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MOVING HOUSES:

HOW SPARKING A HOUSING
RECOVERY IS THE KEY TO
AMERICA'S ECONOMIC RECOVERY

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INTRODUCTION

The run up to the current recession made at least one thing very clear: when the nation's housing sector goes bust, watch out.

In the nation's history, a downturn in the housing industry has often sent the rest of the economy into a tailspin, and that may be one reason so many economists feared broader implications when the housing bubble first began to burst.

But, less frequently noted, and just as important, when the housing market turns around, other sectors frequently recover soon thereafter. In fact, the turning point in five of the last seven recessions has been marked by the moment housing sales began to swing up again.

To date, the bulk of Washington's effort to shore up the housing market has targeted the financial sector and later the glut of foreclosures—and that's not without reason. The crash of the housing bubble helped kick off the financial crisis and drove a spike in loans to homebuyers with little hope of paying them back. And the effects of foreclosure often extend beyond a bankrupt homeowner and a written down bank asset. Abandoned properties diminish the value of surrounding homes, leaving neighborhoods all the poorer.

But the glut of foreclosures does not mark the only casualty of the housing crisis. When the bubble burst, purchases ground to a halt. And without any fluidity in the housing market, prices began to drop, leaving more and more families stranded in their own homes.

For that reason, the report below recommends that policymakers expand the scope of their concern beyond homeowners in the greatest distress, and address a wider-ranging challenge: how to get the rest of America buying homes again.

Already, the Homebuyer Tax Credit included in the \$787 billion stimulus bill has helped spur a wave of new purchasing—but largely only among those who are eligible, namely, first-time homebuyers. With housing starts and sales still depressed in most parts of the country, expanding the universe of buyers eligible to receive the temporary \$8,000 credit and, additionally, enabling homebuyers to get access to the money at the time of purchase, could spark a broader, more immediate recovery in the housing market. Together with the administration's other efforts to spur recovery, a burst of activity in the housing market could provide the nation with the immediate economic jumpstart it desperately needs.

THE HOUSING SECTOR LEADS RECESSIONS...AND SPARKS RECOVERIES

Housing is a linchpin for the broader economy. The industry, which includes spending on household equipment and furniture that are typical for new homes, makes up approximately 10 percent of the nation's GDP. Moreover, the housing sector was responsible for over 75 percent of all job growth from 2004 through 2007.¹

In the past year alone, existing and new home sales have fallen by 13.1 percent and 37.6 percent, respectively. Largely as a result, jobs in the residential construction sector have fallen by 284,000 from peak conditions in 2005, and the U.S. economy expanded at a sub-par rate of only 1.1 percent in 2008.²

But while conventional wisdom often acknowledges that the current recession began when the "housing bubble" burst, too often we fail to appreciate the degree to which the housing sector led the decline in the consumer market more generally.

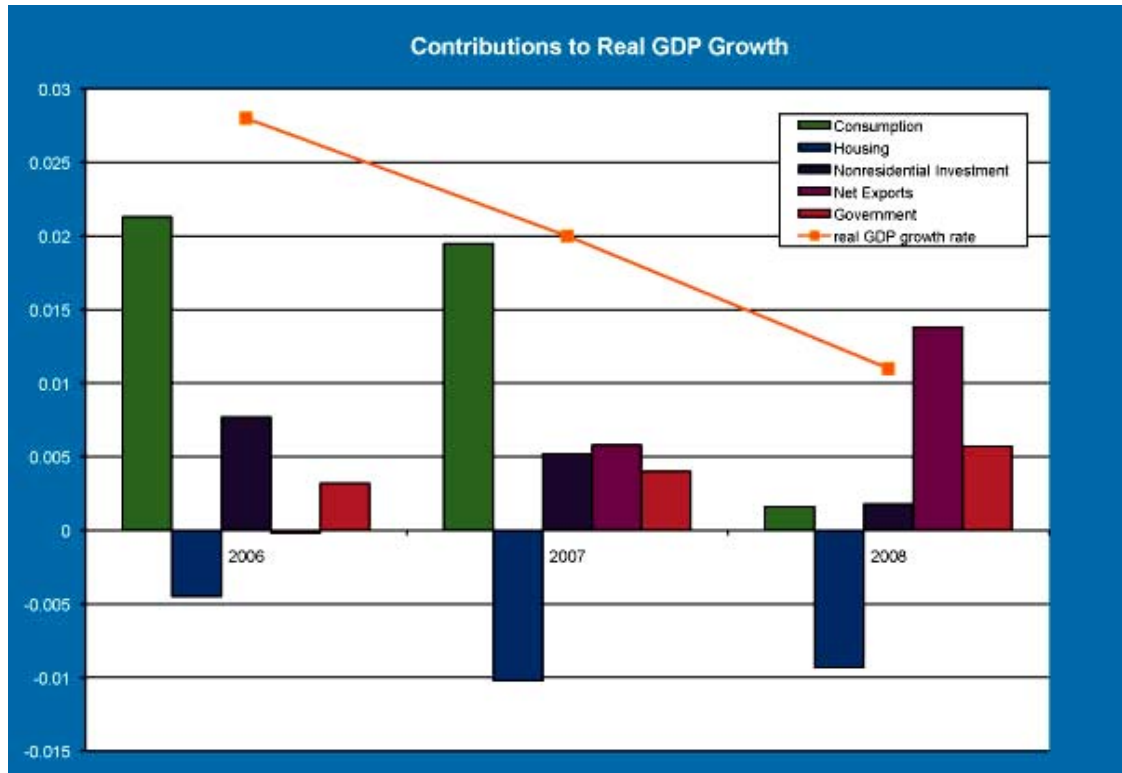
THE CURRENT RECESSION REFLECTS THE OLD PATTERN

The housing market's impact on the fortunes of the U.S. economy cannot be understated. A weak housing sector has led almost every American recession since 1965. The annual growth rate of residential investment (a good measure of homebuilding activity) has dropped by at least 10 percent in five of the seven recessions to hit the United States in the last 40 years.³

As most public data shows, the subprime crisis, followed by a general collapse in housing prices, sales, and construction, all pre-dated the current economic and financial downturn. As Table 1 highlights, the negative impact of the housing sector on real GDP (which began in 2006), led later to declines in two of the other major contributors to U.S. GDP growth: consumption and non-residential investment. Only net exports (spurred on in part by a declining dollar) and government (because of TARP and increases countercyclical spending such as unemployment insurance) bucked the overall trend.

Most who take a cursory glance at Table 1 will note the dramatic decline in consumption's contribution to the nation's GDP. But a second look reveals that the decline in the housing industry largely *predated* the drop in consumption—in fact, consumption seems almost to be weighed down by the housing industry's continued slump.

TABLE 1: HOUSING DECLINE PREDATES DECLINES IN OTHER ECONOMIC SECTORS



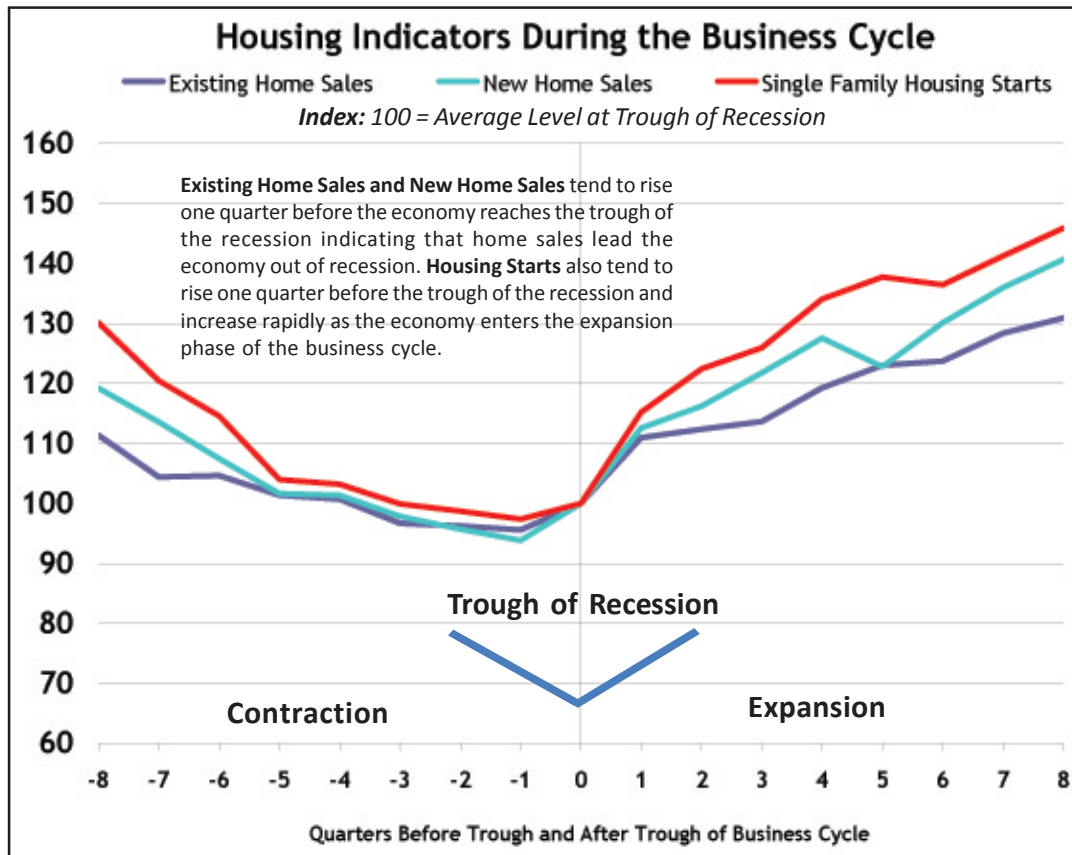
Source: Vlasenko, Polina, "What Contributed to the Fall of GDP in 2008?" *American Institute for Economic Research*, <http://www.aier.org/research/commentaries/1310-what-contributed-to-the-fall-of-gdp-in-2008>, March 18, 2009.

WHAT GOES DOWN OFTEN COMES BACK UP

While housing downturns often lead economy-wide recessions, they frequently also drive the recovery.

As Table 2 indicates, existing home sales and new home sales tend to rise at least three months before the economy reaches the trough of the recession, indicating that home sales typically *lead* the economy out of recession. In addition, housing starts tend to turn around three months before the trough of the recession and increase rapidly as the economy enters the expansion phase of the business cycle.

TABLE 2: HOUSING INDUSTRY TURNAROUND LEADS GENERAL RECOVERY



Note: Includes business cycles with troughs in 1970Q4, 1975Q1, 1982Q4, 1991Q1, and 2001Q4. Excludes 1980 recession.

Source: National Association of Realtors

DESPITE SIGNS OF NEW LIFE, HOUSING SECTOR REMAINS IN DIRE STRAITS

Most economists agree that a recovery in the housing sector is essential for a broader economic upturn, in part because the housing sector’s collapse brought on the recession. Mortgage delinquencies triggered the financial crisis. Tumbling home prices (down 26 percent from their peak) ravaged consumer confidence and ground the normal course of borrowing and spending to a halt. Since late 2007, housing-related jobs—carpenters, real estate agents, appraisers—have dropped by 1 million, one-quarter of all lost jobs.⁴

In the last two months, the housing industry finally received some good news. A report from the Commerce Department revealed that new-home sales had surged 4.7 percent in February 2009 to a seasonally adjusted annual rate of 337,000 from an upwardly revised January 2009 figure of 322,000. The South and West—two regions hardest hit by the housing crisis—posted the biggest gains, rising nearly 10 percent and 7 percent, respectively, with a sales boost from heavily discounted foreclosures.⁵

Unfortunately, the rest of the news on the housing front is still mixed at best, and while some economists believe the housing markets have hit bottom, no one is declaring that housing is on its way to a recovery.

Nationally, sales of existing homes fell 10.3 percent in February 2009 from the previous year, without adjusting for seasonal factors. And the U.S. median sales price slid almost 16 percent to \$165,400.⁶

Outside of the West, sales, as of February 2009, are still 13 percent off what they were in February 2008, and home sales in the Northeast tumbled nearly 20 percent during the same period—making it the region that experienced the steepest decline.⁷ In Pittsburgh, sales dropped nearly 44 percent in February from the year before. The median price there, however, only dipped 1.4 percent to \$109,450, the best showing in the Northeast.

Home sales in the suburban counties surrounding New York City—Suffolk, Nassau, and Westchester counties—were down by 33 percent in February 2009 and the median price had declined more than 13 percent to \$370,000. The supply of unsold homes also increased by nearly 5 percent, the only area in the Northeast to show a rise.⁸

Just as problematic, supply is outstripping demand. The glut of housing stock (single family homes, townhomes, condominiums, co-ops) on the market today could satisfy roughly 10 months of buyers without being depleted—an indication, when compared to the 6.5 month figure from the same period in 2006, that the market is slow.

As a result, the home construction industry remains weak. Housing starts fell 16.8 percent in January 2009 from one month earlier, to a seasonally adjusted annual rate of 466,000 units. That is the lowest in at least 50 years, according to the Commerce Department. It was a dismal number in an already dismal housing market, and the drastic cutback by home builders will weigh down the economy further and likely result in the loss of more jobs in the construction sector and the panoply of industries (such as the appliance, plumbing, and furniture trades) whose survival is largely predicated on home construction and remodeling.

And while February 2009 saw the first increase in construction of U.S. homes after eight months of decline, starts were still down more than 47 percent from February 2008, when over 1.1 million new homes broke ground.⁹

POLICY RECOMMENDATIONS

The correlation between the housing sector and the nation's broader economic health suggests that policymakers should focus on sparking sales and housing starts in the coming months.

Housing affordability is at its highest point since 1970, and with mortgage rates below 5 percent, it should remain there for the near term. But despite deals to be had throughout the market, many prospective homebuyers appear reticent to jump in. That is a shame, considering that a re-enlivened housing market would likely spark recovery throughout the rest of the economy.

For that reason, Washington should consider, now, how it might temporarily provide an extra impetus for individuals to get into the market.

THE HOMEBUYER TAX CREDIT IS WORKING

As part of the \$787 billion stimulus plan, Congress established a temporary, one-year first-time homebuyer's tax credit of \$8,000. The Homebuyer Tax Credit can be put toward the down payment on the first house, condominium, or co-op an individual or family chooses to purchase. First proposed by Paul Weinstein Jr. as a way to help stave off the housing crisis in 2006, initial evidence suggests the credit is working to spark resurgence in the housing market.¹⁰

The current program defines a first-time home buyer as someone who has not owned a principal residence during the three-year period prior to the purchase. The tax credit does not have to be repaid, and is equal to 10 percent of the home's purchase price up to a maximum of \$8,000. The credit is available for homes purchased on or after January 1, 2009 and before December 1, 2009, and is phased out based on income. Single taxpayers with incomes up to \$75,000 and married couples with incomes up to \$150,000 qualify for the full tax credit.

According to data from the National Association of Realtors, first-time buyers accounted for one-half of all home sales in February 2009, with activity concentrated in lower price ranges. Moreover, buyer traffic picked up shortly after the enactment of the Homebuyer Tax Credit.¹¹

Note that if low prices were the only reason that purchases were up, the share of homebuyers might well be evenly spread across the market among those who had previously owned homes. But even if you take into account the fact that homeowners might be reticent to put their house on the market and move, the fact that so many sales went to first-time homebuyers suggests that the credit is working.

EXPANDING THE HOMEBUYER TAX CREDIT

Because the Homebuyer Tax Credit has been so successful in attracting first-time buyers, we recommend that it be expanded to individual and family homeowners looking to move or buy a new home, regardless of whether they currently own real estate.

Under such a plan, the income caps for the existing \$8,000 credit should be lifted for the rest of the year. This would cost the Treasury an estimated \$11.4 billion. In addition, if Congress fails to enact the President's "Making Work Pay" tax credit for middle class families, policymakers should use the money to make the homebuyers credit more generous by ensuring that it is completely refundable and increasing the value of the credit to \$10,000.

Moreover, in order to ensure that the expansion serves as a jumpstart, and not as a permanent new subsidy, the credit should expire at the end of the year, forcing those intent on taking advantage of the credit to get into the market with some alacrity.

GETTING THE HOMEBUYER TAX CREDIT UP FRONT

Typically, tax credits are applied to someone's tax return after the end of the year. That means that those who buy a home before the expiration of the credit on December 1, 2009 will have to wait until they file their tax return *next* year to find the Homebuyer Tax Credit in their bank account. The delay may discourage some potential homebuyers who would be unable to close a deal without the credit in hand.

One way to solve the problem would be to allow taxpayers to transfer the credits to lenders. Congress, however, did not include such a provision in the stimulus package. To address the problem now, the administration should direct the Secretary of HUD and/or the Secretary of the Treasury to use existing authority (possibly through the Home Program or the Troubled Asset Relief Program) to set up a fund that would advance some of the down payment and closing costs, up to the limit of the \$8,000 credit. After borrowers file their taxes, the Treasury would reimburse HUD (or itself) for the money it fronted initially. No interest would be charged for the service, although HUD and/or Treasury could impose a modest processing fee.

KEEP THE PRESSURE ON MORTGAGE RATES

Seeking to prop up the ailing U.S. housing market, the Federal Reserve has committed to buy up to \$1.2 trillion in mortgage-backed securities and \$300 billion in long-term government debt. That move has pushed down mortgage rates to record lows. As a result, mortgage rates have dropped to their lowest levels in 30 years, and Mortgage Bankers Association index of applications has increased by 67 percent on a year-over-year basis.

Unfortunately, the vast majority of applications continue to be refinances of existing homes rather than new purchases. That is why the Federal Reserve should continue to put downward pressure on mortgage rates and consider additional purchases in order to spur new sales.

CRITICISM

In normal economic times, there would be little justification for expanding the credit. The changes proposed above would make the tax code less progressive by skewing benefits toward wealthy buyers. It might also tempt house-flippers, who could use the credit simply to pad their business profit. Finally, expanding the credit might reward people who would have purchased a home anyway, or who would have held out for a better price.

As Robert Samuelson noted in a recent column, “Normally, [an expanded credit] would be an atrocious idea.”¹²

But we cannot let the perfect be the enemy of the good—certainly not in midst of such a serious recession. A complex set of regulations might marginally improve the program—and squeeze a bit more efficiency out. But the months lost haggling over the details, and the complications likely to confuse potential homebuyers overwhelm the efficacy of hammering out a more complex deal.

The National Association of Home Builders (NAHB) estimates that a \$15,000 tax break would cost \$40 billion for one year. However, a universal credit of only \$8,000 or \$10,000 would cost significantly less if timed to expire at the same time as the existing credit. In the larger scheme of stimulus spending, an expanded credit could have an enormous effect on the economy’s general recovery.

CONCLUSION

Already, the Obama administration has laid the foundation for a long-term recovery. The Homebuyer Tax Credit included in the original stimulus bill represented an important step in ensuring that demand meets supply in housing sector.

But the evidence above suggests that the housing market not only plays a leading role in sinking an economy—it can also pull the rest of the nation out of the doldrums.

In the midst of the housing bubble, credit was so easy to come by that many homebuyers took out loans they could never have reasonably hoped to pay back. In large part, those mistakes have driven the current recession, left many in bankruptcy, and driven up the foreclosure rate nationwide.

But a corollary effect was to drive down the normal housing market, where sellers find buyers who are appropriate candidates to take out a reasonable mortgage. Today, getting that market working again could go a long way toward repairing the economy more generally. And it is an investment worth making.

Already, the Homebuyer Tax Credit is working to boost demand among first-time homeowners. The effects are undeniable around the country. As Washington works to be nimble in the face of a continuing recession, policymakers should double-down on policies that work.

Helping responsible homebuyers to enter the market has been a boon in some of the nation's hardest hit communities. We ought to expand that success, and hope that the housing industry's history as an economic leader extends once again to a broad-based economy on the way to recovery.

ENDNOTES

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⁶ Elphinstone, J.W., "Northeast posts 20 pct February home sales drop," The Associated Press, March 24, 2009.

⁷ *Ibid.*

⁸ *Ibid.*

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¹⁰ Weinstein Jr., Paul, "Gimme Shelter," Progressive Policy Institute, October, 2007, <http://www.ppionline.org>.

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¹² Samuelson, *op. cit.*

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