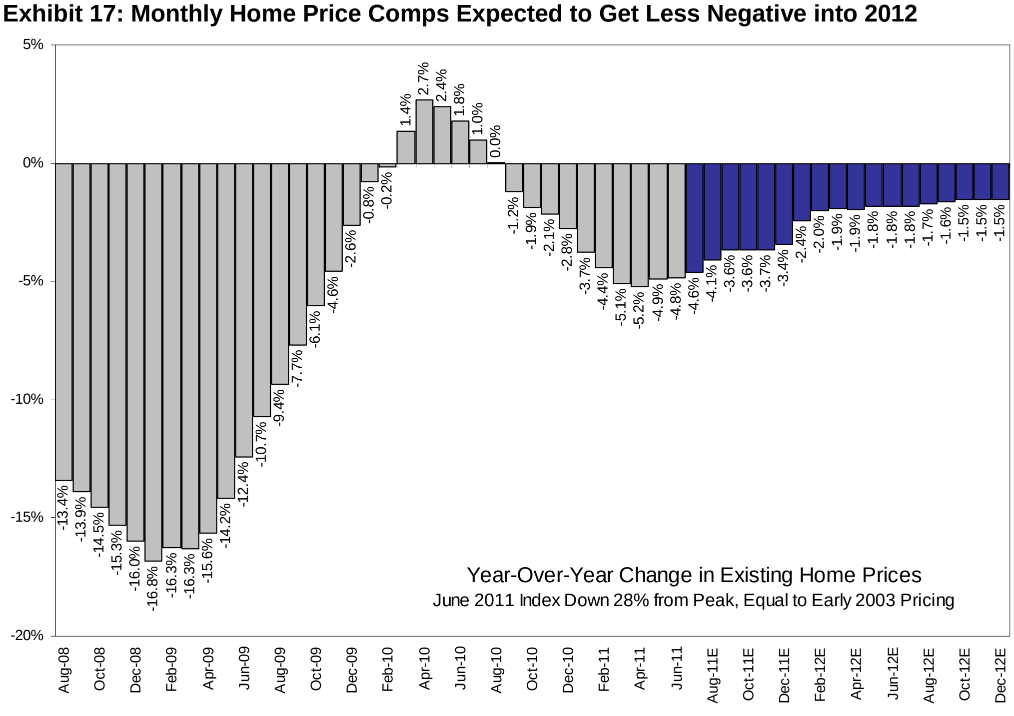
Source: Zelman & Associates analysis

Exhibit 16: Distressed Sales Leading the Way on Deflation; Traditional Market Stabilizing



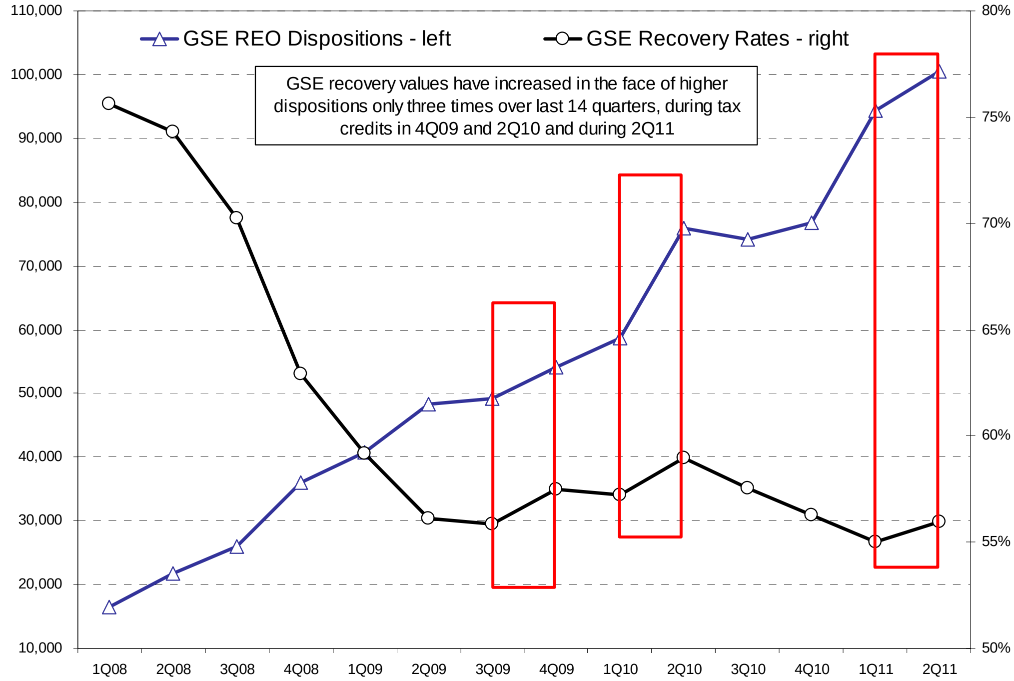
Source: CoreLogic, Zelman & Associates analysis

Exhibit 17: Monthly Home Price Comps Expected to Get Less Negative into 2012



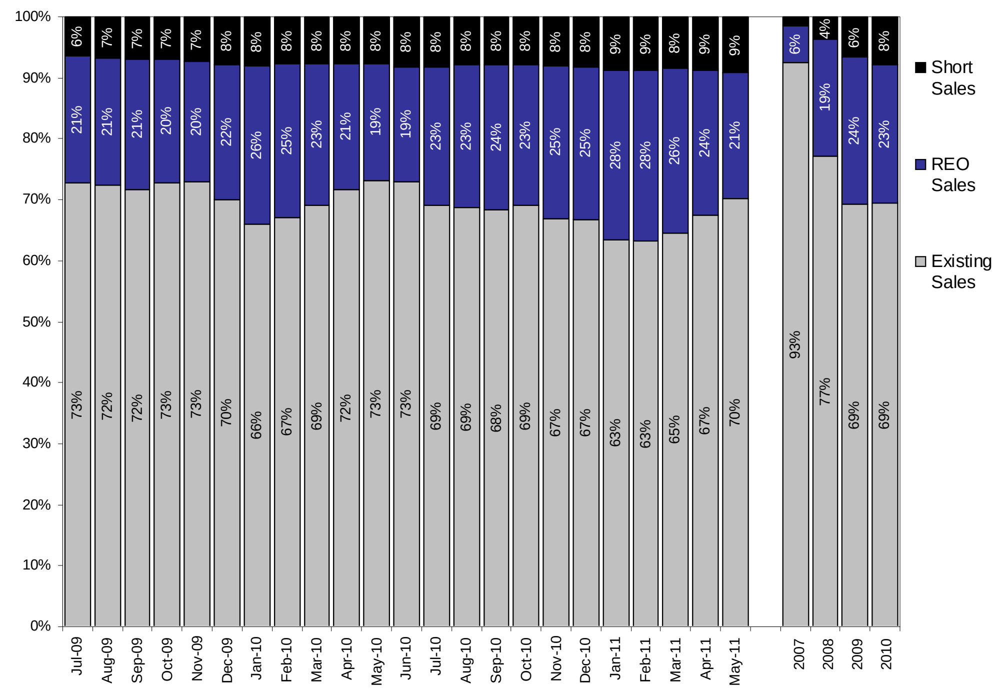
Source: Zelman & Associates analysis

Exhibit 18: While Further Deflation Expected in 2012, Recent Data Has Been Encouraging



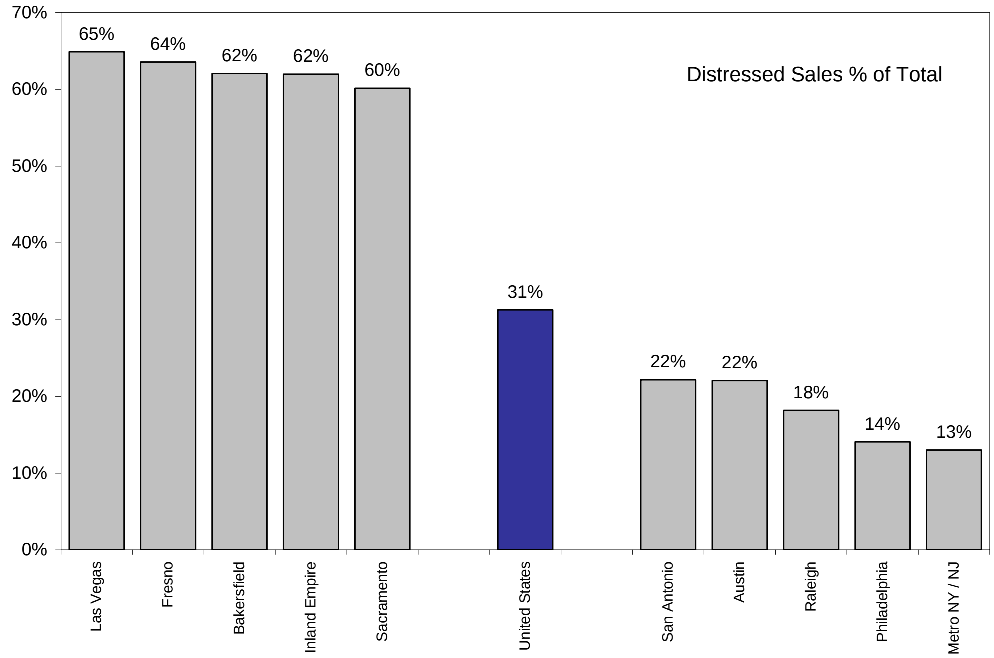
Source: Fannie Mae, Freddie Mac, Zelman & Associates analysis

Exhibit 19: Distressed Sales Have Grown to Unprecedented Levels in Recent Years…



Source: CoreLogic, Zelman & Associates analysis

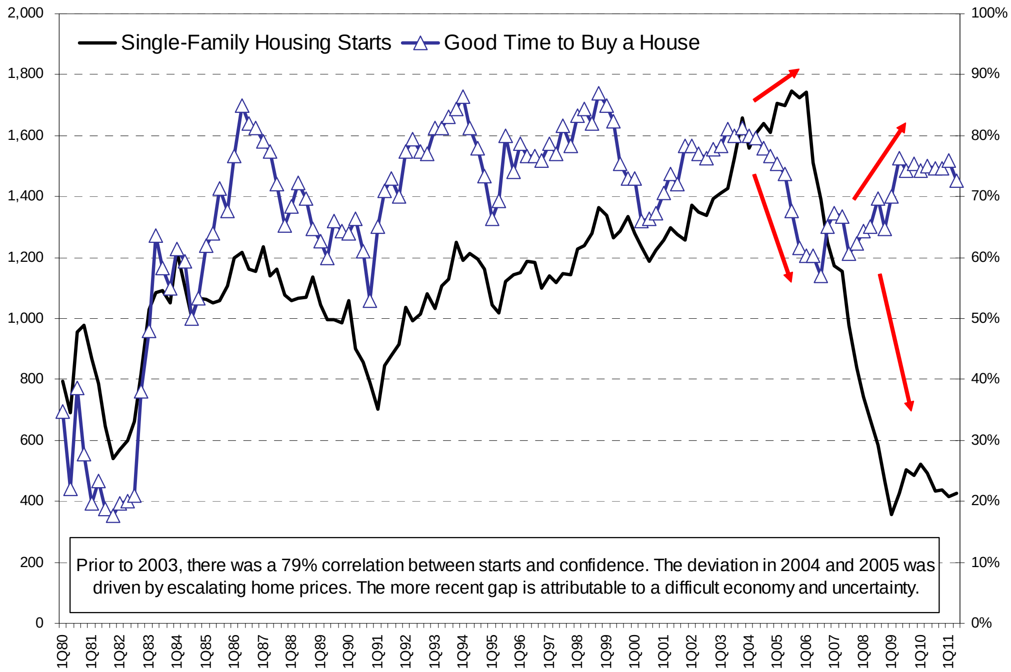
Exhibit 20: …Particularly in Former Hotbed Markets…



Source: CoreLogic, Zelman & Associates analysis

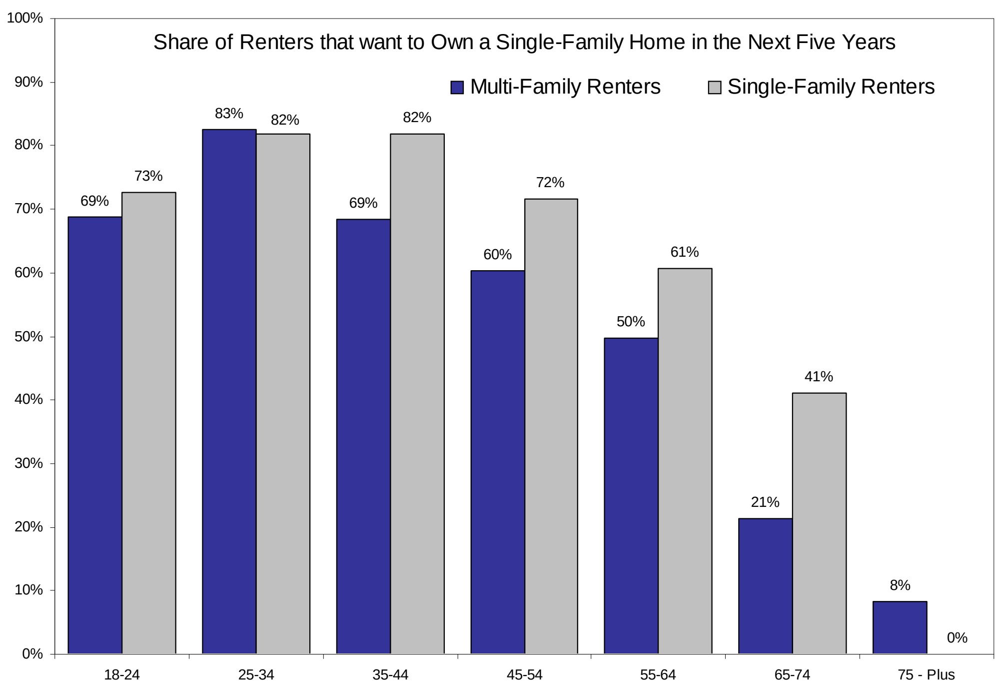
The second piece of the equation is demand, which remains at all-time record lows when measured by sales activity. Despite favorable affordability and historic low interest rates, this has not been enough to move buyers off the sideline. Nevertheless, according to the University of Michigan Consumer Sentiment Survey, 72% of respondents believe that now is a good time to buy a home. Furthermore, a recent survey by our firm of 1,500 renters conducted in five markets showed that 67% of those surveyed want to become homeowners over the next five years, with 82% of renters in the key 25-34 age group expressing their desire to buy a home.

Exhibit 21: Despite Desire to Own, Consumers are Not Pulling the Trigger



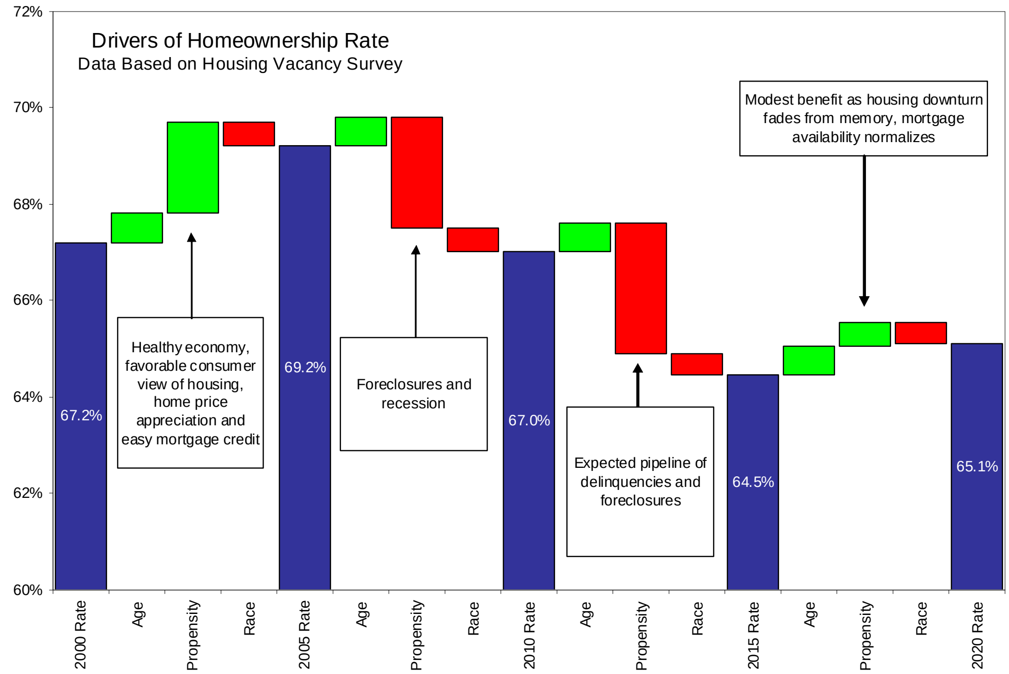
Source: Census Bureau, University of Michigan Surveys of Consumers, Zelman & Associates analysis

Exhibit 22: The American Dream is Still Alive; 67% of Renters Want to Own



Source: Zelman & Associates Renter Survey

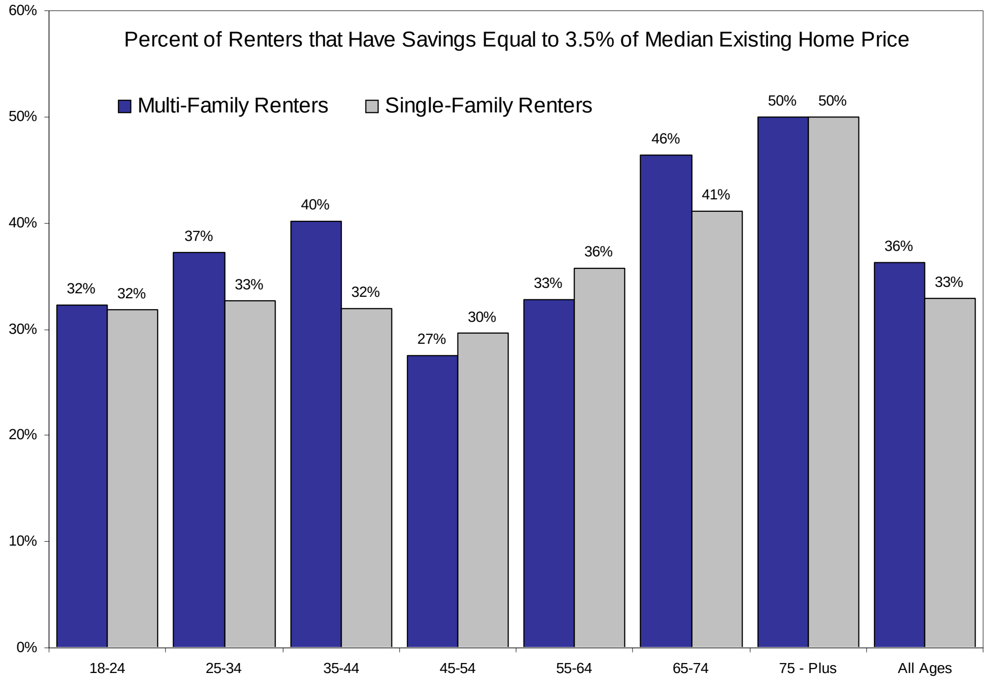
Exhibit 23: Homeownership Rate to Remain Under Pressure During First Half of Decade



Source: Census Bureau, Zelman & Associates analysis

So if people want to purchase a home and think now is a good time to do so, why aren't they acting on those desires? The answer, I believe, is twofold. The first issue is the weak condition of consumers' balance sheets, which are still laden with high levels of net debt and negative equity. Indicative of these challenged consumers, our renter survey showed that just 33% of respondents were able to come up with the minimum 3.5% down payment necessary to purchase a median priced home using FHA financing today.

Exhibit 24: Few Households Can Afford Down Payment Today

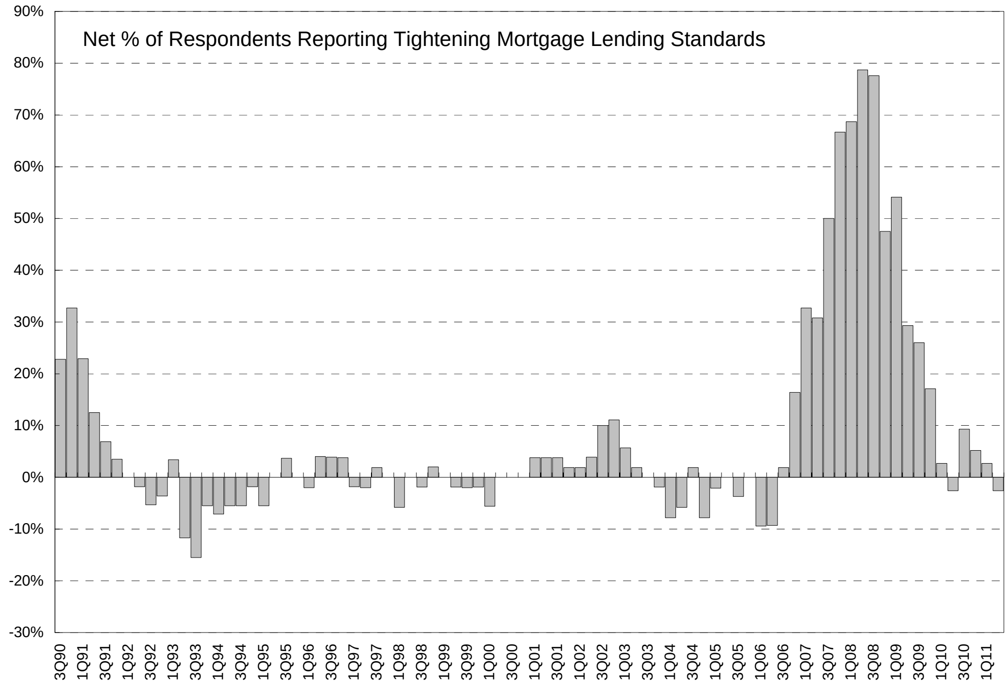


Source: Zelman & Associates Renter Survey

The second issue is uncertainty, which I believe is a nationwide problem negatively impacting home sales and prices given the volatility created by prior tax credits, fear of job loss and mixed messages sent by the government around future housing policy. However, regional differences are significant, with major dichotomies dependent upon levels of unemployment, distressed inventory, negative equity, delinquencies and vacancies.

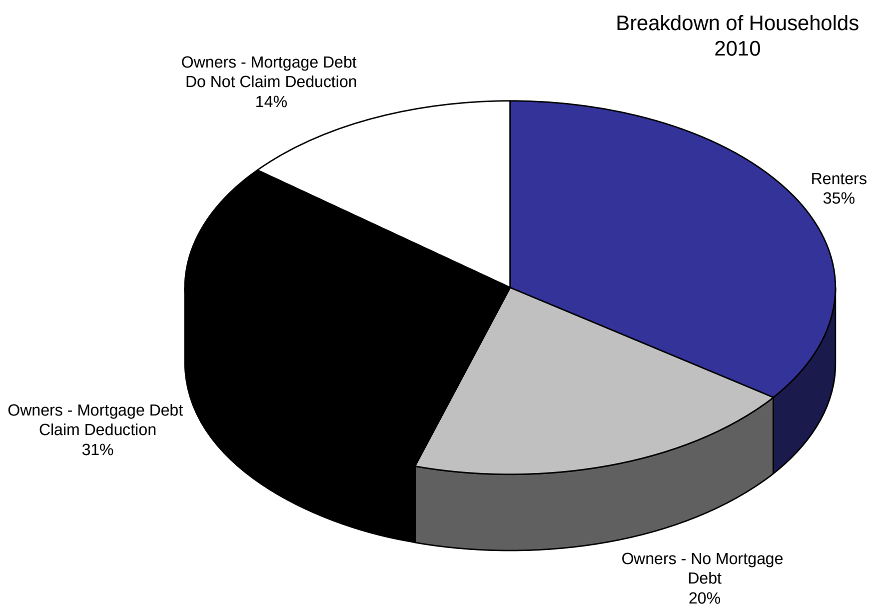
Nationally, one of the most significant problems prospective homebuyers face today relates to stringent underwriting criteria, magnified by strict credit overlays being imposed by banks due to unknown risk related to putbacks or other future unexpected government burdens. As a result, many qualified homebuyers are being turned away. Creating a business environment that would encourage banks to remove these stringent overlays that are above and beyond already-tight lending criteria would be a catalyst to spur housing activity. I also believe that given the still-tenuous nature of the housing market, allowing the GSE and FHA loan limits to roll back to lower levels on October 1st is a significant mistake and should be put off until the market is on more solid footing. Similarly, any legislation related to eliminating or reducing the mortgage interest deduction should be carefully crafted and only considered with a longer-term implementation in mind.

Exhibit 25: Mortgage Underwriting Standards at Extremely Stringent Levels



Source: Fed Loan Survey, Zelman & Associates analysis

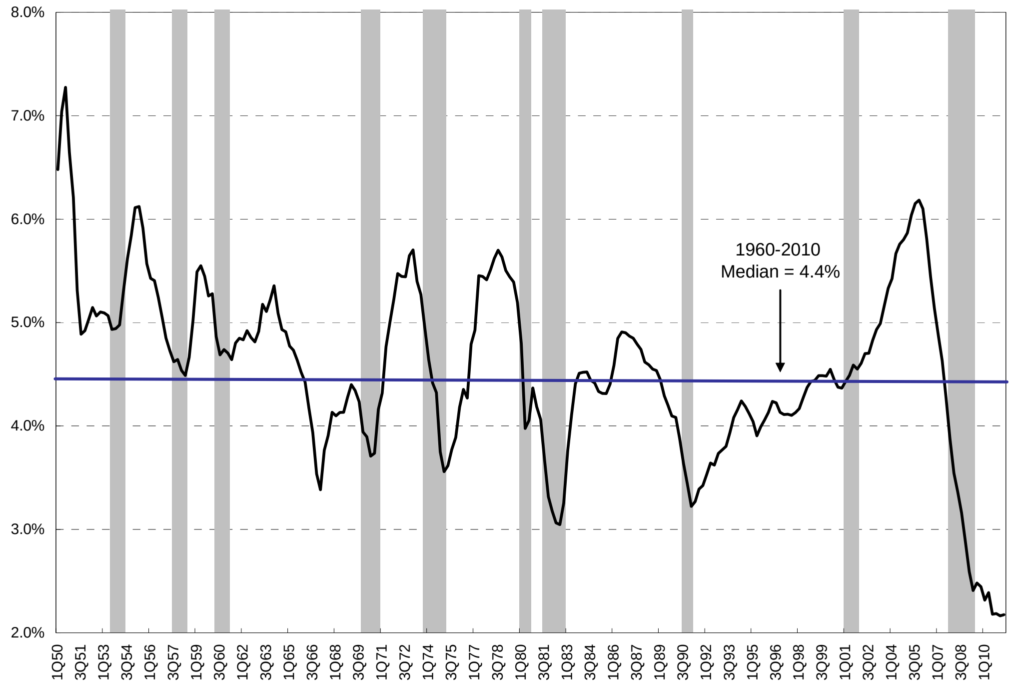
Exhibit 26: Minority Gain from Mortgage Interest Deduction But Important to Psychology



Source: IRS, Zelman & Associates analysis

In closing, housing has historically been a significant driver of recessions and recoveries. Currently, residential investment represents just 2.2% of GDP, representing an all-time trough and well below the long-term median of 4.4%, suggesting that the industry has been a significant headwind on economic growth. Housing's recovery is essential to the overall success of a broad economic recovery, and without it the economy will continue to languish.

Exhibit 27: Residential Investment as a Percent of GDP At Record Trough



Note: Shaded areas are periods of recession.

Source: BEA, Zelman & Associates analysis

Thank you again for the opportunity to testify today.