10 Questions on the Housing Crisis

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HARDWARE RETAILING: *WHAT CAN and should the Obama administration and Congress do to turn around the stalled housing market?*

Duffy: While I would expect to see a continuation of some solutions that the Federal Reserve, Congress and the White House have been attempting to address a stalled market and rising foreclosures, I think the Obama administration will begin to take a more active role instead of the all-volunteer ideas espoused so far.

First, both the Hope for Homeowners and FDIC programs will only help buyers behind on their mortgages, so it completely ignores homeowners who are struggling to keep up with payments on credit cards, drawing down savings or borrowing from relatives. That needs to change.

Secondly, I keep hearing rumors of the FHA working with the same subprime lenders that led to the outsized boom in the first place. Since we can ill afford to have FHA fall like another mortgage domino, the Obama administration needs to appoint a mortgage regulatory czar and provide adequate funding to root out fraud and corruption wherever it exists.

Thirdly, laws will need to be passed to allow mortgage servicers to modify loans so they're not sued by the multiple investors who own mortgage securities. Currently, servicers are prohibited to make any changes that could materially and adversely impact these bond holders.

Fourthly, it looks like the Obama administration will likely change bankruptcy laws to allow judges to modify mortgage loans at risk of foreclosure, also called a 'cram down.' This could include reducing principal, interest rates or extending the mortgage term. Whatever their solutions, I would not expect to see them continue to be voluntary, because those ideas haven't worked well so far.

HR: *Are you in favor of first-time home buyer tax credits or providing a government buy-down of mortgage interest rates for home purchases?*

Duffy: I'm in favor of incentives that work and achieve the goal of restarting a largely frozen market. The problem with the existing $7,500 tax credit is that it's more of a loan that has to be paid back as opposed to a genuine credit for taking the risk of buying a home, so it's done very little to spark the market. Home builders are now floating the idea of a larger tax credit that would never have to be paid back, thereby giving buyers an additional incentive to buy now as opposed to later, and the National Association of Realtors (NAR) supports keeping the credit at the current level but also removing the requirement that it be paid back.

Similarly, any rate buy-downs would probably need to have some clear termination date—such as mid-2009—to move potential buyers off the fence today. Some other incentives that might work include allowing buyers to immediately use that tax credit money for a down payment, re-instituting down payment assistance programs that are tied to buyers' credit ratings, and making permanent higher FHA loan limits in high-cost areas that could reset next year to lower levels.

HR: *Will we start to see the housing market turn around during 2009 or will recovery be delayed until 2010?*

Duffy: Since we're already seeing existing home sales in certain markets starting to rebound due to dramatically lower prices, I think you'll see a pricing floor sometime toward the end of 2009. However, once that occurs you'll probably see prices stay flat through 2010 and 2011 and start to rise again by 2012.

HR: *What are the projections for housing starts and existing home sales in 2009 and 2010?*

Duffy: That depends on who you ask. NAR is projecting a rebound for existing home sales of nearly 5% in 2009 to 5.19 million. Of course, this follows two years of declines of over 12% in home sales. By 2010, the NAR is saying that sales will rise by another 7% to 5.55 million as pent-up demand from the past few years begins to be met.

The NAR is also projecting housing starts to continue falling in 2009 by nearly 22% as builders keep the lid on new releases while mopping up inventory, which would total about 731,000 units. They're saying a rebound for starts won't occur until 2010, and even then it will be fairly weak, approaching a rise of 6% to 772,000 units.

Not surprisingly, the trade group representing U.S. home builders, the National Association of Home Builders, is a bit more bullish on the timing and trajectory of an improvement in home building activity. Their chief economist, David Seiders, is projecting annualized housing starts to hit bottom at 740,000 units in the first quarter of 2009 before rising to 835,000 units by the end of the year. But it's really 2010 that he's eyeing, projecting 1.1 million housing starts by the end of that year.

I'd say the reality lies somewhere in between the two groups: not as rosy as NAHB would hope, but it's possible that a rebound will be more pronounced than the NAR is projecting. Nonetheless, builders should not be looking for the types of rebounds they've experienced in the past—this recovery will take longer and be much more gradual than in the past.

HR: *What is the outlook for affordability in 2009?*

Duffy: The outlook for home affordability in 2009 will be better than it's been in four years. While no one likes to see the value of their homes decline, in the long run the marked improvements in affordability will provide the best engine for a market rebound. With short-term interest rates at new lows and the government suggesting they're examining ways to bring rates for 30-year mortgages down to just 4.5%, 2009 could prove to be a great time to buy for those who see housing as a long-term investment.

Looking forward to 2009, if median prices continue to fall 10% to 15% as many economists forecast and rates stay low, affordability will only continue to improve, especially for the first-time buyer.

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HR: *With the government taking control of Fannie Mae and Freddie Mac, what impact will that have on the housing industry and the ability of consumers to get a mortgage?*

Duffy: In theory, the government's nationalization of these two mortgage giants was necessary to prevent a total meltdown in the mortgage market. After all, once the private mortgage insurers started pulling out of the market, Fannie and Freddie were forced to back up to 80% of the mortgage market, which caused fees to consumers to rise.

With the government now attempting to re-energize the mortgage securitization market and investing $200 billion in the companies, buyers should look for lower rates, reduced fees, more wiggle room for buyers at risk of foreclosure and some type of stabilization in housing prices versus a complete free-fall. The downside is to the U.S. taxpayer, who will ultimately pay higher taxes and face cuts in federal services to fund these bailouts. Ultimately, the goal is to prompt private mortgage insurers to re-enter the marketplace, but that won't happen until the foreclosures have been adequately addressed.

HR: *Which areas of the country have been impacted the most by the housing crisis? Which areas have been least affected?*

Duffy: The areas most impacted by the housing boom—and bust—have been the Sun Belt states such as California, Nevada, Arizona and Florida where you saw more over-building and speculative activity. One state that was seemingly immune to the housing bust was Texas, although its sales have also been declining recently due to the tighter credit environment.

HR: *Do you have any insights into when home prices will hit bottom and begin increasing in value again?*

Duffy: The silver lining of rising foreclosures—which now account for 40% of the market nationally—is that they have forced prices down faster for existing homes than what's been experienced in previous downturns. Consequently, many experts believe that home prices in many markets will hit bottom by the end of 2009, whereas other areas won't hit that trough until 2010. Moreover, many areas will experience another 10% to 15% decline, while some regions that are still priced too high relative to incomes or achievable rents may see steeper declines over the next two years.

As for increasing in value again, this recession is likely to turn into something more 'u-shaped' than 'v-shaped,' and what that means for housing prices is a lengthy bouncing along the bottom until late 2012. However, in those areas in which foreclosed inventory is quickly mopped up by investors, with builders dramatically cutting down on new supply, prices may firm up and begin to rise—albeit slowly—prior to 2012.

HR: *As a general rule, when the housing market slumps the home remodeling market picks up, but that has not been the case during the current slowdown. Are there any hopeful signs that remodeling activity will pick up in the near term?*

Duffy: Another big difference with this housing slump versus past ones is that in order to keep their skeleton crews on staff, home builders are increasingly taking on remodeling work. What this means for existing remodelers is an even tougher environment at a time when the value of homeowner improvements fell by 4% in 2007. In 2008, according to Harvard's Joint Center for Housing Studies, this decline is expected to more than double to 9% and rise to 11% during the first quarter of 2009. And, since the remodeling industry grew by 40% in the last cycle, it's expected to lose about one-third to one-half of that gain in this slump.

Despite these declines, since they're less than the declines impacting the home building industry—which are off by 65% since the start of 2006—builders still see it as a comparatively safe business.

In fact, according to the NAHB, half of the builders are now taking on remodeling jobs, and once they start up these divisions it's unlikely that they'll shut them down when the market improves.

Looking ahead past the slump, given the increasing age of the country's existing housing stock and demographic shifts that support remodeling, the value of remodeling jobs is expected to approach $400 billion by 2015, or closing in on the estimated $455 billion in new construction. By 2020, it's quite possible that the remodeling industry could even eclipse the value of new homes built annually.

HR: *Builder confidence continues to decline as overall uncertainty about the economy negatively impacts consumer behavior. Will builders experience increased difficulty in securing access to necessary capital or will the credit markets begin to open up soon?*

Duffy: That largely depends on whether a builder is public or private. For private home builders, the relationship between them and their lenders has become so strained that more than 140 builders throughout the country have teamed up to form the Building Industry Coalition for Economic Recovery. One of their primary goals is to force lenders to allow them to finish up existing projects rather than force them into foreclosure, which they say can mean a huge difference on the value they can extract from the project (i.e., 40 to 60 cents on the dollar versus 20 to 30 cents).

More recently, builders have asked for congressional support for mortgage 'cram downs,' in which bankruptcy judges will be allowed to modify loan terms in order to prevent foreclosures. This marks a sharp reversal for home builders, who previously resisted this idea because it would alienate lenders. Yet given the strained relationships with their own construction lenders and President-elect Obama's support of such an idea, we might see 'cram down' legislation enacted in 2009. In addition, the Obama administration might start attaching strings to bailing out banks, thereby forcing them to open the lending spigots to businesses including home builders instead of hoarding it as cash reserves.