

Written Statement for

Michael Hodgson

On Behalf of:

The National Association of Home Builders

To The

**United States House
Small Business Committee**

Hearing On

“Role of Small Business in Stimulating the Economy”

April 24, 2008

Introduction

Thank you for the opportunity to submit testimony on behalf of the National Association of Home Builders (NAHB), representing more than 250,000 members in the home building, remodeling, light commercial construction, and housing finance industry. My name is Mike Hodgson and I am the President of ConSol in Stockton, California. Although a small business, ConSol is one of the nation's largest, independent residential energy consulting firms and has been working for builders since 1981, providing a full range of services to improve quality control of energy-related features in new homes.

Generally speaking, the home building industry is dominated by small businesses, 60% of NAHB members build less than 25 homes per year and 88% have less than \$5 million in annual receipts. As Congress continues its work on passing critical housing stimulus legislation, there are a number of ways to include important energy efficiency and sustainability incentives that will have similar stimulative impacts on thousands of small businesses that comprise the majority of our nation's housing and related industries. Specifically, Congress should promote voluntary energy efficiency programs, extend expiring tax incentives for highly efficient new home construction, and provide incentives for the technology future of housing, i.e., green and sustainable residential construction.

NAHB's members are significantly impacted by the credit crunch and there is deep concern that the dislocations in the financing markets will increase the depth and length of the housing downturn. As so many businesses rely upon the strength of the housing industry, it is critical that Congress act now to restore this vital part of the economy and provide small businesses, which comprise the lion's share of the nation's economic engine, with incentives and support to help reverse this slowdown.

This statement provides background and context for the current crisis in the housing markets as well as some suggested solutions to address that crisis. Further, it explores an important evolutionary step in residential construction – energy efficient construction and green building, which will help address heightened concern with global climate change and represents a significant growth area for home building.

Housing Market Conditions

The U.S. housing market now is in the contraction phase of the most pronounced housing cycle since the Great Depression. This dramatic contraction has exacted a heavy toll on economic growth and employment during the past two years, and now has pushed the U.S. economy into recession according to NAHB macroeconomic analysis. The adverse economic impacts of the housing contraction involve not only sharp declines in home sales and housing production, but also depressing effects of falling home prices on household wealth and mortgage credit quality. These events have provoked an alarming surge in mortgage foreclosures that have cut into the homeownership rate. Further, events have seriously damaged financial institutions holding mortgage assets, as well as companies that provide mortgage credit enhancement.

The pronounced decline in mortgage credit quality first became evident in the subprime mortgage sector last year, and that disaster triggered a stampede toward credit quality in national and global credit markets. This process has essentially shut down or seriously damaged a wide range of securities markets, including major components of the mortgage securities markets in the U.S. The freezing-up of private securities markets, both here and abroad, has shifted credit demands to government-related securities markets and to depository institutions – resulting in higher loan volume and pressures on capital positions at the depositories. The banking system, in turn, has been aggressively tightening lending standards in order to control volume, maintain asset quality and shepherd capital.

With private securities markets in disarray and banks retrenching, a bona fide credit crunch is underway. This credit crunch actually appears to be worsening despite the concerted efforts of central banks here and abroad. The Federal Reserve has been easing monetary policy aggressively since last fall, and probably will do more in the near future. These actions have improved the functioning of short-term money markets, including the interbank markets, but the Fed has not been able to relieve strains in longer-term credit markets.

With the deterioration of housing demand, exacerbated by the credit crisis and the fear and uncertainty concerning future housing price declines, for-sale housing market inventories are at historic levels. For example, the new homes inventory stands at a 9.8 months supply. The record volume of vacant homes on the for-sale market inevitably will put persistent downward pressure on home prices for some time. These interrelated factors of inventories and home price decline are central to the outlook for the economy and the financial markets.

Continued downward pressure on home prices also further saps the quality of outstanding mortgage credit, making it even more difficult to refinance or restructure adjustable-rate mortgages that have encountered or are facing payment resets. These effects, in turn, will worsen the alarming upsurge in mortgage foreclosures; move even more homes onto the for-sale market; put even more downward pressure on house prices and mortgage quality; and stretch out the contraction in new housing production even further. This represents quite a feedback loop, with ominous potential consequences for the U.S. economy and the financial markets.

Some have argued that the best way to bring the housing market into balance is to permit housing prices to fall in an uncontrolled fashion over a short period of time. However, this path of adjustment would most likely cause substantial collateral damage to the economy, to financial markets and to America's homeowners. Policymakers should not take that risk. A second round of economic stimulus is urgently needed as a complement to monetary policy adjustments. This time, stimulus measures should be directed squarely at the housing sector--the sector that is at the root of the challenges facing the economy and the financial markets.

Implications for the Economy

With the deterioration of housing demand, exacerbated by the credit crisis and the fear and uncertainty concerning future housing price declines, for-sale housing market inventories are at historic levels. The record volume of vacant homes on the for-sale market inevitably will put persistent downward pressure on home prices for some time. If housing prices fall significantly,

as many economists expect, households spend less because they feel (and are) less wealthy. One key reason for reduced consumer spending is that housing wealth is the primary source of savings for most households. If housing prices fall, then homeowners' wealth decreases. As a result, households may decrease current consumption to offset the lost wealth.

According to a January 2007 report from the Congressional Budget Office (CBO), a 10 percent decline in housing prices from peak to trough – a conservative estimate of what many economists expect – would reduce consumption and ultimately subtract 0.4 to 2.2 percentage points from Gross Domestic Product (GDP) growth. Given that many economists expect meager growth in GDP this quarter, the CBO estimates indicate that falling housing prices can easily push the economy into recession. In dollar terms, the CBO report estimates that a 10 percent housing price decline would subtract \$55 to \$316 billion from GDP.

The contraction in the housing market also is having heavy direct effects on the national economy. In the fourth quarter of 2007, residential fixed investment (home building) subtracted 1.2 percentage points from real GDP growth. In January, when the entire economy lost 17,000 jobs, home building lost more than 28,000. Total homebuilding employment is down by 400,000 since the peak in February 2006, a decline of more than 11 percent, and further declines are inevitable during the months ahead. Furthermore, many home builders are now reporting substantial financial losses when only a few years ago they were generating jobs, providing local development and paying taxes.

NAHB Recommendations

Home Buyer Tax Credit

Two causal factors in the current housing downturn and the related credit crunch are declining house prices and excess inventory. These elements are equally central to the outlook for the broader economy and the financial markets. Policies that stimulate home purchases in the immediate future can pay huge dividends. The biggest bang for the buck most likely would be provided by a temporary homebuyer tax credit, such as the credit approved recently by the House Ways and Means Committee in the *Housing Assistance Tax Act of 2008*. Indeed, the recent revival of interest among prospective buyers suggests that temporary credits could stimulate a wave of home buying that could quickly reduce excess supply in housing markets and halt the dangerous erosion of house prices and mortgage credit quality. NAHB applauds the Congress for its efforts to create a homebuyer tax credit, and stand ready to work with Congress in crafting the most effective credit to help solve the current economic crisis.

Expand the Net Operating Loss Deduction Carryback

Home builders, like many businesses, are now reporting financial losses when a few years ago they were generating jobs, providing local development and paying taxes. For home builders large and small the importance of the ability to claim and carry back net operating losses (NOL) deductions to years when significant taxes were paid cannot be overstated. The inability to do so will result in the need to either increase high-cost borrowing or further liquidate land and homes, which will only compound the existing inventory problem. The additional supply of

homes and land on market for sale, of course, will put even more downward pressure on prices and further add to the housing crisis. Ultimately, the result of this will be more layoffs of workers and reduced development of communities.

Current law allows for a two-year carryback of NOLs, however, home builder losses began in 2006. Expanding the carryback of NOLs beyond two to years when significant taxes were paid provides financial resources to the home building sector as well as all businesses to weather the economic downturn. Further, this will help all businesses, including financial institutions and manufacturers, facing difficult economic decisions concerning employment. Finally, an expansion of the NOL carryback simply allows businesses to accelerate their claim of NOL deductions that under present law would be claimed in the future. The need for these deductions today is critical.

Expand the Mortgage Revenue Bond Program

The existing Mortgage Revenue Bond (MRB) program also offers a method of increasing housing demand. A special allocation of bonds to be used for either purchase or refinancing would be beneficial for housing. The MRB program allows state and local governments to issue tax-exempt debt that may be used to finance mortgages at below-market interest rates. Certain technical restrictions concerning the MRB program could also be made more flexible to enhance its use as an economic stimulus tool. These include the house price limits and the first-time home buyer requirement. Expanding the reach of the MRB program would allow it to have the largest effect, particularly for communities experiencing the possibility of a wave of foreclosures or an extreme excess of inventory. Such positive results will help reduce pressure on housing prices, thereby restoring financial institutions' confidence in the housing market and reducing the effects of the current credit crunch. NAHB thanks the House Ways and Means Committee in approving a temporary \$10 billion expansion of the MRB program the *Housing Assistance Tax Act of 2008*.

The Next Evolution in Residential Construction

NAHB members currently build about 80% of all new units in the United States and, "by 2010, green could make up about 10% or more of the housing market depending on the right mix of incentives and consumer education." According to the Partnership for Advancing Technology in Housing (PATH) and other government business surveys, the majority of builders of green homes and manufacturers of green building technologies are small businesses. This is a significant and important fact because housing comprises 16% of the U.S. GDP. The impact of housing on the economy of the United States is substantial, and by encouraging growth in green building, our nation's home builders have the potential to profoundly affect sustainability and conserve precious natural resources and our environment.

NAHB members are leaders in the green building movement and were active on this effort long before the recent media interest in climate change and global warming. NAHB has been working on green building alongside its 850+ state and local Home Builder Associations (HBAs) for nearly a decade, which is longer than many other green building advocates have even existed. In fact, NAHB will be hosting its 10th Annual National Green Building Conference in

New Orleans next month and has consistently been ahead of the curve in promoting and developing energy-efficient and environmentally-friendly construction techniques for the mainstream home builder.

Being Green is much more than a tankless water heater and a little extra insulation in the attic, it is a holistic approach to how the home exists on the land with the least impact, how conservatively it uses resources; and how it provides healthy, safe, and decent shelter to the resident. Simply put, building greener is building well. It means making intentional decisions that positively impact energy efficiency, resource conservation and indoor environmental quality throughout the entire design and construction process. Green means doing the right thing for the builder, the homeowner, and, most importantly, the environment.

The recent strength and growth of green building is due in large part to its voluntary nature, which provides builders and developers the flexibility that is essential for incorporating the principles of sustainable design in innovative ways to construct a home that is both environmentally sound and affordable to homebuyers. Green home building will continue to be an important component and because of the current flexibility in green building options, builders will be able to successfully adjust to the shifting market demand for greener homes.

NAHB Recommendations for Enhancing Green Building/Energy Efficiency

Extending Tax Incentives for New Energy-Efficient Homes

Perhaps the most important tool for promoting residential energy efficiency and sustainability is to utilize the nation's tax code. The Internal Revenue Code Section 45L New Energy Efficient Home Credit, which was enacted as part of the Energy Policy Act of 2005, is a key market incentive that shifts builders towards significant energy savings in new home construction. The program allows a \$2,000 tax credit to a home builder who constructs a qualified new energy-efficient home, certified to achieve a 50 percent reduction in energy usage, thereby adding a highly efficient home that will likely remain part of the nation's housing stock for 60 years or more.

Tax incentives are effective ways to promote energy efficiency because they combine the tax incentive with market-determined supply and demand for home construction. Other approaches, such as an artificially-imposed mandate, require government officials to sort through reports in order to enforce rules and verify compliance. Meanwhile, a tax incentive simply reduces the cost of construction above minimum building code requirements, i.e building highly energy-efficient homes, thereby encouraging that behavior. Further, with a tax credit, important production decisions are still reserved for builders, buyers and home owners. Consequently, a tax credit program costs little to operate and does not require expensive administrative oversight that is usually associated with a mandate.

NAHB has learned from its members that the credit is particularly beneficial to small home builders, who in many cases have the flexibility to react to marketplace preferences, such as the demand for highly efficient homes. The credit can be an effective means of developing

and maturing this market, which would yield long term benefits with respect to our nation's energy needs.

Unfortunately, the credit is set to expire at the end of this year. The limited window of applicability of the credit also limits its use. Home building is a lengthy process, and builders are unlikely to participate in a program that may end before the construction process is completed. Although the House recently passed H.R. 5351, and the Senate similar passed an amendment to its housing stimulus legislation that extends this credit, there is still no agreement between the chambers over the appropriate offsets. This political disagreement endangers the possibility of extending this credit this year. Unless Congress can end the political debate and extend this credit soon – with or without offsets – it will be a tremendous loss for my business and will eliminate the only federal incentive for efficiency in new homes.

Finally, Congress should also increase the dollar amount of the credit. As nearly everyone agrees that energy efficiency in buildings and homes is a major priority, so similarly Congress should tackle this priority by offering a more meaningful incentive to those that bear the most cost – i.e., builders. Achieving the 50% threshold required by statute can be an expensive proposition, especially for smaller builders. Home builders report that the increased construction cost required to meet the 45L requirement can dramatically exceed the \$2,000 tax credit. In conjunction with the required basis adjustment (which reduces the value of the credit to approximately \$1300), the credit is somewhat limited in its effect. In today's market, these costs cannot be transferred to homebuyers, therefore Congress must provide a way that will help builders ameliorate the expenses associated with achieving such high levels of code compliance.

National Green Building Standard

NAHB, in collaboration with the International Code Council (ICC), initiated a landmark effort in February 2007 to establish the first national consensus standard on residential green building for the United States that will be approved by the American National Standards Institute (ANSI). Normally, standards development processes can take a while to complete, given the extensive public input that requires full consideration. However, the need to develop appropriate strategies to address growing environmental challenges like climate change has motivated our industry to commit to a fast-tracked standards process because we believe that it simply cannot be put off any longer. This process is completed and the Standard will exist as the *only* consensus-based industry standard for residential green construction in the country.

As a national standard, ANSI requires consensus-based decision-making, opportunity for public comment, and other processes to help guarantee that the Standard is acceptable to all members of the home building industry, as well as to those who regulate them. This process involves full participation from interested stakeholders who volunteer to sit on a Consensus Committee, and who provide advice and counsel on how to build a green home, how to verify and certify its integrity, and how to continuously update the standard to ensure improvement and rigor. A membership roster of the official Consensus Committee of the National Green Building Standard is attached to this statement.

This membership roster includes the U.S. Green Building Council, the U.S. Environmental Protection Agency, the U.S. Department of Energy, numerous city and state housing officials, product manufacturers, insulation manufacturers, architects, and some of the nation's largest production home builders. Some of the guiding principles in this Standard include the following:

- ***Lot Design, Preparation, and Development.*** Resource-efficient site design and development practices help reduce the environmental impacts and improve the energy performance of new homes. Siting that saves trees, incorporates onsite storm water retention/infiltration features, and orients the home to maximize passive solar heating and cooling are essential elements used in planning a green home.
- ***Resource Efficiency.*** Most successful green homes start at the design phase, which includes the selection of materials to be used in its construction. Resource efficiency also means reducing job-site waste by developing construction waste management plans, which includes recycling, can reduce normal average construction waste by at least two-thirds, thus reducing the burden on landfill space. Lastly, performing life-cycle analysis (LCA) on building materials helps determine a more accurate impact on the environment, since some materials can be renewable, but very energy-intensive when considering their transport to job-sites. The LCA process involves a “cradle to grade” philosophy and covers how the material is recovered, the product manufacturing process, the home building process, the maintenance and operation, the home demolition, and product reuse, recycling, and disposal.
- ***Energy Efficiency.*** Energy consumption has profound impacts on our environment, from the mining of fossil fuels to the emissions of burning non-renewable energy sources. The impact of a home's energy use over time is a significant factor in how that home will impact the environment. Therefore, energy efficiency is heavily weighted in any green building program. The greatest results in energy efficiency come from a “whole systems” approach. Energy performance does not end with just increasing insulation, using renewable energy, or upgrading the HVAC equipment. Green homes must have a balance between these features and careful window placement, building envelope air sealing, duct sealing, and proper placement of air and vapor barriers from the foundation up to the attic. Once these features are incorporated into the green home, then it will truly be high-performing, energy efficient, less-expensive to operate, and more comfortable to live in than a conventionally-constructed home.
- ***Water Conservation.*** Implementing water conservation measures can reduce mean per capita water usage from 64 gallons per day to 45 gallons per day. Thus, green homes are especially welcome in areas affected by long- and short-term water supply issues. Green homes conserve water both inside and outside the home with more efficient water delivery systems, native and drought-resistant landscaping, and careful treatment of storm water and wastewater in the construction process. .
- ***Indoor Environmental Quality.*** Healthy indoor environments are another hallmark of green building. Following energy efficiency, the quality of a home's indoor air is often recognized as the most important feature of a green home. Although no official authoritative definition

exists of what healthy indoor air means, there are measures that green home builders can take to mitigate the effects of potential contaminants by controlling the source, diluting the source, or capturing some of the source through filtration.

- ***Operation, Maintenance, and Homeowner Education.*** Inadequate or improper maintenance of a green home can defeat the designer and builder's best efforts to create a resource-efficient home. Failing to change air filters regularly, or neglecting to use kitchen and bath exhaust fans in moist air, are very common mistakes most homeowners make. By giving homeowners a manual that explains proper operation and maintenance procedures, includes information on alternatives to toxic cleaning substances and lawn and garden chemicals, and directs them to water-saving practices, a green home builder can help assure that the home functions as carefully as it was constructed, in an environmentally-responsible manner.

Encompassing single- and multi-family construction, remodeling, and land development, the National Green Building Standard demonstrates the level of urgency with which the housing industry is approaching and addressing energy efficiency and sustainability issues. I am proud of the continued effort of the home building community to create the first comprehensive residential green construction standard that not only informs builders on how to build green, but also educates homeowners on how to operate their home in an energy- and resource-efficient manner. What has been developed is a standard that is flexible enough to adjust to the various resource and energy concerns in the varying climate zones around the country, while at the same time encouraging continued innovation in green technology that is already dramatically shifting the market. Green building should continue to exist in its most flexible form.

National Green Building Program

In order to address climate change issues, NAHB is proactively contributing to efforts to reduce greenhouse gas emissions by establishing a national green building program. With this charge, NAHB members stepped up their national campaign to inform the public about the innumerable benefits of green building and sustainability in housing design by launching the National Green Building Program in February 2008 at the International Builders Show. In this program, there is a substantial effort to market the green building standard as an effective alternative, and to monitor state and local legislative and regulatory activity to ensure builders retain the right to choose from the myriad of green building options and are not restricted to the sole use of one branded product or rating system. Viable green alternatives exist in the market today in both residential and commercial construction.

The NAHB National Green Building Program will help home builders push the green building envelope and encourage innovation in green construction. Included in this effort are numerous promotional and educational tools for small businesses affiliated with green building. At a time when the challenge of climate change is moving people to live, work, and function in a more environmentally responsible way, we need to have options to force green building technology to its limit. NAHB's National Green Building Program will provide those options for all builders and, most importantly, will seek to inform current homeowners about how they can improve existing homes with green remodeling, making home occupation and maintenance just as efficient as new home construction.

Conclusion

I appreciate the opportunity to testify on behalf of the 235,000 members of NAHB regarding the serious issues related to small businesses impacted by the credit crunch and economic downturn. I also thank the Committee for the opportunity to discuss the emerging trends in energy efficiency and green building for residential construction. This is an exciting area for our industry. NAHB looks forward to working with the Committee, and the Congress, to develop effective policy responses to help small businesses weather the current housing crisis and enable the continued growth of green building in residential construction.

Smaller businesses in the housing industry are at the cutting edge of pushing efficiency and sustainability technology in home construction. As a small business working with the housing industry to bring more efficiency and sustainability online, I urge you to seize this golden opportunity to restore confidence to the housing market, promote home buying and further growth in residential energy efficiency, and to extend and implement important tax incentives supporting technology advancement in green residential construction. On behalf of NAHB, I look forward to being a partner with the government in that effort, both now and in the future.