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On Behalf of the
National Association of Home Builders

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Introduction
Chairman Terry, Ranking Member Schakowsky, members of the subcommittee, on behalf of the more than 140,000 members of the National Association of Home Builders (NAHB), I appreciate the opportunity to testify today. My name is Rick Judson, and I am a homebuilder and developer from Charlotte, North Carolina, and NAHB's 2013 Chairman of the Board.

NAHB members are involved in the home building, remodeling, multifamily construction, property management, subcontracting and light commercial construction industries. We are affiliated with more than 800 state and local home builder associations throughout the country, and since the association's inception in 1942, NAHB's primary goal has been to ensure that housing is a national priority and that all Americans have access to safe, decent and affordable housing, whether they choose to buy or rent a home.

The State of Housing
The nation's housing markets are beginning to see widespread consistent, sustainable growth. To track this level of improvement, NAHB created the Improving Markets Index (IMI), a conservative listing of markets showing long-term improvement in employment, home prices, and building permits. As of May 2013, the IMI listed 258 metros areas as improving, with at least one in each state and now covering over 70 percent of all markets.

However, economic and policy headwinds remain that have slowed builders' ability to build and prospective home buyers' ability to make a home purchase. If these headwinds are reduced, then housing's contribution to economic growth would be larger and the overall economic recovery more robust.

The home building industry is uniquely large and decentralized. As of April 2013, total employment in home building stands at 2.132 million individuals; broken down as 586,000 builders and 1.545 million residential specialty trade contractors. These numbers are down 1.318 million individuals from peak employment in April 2006, a 38% decline. These workers and entrepreneurs are spread out across the nation.

Like most of the construction sector, home building is dominated by small firms. The median gross receipts for NAHB members is just under $1 million. Approximately 80 percent of our builders build 10 or fewer homes per year and employ 10 or fewer employees.

Collectively, however, they represent a massive industry, employing millions of people and generating 17% of our nation's gross domestic product. Housing contributes to the national economy in two basic ways: through private residential investment and consumption spending on housing services. Historically, residential investment has averaged roughly 5% of GDP while housing services have averaged between 12% and 13%, for a combined 17% to 18% of GDP. These shares tend to vary over the business cycle.

The Great Recession and its lingering impacts significantly reduced the production of housing. Due to these declines, the industry is operating well below historic norms. In order to meet the housing needs of a growing population and replacement requirements of older housing stock, the industry is expected to be building about 1.4 million new single-family homes each year and more than 1.7 million total housing units. In comparison, in 2012, home builders constructed only 534,000 single family homes and 247,000 multifamily units.

Nonetheless, over the last two years, home building has experienced significant growth. In fact, since the last quarter of 2011, advances in home building have been responsible for 20% of total economic expansion. And this growth creates jobs. According to NAHB estimates, 305 full-time equivalent (FTE) jobs, and $8.9 million in tax revenue are generated by the construction of 100 single family homes. Similarly, 100 new multifamily units results in 116 FTE jobs and $3.3 million in tax revenue. Further, the building and improvement of the housing stock of a local area provides a tax base for state and local governments. While typically not included in federal analysis, the taxes attributable to housing are substantial. According to Census data and NAHB calculations, property taxes attributable to housing totaled approximately $300 billion in 2012.

The rise and fall of housing activity has been the dominant economic factor of the last decade. Housing typically leads the economy out of recession, although in the period after the Great Recession, housing has not played that role. There are many reasons why the recovery has been slower than past history would suggest.

Regulatory burdens, increased construction costs and particularly the lack of available financing have hindered a healthy recovery and impending tax reform has significant upside and downside risks for the industry.

Building Materials

As the housing recovery continues, rising costs of building materials are decreasing affordability and preventing builders from meeting the demand for new homes. In response to the prolonged housing downturn, many building materials companies cut back on production and capacity. Over the past year, as residential construction showed signs of a sustained recovery, certain materials prices increased.

For the industry, lumber has always been a volatile-priced product. Such wide price swings in lumber, over a short period of time, can have a direct effect on the affordability of homes.

NAHB research shows lumber and wood products account for 15% of the cost of construction for a single family house. The prices of these materials have soared as the housing recovery gained momentum in 2012. For example, prices of oriented strand board (OSB), an engineered wood product, have grown 80% over the last year, and framing lumber prices increased by 32% to a recent peak over a six month period.

Gypsum prices also continue to be a main driver for residential construction cost increases in 2012, rising 39% above the most recent low in February of 2011. Approximately 90% of gypsum is used in the manufacture of wallboard for residential and non-residential building applications. A further 5% is used as an additive in cement production.

The rising cost of inputs drives up the cost of construction, which in turn, increases the price of a new home. The impact is of particular concern in the affordable housing sector where relatively small price increases can have an immediate impact on low- to moderate-income home buyers who are more susceptible to being priced out of the market.

As noted earlier, home builders are generally organized as small businesses. Many of these small-volume builders and subcontractors do not have the capital to finance the up-front costs associated with input price volatility, and consequently, increases in building material costs lead to fewer homes constructed.

Residential construction has finally turned the corner and is contributing to, rather than subtracting from, Gross Domestic Product growth and an improving labor market. Any effort to ease escalating price pressures, help rebuild the supply chain, and support a continuing housing recovery is effective economic policy. Policies that streamline permitting processes, attract investment in domestic mining of critical minerals, and encourage multi-use forest management practices for national forests are meaningful steps forward. It is important for Congress to take a deep look at these issues and determine what actions can be taken in an environmentally-friendly way.

Building Energy Codes

Building energy codes, such as the International Energy Conservation Code (IECC) are used across the country to establish minimum standards for building energy efficiency. The codes are developed by private entities, but are then adopted by state and local governments. The Department of Energy (DOE) participates in this process. While they do not develop the codes themselves, they are authorized to provide "technical assistance." NAHB has serious concerns that this has been broadly interpreted to allow them to offer support or opposition for certain proposals.

Over the last few years, the industry has seen some negative trends in code development leading to less choice and decreased value to the consumer. First, there has been a move towards using a more prescriptive approach – mandating the use of certain products or techniques. Unfortunately, some businesses have realized that by inserting specific products into the IECC, they can require the use of their products and increase their profits. Instead of allowing the builder to make decisions in the interest of the buyer – based on personal preferences, cost, behavior, etc. – the IECC, in some instances, dictates how to build and what products to use.

DOE has supported such efforts in the past, including measures to give preferential treatment to foam sheathing over wood products. The Department also sought to delete measures aimed to promote flexibility in the IECC – one such provision allowed builders to trade off energy measures - wall insulation, for example, provided they installed more efficient mechanical equipment. The same net energy use would be maintained, but the builder would have more design and construction options. Unfortunately the Department was successful and this was removed from the code in 2009.

Another unfortunate trend is the attempt to mandate further energy use reductions, without real consideration of economic costs. I am a certified green professional – I know how to build green homes. I know how valuable the energy savings are to the consumer, but even with these savings, there is a significant, upfront cost.

According to an NAHB market report, "What Home Buyers Really Want," buyers are willing to pay more for lower utility costs, but according the data, buyers need a 14 percent return on investment, which corresponds to a 7-year payback period. The latest version of the IECC had such significant cost increases that it would take the average family 13.3 years just to break even on required mandates. In fact, for most of Nebraska, the payback period is 17.3 years.

Please keep in mind that the energy code is not an "option" for buyers looking for a more efficient home. Rather, this is a requirement for every single home in that jurisdiction – including low-income housing and homes for first-time homebuyers. The energy code is a baseline for all homes. If we want to seek further efficiency gains, incentive programs, green building rating systems, and other programs can be used to encourage homeowners to make those decisions. Energy efficiency tax credits, such as the section 25C and 25D credits, stand out as examples of this better approach. In contrast, increasing housing costs for all homebuyers will have the unintended consequence of reducing housing affordability.

Increases to the cost of doing business, raise home prices and impede growth in the industry. If the price of a home increases by $1,000, either through cost increases for materials or due to regulations, 246,000 households are priced out of mortgage eligibility for a 30 year, fixed-rate mortgage with a 5% interest rate. It is important, not only to the home building industry, but the entire economy as well, to minimize any barriers to building.

<u>Housing Production Credit Crisis</u>

One key factor contributing to housing's current depressed state has been continued lack of Acquisition, Development and Construction (AD&C) lending by the banking community. According to FDIC data, the outstanding stock of AD&C loans is down 80% since 2007, despite recent increases in underlying demand for new construction.

The unwillingness of banks to provide financing to home builders has stymied the recovery of our industry and slowed the overall economic recovery. Our members have spent years caught in a debate between banks and federal regulators over who is to blame for the lack of construction lending to the home building sector. Our members hear one story from their banks and another from federal regulators. There is no clear understanding as to whether federal banking regulators are pressuring the banks not to lend; whether the local field examiners are 'acting rogue' against the guidance of the federal regulators in D.C. or if banking institutions are overhauling and downsizing portfolios independent of regulator/examiner pressure.

Home builders continue to report that lenders are unwilling to extend new AD&C credit or to modify outstanding AD&C loans in order to provide more time for builders and developers to complete projects and pay off loans. Banks themselves often cite regulatory requirements or examiner pressure as reasons for them to shrink their AD&C loan portfolios. While federal banking regulators insist they are not encouraging banking institutions to stop making loans or to indiscriminately liquidate outstanding loans, reports from NAHB members in a number of different geographies strongly indicate that bank examiners in the field have adopted a significantly more aggressive and negative posture toward AD&C loans.

Since mid-2008, NAHB's *Survey of Acquisition, Development and Construction Financing* has shown problems with AD&C credit availability. Builders have consistently reported that the most common reason their banks give them for not extending new credit for viable projects is pressure from regulators. Builders also report that banks are tightening terms on outstanding, often performing, construction and development loans by demanding additional assets as collateral, requiring partial pay-downs based on reappraisals, and refusing to allow additional draws. Again, banks cite these tightening actions are due to pressure from regulators.

NAHB has presented federal banking regulators with specific instances of credit restrictions, provided data showing no difference in credit access based on market conditions, and requested specific changes to current regulatory guidance. To date, these efforts have not produced any tangible results. It is clear that further action is needed to get credit flowing again to home builders. Without such action, the housing recovery will continue to limp along dragging down our nation's ability to recover from the current economic downturn.

With the introduction of legislation in the House and Senate to address the regulatory barriers to construction lending, the profile of this lending crisis has been raised significantly in Congress. NAHB strongly supports H.R. 1255, the *Home Construction Lending Regulatory Improvement Act of 2013*, introduced by Representatives Gary Miller (R-CA) and Carolyn McCarthy (D-NY), and S. 1002, the *Home Building Lending Improvement Act of 2013*, introduced by Senators Robert Menendez (D-NJ) and Johnny Isakson (R-GA). Both of these bills would require banking regulators to issue new guidance specifically addressing key regulatory areas that have significantly hampered the flow of credit to our nation's home builders.

In short, NAHB strongly supports congressional action to help restore the flow of credit to our nation's home builders. By addressing the regulatory barriers to sound AD&C lending, Congress can help put Americans back to work and strengthen our communities by increasing the property tax base that supports local schools, teachers, police, firefighters and public services.

Tax Reform

The idea of a simpler, less complex tax code has great appeal to NAHB's membership. At the same time, our industry remembers painful lessons from the *Tax Reform Act of 1986*, when the commercial and multifamily sectors experienced a downturn due to unintended consequences. For this reason we urge Congress to be cautious and thoughtful when it comes to housing and tax reform.

NAHB also defends housing choice. While homeownership offers communities and households numerous benefits, it is important to recognize that for every family there is a time to rent and a time to own a home. For these reasons, NAHB supports policies that promote a healthy rental housing sector, including support for the Low-Income Housing Tax Credit, which was created as part of the *Tax Reform Act of 1986* and has become a successful public-private partnership that assists in the development of affordable housing.

Homeownership remains the major path to wealth for the middle class. We believe that any policy change that makes it harder to buy a home, or delays the purchase of the home until an older age, will have significant long-term impacts on household wealth accumulation and the makeup of the middle class as a whole. As most homeowners benefit from the mortgage interest deduction, and most of that benefit flows to younger, middle class families, weakening the deduction and making homeownership less accessible is likely to diminish the financial success of future generations.

The use of debt is also critical for the supply side of the housing market. The small businesses in the residential construction sector depend on debt to finance business operations, make payrolls, and build or improve homes. Approximately 80% of NAHB's membership consists of businesses organized as non C-Corporation entities (sole proprietorships, partnerships, LLCs and S Corporations). And, few of the 20% of members organized as C Corporations are publicly-traded corporations.

For such small firms, equity financing from Wall Street is not an option. The average NAHB member, be they a land developer, remodeler, or home builder, must seek business financing in the form of debt from banks – AD&C lending as noted above. It is typical with such loans for small businesses to offer up personal guarantees (effectively using personal assets as collateral) in order to attract capital to small business. For these reasons, the tax treatment of debt and the prospects for a recovery in housing, and the economy as a whole, are directly related.

NAHB supports the goal of many in Congress to reform the tax code. How housing is dealt with in tax reform will shape the economy moving forward. Housing can be a key engine for job growth that this country needs. NAHB believes that lower rates, simplification, and a fair system will spur economic growth and increase competitiveness. And these economic outcomes are good for housing, because housing not only equals jobs, but jobs means more demand for housing. To foster that virtuous cycle for economic growth, we believe strongly that you must look upon changing the homeownership tax incentives with extreme caution.

<u>Conclusion</u>

While there is still work to do before we see a healthy housing market back at historic norms, I would like to conclude by looking ahead to a hopeful future for our industry. Because of the down turn, there is considerable pent-up housing demand. Based on NAHB estimates, approximately 2.1 million potential homes are needed to account for newly developed households that have delayed buying due to poor economic conditions. When this pent-up housing demand is unlocked, these future renters and homebuyers will need additional housing to start families and invest in their neighborhoods.

Perhaps even more telling are the attitudes of builders themselves. NAHB conducts monthly and quarterly surveys of the residential construction sector that provide a market pulse of current conditions. The most prominent is the monthly NAHB/Wells Fargo Housing Market Index (HMI), which reports builder confidence within the single-family market. While this number has fluctuated month to month, our most recent May numbers show an increase to 44, significantly higher than the low of 8 set during January 2009.

This rise in confidence is consistent with the rise in overall housing starts. In 2009, total housing starts numbered only 554,000. NAHB forecasts that housing starts for 2013 will number just about 1 million. The industry is only about half back to the historic norms necessary to meet the housing needs of a growing population. This future growth, if not impeded by the issues discussed in this testimony, will create jobs, increase small business successes, and raise tax revenue for state, local and federal governments.

Thank you for your time. We look forward to working with the Subcommittee in the future.