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Testimony of

Mr. Barry M. Grooms
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On Behalf of the National Association of REALTORS®

In regards to the
Exclusion from gross income of discharge of qualified principal residence indebtedness

House Committee on Way and Means
Subcommittee on Tax Policy

Hearing on
"Post Tax Reform Evaluation of Recently Expired Tax Provisions"
March 14, 2018

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EQUAL HOUSING OPPORTUNITY

Chairman Buchanan, Ranking Member Doggett, and Members of the Committee, my name is Barry Grooms. I am a 20-year veteran of the real estate profession, and a co/owner of a 50-agent brokerage in Florida. I am here representing the more than 1.3 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR) who work in all aspects of real estate. NAR represents a wide variety of real estate industry professionals. I am currently the Vice President of the 179,000 member Florida Association of REALTORS. I have served as Public Policy Chairman for the Florida Association of REALTORS, Chair of Tax and Business and the Issues Mobilization Committee. I am a working owner and have personally brokered 178 real estate short sales and 209 bank-owned real estate transactions since 2009.

Thank you for inviting me to testify today on the important topic of whether the tax exclusion for forgiven mortgage debt should remain expired or be made a permanent part of our tax law. Since it was first added to the Internal Revenue Code in 2007, this provision has provided much-needed financial relief for millions of distressed households.

In my home state of Florida, the exclusion has been especially vital in saving families from financial devastation. Residents of the Sunshine State suffered through some of the darkest days of the Great Recession. In fact, at the worst of the housing crisis, six metro areas in Florida were on the list of the 20 most troubled housing markets.

However, at that difficult time there was plenty of despair to go around. According to the data analytics firm Core Logic, at the depth of the Recession as many as 25 percent of mortgaged residential properties in the U.S. suffered negative equity.[1] While the pain was most severe in a handful of states, there was lots of financial distress everywhere.

Am I saying that more than one in four households found themselves in need of the kind of relief offered by the mortgage debt cancellation exclusion? No. Just because one's home goes under water, it does not necessarily mean it will lead to a default or another crisis with one's mortgage.

But please consider this. The kind of financial contagion we became far too familiar with over the past decade is not unlike the influenza epidemic we have unfortunately experienced this winter. The virus is all around us, but luckily does not seriously affect everyone.

However, almost everyone is susceptible to the flu's devastation. And in the case of the financial troubles that swirled all around so much of the nation, most of those who were felled were hit by a double whammy of problems, first from the more widespread downturn that took away their home equity and then perhaps from a job loss or a family illness or something else that temporarily knocked out their monetary immune system. This left them in a position where they had to turn over their deed in lieu of foreclosure, sell short their home, or somehow rework their mortgage in a way that left them with some of their mortgage debt discharged.

As a REALTOR® in Florida for 20 years, I saw firsthand many times what can happen when a family is double-struck with a financial catastrophe that hits at a time when they have negative equity in their home.

I recently received a call from past clients, a married couple, who asked me to sell their home. However, after meeting with them to determine their needs, I discovered they owned $85,000 more than their home is worth. During the meeting, they told me that they needed to move because the

[1] https://www.corelogic.com/insights-download/homeowner-equity-report.aspx

home was in need of immediate repairs and that they didn't have the money to fix anything. The husband is a firefighter with 10 years under his belt and there was no possible way for him to advance unless a position opens up, which is not likely for many years.

The wife could only work two night shifts as a registered nurse because of his schedule and due to the needs of their two young children. They are not investors looking for a hand out or someone playing the system by a strategic bailout. Rather, these are real people put in a very bad situation. If their only option is a short sale and they are forced to pay taxes on what they lost, this could force them to leave our community. People like these are the fabric of the community and provide so much more than what they do at work. They volunteer at schools, church, and provide stability to a neighborhood. The community would share the loss if they had to move away, and everyone would lose. This is just one example of many taking place right now in a lot of communities across the country. Many of the stories are worse.

Imagine the despair that comes when those who have lost their home are informed that the $85,000, or $40,000, or $150,000 amount by which their mortgage debt was reduced has to be included as income on their tax return, with perhaps tens of thousands of dollars added to their tax bill. In most cases, these families are already in financial straits. They simply do not have the cash to pay the tax that would be due if the exclusion is not available.

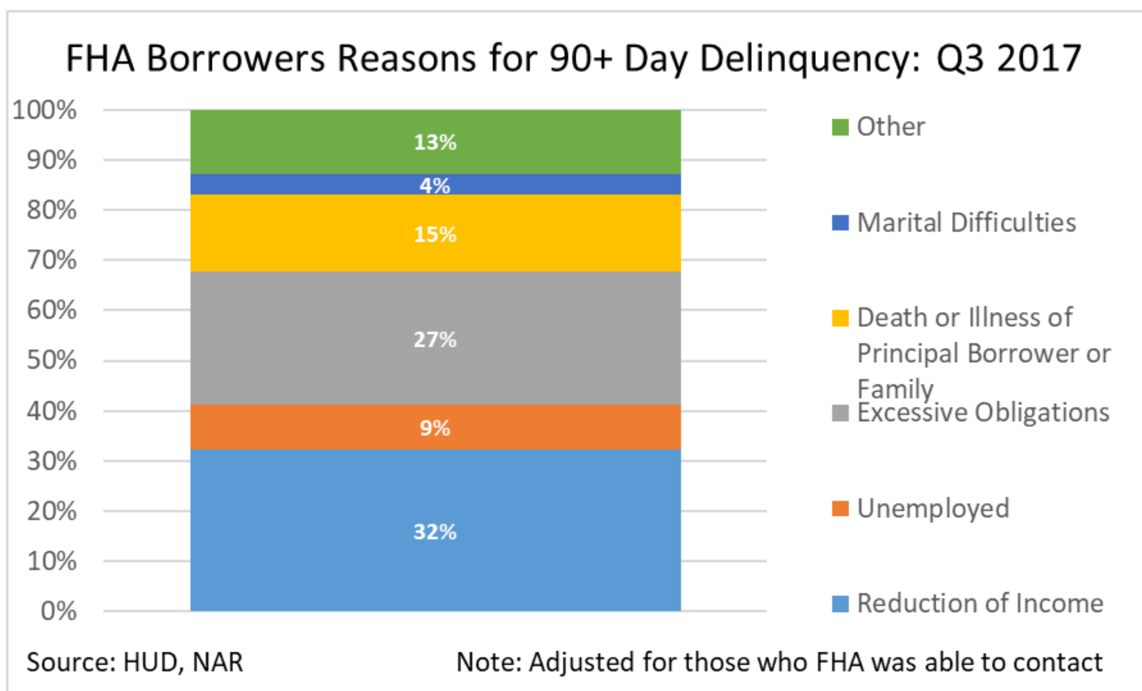
This despair is very real, and has been present for several of the past ten years, despite the *de facto* continuous presence of the exclusion in the law. This is because the provision has been allowed to expire again and again, and was often restored on a retroactive basis, leaving affected taxpayers sweating it out over whether it was going to be available for them when they needed it most.

As recently as a few weeks ago, before the latest retroactive extension of the provision, which had expired at the end of 2016, I saw the anguish on the faces of people who had gone through short sales last year as the April 15th due date for their 2017 tax returns approached. What would happen if those tax returns showed an unanticipated multi-thousand dollar additional amount due? Had these families owned the resources to pay these extra taxes, they likely would not have had to suffer the short sale or foreclosure of their home.

One of the principles of good tax policy says that citizens should not have to pay tax when there is no cash available to do so. And in cases where a homeowner has lost her residence because of a one-two knockout punch to her financial situation that leads to mortgage debt being forgiven, the cash to pay the tax is seldom there.

Exacerbating the double-misfortune aspect of those who find themselves with a discharge of mortgage debt is the fact that many owners who go into a distressed sale are already facing some hardship that impairs their income or liquidity. A vein of mortgage finance research focuses on the "double trigger" theory where homeowners generally continue to pay their mortgage payments when in negative equity, but enter foreclosure or sell short only after a negative life event like a job loss, reduction in income, death of a spouse, or a serious illness.
One study of subprime owners with no equity who originated their loan in 2006 found that 80 percent of those who entered foreclosure did so due to "income shocks combined with negative equity."[2] Even then, the authors of the study found that the, "median borrower does not walk away until he owes 62 percent more than their house's value." As depicted below, even in relatively good times, a high share of delinquencies on FHA loans are due to negative life events. Given the close ties that homeowners develop with their homes and communities, it should be no surprise that an owner would fight to hold onto his or her home.

[2] https://www.federalreserve.gov/pubs/feds/2010/201035/201035abs.html



However, sometimes one must sell a home in order to take advantage of new opportunities. As any economy shifts, one industry may rise as another declines. This dynamism requires a degree of mobility in the work force. The debt burden of selling a home below what is owed on it can impair an owner's ability to move for better jobs[3].

Also, researchers have found that "unemployed individuals with negative home equity are disproportionately more likely to move, and more strongly so, if the local labor market is weak,"[4] thereby multiplying the local stress. However, not cited was the fact that these owners benefited from the Mortgage Forgiveness Debt Relief Act of 2007, a testament to the benefit of this provision. While a new class of "involuntary landlords" – homeowners in negative equity who rented their homes and successfully moved elsewhere to accept new employment – developed after the Great Recession, not all owners are so lucky.

Some who oppose making the exclusion for cancelled mortgage debt permanent will cite the moral hazard argument. It is true that a lender forgiving debt can sometimes incentivize homeowners to simply walk away from their property and their obligations. However, the academic research listed earlier suggests that this is not common.

Furthermore, very real and negative consequences still exist for owners who do walk away. Not all creditors will forgive debts and in many states, laws exist allowing creditors to pursue debtors. Moreover, even if the debt is forgiven, the impact of a foreclosure can be almost ruinous to near- to mid-term future prosperity by reducing one's credit score by nearly 150 points.[5] And, virtually all lending programs will not extend credit to a distressed seller or foreclose seller for one to several years depending on the circumstances.

We must also examine the harm to the surrounding neighborhood and community when considering the moral hazard argument. Most would likely agree that the worst possible outcome

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[3] https://www.aeaweb.org/conference/2016/retrieve.php?pdfid=933
[4] http://www.uh.edu/~bsorense/DHLS_July12_2016.pdf
[5] https://www.vantagescore.com/images/resources/loan_restructuring_options.pdf

for everyone – the affected household, the lender, the neighbors, and the community – would be for the borrower to just walk away from the property. Studies show that there is no negative spill-over effect of a short-sale to the neighbors of the house sold short. However, for homes sold within 0.1 miles of a foreclosed or REO property sold within the prior three months of the sale, there is a 1 percent negative impact on home prices. This can compound to as high as an 8 percent downward adjustment depending on the number of foreclosures in the neighborhood.[6]

Therefore, any factor that encourages a distressed homeowner to avoid a foreclosure in favor of a short sale is positive for everyone. And the exclusion for discharged mortgage debt encourages the borrower to sell the home short instead of walking away. Without the exclusion, however, the temptation to leave and let the lender foreclose greatly increases.

There is one more significant point I would like to make, Mr. Chairman and members of the Committee. The exclusion for mortgage debt cancellation also delivers a huge dose of fairness to our tax system.

When the investment in a home goes well, as so often happens, and the owner eventually sells at a gain, the tax system rewards the accomplishment with a tax exclusion of up to $500,000 for married couples filing a joint return (up to $250,000 for a single filer). This wise policy not only helps a family save for retirement, but it also greatly reduces complexity for taxpayer and tax administrator alike. Homeowners everywhere are grateful this provision was preserved in tax reform.

But what happens on those occasions where, most often through no fault of the homeowner, things go sour financially, equity is lost, and before it is recovered, some other unhappy situation forces the family to have to sell short or suffer a foreclosure? When this occurred up through 2017, the exclusion for the mortgage debt cancellation stepped in and relieved the often-impossible tax burden.

If the exclusion is allowed to expire, however, we are left with a tax policy that rightly and richly rewards good fortune, but piles on when the tables are turned. Essentially, the former owner whose double misfortune (first by seeing the home's value drop and second by suffering a family financial catastrophe, such as a job loss) led to a situation where mortgage debt is forgiven in foreclosure or short sale would lose twice more – once by missing out on any subsequent gain on the home value and then again by incurring a tax on forgiven debt.

Yes, the equity situation for homeowners in America is much better today. But there are still approximately 2.5 million homes with their mortgages under water today.[7] As the table below shows, in Florida, this is roughly 9 percent of all homes with a mortgage. But there are likely thousands, and perhaps tens of thousands, of such homes in each of your districts. Some unfortunate percentage of this group will, even in good economic times, find themselves caught in the snare of negative home equity at a time when adverse family financial circumstances force them to have to accept a reduction in their mortgage principal.

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[6] https://faculty.unlv.edu/nasser/Published%20Papers/JRER_forthcoming_%20Spillover%20Effects%20of%20Foreclosed%20Residential%20%20Properties.pdf

[7] https://www.corelogic.com/insights-download/homeowner-equity-report.aspx

Count and Share of Mortgages in Negative Equity: Q3 2017					
State	Negative Equity Share	Negative Equity Count	State	Negative Equity Share	Negative Equity Count
National	4.9%	2,528,700	Missouri	3.9%	34,300
Alabama	4.3%	20,000	Montana	2.3%	3,500
Alaska	1.7%	1,800	Nebraska	4.5%	12,100
Arizona	7.2%	98,600	Nevada	8.9%	49,800
Arkansas	5.5%	17,800	New Hampshire	5.2%	13,900
California	3.2%	213,200	New Jersey	7.6%	137,900
Colorado	1.7%	20,600	New Mexico	4.5%	12,100
Connecticut	8.2%	70,500	New York	4.6%	95,800
Delaware	6.0%	12,900	North Carolina	3.7%	66,500
District of Columbia	3.5%	3,600	North Dakota	3.5%	3,100
Florida	9.0%	356,100	Ohio	6.9%	151,200
Georgia	4.6%	80,800	Oklahoma	4.9%	25,100
Hawaii	1.7%	4,100	Oregon	1.7%	12,300
Idaho	2.5%	7,600	Pennsylvania	4.0%	85,000
Illinois	8.7%	193,800	Rhode Island	7.5%	18,400
Indiana	2.4%	21,700	South Carolina	4.1%	31,900
Iowa	5.1%	24,000	South Dakota	NA	NA
Kansas	3.2%	11,300	Tennessee	3.7%	40,100
Kentucky	4.1%	17,300	Texas	1.5%	56,400
Louisiana	10.1%	43,200	Utah	1.5%	7,900
Maine	2.7%	2,300	Vermont	NA	NA
Maryland	7.7%	105,000	Virginia	5.3%	80,000
Massachusetts	4.4%	68,100	Washington	1.6%	23,700
Michigan	6.2%	91,300	West Virginia	5.4%	2,900
Minnesota	3.3%	25,500	Wisconsin	5.7%	46,500
Mississippi	7.6%	5,400	Wyoming	3.0%	1,700
Source: Corelogic					

As with the wave of reduced negative home equity, it is great to know that the influenza epidemic is abating throughout the nation too. But pockets of high incidence remain. Moreover, we all know that the flu will be back. Luckily, our best infectious disease specialists at the Centers for Disease Control and Prevention are already hard at work to minimize the damage it will bring.

We all know that cases of negative home equity will ebb and flow as well, despite our personal best efforts and even with a strong economy, which unfortunately cannot last forever. This is why we need a permanent exclusion provision in place to offer assistance to those affected, and to minimize the damage to our families, neighborhoods, and communities.

The NATIONAL ASSOCIATION OF REALTORS® thanks you for your attention to this pressing issue and stands ready to work with you address this important problem that faces American families.