Testimony of

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On behalf of the

Independent Community Bankers of America

Before the

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House of Representatives
Committee on Small Business

Hearing on

"The Housing Crisis: Identifying Tax Incentives to Stimulate the Economy"

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Good morning. My name is John Puffer and I am Chairman and President of Pilot Bank in Tampa, Florida. Chairwoman Velazquez, Ranking Member Chabot, and members of the committee, I am pleased to be testifying today on behalf of the Independent Community Bankers of America[1] on tax incentives for the housing sector to stimulate the economy.

ICBA represents 5,000 community banks throughout the country, with 180 community bank members in Florida. Community banks are independently owned and operated and are characterized by personal attention to customer service and lending to small business.

Pilot Bank was formed in 1987 and is a locally owned community-oriented bank in Tampa, Florida. Since 1987 we have grown to more than $240 million in assets and we currently serve more than 13,000 account holders. We pride ourselves on small business relationship banking and are proud to support our local communities and the nation's economic growth by supplying capital to individuals and small businesses.

Summary of Testimony

Housing market woes still plague the U.S. economy. The sharp decline in the housing and housing finance sector remains at the heart of our nation's weak economy and troubled credit markets. The weak housing sector continues to have a ripple effect throughout the entire nation and is putting severe stress on households and small businesses nationwide. Restoring confidence in the housing market is vital to restoring economic growth.

The current turmoil in our housing and financial markets is also jeopardizing the availability of credit for small business. Some of the nation's largest lenders and money-center banks tripped up on aggressive subprime lending and toxic investments and are now forced to pull in their lending across-the-board, write down losses, and rebuild capital.

Community banks represent the other side of the financial story. Community banks rely on relationships in their communities, not on relationships with investment banks or hedge funds. Common sense community bankers largely avoided the subprime debacle. Community bankers live and work in the communities they serve and do not put their customers and neighbors in loan products they could not possibly repay. Community banks did not cause the current turmoil in the housing sector but are well-positioned, well-capitalized and willing to help.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

Despite the aggressive monetary easing by the Federal Reserve Board and the enactment of a fiscal "stimulus" package, the housing sector continues to decline. This warrants additional targeted policy action to address the collapse in the housing sector and the economic damage it is causing. ICBA recommends and supports additional incentives, such as a temporary first-time homebuyer tax credit, and property tax relief to help struggling homeowners, jumpstart home sales, and strengthen the housing sector, credit markets, and small businesses.

Housing Market in Turmoil

Homeownership is the building block of our neighborhoods, communities and nation. Homeownership makes people stakeholders in their communities. Unfortunately, recent economic data continues to paint a troubling picture for the housing and housing finance sector and homeownership is in a protracted decline. Home values continue to fall sharply. The S&P/Case-Shiller home price index in March dropped 14.4 percent from a year earlier, the most since the figures were first published in 1988. The Commerce Department reported that April sales of new homes were down 42 percent from year-ago levels, the largest year-over-year drop in nearly 27 years. There was a 10.6 month supply of unsold homes on the market at the end of April, representing 456,000 unsold homes.

Nationwide, RealtyTrack reported that default notices, auction sale notices, and bank repossessions were reported on 649,917 properties during the first quarter of 2008, a 23 percent increase from the previous quarter and a 112 percent increase from the first quarter of 2007. The report also showed that one in every 194 households received a foreclosure filing in the first quarter of 2008. In my home state of Florida, the state recorded 87,893 properties in some state of foreclosure, or one for every 97 households in the fist quarter of this year, and 178 percent higher than the same period a year ago.

While it is true that some regions of the country witnessed unsustainable price appreciation and speculative buying, the weakness in housing is nationwide. The Office of Federal Housing Enterprise Oversight (OFHEO) home price index showed home prices dropping in 43 states and *all* census divisions in the first quarter of 2008. Notably, California, Florida, Nevada, and Arizona had the largest declines. These areas typically had a large share of subprime, jumbo, and investor loans.

Broad Economy Plagued By Housing Decline

The housing market remains in decline, foreclosures are rising, and a growing number of homeowners are falling into negative equity positions in their homes. The delinquency rate on mortgages hit a record high 3.68 percent in the first quarter of this year according to the Mortgage Bankers Association. The largest underlying problem plaguing the economy remains the declining housing sector. Plunging home values are putting record numbers of borrowers' underwater and fueling record foreclosures.

The housing markets' continued woes have been a big factor drowning consumer confidence. The Conference Board's gauge of consumer sentiment has dropped by almost half since July, when housing troubles triggered the most severe credit crisis in at least a decade. The Conference Board consumer confidence index fell in May to its lowest level since October 1992, hitting a 15-year low. Buying plans for homes fell sharply to their lowest level since October 1982 according to the Conference Board. Household net worth has declined for the past two quarters in a row largely due to the sharp drop in home values according to Federal Reserve data.

The recent release of the minutes from the April 29-30 Federal Reserve Board's Federal Open Market Committee meeting confirms the concern and risk emanating from the ongoing decline in the housing sector:

> *"The housing market had continued to weaken since the previous meeting, and participants saw little indication of a bottoming out in either housing activity or prices. Housing starts and the demand for new homes had declined further, house prices in many parts of the country were falling faster than they had towards the end of 2007, and inventories of unsold homes remained quite elevated. A small number of participants reported tentative signs that housing activity in a few areas of the country might be beginning to pick up, and a narrowing of credit risk spreads on AAA indexes of sub-prime mortgages in recent weeks was also noted. Nonetheless, the outlook for the housing market remained bleak, with housing demand likely to be affected by restrictive conditions in mortgage markets, fears that house prices would fall further, and weakening labor markets. The possibility that house prices could decline by more than anticipated, and that the effects of such a decline could be amplified through their impact on financial institutions and financial markets, remained a key source of downside risk to participants' projections for economic growth."*

Housing Crisis Impairs Labor Markets and Growth

The ongoing stress in the housing sector is damaging the labor markets and the entire economy. Housing and household related spending accounts for nearly 20 percent of the nation's Gross Domestic Product. U.S. GDP growth registered an anemic 0.6 percent in the fourth quarter of 2007 and 0.9 percent in the first quarter of 2008. This marks the first time the U.S. has experienced two consecutive quarters of sub-1% growth in GDP since the recession of 1990-1991.

The decline in housing construction has subtracted 1.25 percentage points off GDP growth in the fourth quarter of 2007 and 1.17 percentage points off 2008 first quarter growth. Associated construction-related job losses exceed 400,000 according to the Department of Labor. Housing activity had peaked nearly three years ago and since, home sales have fallen nearly 40 percent, housing starts more than 60 percent, and home prices some 15 percent. Yet no clear sign of the housing decline bottom is visible. Rising mortgage defaults have caused lenders to tighter up on credit and potential buyers have been sitting on the sidelines even as interest rates are at historically attractive levels. With the unsold inventory of homes at record highs, additional policy incentives for home sales would go a long way in addressing the root cause of the ongoing weakness in the U. S. economy.

Further Economic Stimulus Still Needed

Responding to a slowing economy, ICBA was out front in early January with a "9-point Economic Stimulus" package (attached) focused on communities and small business needs. Because the troubles in the subprime mortgage market quickly spread to the entire housing sector and broad credit markets, ICBA included a targeted homebuyer tax credit as the first item in its proposed economic stimulus plan. Despite aggressive Federal Reserve Board monetary policy easing and a fiscal stimulus package, ICBA believes severe and ongoing problems in the housing sector warrant additional policy action.

Housing-Triggered Recession in Many States

While economists debate the chances of the nation slipping into recession, severe housing market declines have already caused a recession in many states. Notably, states like California, Nevada, Florida, Michigan and Ohio have all witnessed dramatic declines in their housing markets and associated economic decline. The freefall in housing is causing a vicious downward cycle and economic weakness. As home sales and prices decline, foreclosures mount, unsold housing inventory rises and prices decline further.

Additionally, the broad credit markets have been severely damaged by the sharp decline in housing prices and the decline in the collateral real-estate represents. Some 45% of small business loans outstanding are collateralized by some type of real estate asset. Small business owners in particular often rely on the equity in their homes for collateral and widely use home equity loans and lines of credit. Small business access to capital is vital to the strength of our economy and employment. Small businesses represent a whopping 99% of all employer firms and employ half of the private sector workers. There are more than 26 million small businesses in the U.S. Small businesses have created 70 percent of the net new jobs over the past decade. Without further fiscal policy assistance to address the struggling housing sector, further declines in the credit availability for small businesses will jeopardize their ongoing viability.

Foreclosure Fiasco

The U.S. housing market is currently stuck in a downward spiral. When home values continue to drop sharply and people owe more on their mortgages than their homes are worth, foreclosures become a growing economic problem. Higher unemployment levels and sharp increases in food and energy prices are putting additional stress on mortgage holders and potential home buyers. Current economic conditions and elevated adjustable-rate mortgage resets suggest homeowners will continue to face a growing number of foreclosures.

Financial institutions in general have already experienced some $379 billion in asset writedowns and credit losses since the start of 2007. When the largest lenders lack capital, they are unable to lend to small business and consumers, exacerbating the economic downturn. Additionally, declining home values and rising foreclosures increase stress in the credit markets by jeopardizing the value of mortgage-backed securities and crimping liquidity.

The vicious downward cycle in the housing sector must be broken. Fortunately, Congress is advancing additional proposals to help address the troubled housing sector and its negative impact on the economy. The ICBA respectfully recommends a number of economic stimulus items (attached) to help the credit markets, small businesses, and job growth.

Homebuyer Tax Incentives Can Help

The ICBA's economic stimulus plan recommends a $5,000 first-time homebuyer federal tax credit for one year in order to jumpstart home sales, reduce unsold inventories, and stabilize home prices and foreclosures. A first-time homebuyer tax credit would provide a reasonable incentive for potential qualified buyers to get off the sidelines and to take advantage of low interest rates and the temporary tax break to purchase a home. Stabilizing home prices will lower mortgage refinancing qualification hurdles as well and help to keep more people in their homes. ICBA is pleased to see a homebuyer tax credit advancing in both the House and Senate as part of a housing and economic stimulus package effort.

The ICBA-recommended first-time homebuyer tax credit would allow a federal income tax credit up to $5,000 for the purchase of a primary residence. To qualify for the credit, the purchaser may not have owned a primary residence in the previous 12 months prior to the purchase of the home. The credit would be temporary and available for one year from the date of enactment. The credit is not a "bailout" and would directly benefit individuals by giving them a tax cut incentive to purchase a first-time home.

Homebuyer Credit Should be Simple

A $5,000 first-time homebuyer tax credit already exists in the tax code for the District of Columbia and is a proven success. A study of the D.C. first-time homebuyer tax credit found that it substantially increased the demand for owner-occupied housing, raised home values and stabilized home prices.[2] Similarly, Congress successfully enacted a temporary tax credit for the purchase of a new home in 1975 to reduce the then-record housing inventory and to restore stability to the housing market.

The implementation of a temporary, one-year nationwide tax credit could and should be simple if modeled on the existing D.C. credit. The forms, procedures and instructions already exist for D.C. and would simply have to be updated to apply nationally.

Local Infrastructure Needs

Tax incentives can help stimulate the troubled housing sector and local infrastructure needs should also be addressed in the tax code to help boost economic activity. To more efficiently finance local projects, ICBA recommends an immediate increase in the annual issuance limitation for qualified-tax-exempt muni-bond obligations from $10 million to $30 million. This would create greater credit availability and expedite low-cost funding for local projects such as school construction, water treatment plants, and other municipal projects. The cost of municipal projects have increased dramatically over the years while this annual bond limitation threshold has not been increased in 22 years and has not kept pace with inflation. An increase would help assist financially struggling state and local governments finance their infrastructure needs with lower cost financing, creating more small business opportunities and local jobs.

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[2] Tong, Zhong Yi. 2005. "Washington, D.C.'s First-Time Home-Buyer Tax Credit, An Assessment of the Program." Special Report, Fannie Mae Foundation, March.

ICBA Commends Congressional Housing Proposals

ICBA continues to advise lawmakers that common sense community bank lenders did not cause the current housing crisis and that they are well positioned and ready to help bolster the troubled housing sector. ICBA is encouraged by the major congressional housing packages designed to address the troubled housing markets that have cleared the full House and the Senate Banking Committee. Notably, ICBA commends the American Housing Rescue and Foreclosure Prevention Act of 2008 (H.R. 3221) that passed the full House on May 8 and the Federal Housing Finance Regulatory Reform Act of 2008 that cleared the Senate Banking Committee on May 20. The centerpiece of both proposals would address the foreclosure problem by establishing a Federal Housing Administration program to insure up to $300 billion in refinanced mortgages for struggling borrowers after loan holders reduce principal.

ICBA believes growing foreclosures can impact not only the borrowers and lenders, but entire communities and towns by depressing property values and eroding the local tax base. The legislation provides a *voluntary* means for qualified borrowers to remain in their homes and will help ameliorate the broader negative consequences of the wave of foreclosures. Community bankers believe that these are important features and hope that they can use this program to assist borrowers with loans from other lenders who need to refinance into more affordable loans.

ICBA also supports the House and Senate Banking proposals for increasing the GSE conforming loan limit for high-cost housing areas. This would greatly assist homebuyers in communities along the coasts and in larger cities where the median home price is relatively high and would help community banks manage the risk of originating these larger loans. The House bill sets the conforming loan limit for high-cost areas at 125% of area median home price, capped at 175% of $417,000. The Senate bill limits it to the area median home price capped at 132% of $417,000.

ICBA supports additional tax provisions in H.R. 3221 including:

- Allowing the Federal Home Loan Banks to guarantee community bank letters of credit issued to enhance the credit rating of local government bonds. This would help ensure that municipal bonds guaranteed in this manner are tax-exempt just like bonds guaranteed by private bond insurers. (Included in House passed H.R. 3221.)

- Granting an additional standard deduction for real property taxes for homeowners that claim the standard deduction. This would allow up to a $350 deduction ($700 joint return) for State real property taxes paid in 2008. (Senate version’s property tax deduction is $500 individual / $1,000 joint return.)

- Allowing a temporary increase in State mortgage revenue bond authority to allow for the issuance of an additional $10 billion of tax-exempt bonds to refinance subprime loans, provide loans to first-time homebuyers, and to finance low-income rental housing.

Notably, the House-passed housing bill (H.R. 3221) also incorporates the ICBA-backed tax provision for a homebuyer tax credit. This credit would work as an interest free loan giving new homebuyers a $7,500 tax credit (repayable over 15 years) to help jumpstart home sales and stabilize declining prices. ICBA also supports the Senate-passed version that includes a similar tax credit, but limits it to the purchase of foreclosed properties. The Senate credit would allow a $7,000 tax credit for the purchase of a home in foreclosure to be claimed over two years.

All these targeted housing incentive proposals would help to stem the ongoing decline in the housing sector that is rippling through the entire economy and hurting individuals and small businesses. Small business optimism is plummeting and credit availability is a genuine concern. In March, the National Federation of Independent Business index of small-business optimism dropped to its lowest level since it began this survey in 1986. Housing incentives can be an important key to unlocking greater confidence and economic growth. The ICBA strongly supports additional targeted housing tax incentives to break out of the downward spiral in the housing market.

Conclusion

ICBA believes the ongoing sharp decline in real estate values must be addressed before genuine stability can be achieved in the broad credit markets and economy. America's small businesses are facing difficult economic times and acquiring credit is getting more problematic due to the turmoil in the housing sector. The road to economic recovery must go through housing. As policymakers work on ways to stimulate the housing market, small business would benefit from many of the housing tax incentives advancing in Congress. Community banks like Pilot Bank are well-positioned and prepared to help. I appreciate the opportunity to testify today on behalf of the Independent Community Bankers of America. Thank you.

Summary of ICBA-Proposed Economic Stimulus Package Measures

- <u>First-Time Homebuyer Tax Credit</u>. One-year, $5,000 federal tax credit for first-time home purchase. Proven incentive that will help sales of 10-month supply of unsold homes and will boost the housing and housing-finance sectors. (Note: Both House and Senate tax committees have passed version of homebuyer tax credit which is advancing as part of "housing" package.)

- <u>Extend Work Opportunity Tax Credit</u>. Enhances and extends the employers' WOTC through 2009 to create jobs by encouraging greater hiring of new workers.

- <u>Super SBA Small Business Loan Program</u>. A "low-doc," expedited SBA 7(a) loan program with 85% government guarantee for small business loans up to $250,000 and reduced lender and borrower fees. Will provide greater small business capital in expedited manner to start, or grow a small business and create jobs. (Advanced by Reps. Bean, Velázquez, others in H.R. 1332 passed by House.)

- Immediate AMT Relief. Immediate individual AMT relief for tax years 2008, 2009. Will provide tax certainty and prevent additional taxpayers from being swept into punitive Alternative Minimum Tax calculations and payments and increase their after-tax incomes. Notably, AMT relief can be rebated in advance directly to taxpayers. (Note: Senate Finance Committee Chairman Max Baucus (D-MT) and Ranking Member Chuck Grassley (R-IA) advanced AMT fix legislation 4/2008.)

- Immediate Increase in Muni-Bond Threshold. Updates from $10 million to $30 million the annual issuance limitation for qualified-tax-exempt-obligations. Will create greater incentives and expedite low-cost funding for local projects such as school construction and other municipal projects. Will assist financially struggling state and local governments.

- Small Business Subchapter S Tax Relief. There are more than 3.5 million Subchapter S businesses in U.S. Will increase the ability to start S corporations or raise needed capital by increasing the shareholder limit to 150 from 100.

- Enhanced Small Business Section 179 Immediate Expensing. Increases allowable Sec. 179 small business immediate expensing base to $250,000 and investment limitation to $800,000 for tax year 2008. Will boost small businesses capital investment in equipment and software and free-up needed cash flow. (Note: Enacted into law as part of first "stimulus" package 2/13/08.)

- Increase SEC Registration Threshold. Immediately increase the SEC registration threshold from 500 to 1,000 shareholders. Will help lift the tremendous dead-weight regulatory cost and burden of SEC registration for the nation's smallest companies. Will prevent costly public-to-private conversions.

- Short Form Call Report. Permit highly-rated, well-capitalized banks with assets of $1 billion or less to file a short form Call Report in two non-sequential quarters for each year. Will free up community lenders' time and resources to focus on community needs.