Statement of the National Association of Home Builders

"The State of the Nation's Housing Market"

United States Senate Committee on Banking, Housing, and Urban Affairs

Hearing October 20, 2009

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 market, prospects for the future and what else can be done by the federal government to address these challenges.

Downturn in the Housing Market and Overall Economy

Leading into this year, the markets for new and existing homes were in a state of free fall. Between January of 2006 and January of 2009, sales of existing homes fell by one-third, from 6.72 million (at seasonally adjusted annual rate) to 4.49 million. Over the same period, total housing starts fell 79 percent, from 2.27 million (seasonally adjusted annual rate) to 488,000. The decline was even more precipitous for single family housing starts, which fell by more than 80 percent, from a peak of 1.82 million at the start of 2006 down to 357,000 in the first two months of 2009. The inventory of new unsold homes on the market increased to a record high of more than 12 months supply.

Meanwhile, the repeat home sales index published by the Federal Housing Finance Agency showed house prices declining every quarter since the beginning of 2008. One positive impact of the decline in house prices is that is has, in combination with historically low interest rates on fixed rate mortgages, improved housing affordability for many Americans—especially for first-time home buyers who do not suffer a loss in equity from selling a previously owned residence. NAHB's Housing Opportunity Index (HOI), which measures the share of homes sold that a median-income family can afford, increased to over 72 percent in the first two quarters of 2009. This marks the first time the national HOI has been over 70 percent since NAHB began reporting the index in 1992.

However, this improvement in affordability has not translated into housing sales and starts as strongly as it would have in the past. At present, in order to obtain a mortgage, buyers need exceptionally good credit and access to timely and accurate appraisals, which are often not available. These factors reduce the pool of eligible buyers well below the level we would otherwise expect.

In addition to problems in the housing market, by the start of 2009 the overall U.S. economy was in a state of recession. Real GDP contracted at a rate of over 6 percent in the first quarter, one of the worst performances in the entire post-war period. Labor markets softened, and the unemployment rate rose above 9 percent. The decline in the housing market and the overall economy were related, as the drop in single family construction alone resulted in more than 3 million lost jobs in construction and the related industries supplying materials and services to home builders and buyers.

Positive Impacts of the First-Time Homebuyer Tax Credit

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

Overall, there is strong evidence that the federal first-time home buyer credit is working to stabilize housing markets in the United States. Since the credit has been in effect, existing home sales, which were in sharp decline, have stabilized and started to edge up gradually, from a low of 4.49 million to 5.10 million in August. Similarly, housing starts stabilized and started to edge up from a low point of 479,000 to 587,000 in that same month. Single family starts, in particular, improved steadily, from the low point of 357,000 in January and February up to 494,000 by July of this year. Incomes of buyers who can claim the federal credit are limited, and sales of new homes have increased most in the affordable range—homes priced under $200,000.

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

The modest improvement in new home construction has not produced an inventory of unsalable homes, as the inventory of new homes on the market has continued to decline from a peak of 572,000 in July 2006 down to 261,000 in August of 2009—the lowest this measure has been since 1992. The decline has reduced the month's supply of unsold homes, but not as dramatically because sales continue at a very slow pace. The NAHB Housing Market Index (HMI) languished at a single digit rate for five straight months from late 2008 through the first quarter 2009, but has improved steadily since then, up to 19 in September. Although still very low by historical standards (and values less than 50 indicate negative conditions), this is the highest the HMI has been since the middle of 2008.

A Fragile and Uncertain Recovery in Housing

These recent positive prospects notwithstanding, a number of housing-specific headwinds will continue to buffet any significant housing recovery:

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

- Extremely difficult financing terms and availability for builder Acquisition Development & Construction (AD&C) loans.

After several months of gradual improvement, the rate of single-family production declined in August, from 494,000 down to 479,000, suggesting that upward momentum is being lost as builders anticipate the depressing effect that expiration of the home buyer tax credit may have on demand. NAHB survey data also indicate a loss of momentum that underscores the fragile nature of the recovery in the housing sector. The NAHB HMI for October 2009 has fallen from 19 to18, the first decline in the index following five months of increases, due in part to the tax credit program. In particular, all the components of the index (present sales, expected sales over 6 months, and prospective buyer traffic) fell in October.

Indeed, there continue to be reasons why prospective home buyers are reluctant to purchase a home. In a September 2009 NAHB survey, 81 percent of home builders reported prospective buyers holding back because they cannot sell their existing homes at favorable prices. As well, 73 percent reported prospective buyers waiting on a purchase because they think their employment/economic situations are deteriorating.

Since September 2008, the nation has lost a total of 5.8 million jobs, including 443,000 residential construction jobs. The national unemployment rate for September was 9.8% — up from 9.7% in August. The construction unemployment rate increased in September, jumping to 17.1% from 16.5% the month before. It is worth noting that the construction sector has registered the highest unemployment rate among the major sectors of the economy, with durable goods manufacturing registering the next highest unemployment rate at 13.1%. While it is normal for employment to lag the rest of the economy, job growth could prove to be sluggish in this recovery, putting a drag on the general economy and the housing sector, in particular.

With respect to overall consumer confidence, the University of Michigan's consumer sentiment index rose to 73.5 in September from 65.7 in August, while the Conference Board's Confidence Index slipped from 54.5 in August to 53.1 in September. On housing in particular, consumers' views of the marketplace held steady in the Michigan survey, but there was, consistent with NAHB builder survey data, declines in the Conference Board's assessment of consumer plans to buy a house over the next six months.

And despite the positive impacts of the $8,000 tax credit, NAHB survey data of home builders reveal that only 27% of builders recorded any new home sales to a move-up buyer who was able to sell their existing home to a first-time homebuyer tax credit qualified buyer. Only 2% of builders indicated that half of their single-family sales were to such move-up buyers. This seems to suggest a great value in expanding the tax credit to all buyers of principal residences.

These survey data are consistent with Census New Home Sales data, which indicate limited positive impacts of the tax credit for homes priced $300,000 or less (typical markets for first-time homebuyers), but continued weakness in sales of homes priced higher than $300,000. In whole, these data indicate a languishing market for the move-up buyer sector.

And, as discussed in more detail below, NAHB survey data indicate difficulty in financing development. More than 70% of surveyed builders reported worse conditions for obtaining new loans for the purposes of land acquisition and development or multifamily construction (rental and owner-occupied), while nearly 60% reported worse conditions for single-family construction loan availability.

Moreover, despite the modest improvements in some measures, production of new housing remains far below sustainable levels. NAHB is forecasting 568,000 in 2009 and 716,000 in 2010. Given the size of the U.S. population and projections the forecast for household formations, the long-run sustainable rate of production should be between 1.8 million and 1.9 million per year.

The considerable gap between the amount of housing being produced and the amount needed, coupled with signs that the small amount of upward momentum in housing markets is being lost, indicates that buyers are now especially in need of a stimulus to help them overcome the obstacles of a tight credit market and problem appraisals, and keep production on the track toward a long-run sustainable path.

The Economic Benefits of Extending and Expanding the Homebuyer Tax Credit

As the deadline for the homebuyer tax credit program approaches, NAHB supports extending and enhancing this important housing demand stimulus program. In particular, NAHB recommends extending the sunset date until December 1, 2010, and expanding the eligible buyer definition to include all purchasers of a principal residence.

We estimate that these enhancements would increase home purchases by 383,000 in the next year; increase housing starts by 82,000; create more than 347,000 jobs; generate $16.1 billion in wages and salaries; $12.1 billion in business income and tax income of $8.4 billion for the federal government; and $3.2 billion for state and local governments.

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

Other Housing Finance Challenges

In addition to the approaching expiration of the first-time homebuyer tax credit, there are other challenges that prevent the housing sector from contributing to a vigorous economic recovery.

AD&C Lending

As noted earlier, another persistent problem in the home building industry that is blunting the recovery of the housing market is the availability of credit for Acquisition, Development and Construction (AD&C) loans. Banks are increasingly refusing to extend new AD&C credit or to modify outstanding AD&C loans in order to provide builders more time to complete their projects and pay off these loans. Often this is being forced by examiners demanding that banks shrink their AD&C loan portfolios.

On outstanding loans, examiners are requiring banks to obtain new appraisals on properties for fully performing loans, which can result in the banks having to downgrade those loans, turning them into troubled “non-performing performing loans.” Once a loan is classified as such, the institution must hold more capital against the loan.   As a result, an increasing number of builders are being required to put up additional equity or collateral due to reappraisal of collateral or revaluation of their loan. Since most home building companies are small businesses and do not have the capacity to meet significant equity calls, the result is often foreclosure on a loan that had been performing.

NAHB is proposing that members of Congress urge the federal banking regulators to put a halt to these shortsighted practices that are adversely affecting the financial condition of the banking industry as well as having devastating impacts on home building companies. Instead, financial institutions should be encouraged to fund viable new projects and to take steps to avoid foreclosure on AD&C loans by accommodating loan modifications and workouts. This would provide relief for a major sector of the economy that has suffered because of regulatory excess and the inability of banks to provide the necessary funding and flexibility that would otherwise keep loans performing as scheduled.

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

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

Real Estate Appraisals

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

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

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

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

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

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

Conclusion

NAHB appreciates the opportunity to share our views on the current state of the nation's housing markets and policy options to enable an effective and viable long-term renewal of this critical sector of the economy. There are significant challenges to overcome, but they are not insurmountable. We are ready to work with the Committee and the Congress to meet these challenges and ensure sustainable economic recovery.