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Economic Benefits of an Improving Housing Market

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Economic Benefits of an Improving Housing Market

Preface

The housing market is finally showing signs of improvement – inventory is down, home prices are up and more people are buying homes. It appears that housing – once considered a key economic driver that pulled our nation's economy out of past recessions – has momentum again.

Economic Benefits of an Improving Housing Market is a white paper prepared by the Democratic Governors Association and the Center for Innovative Policy as part of their Policy Series, with guidance provided by the National Association of Home Builders and My Campaign Group. The paper explores the economic benefits that a strengthening housing market holds for states, both in terms of job creation and revenue, among other positive developments. It discusses policy changes that are needed at the federal level to foster continued industry growth, and presents a range of opportunities for states to consider in order to maximize the housing recovery and to meet forecasted labor demands.

Democratic governors are committed to preserving and expanding affordable housing in their states, and understand the positive benefits it provides to families and communities as well as businesses and workers. That's why they've fought for protections to aid struggling home owners to keep families in their homes. Many have implemented policies and programs to help home owners, acting in good faith, renegotiate mortgage terms and provide legal protections to those impacted by fraudulent lending practices. Democratic governors realize how essential housing is to their state's economic growth and ability to create jobs, not just in the construction industry, but also across other related industries. As a result, they've passed laws that help fast-track the foreclosure process for vacant and abandoned properties to help preserve home values and keep neighborhoods strong.

Introduction

The home is central to American life. It's where dreams thrive and the future takes shape. It's where families make lifelong memories and children are nurtured, so they can build a better tomorrow.

Owning a home is a treasured ideal for most families, and serves as a source of pride and accomplishment. Homeownership is a gateway to the middle class that provides a solid foundation for family and personal achievement, promotes social stability, builds stronger communities and is critical for creating wealth and providing upward mobility as well as financial security. Yet this was all threatened when the housing bubble burst in 2008, and today, many of the issues that led to the housing market's decline haven't been resolved.

Housing's Outlook

After years of doom and gloom, the housing market is poised for growth. The National Association of Realtors recently reported a 6.5 percent increase in home sales, as median home prices were 14 percent higher than in July 2012.[1] Although the housing market still has a ways to go before it's considered strong, housing's outlook is brighter.

Standing in the way of full recovery; however, is the need to restructure the housing finance system – something that not only will take several years to complete, but also will require agreement from members of Congress on action necessary for the overhaul to happen. Further complicating matters is the need to include a mechanism that protects the 30-year fixed mortgage, ensuring it remains relatively stable in spite of changeable market conditions. Equally important is the need to preserve other finance vehicles that make homeownership viable and rental housing more accessible for low- and middle-income families. Unless and until agreement in Congress can be reached and a solution to the housing finance system can be brokered, the housing market will remain vulnerable to weakness.

Despite these issues, opportunities exist for states to capitalize on housing's growth through a myriad of policy interventions and programs to aid builders, investors, homebuyers and homeowners, wanting to capitalize on the market's uptick, which in turn will create jobs and generate tax revenue for states.

Overview

A housing boom in the mid-2000s, spurred by risky mortgage products and lax underwriting standards, was unsustainable. When house prices began to decline and credit tightened, this set off a wave of foreclosures that created a downward spiral in the housing market. Home prices declined 30 percent, on average, from their peak in 2006,[2] leaving millions of borrowers "underwater" – owing more on their homes than properties are worth – prompting further foreclosures, and the pain may not be over. The Federal Reserve Bank of New York estimates that the number of foreclosures could increase to as many as 1.8 million in 2013 from 1.1 million in 2011, adding to the number of distressed homes owned by lenders and stifling housing's recent growth.[3] Residential construction also took a hit, with new single family home starts plummeting to roughly 425,000 per year compared to 1.75 million home starts at the market's height.[4]

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[1] Existing home sales up 6.5 percent as housing recovers, *USA Today*, August 21, 2013, http://www.usatoday.com/story/money/business/2013/08/21/home-sales/2680599/

[2] Housing and the Economic Recovery, Federal Reserve Bank of New York, January 6, 2012, http://www.newyorkfed.org/newsevents/speeches/2012/dud120106.html

[3] Ibid.

[4] Ibid.

The effects of a weak housing market have impacted national, state and local economies on a number of fronts. As home prices dropped, so did consumption and overall wealth. Research shows that home prices are directly tied to household spending.[5] As prices fell and people consumed less, many state and local governments, already hard hit by the economic recession, experienced a further decrease in tax revenues. And just as governments' budgets got tighter, the demand for public services increased. Many states were forced to cut services, lay off employees and spread out obligations over longer periods of time in order to keep budgets balanced.

Credit also became less available, not just for home buyers but also for builders, investors and small businesses. Lenders instituted more stringent loan requirements to protect against more loss. Restricted access to credit further depressed demand for housing, as fewer people were able to purchase homes.

Although it has been over five years since the credit crisis and subsequent federal bailouts happened, our housing finance system has yet to be reformed. And with banks still refusing to make loans absent the federal government's backing – the housing market will continue to stagnate. Private capital must assume a greater position in the marketplace to truly propel housing forward.

President Obama has urged Congress to pass a housing reform plan by the year's end – a plan that would significantly reduce government's role in financing housing and replace it with private lending. Doing so would provide greater certainty and strengthen the housing market, unleashing spending and creating new jobs.

Yet competing legislative and regulatory proposals, pushed by House Republicans, are also being considered. Many of them would significantly harm home owners and home buyers, and potentially cause growth in the housing market and overall economy to come to a screeching halt. Millions of Americans would have to delay homeownership or give up the hope of ever owning a home if certain Republican proposals were enacted. In addition, many of these same proposals threaten a system designed to ensure affordable, high-quality rental housing is available to meet the market's needs.

Housing plays an important role in the U.S. economy. Steps taken to reform the housing finance system must ensure that housing and homeownership remains a national priority, as any change will impact job creation and future economic growth. As the nation prepares to transition to a new housing finance system, states should continue to pursue policy interventions and programs to strengthen the housing market and create jobs.

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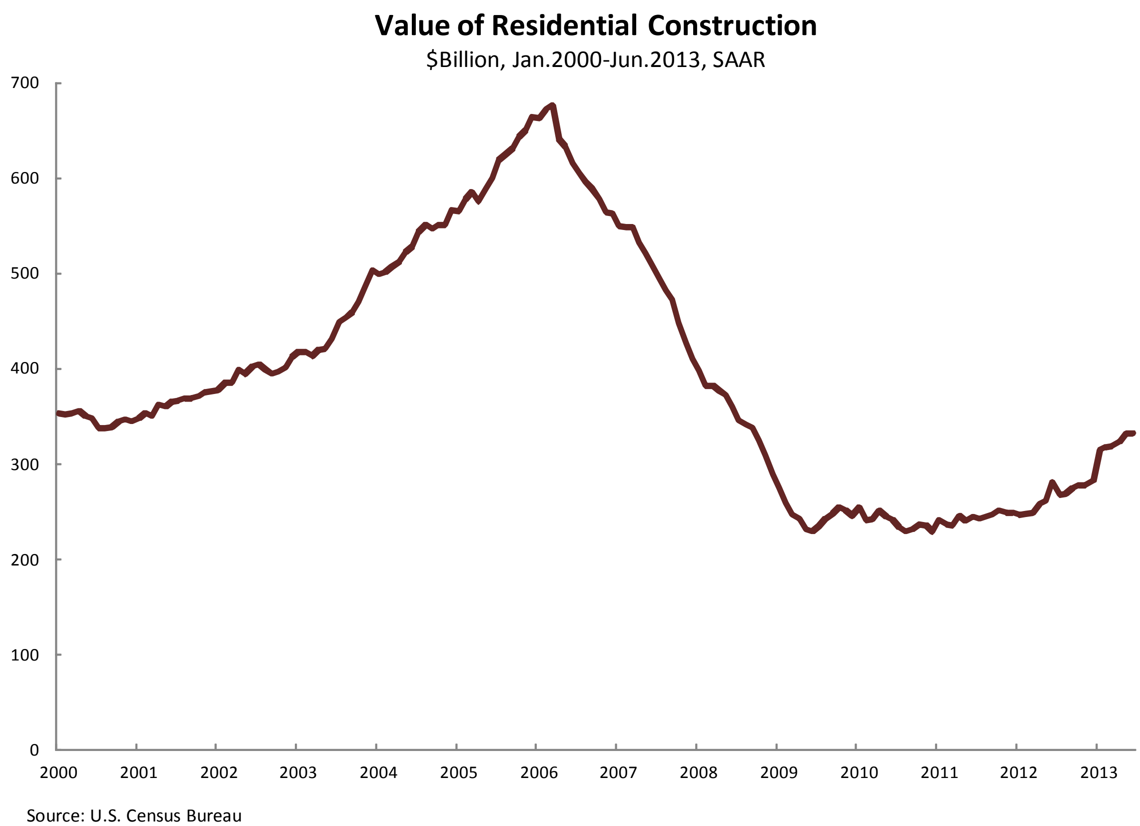
[5] Floyd Norris, "Housing Offers Hope of Strength In the Economy," *New York Times*, January 24, 2013, http://www.nytimes.com/2013/01/25/business/signs-of-a-housing-recovery-point-to-a-stronger-economy.html?_r=0

Importance of Housing to the Economy and Its Recovery

Housing represents more than 17 percent of the nation's gross domestic product (GDP) when the economy is healthy and employs millions of workers.[6] Chart 1 shows that spending on private residential construction, including new homes and improvements to existing structures, totaled over $600 billion in 2005 and 2006; by comparison it fell to under $250 billion in 2009 through 2011.[7] Due to recent improvements in the housing market over the course of 2012 and 2013, the pace of residential construction spending rose to $332 billion in June, the highest monthly pace since 2008, although still well below pre-crisis levels.[8] Considering its enormity and value to our overall economic stability, our nation's long-standing commitment to homeownership should remain a top priority.

Chart 1



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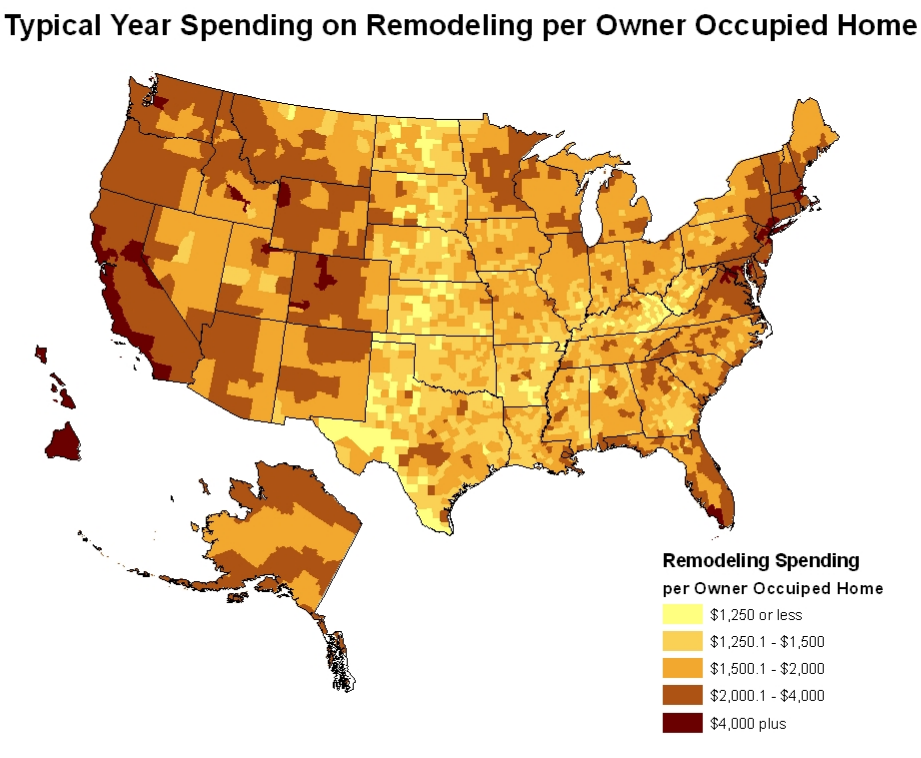
[6] GDP statistics published by the U.S. Bureau of Economic Analysis, summarized on the National Association for Home Builder's web page on Housing's Contribution to Gross Domestic Product.
[7] U.S. Census Bureau, Construction spending estimates.
[8] "Construction Spending: Improvement Spending Shows Strength, National Association of Home Builders, Eye on Housing, August, 1 2013, http://eyeonhousing.wordpress.com/2013/08/01/construction-spending-improvement-spending-shows-strength/

Even after the downturn, spending on new residential single-family and multifamily construction totaled $150 billion in 2012.[9] When 100 families move into new homes, they spend an additional $740,000 on appliances, furnishings and property alterations, creating a further economic stimulus.[10]

Like new construction, remodeling of both owner-occupied homes and rental properties also contributes billions of dollars to the nation's economy each year, totaling $125 billion in 2012.[11] On average, owners of existing homes spend $2,000 on home upgrades each year, and many home owners spend thousands more, see Chart 2 below.[12]

Chart 2



Source: NAHB estimates based on the 2006-2010 American Community Survey and 2009 American Housing Survey data

[9] U.S. Census Bureau, Construction spending estimates.
[10] "Spending Patterns of Home Buyers," Housing Economics Online, December 2008.
[11] U.S. Census Bureau, Construction spending estimates.
[12] "Remodeling per Home Highest on the Coasts, in Resort Areas," National Association of Home Builders, Blog Post, April 4, 2012, http://eyeonhousing.wordpress.com/2012/04/04/remodeling-per-home-highest-on-the-coasts-in-resort-areas/ (NAHB estimates based on the 2006-2010 ACS and 2009 AHS data).

More than any other consumer product, housing is truly "Made in America." Homes must be built here, and even most of the products and materials used to build them are manufactured in the U.S.

Beyond the economic benefits from spending that housing provides, homeownership also generates wealth that can be tapped to cover education or emergency expenses as well as to help fund retirement. Many see a home as an investment and their biggest asset.

In fact, the primary residence is the largest asset category on the balance sheets of households. Even after the downturn, the primary residence accounts for almost one-third of all assets held by U.S. households, according to the latest Survey of Consumer Finances.[13] The primary residence is also a widely held asset. A greater share of households (67 percent) hold a primary residence as an asset than hold a retirement account (50 percent) or stocks and bonds (16 percent).[14]

During the housing downturn, American homeowners lost nearly $7 trillion in wealth, as owners' equity in household real estate dropped from $13.16 trillion in 2005 to $6.23 trillion at the end of 2011.[15] As of the first quarter of 2013, owners' equity had recovered to $9.07 trillion. It's important to help U.S. households recover their trillions of dollars of lost wealth by adopting policies that would keep home values moving on an upward trend, and avoiding policies that would suppress home values.

Impact on Jobs

Construction has long been a job generator. The National Association of Home Builders (NAHB) estimate building 100 average single-family homes creates 305 jobs.[16] Although construction represents the largest industry directly impacted by housing, home building influences employment in many related industries. About half of the 305 jobs created by building a 100 single-family homes are in the construction industry, whereas the rest are spread across other industries, including manufacturing, retail and wholesale trade, financing, real estate brokers and professional services, like architects and engineers.[17]

Jobs across all industries impacted by housing were negatively affected by the recession and housing crisis, but construction was among the hardest hit. The U.S. Bureau of Labor Statistics (BLS) reports that as of July 2013 construction employment remains 1.9 million below its peak in April 2006.[18] However, there are signs that construction is improving and adding jobs. For

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[13] Survey conducted in 2010 by the Federal Reserve Board of Governors.
[14] Ibid.
[15] Flow of Funds Accounts of the United States, Federal Reserve Board of Governors, June 7, 2012.
[16] The Direct Impact of Home Building and Remodeling on the U.S. Economy, http://www.nahb.org/generic.aspx?sectionID=734&genericContentID=103543&channelID=311
[17] Ibid.
[18] Current Employment Statistics Highlights, U.S. Bureau of Labor Statistics, July 2013, http://www.bls.gov/web/empsit/ceshighlights.pdf

example, residential construction is now growing at a faster rate in more than a decade.[19] This spending will also spill over into other areas, like furniture and appliances, as long as the right policies are available to support it.

As of June of this year, the number of open, unfilled positions in the construction industry hit a five-year high.[20] Not since 2008 have we experienced a period where job openings exceeded 100,000 for five of the last six months.[21] It's anticipated that the construction industry, in particular, the residential building sector will continue to grow, with the potential of creating more jobs, assuming the availability of skilled labor to fill vacancies exists.

The gap between current production and potential housing production is 800,000 homes.[22] Housing starts are currently running under 900,000 and underlying demand is 1.7 million units annually.[23] Filling this gap has the potential to create 2.4 million jobs.[24]

Impact on States

Building homes also generates millions in revenue for governments to provide critical services and lessens demand for public assistance by creating more employment opportunities. The NAHB estimates that building 100 average single-family homes $9 billion in government revenue – $6.7 billion in federal taxes and $2.3 billion in state and local taxes.[25] All are positive for states. But there's more at stake than even these benefits.

Businesses and workers are attracted to states that have a strong housing market. Employers claim that it's more costly to recruit and retain employees in places where there's an insufficient supply of affordable housing.[26] The same feeling is expressed by high-skilled and educated workers, who when given the choice, prefer to live and work in places where housing is affordable.[27] Subsequently, research shows that affordable housing helps businesses recruit and retain skilled workers, and therefore is a top consideration when businesses are looking to build, expand or relocate.[28]

Developing more affordable housing helps drive consumer spending, both for construction workers, who now have more disposable income, and households that occupy the homes. For

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[19] Floyd Norris, "Housing Offers Hope of Strength In the Economy," *New York Times*, January 24, 2013, http://www.nytimes.com/2013/01/25/business/signs-of-a-housing-recovery-point-to-a-stronger-economy.html?_r=0
[20] "Number of Open Construction Jobs Hits Fix-Year High," National Association of Home Builders, Blog Post, August 6, 2013, http://eyeonhousing.wordpress.com/page/2/ (statistics based on Bureau of Labor Statistics Data)
[21] Ibid.
[22] National Association of Home Builders' estimates
[23] U.S. Census Bureau, http://www.census.gov/construction/nrc/pdf/newresconst.pdf, National Association of Home Builders' estimates
[24] "The Direct Impact of Home Building and Remodeling on the US Economy," Housing Economics Online, October 2008.
[25] Ibid.
[26] "The Role of Affordable Housing in Creating Jobs and Stimulating Local Economic Development," National Housing Conference, January 2011, http://www.nhc.org/media/files/Insights_HousingJobs_Factsheet_Jan_10.pdf
[27] Ibid.
[28] Ibid.

example, affordable mortgage and rent payments can increase residual household income by as much as $500 a month that can be spent on other items.[29] An increase in consumer buying power translates into higher sales for state and local businesses.

Preserving Homeownership

Mortgage rates are rising. Already this year, the average interest rate for a 30-year fixed mortgage has increased by about 1 percentage point, making it comparable to rates not seen since August 2011.[30]

The increase in mortgage rates could impact housing affordability, as higher rates could result in higher mortgage payments unless home buyers make larger down payments to offset the rate difference and ensure that payments remain the same. Yet not all home buyers will be able to make these adjustments.

At some point, however, escalating mortgage rates could increase monthly payments even with higher down payments. If this occurs, home buyers might be forced to lower bid prices on homes to offset the increase in borrowing costs. Lower bids could negatively impact home values and constrain growth of the housing market.

Any change made to the tax code should therefore take into account the effect it could have on a fragile housing market.

Mortgage Interest Deduction

There are a variety of ways to promote homeownership. Organizations, like the NAHB and the National Association of Realtors, tout the Mortgage Income Deduction (MID) as an example.

The MID allows home owners to reduce their taxable income by deducting their mortgage interest. As interest rates rise, the MID becomes more valuable to home buyers using it to reduce their mortgage payments.

Congress is considering proposals to eliminate or reform the MID, citing deficit concerns and ineffectiveness as reasons.

The NAHB claims that modifying the MID could reduce demand for housing by raising taxes on prospective home buyers and current home owners. They contend that reduced demand for

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[29] Ibid. (See also: Assessing the Economic Benefits of Affordable Housing: http://www.oakha.org/OhaNews/EconomicimpactfinalStudy.pdf)

[30] "The Impact of Rising Interest Rates on Housing Affordability," National Association of Home Builders, Blog Post, August 5, 2013, http://eyeonhousing.wordpress.com/page/2/

housing would place downward pressure on home prices, and put more home owners underwater, triggering a new wave of foreclosures.

Considering it only takes a 6 percent drop in home values to erase $1 trillion in household wealth; the repercussions to the economy and individual families would be staggering.[31] A study by the Tax Foundation found that eliminating the MID would result in the loss of 659,000 jobs nationwide, reduce GDP by $254 billion and cut wages by 1.1 percent.[32] Additionally, falling home prices could result in a decline in state and local tax revenues, which would make it harder for governments to fund schools, infrastructure, public safety and other important government functions.

However, others, such as the Center for Budget and Policy Priorities (CBPP), see reforming the MID as beneficial to expanding homeownership, especially for low- and middle-income households. They contend that in 2012 the majority of households that benefited from the MID had yearly incomes above $100,000, while nearly half of households with mortgages, predominately low- and middle-income households, received no benefits.[33] Additionally, three bipartisan budget panels have recommended converting the MID into a credit and reducing the maximum amount of interest it covers. CBPP maintains that this would ensure that more low- and middle-income households benefit from lower housing costs as well as guard against falling home prices and raise revenue to reduce the federal budget deficit.[34]

Although opinions differ on whether reforming the MID is necessary, most Democratic lawmakers would agree that eliminating it completely is the wrong approach to boosting homeownership – a position that most Americans also support.[35]

Low-Income Housing Tax Credit

The Low-Income Housing Tax Credit (LIHTC) is often hailed as a successful program to finance the development of affordable rental housing for low-income households. The program has provided more than 2 million affordable rental units since it was created under the Tax Reform

[31] The National Association of Home Builders' calculations using Federal Reserve Flow of Funds data: http://eyeonhousing.wordpress.com/2013/07/25/analyzing-claims-regarding-the-mortgage-interest-deduction/
[32] Case Study #1, Mortgage Interest Deduction for Owner-Occupied Housing, Tax Foundation, July 29, 2013, http://taxfoundation.org/article/case-study-1-mortgage-interest-deduction-owner-occupied-housing
[33] Mortgage Interest Deduction Is Ripe for Reform, Center for Budget and Policy Priorities, June 25, 2013, http://www.cbpp.org/cms/?fa=view&id=3948
[34] Ibid.
[35] July 2013 United Technologies/National Journal Poll, http://www.nationaljournal.com/congressional-connection/coverage/poll-americans-don-t-want-congress-messing-with-their-tax-breaks-20130724 and June 2011 New York Times/CBS News Poll, http://www.nytimes.com/2011/06/30/business/30poll.html?_r=1&emc=na

Act of 1986.[36] It's a public-private partnership between governments and private industry that unites developers and investors to build, renovate and preserve affordable housing.

According to data from the U.S. Census, 40 percent of renters are "rent-burdened," or spend more than 30 percent of their household income on rent.[37] Eliminating the LIHTC would halt production and rehabilitation of affordable housing when it's needed most.

Aside from providing affordable housing to people in need, the LIHTC also creates jobs. The NAHB calculated that the tax credit generates nearly $7.1 billion in economic benefits, creates about 95,000 jobs annually nationwide and provides about $2.8 billion in federal, state and local taxes.[38]

The LIHTC is an essential program that ensures the supply of affordable rental housing in states and cities throughout the U.S. It's an important financing mechanism that helps stabilize and grow the housing market at a time when demand for affordable housing surpasses supply. As Congress considers housing reform measures, it should act to protect the LIHTC and provide resources so that governors are better equipped to address the shortage of affordable housing in their states.

Call on Congress to Create a Federal Renters' Tax Credit

Congress should create a federal renters' tax credit. Such a credit could help improve the usefulness of the nation's housing expenditures and ensure they're distributed more fairly in order to address a portion of unmet need for housing assistance among low-income renters. Due to funding limitations, existing rental subsidy programs only reach 25 percent of low-income renters who qualify.[39] At the same time, low-income renters typically pay a larger share of their income for housing than higher income households.[40] Consequently, rental assistance programs are a key element to reducing homelessness and housing instability.

A federal rental tax credit could substantially reduce housing costs for more than a million of our nation's lowest-income rental households.[41]

[36] Low-Income Housing Tax Credits, The U.S. Department of Housing and Urban Development http://www.huduser.org/portal/datasets/lihtc.html
[37] Housing Tax Incentives Critical to Maintain a Thriving Middle Class, National Association of Home Builders, April 25, 2013, http://www.nahb.org/news_details.aspx?newsID=16259
[38] The National Association of Home Builders' estimated the economic impact of the LIHTC based on data contained in the National Council of State Housing Agencies 2009 Factbook: www.ncsha.org
[39] "Renters' Tax Credit Would Promote Equity and Advance Balanced Housing Policy," Center for Budget and Policy Priorities (CBPP), August 21, 2013, http://www.cbpp.org/cms/?fa=view&id=3802
[40] Ibid.
[41] Ibid.

Housing Finance System Reform

Members of Congress on the Republican-led House Financial Services Committee have proposed to end federal support of the housing finance system, essentially eliminating government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, and the federal backstop that enables the federal government to guarantee mortgage backed securities. In its current form, the Protecting American Taxpayers and Homeowners (PATH) Act would likely increase interest rates and fees on all kinds of mortgage products, including the 30-year, fixed mortgage – the primary financing vehicle used by the middle class to buy homes. The move could destabilize the housing system, making it more vulnerable to future federal government bailouts and place a greater burden on the American taxpayer in the event the housing market was to collapse.

Modify but Don't Eliminate the Federal Backstop

Although it's necessary for private lenders to assume a larger role in the credit market, private lenders don't need to entirely replace federal government support in order to reform the housing finance system. After all, a federal backstop helps private lenders make more loans and charge less for them. Without it, private lenders will bear all of the risk, which will likely be reflected in higher fees that will ultimately make homeownership less affordable for more Americans and drive down home values.

Any housing reform plan should include a federal backstop. Perhaps one that's better defined and provides greater transparency for private lenders and taxpayers to know how much risk each shares if the market were to decline.

Preserve Access to Affordable Credit

The PATH Act could also restrict access to affordable credit, specifically the 30-year, fixed mortgage. These loans provide predictable monthly payments and are intended for home buyers with average incomes. They allow households to budget for their loan with the peace of mind that payments will remain constant over the life of the loan, regardless of whether interest rates increase. The 30-year, fixed mortgage has been a key factor to increasing homeownership rates in states throughout the U.S. If access to these loans were restricted, it would make it more difficult for middle class households to purchase a home.

Rather than expand access to 30-year, fixed mortgages, the PATH Act would force more home buyers to take out adjustable rate mortgages (ARMs). These loans shift a greater share of the risk from private lenders to the home owners, as monthly payments adjust with interest rate changes. For example, if mortgage rates rise, payments for ARMs also would increase, which could make it more difficult for home owners to afford to make their monthly mortgage payments.

The PATH Act ultimately would create uncertainty in the mortgage marketplace, limiting the number of households eligible for mortgage credit and setting off a chain reaction that could cause the economy to fall back into a recession. States would almost immediately feel the impact, as residential building would seize, jobs would be shed, housing stock would rise and home values would fall, thus placing greater strain on state budgets.

Protect Access to FHA-Insured Loans

Federal Housing Administration (FHA) loans are government-backed loans that require a lower down payment and, at present, have a higher loan limit than most traditional mortgages.[42] During the housing boom, these loans were nearly nonexistent, because of the availability of interest-only and no down payment loans. However, since the housing crisis, more borrowers are seeking FHA loans, because of their less stringent lending requirements. These loans allow home buyers to purchase homes with less money down, thus expanding homeownership to more low- and middle-income households.

The PATH Act seeks to restrict access to FHA loans to certain borrowers, specifically first-time and low-to-moderate income home buyers, requires larger down payments for other home buyers and raises FHA insurance fee requirements.[43] This move would likely constrain the flow of available credit to home buyers and put homeownership out of reach for more Americans.

Maintain Government's Role in Multifamily Mortgage Programs

State Housing Finance Agencies (HFAs) use multifamily mortgage programs to finance the development of rental housing for low-income households. Under the PATH Act, the program would be scaled-back. This would significantly reduce the amount of capital available for affordable housing developments at a time when more than one-third of Americans live in rental housing and demand for rental housing is forecasted to increase.[44]

Multifamily mortgage portfolios of both Fannie Mae and Freddie Mac performed well and weren't responsible for financial problems associated with these entities. Tampering or eliminating these programs will therefore have little to no effect on the federal budget, but could result in drastic consequences for state and local governments that depend on these programs to supply affordable rental housing to low- and middle-income households, not served by private lending sources. Furthermore, the legislation would impose burdensome occupancy and rent restrictions on housing financed with FHA multifamily mortgage insurance.

Additionally, the PATH Act would eliminate the Housing Trust Fund – a critical fund source that state HFAs use to construct affordable rental housing. Cutting off another important financing source for states would jeopardize the overall health of the housing finance system and possibly create affordable housing shortages in states where demand is greatest.

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[42] Pursuant to the Consolidated and Further Continuing Appropriations Act of 2012, P. L. 112-55, the maximum FHA high cost area loan limit is $729,750, compared to $625,500. The higher FHA loan limit is due to expire on December 31, 2013 unless Congress acts to extend the expiration date.
[43] 7 things to know about an FHA loan, http://www.bankrate.com/finance/real-estate/7-things-to-know-about-an-fha-loan.aspx
[44] The American Community Survey, 2011.

The Way Forward

As members of Congress continue debating plans to reform the housing finance system, it's hard to dismiss that maintaining some form of a federal backstop is important to stabilizing the housing market. Proposals to revamp the existing federal backstop should include changes that preserve financial stability, promote investor confidence and limit taxpayer exposure by ensuring it's only triggered under extreme circumstances. Creating a secondary federal backstop, such as the one proposed in the Senate, would essentially act as a disaster insurance plan that would prevent interest rates from rapidly escalating, causing a substantial number of homes to go unsold or not be built.

States should continue to closely monitor congressional activity on the housing finance system, as changes could impact the health of their housing markets and require subsequent action to stem potential job loss and ensure access to affordable housing isn't compromised.

Eliminating Barriers and Overcoming Potential Challenges

Restricted Credit

New housing production relies on the availability of credit. Until recently, commercial banks and other financial institutions provided the majority of housing production credit for the residential construction industry, which is known as acquisition, development and construction (AD&C) funding. However, new financial and regulatory constraints brought on by the housing crisis have made it harder for these lenders to provide the amount of credit necessary given current economic conditions.

Without sufficient access to credit, builders can't build homes even in markets that need and want them. The only way to address this problem is to ease restrictions in order to restore the flow of credit from lenders to developers.

Bipartisan legislation (the Home Building Lending Improvement Act of 2013) introduced in the Senate seeks to encourage residential construction lending as of means of spurring job growth and keeping the housing recovery on track. A similar bipartisan bill pending in the House, H.R. 1255, the Home Construction Lending Regulatory Improvement Act of 2013, would also help provide home builders access to credit for viable home building projects.

States should advocate support of these bills from their Congressional Delegations.

Labor Shortages

The pace of the housing market's recovery will hinge on the availability of skilled labor to meet growing demands. A March 2013 survey of NAHB members found that since June 2012 residential construction firms have been reporting an increasing number of labor shortages across all industry areas, including carpenters, excavators, bricklayers, plumbers, roofers, building maintenance managers, framers, weatherization and HVAC workers.[45] The same survey showed that 46 percent of builders experienced delays in completing projects on time, 15 percent had to turn down some proposals and 9 percent lost or cancelled sales, as a result of labor shortages.[46]

The number of open, unfilled positions in the construction industry reached a five-year high in June, with vacancies climbing to 133,000 from 102,000 in May.[47] Total number of open positions exceeded 100,000 for five of the last six months, which is consistent with labor shortages reported by builders.[48]

Many skilled residential construction workers were forced out of the industry during the recession when there was depressed demand for homes, and sought employment in other industries. Now that demand is picking up, there are less skill workers available to satisfy these needs.

As the economy continues to improve and housing market rebounds, demand for housing is poised for growth, especially given that 3 million household formations were delayed due to the Great Recession.[49] In normal economic times, demand for new homes is about 1.7 million annually.[50] Consequently, if states are already experiencing labor shortages in certain areas, the problems will likely become worse, as demand for homes rise, without immediate action to replenish the construction workforce pipeline.

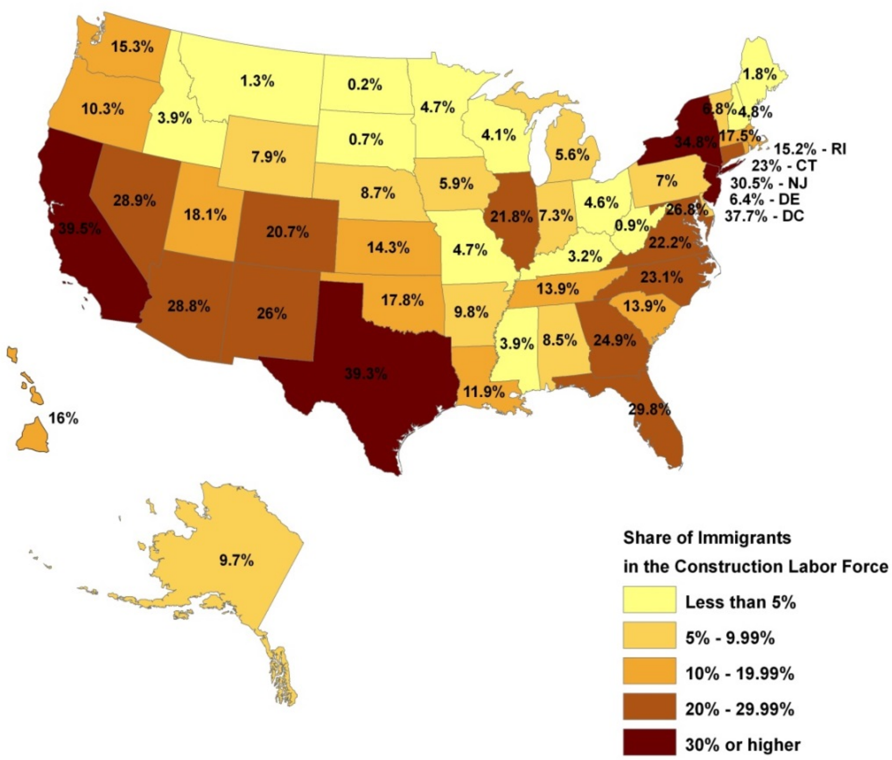
Immigration Reform Needed to Fill Expected Job Vacancies

Immigrants have been an important source of construction workers for U.S. firms. Foreign-born workers comprise 22 percent of the construction labor force.[51] Depending on location, some states, particularly those near the southern border, rely on foreign-born construction workers for as much as 30 percent of their total construction workforce, as Chart 3 shows.[52] It's these same states that could have the most difficulty filling construction job vacancies when the housing market fully bounces back.

[45] "Evidence of Growing Labor Shortages in Home Building," National Association of Home Builders, Eye on Housing, March 2013, http://eyeonhousing.wordpress.com/2013/03/26/evidence-of-growing-labor-shortages-in-home-building/
[46] Ibid.
[47] "Number of Open Construction Jobs Hits Five Year High, National Association of Home Builders, Eye on Housing, August 8, 2013, http://eyeonhousing.wordpress.com/2013/08/06/number-of-open-construction-jobs-hits-five-year-high/
[48] Ibid.
[49] "Pent-Up Housing Demand: The Household Formations That Didn't Happen – Yet," National Association of Home Builders' estimates, February 2, 2011, http://www.nahb.org/generic.aspx?genericContentID=152243&channelID=311
[50] National Association of Home Builders' estimates.
[51] U.S. Census Bureau, 2011 American Community Survey, http://www.census.gov/acs/www/data_documentation/2011_release/
[52] Ibid.

Chart 3

State-by-State Share of Immigrants in the Construction Labor Force



Source: Housing Economics Online

The current debate on immigration reform provides Congress an important opportunity to create a new visa program that will allow home builders to hire foreign-born workers when there's a shortage of domestic workers to fill open jobs. If Congress fails to act to address this important issue, labor shortages that are already apparent throughout the residential construction sector will become more widespread and hinder housing market growth and slow economic recovery. The bottom-line: Congress must pass a comprehensive immigration reform plan to ensure we have the workers we need to prevent labor shortages, while also maintaining border security and bringing current undocumented workers out of the shadows. Congress must act.

Considerations and Options for States

Pursue Innovative Solutions to Bridge the Gap between Financing and Builder Activity: the Wall Street-Builders-State Partnership

Banks and financial institutions have made it much harder for small- and mid-size home builders to obtain AD&C funding to finance construction activities. According to FDIC data, the outstanding stock of AD&C loans made by FDIC-insured institutions for 1-4 unit home building is down 80 percent since the credit crisis occurred five years ago.[53] Essentially, AD&C lending dropped from its peak of$203.8 billion in the first quarter of 2008 to $40.7 billion where it stands today.[54]

To fill this financing gap, NAHB is collaborating with private investors to develop alternative financing sources in order to provide much needed capital to builders. One effort gaining traction would utilize state housing finance agencies (HFAs) to administer loans on behalf of private investors. In this program, which is still in the development phase, HFAs would review and make lending decisions on builder loan applications; inspect the progress of home construction and approve loan draws as stages of building are completed and process loan repayments to investors. HFAs would receive fees for their services. HFAs could also take a share of the loans and receive fees and interest for assuming a portion of the credit risk.

This program has tremendous potential for state revenue and job creation. Based on the NAHB's 2014 construction forecast and a survey of builders' use of non-bank financing, NAHB estimates that such a program could grow to as much as $25 billion[55] if implemented nationally, which could finance the construction of 138,000 single-family homes, supporting 422,000 jobs. Appendices1 and 2 at the end of the document show an estimated allocation per state for a $25 billion fund, the number of homes financed per state and the economic impact for each state through job creation, taxes, fees and business income.

Several states in the northeast are taking a serious look at this program as a possible option to nudge along badly-needed financing.

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[53] National Association of Home Builders Eye On Housing, Stock of Residential AD&C Loans Declines Slightly, http://eyeonhousing.wordpress.com/2013/05/29/stock-of-residential-adc-loans-declines-slightly/
[54] Ibid.
[55] NAHB used Census permit data to forecast the dollar volume of the home building market for the debt-financed share of home building for 2014 by state. Then, used NAHB survey data to calculate the difference between market share of those using non-bank financing for home building today compared to prior years. The difference is the estimated share of home construction that would benefit from an improved AD&C fund system.

Expand Pre-Apprenticeship and Training Programs in the Construction Trades

States may want to consider expanding pre-apprenticeship and training programs in building trades based on the forecasted demand for skilled workers predicted in the construction industry. These programs are critical to responding to the housing industry's needs, and equipping workers with skills that could lead to long-term employment, particularly at a time when millions of Americans are searching for jobs.

States might consider partnering with the AFL-CIO or its affiliate trade associations to develop or expand pre-apprenticeship programs that create pathways to careers for workers interested in pursuing a profession in unionized construction trades. Many of these programs are designed to equip workers with the necessary skills in various trade occupations to successfully compete for building and construction trade apprenticeship programs.

The Home Builders Institute (HBI),[56] a non-profit organization based in Washington, D.C., also provides career training to support the national building industry, and could be a good resource for states wanting to expand or enhance their workforce training programs. HBI can work with states to design customized programs that meet the specific needs of each state's unique construction industry to ensure a ready supply of skilled workers are available to fill vacancies now and in the future.

Boost Homeownership for First-Time Home Buyers

Massachusetts Governor Patrick got the commitment of several national and community banks to approve at least 10,000 mortgages for first-time home buyers over the next five years. The Massachusetts Homeownership Compact[57] is an agreement between the state and participating financial institutions to provide a specific number of mortgage loans to first-time home buyers with household incomes below the area median income, as a way to increase homeownership throughout the Commonwealth. The compact is also meant to stimulate economic growth and promote neighborhood stabilization.

Increase the Number of Graduates with Residential Construction Management Degrees

The National Housing Endowment's Homebuilding Education Leadership Program (H.E.L.P.)[58] awards grants to colleges and universities to expand or establish academic programs in residential construction management, with the goal to increase the number of qualified graduates entering the residential construction profession nationwide. The program aims to educate and train future generations of leaders in the residential construction industry, and

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[56] Home Builders Institute: http://www.hbi.org/

[57] Governor Patrick Announces Massachusetts Homeownership Compact, Press Release, June 10, 2013 http://www.mass.gov/governor/pressoffice/pressreleases/2013/0610-home-ownership-compact.html

[58] National Housing Endowment H.E.L.P. Initiative: http://www.nationalhousingendowment.org/category.aspx?sectionID=1718&channelID=1407

thereby increase the body of knowledge on housing issues. Since the program's started in 2006, the Endowment has awarded grants to 22 universities in 17 states.[59] States may want to inform their public higher education institutions about opportunities and programs offered through the National Housing Endowment and encourage them to apply for grants available through H.E.L.P., as a way to increase the number of college graduates with degrees in residential construction management in their states.

Expand Rental Housing and Create Jobs

In 2012 under the leadership of Governor Martin O'Malley, the State of Maryland enacted a new "Rental Housing Works[60]" initiative that was designed to both create jobs as well as provide affordable housing for low-income Maryland families. The program is designed to provide critical "gap funding" for shovel ready projects, funding beyond the resources already dedicated to addressing the affordable housing need in Maryland. Rental Housing Works received a total of $37.5 million to date, $17.5 million in funding in its first year of operation, and an additional $20 million in year two.

In the last state fiscal year, Rental Housing Works financed 2,310 units of affordable housing, while creating 3,037 jobs (direct and indirect). The total economic impact of this initiative has been $423.5 million, which includes total construction expenditures of $362.2 million. In addition, this initiative has improved the financial health of both local governments and the state by generating additional immediate- and long-term revenue, including increased revenue for state and local income and sales taxes from the jobs generated and materials purchased under the initiative ($7.4 million during the construction phase), as well as increased property tax receipts ($2.8 million), as rental housing has been constructed or rehabilitated. The 15-year net present value of all state and local tax receipts of just the first year of the program was $43.2, showing that the initiative will more than double the initial investment by the state, while furthering to fuel a strong economic and job recovery.

Preserve Homeownership through Refinancing Opportunities

Initiated in 2013, the State of Maryland, through the Maryland Department of Housing and Community Development (DHCD), is offering refinance opportunities for Maryland home owners who are current on their mortgage, but are having difficulty refinancing in the private market due to recent devaluation of home values. DHCD offers three paths for refinancing based on whether home owners have a DHCD loan with conventional insurance, a DHCD loan with FHA insurance, or don't have a DHCD loan but still meet the requirements of the program. By doing this, the Department preserves homeownership, while refinancing these loans at lower rates provides additional resources to the home owner. The lower payments as a result of the refinancing then allow the home owner to use the money saved from their lower house payment for other purposes, providing both short- and long-term benefits to the economy.

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[59] Ibid.

[60] Multifamily Housing Development, Rental Housing Works (RHW), Maryland Department of Housing and Community Development, http://www.dhcd.maryland.gov/Website/programs/RHW/Default.aspx

Create a Homeowner Bill of Rights

Responding to the state's foreclosure and mortgage crisis, California Governor Brown passed the Homeowner Bill of Rights law (AB 278/SB 900)[61], which was officially enacted this year. Its purpose is to guarantee a level of fairness and transparency to home owners in the foreclosure process, and provide them legal protection in the event that their rights are violated. The law is designed to stop abusive practices of unscrupulous lenders and help families, acting in good faith, renegotiate their mortgages, so they can stay in their homes.

The Homeowner Bill of Rights has four main components:

1. Banning "dual track" foreclosures to prevent lenders from simultaneously foreclosing on a borrower, while negotiating loan modification terms.
2. Guaranteeing a single point of contact for home owners negotiating a loan modification with lenders.
3. Requiring lenders provide more advanced notice to borrowers before taking action on a loan modification or foreclosing on a home.
4. Preventing lenders from proceeding with a foreclosure until mistakes with mortgage documents are corrected and information is verified, and subjecting banks to civil penalties for approving multiple loans in which documents haven't been properly recorded.

Passage of the law made California the first state to extend National Mortgage Settlement Rules to all lenders doing business in the state, which otherwise would only have applied to five financial institutions.

Leverage Public and Private Resources

Included as part of New York Governor Cuomo's 2013 agenda[62] is a plan to create a $1 billion House NY Program. The program seeks to invest $1 billion to build or preserve over 14,000 units of affordable housing over the next five years. The investment will help satisfy unfulfilled housing needs across the state, in addition to revitalizing New York's Mitchell-Lama Affordable Housing Program that involves rehabilitating housing units that suffer from differed maintenance and other problems. The state plans to invest funds to leverage a mix of public and private resources to finance affordable housing units through the use of low-interest loans, grants and tax credits available to developers.

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[61] AB 278 http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_0251-0300/ab_278_bill_20120711_chaptered.pdf and SB 900 http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0851-0900/sb_900_bill_20120711_chaptered.pdf

[62] Outline of New York Governor Cuomo's 2013 Agenda: http://www.governor.ny.gov/press/01092013-cuomo-agenda-2013

Conclusion

The housing crisis highlighted weaknesses in our nation's housing finance system and problems that have yet to be resolved. It's clear that until these issues are addressed, any improvement in the housing market will be limited and short lived. While most reforms must be left to Congress to make, whatever changes are enacted will most certainly impact states' abilities to expand affordable housing and most likely will require additional action by states to further strengthen their individual housing markets.

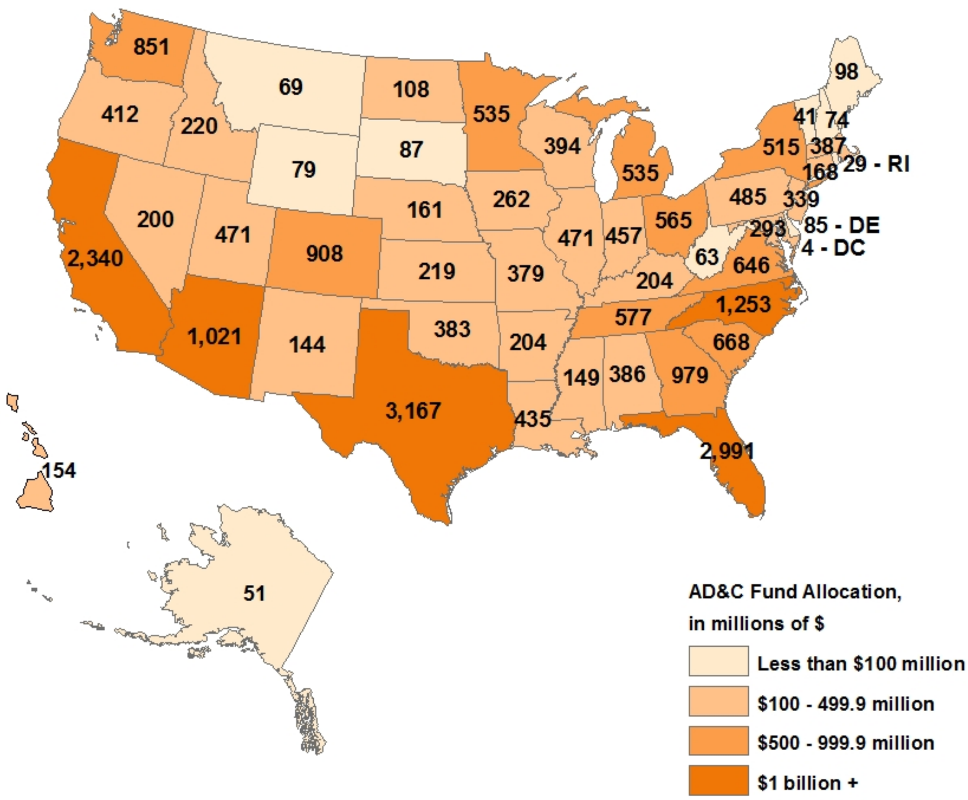
Appendix 1: AD&C Funds by State

2014 Estimates	Fund Activity		Economic Impact			
State	Fund Allocation ($M)	Single-Family Homes	Jobs	State/Local Taxes/Fees ($M)	Federal Taxes ($M)	Business Income ($M)
Alabama	$386	2,378	7,249	$54	$158	$204
Alaska	$51	232	707	$5	$15	$20
Arizona	$1,021	4,987	15,202	$113	$331	$428
Arkansas	$204	1,311	3,998	$30	$87	$113
California	$2,340	9,576	29,192	$218	$636	$822
Colorado	$908	3,757	11,455	$85	$250	$323
Connecticut	$168	735	2,240	$17	$49	$63
Delaware	$85	740	2,256	$17	$49	$64
District of Columbia	$4	30	90	$1	$2	$3
Florida	$2,991	13,135	40,044	$299	$873	$1,128
Georgia	$979	6,087	18,556	$138	$405	$523
Hawaii	$154	579	1,764	$13	$38	$50
Idaho	$220	1,246	3,799	$28	$83	$107
Illinois	$471	2,367	7,217	$54	$157	$203
Indiana	$457	2,745	8,370	$62	$182	$236
Iowa	$262	1,703	5,192	$39	$113	$146
Kansas	$219	1,198	3,652	$27	$80	$103
Kentucky	$204	1,364	4,157	$31	$91	$117
Louisiana	$435	2,726	8,311	$62	$181	$234
Maine	$98	669	2,039	$15	$44	$57
Maryland	$293	1,764	5,378	$40	$117	$151
Massachusetts	$387	1,620	4,939	$37	$108	$139
Michigan	$535	3,009	9,173	$68	$200	$258
Minnesota	$535	2,563	7,815	$58	$170	$220
Mississippi	$149	1,081	3,296	$25	$72	$93
Missouri	$379	2,451	7,472	$56	$163	$210
Montana	$69	343	1,046	$8	$23	$29
Nebraska	$161	1,048	3,194	$24	$70	$90
Nevada	$200	1,495	4,558	$34	$99	$128
New Hampshire	$74	448	1,367	$10	$30	$39
New Jersey	$339	1,955	5,959	$44	$130	$168
New Mexico	$144	1,023	3,119	$23	$68	$88
New York	$515	2,391	7,290	$54	$159	$205
North Carolina	$1,253	7,715	23,521	$176	$513	$662
North Dakota	$108	693	2,112	$16	$46	$59
Ohio	$565	3,161	9,636	$72	$210	$271
Oklahoma	$383	2,332	7,111	$53	$155	$200
Oregon	$412	1,980	6,036	$45	$132	$170
Pennsylvania	$485	3,088	9,414	$70	$205	$265
Rhode Island	$29	174	531	$4	$12	$15
South Carolina	$668	3,709	11,308	$84	$247	$318
South Dakota	$87	622	1,897	$14	$41	$53
Tennessee	$577	3,440	10,486	$78	$229	$295
Texas	$3,167	19,555	59,615	$445	$1,300	$1,679
Utah	$471	2,383	7,264	$54	$158	$205
Vermont	$41	234	712	$5	$16	$20
Virginia	$646	3,909	11,918	$89	$260	$336
Washington	$851	4,010	12,225	$91	$267	$344
West Virginia	$63	467	1,424	$11	$31	$40
Wisconsin	$394	2,127	6,484	$48	$141	$183
Wyoming	$79	380	1,158	$9	$25	$33
United States	$25,716	138,735	422,948	$3,156	$9,221	$11,913

Source: National Association of Home Builders

Appendix 2

AD&C Private Equity Fund Allocation



Source: National Association of Home Builders