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Examining the First-Time Homebuyer Tax Credit

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Examining the First-Time Homebuyer Tax Credit – Overview

The Housing Problem

The housing sector is currently locked in a self-reinforcing cycle of rising foreclosures and falling prices. This cycle is the direct result of a surplus in the supply of homes for sale relative to consumer demand. A combination of programs aimed at reducing foreclosures and stimulating consumer demand is needed to stabilize this very important sector of the economy.

In recent weeks, the housing market has shown a modest increase in sales volume and prices appear to have stabilized, albeit at low levels. As this report will demonstrate, these improvements are primarily attributable to the effectiveness of the first-time homebuyer tax credit in reducing excess inventory. Notwithstanding the encouraging indicators within the housing market, we note that the sector remains at historically depressed levels and, most importantly, faces continuing challenges from rising unemployment, the threat of further price depreciation and elevated foreclosures that will persist for the next 12 to 18 months.

The Role of the First-Time Homebuyer Tax Credit

The Fix Housing First Coalition retained Rosen Consulting Group to evaluate the effectiveness of the first-time homebuyer tax credit in stimulating consumer demand and reducing the supply of homes available for sale. Dr. Kenneth T. Rosen is Chairman of Rosen Consulting Group. Dr. Rosen is the leading expert on housing economics and also Chair of the Fisher Center for Real Estate and Urban Economics at the Haas School of Business at the University of California, Berkeley. The research team reached the following conclusions:

1. The tax credit has been effective in reducing the supply of homes for sale. The inventory of for-sale homes priced less than \$300,000 has declined from 8.1 months to 6.0 months – a 25.9% decrease in supply.
2. The housing market will be challenged by more foreclosures, job losses and weak consumer confidence in the next 12 to 24 months. Extending the current tax credit is therefore essential to sustaining any recovery in the housing market.
3. The tax credit has not triggered speculative homebuilding. Indeed, housing starts are down by nearly 50% compared with a year ago.
4. Expanding the tax credit to all home buyers would accelerate price stabilization. Over the past year, the supply of higher-priced homes has continued to increase.
5. Stabilization of the housing market is a prerequisite to a general economic recovery. History has shown that growth in the housing sector is a leading economic indicator.

Conclusions

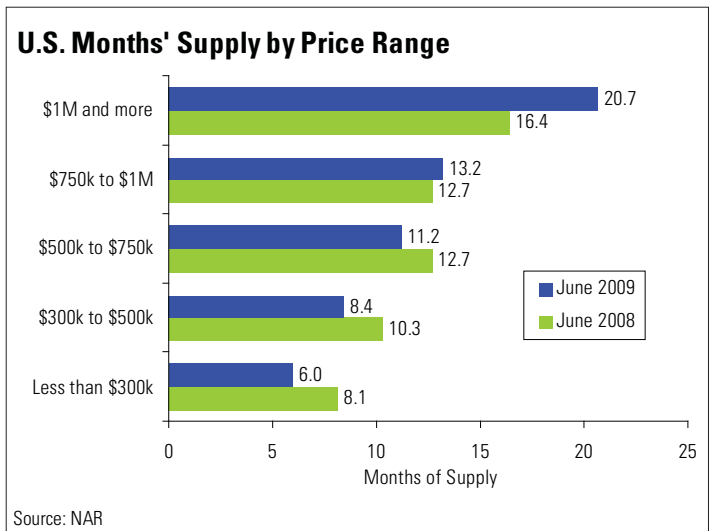
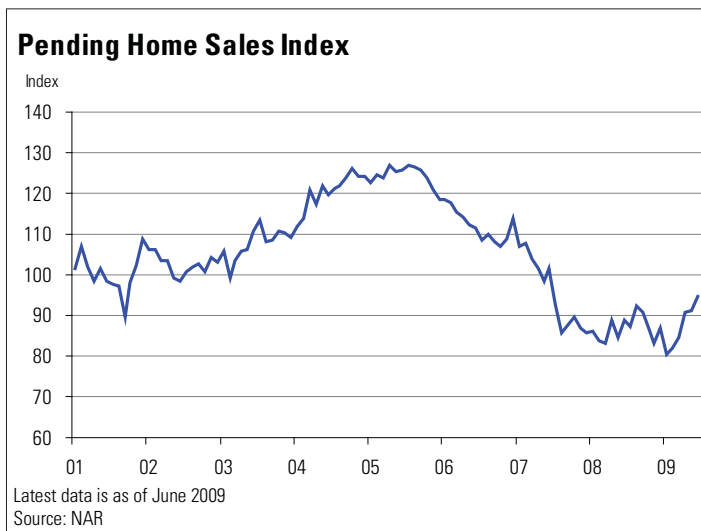
The U.S. housing market is faced with unprecedented challenges which require an extraordinary public policy response. The first-time homebuyer tax credit has proven to be an effective tool in stimulating demand and reducing supply. Given current conditions in the housing market, this program should, at a minimum, be extended and if possible, expanded.

Examining the First-Time Homebuyer Tax Credit – Executive Summary

Rosen Consulting Group (RCG) was retained by the Fix Housing First Coalition to evaluate the effectiveness of the 2009 first-time homebuyer tax credit and the potential need for an extension of the program. RCG is uniquely qualified to examine this issue and has extensive experience in analyzing the national and local housing markets and economic conditions. Dr. Kenneth T. Rosen, Chairman of RCG, has authored numerous articles and books on real estate and real estate finance. He is the leading expert on housing economics and originated the premise for the 1974-1975 homebuyer tax credit while at the Joint Center for Urban Studies of MIT and Harvard University. He is a special real estate advisor to the World Economic Forum and Chair of the Fisher Center for Real Estate and Urban Economics at the Haas School of Business, University of California, Berkeley.

Extraordinary Response to an Unprecedented Problem

Facing the most significant economic crisis since World War II, Congress and the White House passed the Housing and Economic Recovery Act of 2008 in an effort to provide support to the contracting economy and beleaguered housing market. With housing facing the greatest decline since the Great Depression, the federal government looked back to the 1970s housing crisis for a tool that would promote homeownership and return stability to the market and enacted the initial \$7,500 repayable homebuyer tax credit. As the for-sale housing market continued its freefall, the American Recovery and Reinvestment Act of 2009 amended the tax credit by increasing the maximum amount to \$8,000 and eliminated the repayment of the credit. The tax credit has served to stimulate demand for homes, particularly among low- and middle-income families. However, household finances are under greater pressure as macroeconomic conditions have deteriorated significantly since the passage of the aforementioned acts and the tax credit's expiration threatens the nascent recovery.



Credit is Proving Effective in Reducing the Supply of Homes

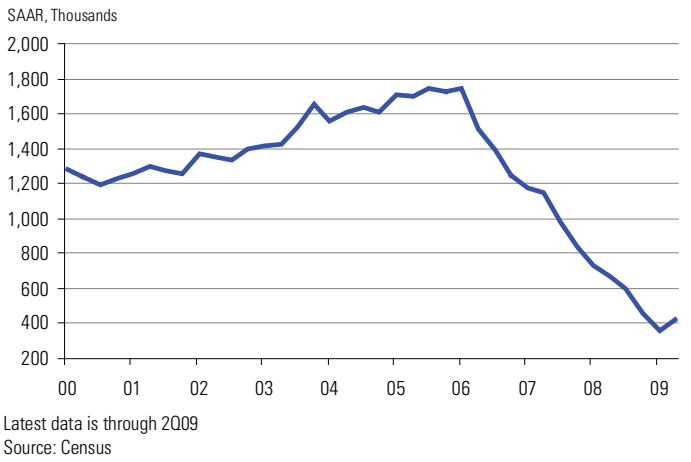
The non-repayable first-time homebuyer tax credit has been the primary cause of the recent return of buyers to the for-sale housing market. Since the beginning of the year, the tax credit and increased housing affordability have spurred demand by families, particularly for homes at the lower end of the housing market. The seasonally adjusted annual average rate of existing sales reached nearly 4.9 million homes in June, 8.9% higher than the trough in January 2009. Further indicative of the change in buyer sentiment, the National Association of Realtors' Pending Home Sales Index reached 94.6 in June, 17.7% higher than the low in January. Many of these purchasers are first-time homeowners, responding to the tax credit and improved affordability.

The effectiveness of the tax credit among low- and middle-income households is clearly depicted by analyzing the for-sale inventory data. For-sale inventory is often measured by the number of months it would take to absorb all of the homes currently available for sale at the current rate of sales. In June 2009, the months of supply of homes priced less than \$300,000 fell to 6.0 months, down from 8.1 one year earlier, an improvement of 25.9%. In the \$300,000 to \$500,000 price range, the months of supply fell to 8.4 months from 10.3 months in June 2008, 18.4% better than the previous year. On the opposite end of the pricing spectrum, between June 2008 and June 2009, the months of supply for homes priced between \$750,000 and \$1 million increased by 3.9% while the months' supply of homes priced greater than \$1 million increased 26.2%.

Credit Has Not Caused an Increase in New Home Construction

Typically, increased demand spurs new home construction; however, this is not the case currently as housing starts remain very low. In the second quarter, starts totaled 423,000 homes on a seasonally

U.S. Housing Starts



adjusted annual average basis, approximately 60% lower than the long-term average of 1.1 million units. This was the second-lowest quarterly figure on record, following the first quarter which was the lowest level of construction activity since the data began in 1959.

Conditions in the Housing Market Remain Very Challenging

Despite the low level of construction activity, available supply is under upward pressure from a high rate of foreclosure and a significant demand shortfall, even with the current credit. In the first six months of 2009, foreclosure proceedings began on more than 1.5 million homes, in addition to the more than 2.3 million properties in the foreclosure process in 2008. As many of these foreclosures become lender-owned, these homes are added to the number of properties for sale and increase available supply. The large number of foreclosures is the primary contributor to the increasing number of vacant homes, not new construction activity. If the tax credit expires, it is likely that lender-owned properties will quickly increase available supply as buyer demand retracts, particularly among low- and middle-income families.

Monthly Foreclosure Filings



Extension is Needed to Sustain Existing Demand

The current contraction in the housing market is as unprecedented as the preceding bubble, and the collapse helped push the United States into the current recession. In recent months, there have been signs of recovery in the housing market. Many of these “green shoots” are a direct result of the first-time homebuyer tax credit. Without demand stimulated by the tax credit, sales activity can be expected to return to the low levels of earlier in the year as households struggle with the threat of job loss and consumers remain unconvinced of a rebounding economy. The for-sale housing market was in the midst of the worst decline since the Great Depression and the budding recovery is not a certainty. As the housing market is currently in the early stages of a slow recovery, it is imperative that the credit be extended in order to maintain the positive signs of a recovering housing market.

Expanding the Credit to All Purchasers Would Accelerate the Housing Recovery

Home purchases by low- and middle-income families, who typically face the largest down payment constraint, are directly a result of the tax credit and improved level of affordability. If sales activity were evenly distributed, this disparity in activity by price range would not exist, further highlighting the effectiveness of the tax credit in generating buyer demand among first-time homeowners. Expanding the tax credit to existing homeowners is likely to spur a similar increase in demand by the trade-up market, helping to refresh the supply in the starter-home category.

Similarly, expanding the income limits beyond the current thresholds would enable more households to take advantage of the tax credit and spur additional demand. Particularly in higher cost areas such as the coastal markets, families require greater incomes in order to afford to buy a home. As such, many households do not qualify for the tax credit as currently legislated. By increasing the income phase outs to \$125,000 for individuals and \$250,000 for a married couple, levels typically cited by the White House as the boundary for the middle class, more middle-class families will be able to purchase homes and help to stabilize the market sooner.

A Housing Recovery is a Prerequisite for a General Economic Recovery

A recovery in the residential market has led the nation out of recession in nearly every economic recovery of the past 40 years. Without an improvement in housing, we believe the economy will continue to stagnate. Most of a family’s wealth is tied to its home, and stabilizing values will go a long way in boosting consumer confidence. Additionally, halting the free-fall in home prices will help to prevent additional foreclosures. The ancillary benefits of homeownership are well-documented and we believe that extending the first-time homebuyer tax credit through 2010, allowing for monetization and expanding the credit to existing homeowners are likely to stimulate a more immediate economic recovery.

Examining the First-Time Homebuyer Tax Credit

The Fix Housing First Coalition retained Rosen Consulting Group (RCG) to produce the following study, which examines the success of the first-time homebuyer tax credit as well as the impact of an extension and expansion of the program. RCG is highly qualified to conduct this analysis, with a team of experienced analysts and economists that carry out ongoing research on the economy and housing markets, both nationally and on metropolitan areas throughout the country. Dr. Kenneth T. Rosen, Chairman of RCG, is world-renowned for his work regarding housing market economics and has published many articles and books on real estate and real estate finance. Among his most notable accomplishments, Dr. Rosen developed the conceptual framework for the 1974-1975 homebuyer tax credit during his time at the Joint Center for Urban Studies of MIT and Harvard University. Dr. Rosen also forecasted the tech bust of the early 2000's, as well as the current real estate downturn. In addition to heading RCG, Dr. Rosen is presently Chair of the Fisher Center for Real Estate and Urban Economics at the Haas School of Business, University of California, Berkeley, as well as a special real estate advisor to the World Economic Forum. Given Dr. Rosen's strong background in real estate analysis, as well as his team of well-educated, seasoned professionals, RCG is uniquely qualified to produce this report.

An Unprecedented Problem

The first-time homebuyer credit, established by the Housing and Economic Recovery Act of 2008 and amended by the American Recovery and Reinvestment Act of 2009, has been critical in helping to stabilize the for-sale housing market. Prior to the 2009 version of the credit, the for-sale housing market and the overall economy were in the midst of a recession. In fact, a glut of supply from unsold homes and rising foreclosure activity, rapidly falling home values and deteriorating macroeconomic economic conditions worked together to send the housing market into its worst crisis since the Great Depression of the 1930s.

During the housing boom, home values nationwide increased so fast that many potential buyers gradually became priced out of the market, despite the relatively lax mortgage lending environment at the time. As a result, sales of new and existing homes began falling in late 2005, a trend that continued into 2009. While sales volume declined during this period, inventory levels of new and existing homes did not drop initially. Private homeowners and investors that entered the market during the boom still had an incentive to sell homes and capture the remaining capital gains. The supply of new homes peaked in early 2009, higher and later than that of existing homes, a result of a more dramatic decline in sales volume compared with existing homes.

As sales slowed and foreclosures mounted, prices tumbled. The median sales price for an existing single family home, measured by the National Association of Realtors (NAR), fell in 2006 for the first time since 1990. Home price depreciation intensified through the next two years. From peak to trough, home prices have fallen by their greatest amount since the 1930s. Declining home prices in the United States have had a profound effect on financial systems and economies around the world, a fact illustrated in the globally-synchronized nature of the current recession and near-meltdown of financial markets in 2008.

In addition to these extraordinary circumstances weighing on the housing market, deteriorating conditions within the overall economy have reduced demand for new housing. In fact, the U.S. economy has spiraled downward into the worst recession since World War II. Since the onset of the recession, household finances have come under heavy pressure. The current recession has been the longest in duration and most significant in terms overall job losses since the Great Depression. With nearly 6.7 million jobs lost since December 2007, the unemployment rate has more than doubled since early 2007. In addition, these typical labor market indicators do not capture the rising use of furloughs, shortened work weeks, or wage and salary reductions.

Prior to the enactment of the tax credit, demand-side forces had weakened considerably. Since the non-repayable credit was signed into law in February 2009, however, home sales have begun a slow recovery as a result of families taking advantage of the tax credit and increasing affordability levels spurred by low mortgage rates and lower-priced housing.

Although the for-sale market remains oversupplied because of insufficient demand, the tax credit is helping to correct this oversupply by stimulating buyer activity. Quantifying the number of new homeowners that utilize this credit will be impossible until both 2008 and 2009 tax return data are available from the Internal Revenue Service. However, by examining several for-sale housing indicators, it is apparent that the tax credit has improved demand for homes at the lower end of the housing market. Many of these low-to-middle-income families had sufficient income to afford mortgage payments, particularly at the current depressed prices, but had yet to become homeowners as mortgage credit remained tight and buyers were fearful of ownership in a declining price environment. The tax credit has helped push these buyers over the threshold by helping them meet down payment requirements. Also, anecdotal evidence shows that increased affordability alone was not sufficient to attract new homebuyers and the federal tax credit helped to counter the demand-side recession in a manner similar to the "Cash for Clunkers" program. These new homeowners are stabilizing neighborhoods across the

country, occupying foreclosed homes and preventing blight from spreading, and by stabilizing prices, helping to preserve trillions of dollars in home equity of existing homeowners.

The benefits of the tax credit are very clear. However, the looming expiration of the credit on November 30, 2009 has the potential to curtail activity in the for-sale housing market and abort the “green shoots” in the housing market. An extension of the tax credit through September 2010 will have the added benefit of supporting homeownership during a more stable economic environment. More families feeling secure in their jobs and at their income levels should translate into a greater number of first-time homeowners moving into homes.

One of the greatest hurdles to homeownership is the down payment. Monetizing the tax credit will reduce this down payment constraint and create a greater homeownership rate among low-to-middle-income and minority families. These groups often have sufficient income to afford mortgage payments, but lack the necessary cash savings for a down payment on a home. By monetizing the credit, many families will be able to take advantage of the highest affordability levels in more than a generation and realize their goal of homeownership.

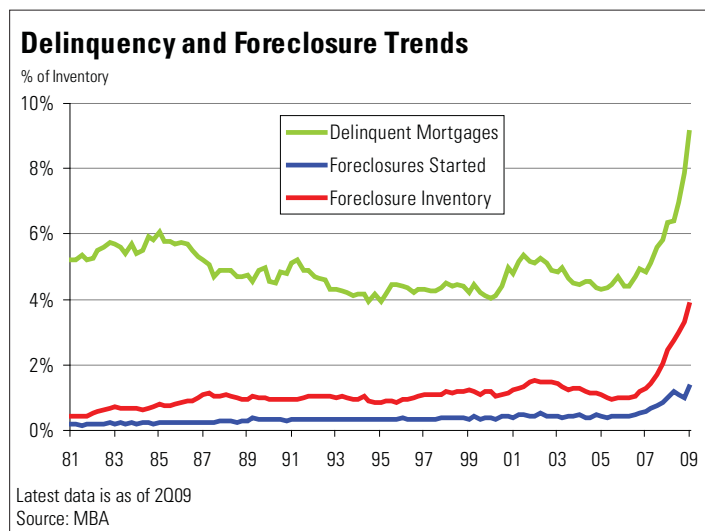
Finally, expanding the program to include existing homeowners and not just first-time buyers will create more liquidity in the market. An expanded credit will allow families to trade up and create opportunities for additional first-time homeowners in the starter-home category. The increase in sales activity will help sustain the drive to build homeownership and fuel the fledgling economic recovery across the country. The income limits of the tax credit assure the benefits will be targeted at low- and middle-income families.

State of the Housing Market

How Did We Get Here?

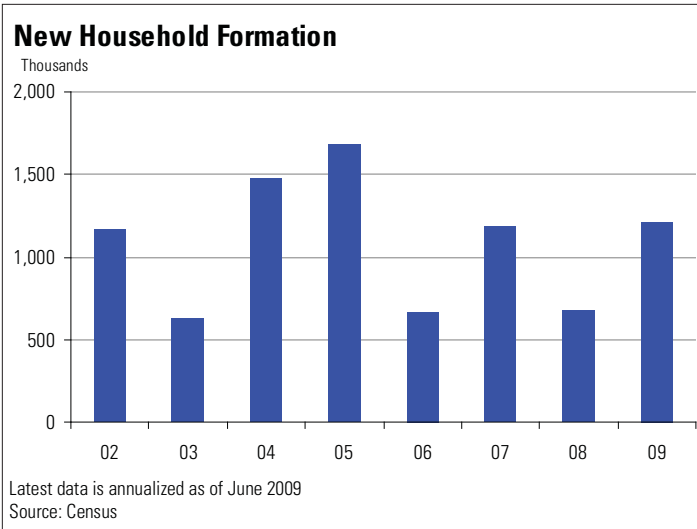
The housing boom was created by an overabundance of cheap mortgage credit and the resulting lax lending standards. Underwriting practices declined to such a point that nearly anyone could qualify for some type of mortgage loan. In particular, three types of aggressive loans were at the core of the problem: subprime, option-ARM, and Alt-A mortgages. More than \$2.8 trillion of these mortgages were originated from 2004 to 2007, representing more than 40% of mortgage originations during this period. Many of these loans required little or no down payment, lacked full income verification (so-called “liar loans”), or were negative amortization loans. A substantial number of these loans also had potentially large payment-resets built into the structure of the loan.

The proliferation of risky mortgages that were offered to high credit risk borrowers caused foreclosures to increase dramatically. Anecdotal evidence suggests that many of the delinquencies and foreclosures reported during the beginning of the housing bust were caused by payment shock rather than the usual suspects of job losses and medical and family issues. However, rising unemployment rates and high levels of negative home equity are compounding the problem, not only for the risky mortgage pool, but also for the prime mortgage market. Delinquency rates have been rising substantially for prime adjustable-rate mortgages and jumbo mortgages and are starting to increase rapidly among prime fixed-rate mortgage borrowers as well. The abundance of mortgages available to poorly qualified borrowers, as well as speculative investors, drove demand for housing during the boom and eventually led to the housing market crash.

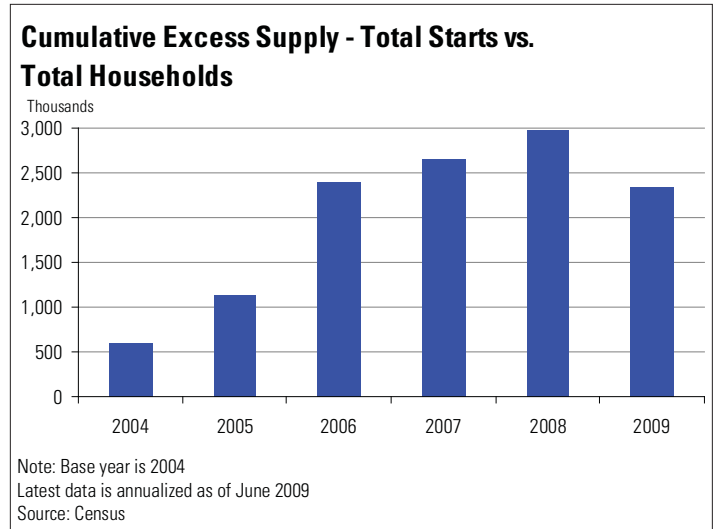


The number of delinquent mortgages and foreclosure filings increased dramatically in the first half of 2009.

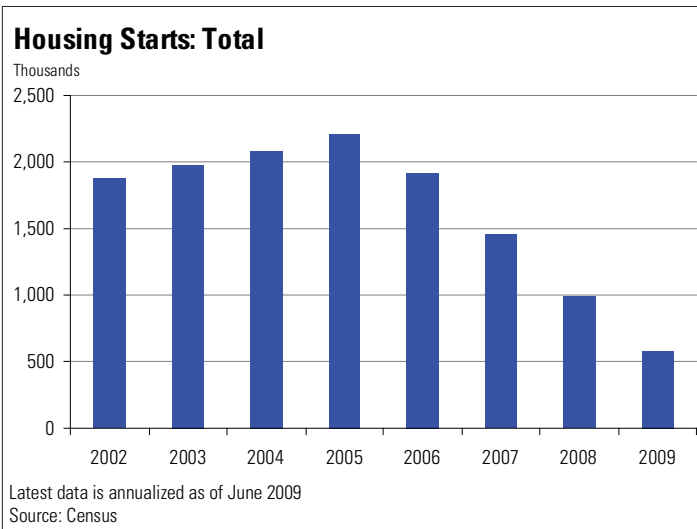
Housing construction rose in concert with increased demand created by over-lending and speculative activity. The number of new households formed was more than 5.0 million between 2004 and 2007, a period that included the peak of the boom, as compared with approximately 4.4 million during the prior four years. However, with an aggregate nearly 7.7 million single family and multifamily units started between 2004 and 2007, a comparison of household formation and housing starts indicates that there was a cumulative excess supply of more than 2.6 million units during this period. Using 2004 as the base year, this overbuilding has led to an excess supply overhang of approximately 2.3 million units at present. In a more normal economic environment, excess housing supply would have been much more rapidly depleted given the unprecedented pullback in housing construction. However, some potential new households coping with job losses and financial insecurity are waiting on the sidelines and thus, keeping single family market conditions from returning to their long-run equilibrium.



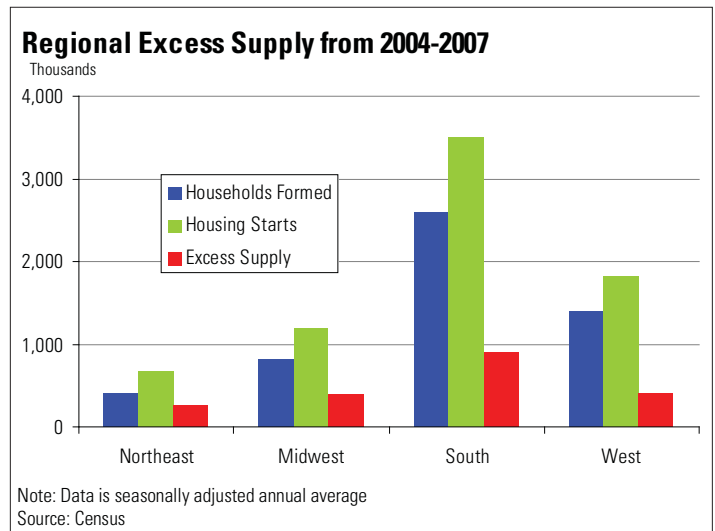
Household formation is rebounding in 2009.



Excess supply has decreased thus far in 2009 because housing construction has fallen substantially. As household formation rebounds from its recessionary level, excess supply will be absorbed.



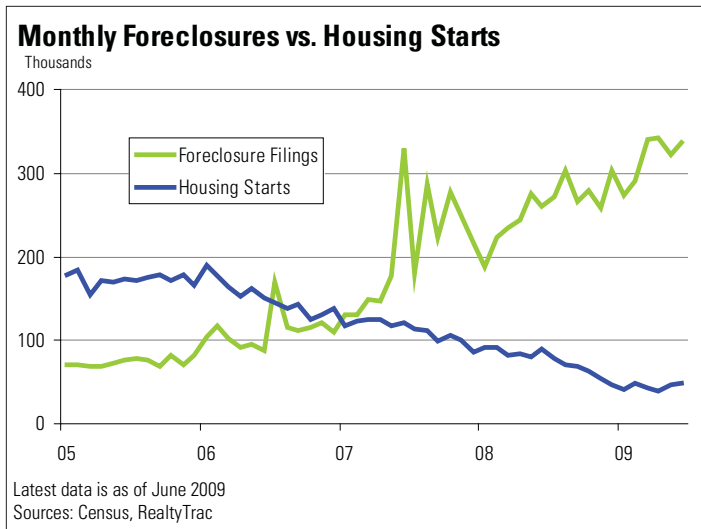
Housing starts have fallen dramatically since 2005s peak of more than 2.0 million.



The Southern region was the most oversupplied from 2004 to 2007, while the Northeastern region was the least oversupplied.

In 2008 and early 2009, household formation remained weak, as people generally tend to double up or move back with family during recessions, contributing to reduced demand for housing, especially rental housing. However, the number of housing starts has fallen even further, as supply and demand move back toward equilibrium. As of June 2009, the number of single family homes and condominiums started had fallen 74.4% from the peak level in January 2006. Additionally, the household formation rate has ticked up slightly in recent months according to preliminary data, potentially as a result of the tax credit. Without the demand created by an extended tax credit, the rate of household formation would likely decline again and remain low for an extended period of time.

The degree to which each region was oversupplied during the housing boom varied; however, an excess supply of housing occurred in all four regions. In comparing housing starts with households formed during the 2004 to 2007 period, the Southern region recorded the largest excess supply of approximately 460,500 housing units, reflecting in large part the massive Florida overbuilding boom. The Midwest followed with 281,600 excess housing units. Although many of the hardest-hit housing markets were in the Western region, it contained the second-smallest excess supply, largely as a result of the rapid rate of household formation. From 2004 to 2007, housing starts exceeded new households by 200,100 households. The excess supply in the Northeast was the smallest with approximately 43,800 households.



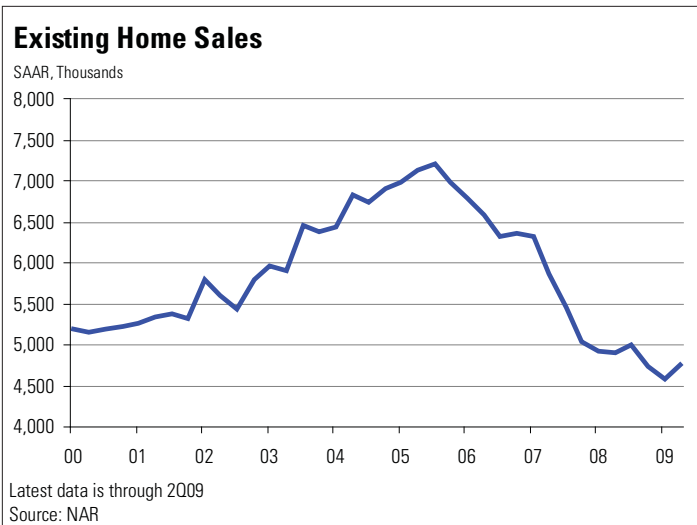
Foreclosures have increased sharply, contributing to the jump in for-sale home inventory, while starts have dropped significantly.

Although the stock of single family homes and condominiums for sale has risen sharply since the bust, this trend was driven largely by an increase in the number of foreclosed properties as a result of lax lending standards in previous years, rather than overbuilding. Even during the boom, the number of monthly housing starts never exceeded 200,000 units, while the number of monthly foreclosure filings has surpassed 300,000 many times since 2007. In June 2009, the number of housing units (single family and condominiums) completed was 48,500, while the number of foreclosure filings was more than 336,000. In this way, since 2007, the effects of foreclosure have impacted excess housing inventory to a much greater extent than new housing supply.

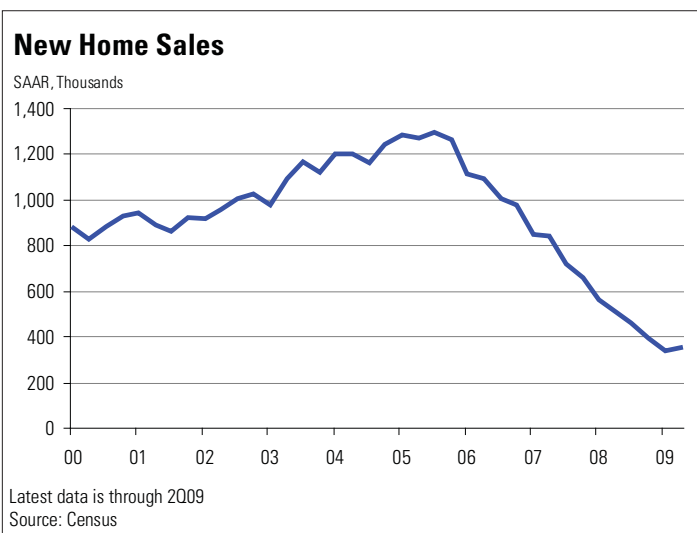
Housing Market Generally Improved

New and Existing Home Sales Improve

Sales in both the existing and new home categories have been improving in recent months. Total existing home sales, including single family houses and condominiums, rose to nearly 4.8 million in the second quarter of 2009, on a seasonally adjusted annual rate basis, a 3.8% increase from the first-quarter 2009 trough. New single family home sales increased to 356,000 during the same period, also on a seasonally-adjusted annual rate basis.



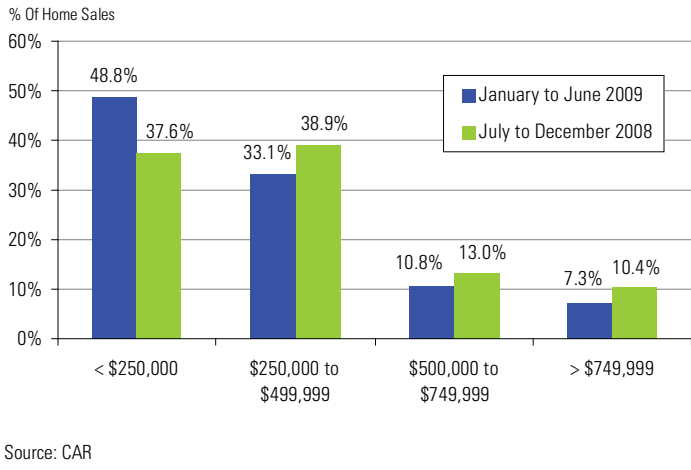
Existing homes sales are beginning a slow recovery.



New home sales are showing a slight improvement.

According to the National Association of Realtors (NAR), homes are selling more rapidly at lower price points, particularly for homes priced below \$500,000. However, home sales in the higher-price tiers are weak. According the Federal Reserve Board's second-quarter *Beige Book*, many districts reported pricing disparities in home sales, with more homes selling on the low end, while home sales for higher-priced properties were stagnant. We can point to California as an example of the disparity between demand for lower-priced homes and higher-priced homes. Between January and June of 2009, homes priced below \$500,000 made up 81.9% of total sales, compared with 76.6% of sales during the period between July and December of 2008. Homes priced below \$250,000 made up 48.8% of total sales in the first half of 2009, while they made up only 37.6% of sales in the second half of 2008.

California Home Sales by Price Category

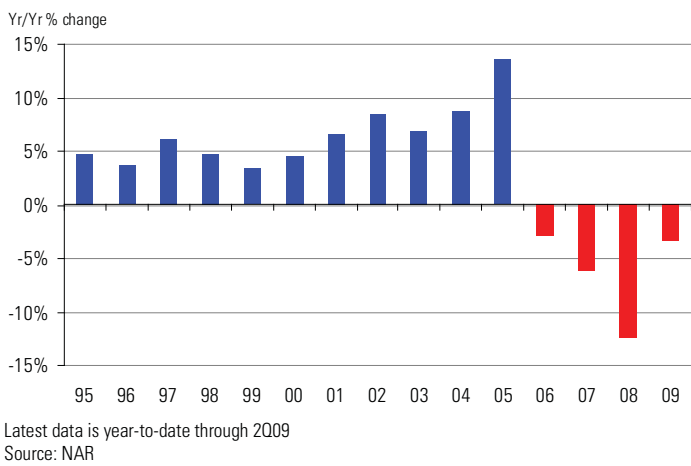


California home sales have accelerated in the lower-priced home market.

Median Price Stabilization

During the past three years, home prices have fallen by the greatest amount since the Great Depression. The record drop in home prices has left many homeowners with negative equity, and we expect additional mortgage payment defaults and foreclosures, which will drag prices down further. However, the first signs of stabilization are beginning to emerge, especially among the lower-priced segment. With the importance of stabilizing property values now readily apparent, preventing further home price declines will likely go a long way in strengthening the overall economy. The median price declined between the second quarter of 2009 and the fourth quarter of 2008 by 3.4%, compared with a 12.4% decline between the fourth quarters of 2007 and 2008. Through the first half of 2009, it appears that home prices are beginning to stabilize.

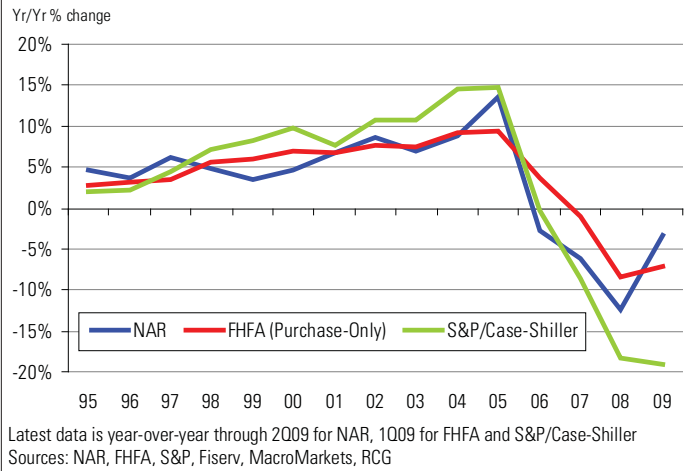
Median Home Price Change



Median home prices are stabilizing after showing the largest decline since the Great Depression.

The increased number of sales resulting from the tax credit is likely bolstering pricing. The monthly median price of an existing single family home recorded by NAR reached a low of \$164,200 in January (not seasonally adjusted). By June, with the impact of the 2009 tax credits finally reflected in the data on closed sales, the median price increased to \$181,600. In examining the data by quarters, the median price was approximately \$174,100 in the second quarter, an increase of 4.1% from the first quarter. However, the price data are not seasonally adjusted, and thus the increase could be partially due to the normal seasonal fluctuations, where prices tend to increase more rapidly during the middle of the year. While the median price did in fact increase from the previous quarter and prices may be at the trough, this latest figure represents a 23.3% decline from the peak level achieved in the second quarter of 2006. Other home price indices, including the S&P/Case-Shiller Index and the FHFA Purchase-Only Index, also indicate that single family housing values are bottoming.

Home Price Indices



Prices are bottoming across three major price indices.

Unsold Inventory Levels Falling

Supply conditions have been improving since early 2009. Currently, rising sales volume is correcting supply levels. As of the second quarter, approximately 3.2 million existing homes were on the market, compared with more than 3.3 million in the fourth quarter of 2008. New homes available for sale totaled approximately 292,000 during the second quarter, compared with 367,000 during the fourth quarter of 2008. The unsold inventory of new homes declined by 20.5% between the fourth quarter of 2008 and the second quarter of 2009, while the inventory of unsold existing homes declined by only 4.1%, which indicates builders have significantly slowed new construction, and that some buyers are opting to purchase new homes that are now priced at or below the median price.

New and Existing Homes Available For Sale

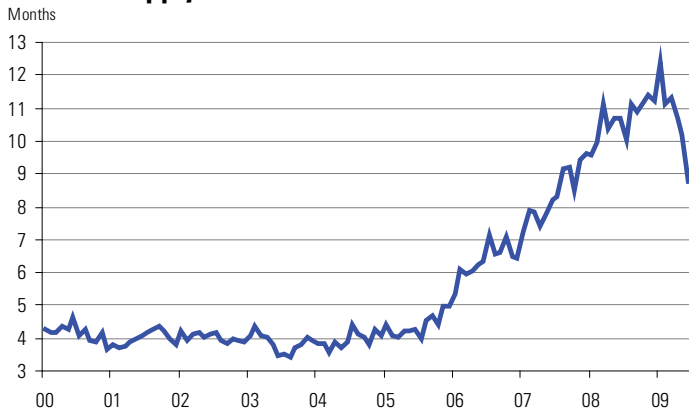


Note: New homes data is seasonally adjusted; existing homes data is not seasonally adjusted
 Latest data is through 2Q09
 Sources: NAR, Census

New home supply is declining, while existing home supply remains high.

Current supply levels indicate inventory relative to sales volume has corrected somewhat since peaking within the last year; however, supply levels remain elevated. The number of homes available for sale compared with total homes sold each month was twice as high in recent months as it was on average between 2000 and 2004; however, the trend is the result of reduced buyer demand. The main problem in the market today is weak demand despite vastly improved affordability.

Months' Supply of New Homes



Latest data is through June 2009
 Source: Census

Months' supply of new homes is still elevated because of weak sales.

Months' Supply of Existing Homes



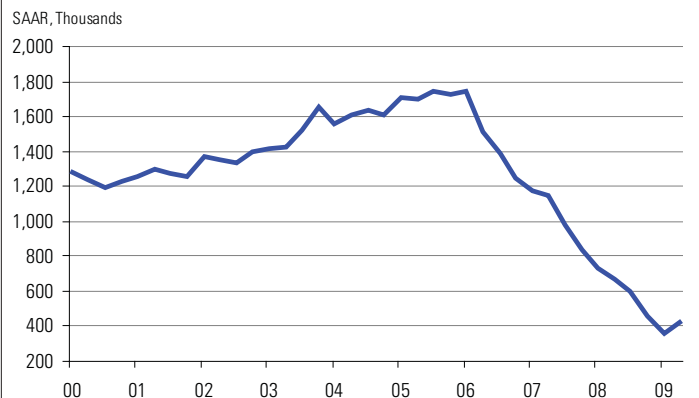
Latest data is through 2Q09
 Source: NAR

Months' supply of existing homes remains elevated.

Housing Starts Stabilizing

At the onset of the housing market crash, homebuilders were relatively quick to respond to the falling volume of new home sales. Single family starts fell from a peak quarterly seasonally adjusted annual rate of 1.75 million in the third quarter of 2005 to 1.25 million in the fourth quarter of 2006 and less than one million starts by the third quarter of 2007. Construction activity remained low in the first quarter of 2009, when homebuilders began construction at an annual rate of 358,000 units, the fewest starts since at least 1959. Though the number of starts increased marginally to 423,000 on a seasonally adjusted annualized basis in the second quarter of 2009, new home construction activity relative to the volume of new home sales is far lower than both short-term and long-term historical averages.

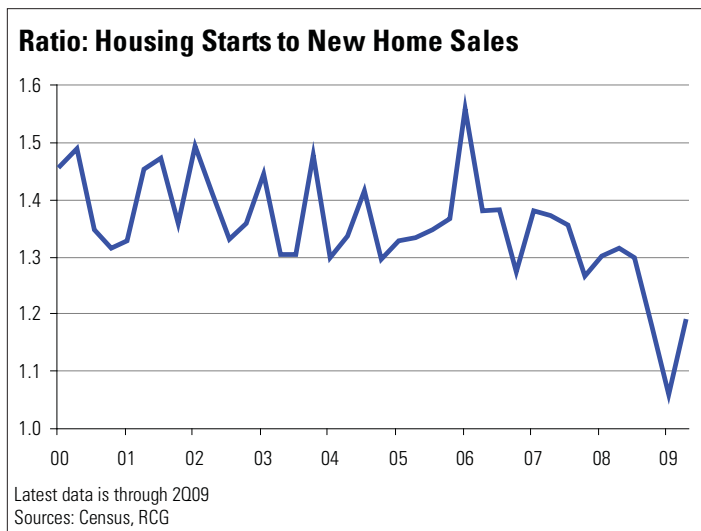
U.S. Housing Starts



Latest data is through 2009
 Source: Census

Housing starts are picking up slightly, but remain near record lows.

A simple method to measure the supply response within the new home market is the ratio of housing starts to new home sales. Home building levels relative to sales volume picked up in the second quarter of 2009 to 1.19, roughly equal to the level from the fourth quarter of 2008, but still far less than historical averages.



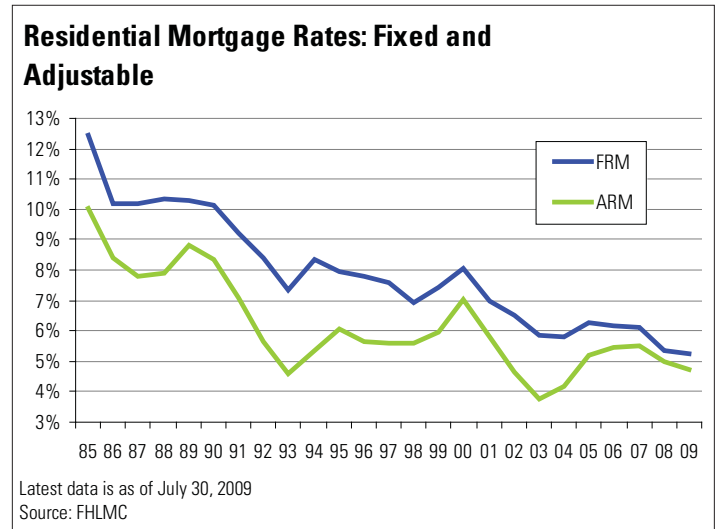
Ratio of housing starts to new home sales is still near record low levels.

Causes of Housing Market Improvements

The single family housing market has shown improvement during the past several months as a result of higher affordability levels, low mortgage rates, and the first-time homebuyer tax credit. Combined, these factors have helped increase the pool of potential buyers and returned some demand to the housing market.

Low mortgage rates played a key role in boosting sales and refinancing activity during the first half of the year. Mortgage rates were pushed down as the Federal Reserve purchased Treasuries and mortgage-backed securities through much of the first half of 2009. The 30-year fixed mortgage rate declined steadily beginning in February, hitting a low of 4.78% in late April. The rate has since come up slightly, peaking at 5.59% in June but dropped to 5.25% at the end of July. Refinancing activity has mirrored the recent fluctuation in mortgage rates. The weekly Refinancing Index produced by the Mortgage Bankers Association (MBA) increased sharply in January and again in late March in response to large declines in mortgage rates. At the end of July, however, the index dropped to 1862.1, a decrease of 10.9% from the previous week. In fact, the Index has remained in the 2000 range for much of July, compared with levels exceeding 6000 in April. We believe that lower mortgage rates, particularly between March and May, enabled more people to buy

homes or refinance existing mortgages. As mortgage rates have come back up, even if only slightly, signs that demand is receding have emerged. If mortgage rates were to rise sharply, the housing market's recovery could be aborted.

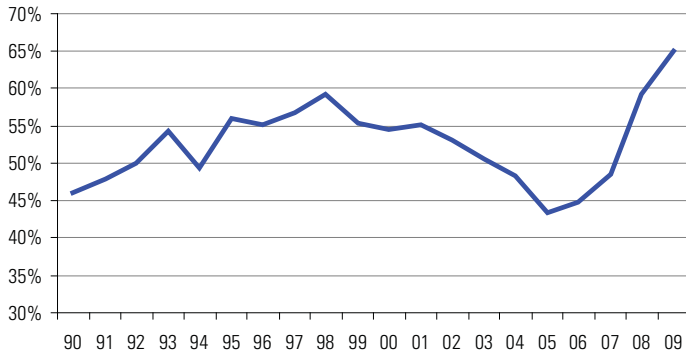


Low mortgage rates stimulated demand during the first half of the year.

In part because of low mortgage rates, higher affordability levels are attracting potential buyers to the housing market. Particularly for those that are on solid financial footing, the current environment is an ideal time to buy. According to RCG's calculation, affordability is at its highest level in the past twenty years, with nearly 65% of households able to purchase a median-priced home as of the first quarter. Just four years ago, affordability was at a low of 43.4%. The affordability index produced by NAR reached unprecedented highs earlier this year, in line with median home price declines and low mortgage rates. The index hit a record-high of 178.8 in April 2009 and decreased only slightly to 171.6 in May, compared with the record-low of 100.9 in July 2006. In June of this year, the index continued to decline, dropping to 159.2, attributable to the increase in mortgage rates. At 100, the index shows that a family earning the median income has exactly the amount of income necessary to qualify for a conventional mortgage and purchase a median-priced home given current mortgage rates, while a value higher than 100 indicates that a family earning the median income has more than enough income to afford a home under these conditions. Although the index has dropped slightly as mortgage rates have risen, the fact that it remains significantly higher than 100 illustrates that the pool of potential buyers remains large because of lower financing costs and home prices.

Affordability: United States

% Able to Afford a
Median-Priced Home



Latest data is as of 1Q09

Sources: NAR, CAR, various brokerages and Realtor associations, RCG

Affordability levels have jumped as a result of price and interest-rate declines. This high level of affordability has stimulated housing demand.

The introduction of the first-time homebuyer tax credit has been the third key element stimulating the housing market, particularly the lower end of the market. Individual first-time homebuyers qualify if they make less than \$75,000 per year, with an income cap of \$150,000 for families, which targets a portion of the market that is especially sensitive to economic incentives. Additionally, due to the lower price, this demographic is more likely to purchase a real estate-owned (REO) property or short sale. Because the first-time homebuyer credit targets a demographic that is especially wealth constrained, it also considerably increases the pool of potential buyers and has been a catalyst of the “green shoots” exhibited during the first half of 2009. The tax credit has pushed households over the threshold and has stimulated sales. A more complete discussion of the tax credit follows on page 11.

Big Headwinds Remain

Despite the “green shoots” that have emerged in the single family housing market, there is still a long way to go in terms of a recovery. The current demand-side recession stems from the two biggest obstacles facing the housing market and the economy at large: the rising number of foreclosures and their effect on home prices; and the negative impact of job losses on housing demand. Because of these remaining headwinds, more needs to be done to ensure continued demand for housing, which will hasten the economic recovery.

Foreclosures Increasing

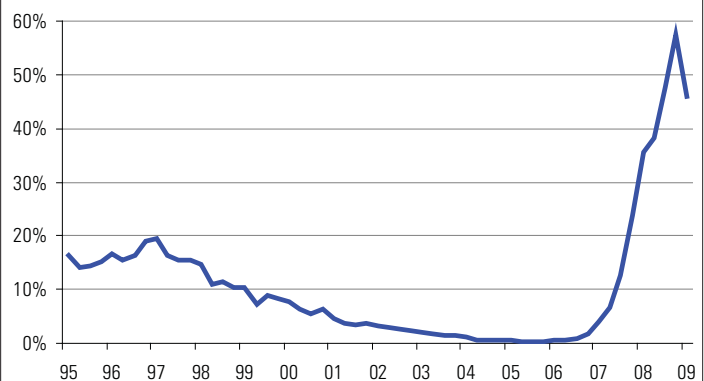
The rate of foreclosure remains rapid in the United States, as households respond to the effects of layoffs and still-declining prices in many areas. Based on legislation currently in place, RCG believes that the foreclosure rate will peak in 2009 at 5.9% and decrease only slightly to 4.4% in 2010, as compared with 1.5% during 2008. Using the number of mortgages being serviced in the first quarter of

2009, this rate would equal approximately 2.7 million foreclosures in 2009 and 2.0 million foreclosures in 2010. Unless action is taken to stimulate demand, these foreclosures will greatly expand the existing inventory of homes for sale during these years. This increased inventory will put downward pressure on homes prices through this time, creating headwinds in the for-sale housing market.

The prevalence of foreclosure auctions and short sales is dragging down house prices in many metropolitan areas. In many markets, 50% to 70% of completed home sales are resales of lender-owned properties. In California, for example, slightly more than 45% of all sales were classified as REO sales as of June 2009, according to DataQuick. With foreclosures accounting for a significant share of sales in many regions, the net effect has been continually falling median sales prices in the recent quarters.

REO Sales in California

% REO Sales

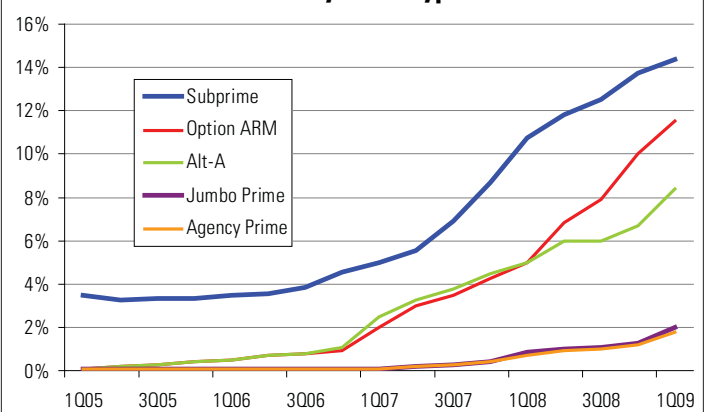


Latest data is as of June 2009

Source: NAR

Lower-priced REO properties make up a large percentage of total sales.

Foreclosures in Process by Loan Type



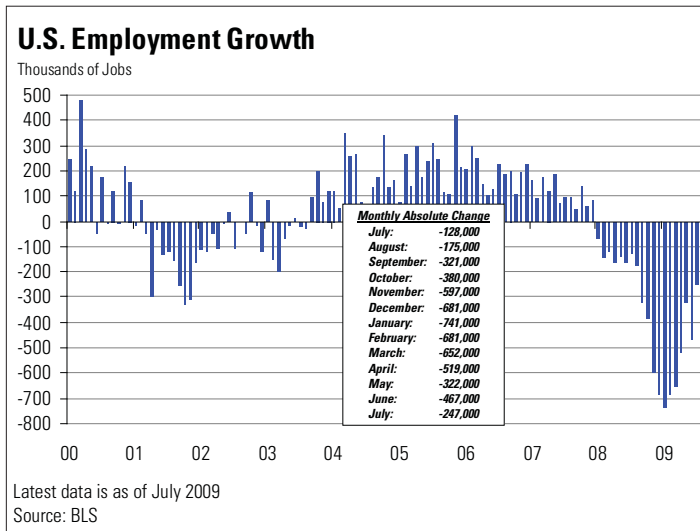
Sources: MBA, WSJ, LPS Applied Analytics, RCG

Foreclosures are still rising at a substantial rate.

Large Job Losses Continue

Job losses continue, but at a lower rate. The monthly pace of job loss, while still significant, has decelerated since a trough reached in January 2009. Monthly job losses averaged slightly more than 430,000 between April and June, compared with a loss of more than 740,000 jobs in January alone. The total unemployment rate was 9.4% in July, a slight dip from its level in June, but still one of the highest levels since the early 1980s. As the recession continues and jobs are scarce, unemployed workers are finding it increasingly difficult to find a new job. In July, the seasonally adjusted number of long-term unemployed workers (unemployed for 27 weeks or more) increased to 5.0 million, nearly 1.8 million higher than in March.

The most important effects of job losses on the housing market are threefold. Firstly, and most prominently, job losses shrink the proportion of potential homebuyers and reduce the demand for single family homes. Second, job losses lead to rising mortgage delinquencies and foreclosure among those that do own homes, ultimately adding to the inventory of unsold/unoccupied houses. Lastly, layoffs, furloughs, and other downsizing activities by employers contribute to increasing anxiety about job security. In the current environment, even those with jobs may be less likely to enter the for-sale housing market.



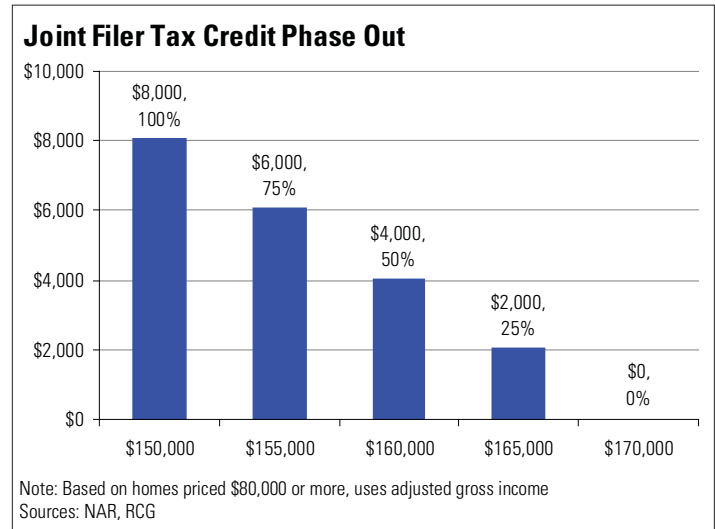
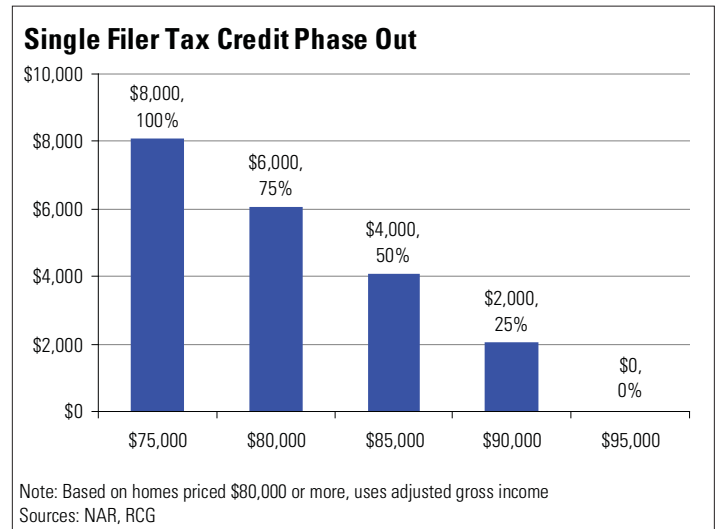
Job losses are crippling housing demand.

Impact of the Tax Credit

Overview of Tax Credit

As the tax credit currently exists, first-time homebuyers purchasing a primary residence between January 1, 2009 and November 30, 2009 may receive a tax credit for 10% of the purchase price of the home, up to a maximum of \$8,000. In order to qualify for the full refund, single filers must have a modified gross income no greater

than \$75,000, and joint filers no greater than \$150,000. The refund is phased out for incomes up to \$95,000 for single filers and \$170,000 for joint filers. Homebuyers must then remain in the home as a primary residence for 36 months in order not to have to repay the credit. For households that purchased a home between April 9, 2008 and December 31, 2008, a \$7,500 repayable credit was available.



The first-time homebuyer tax credit begins to phase out for incomes over \$75,000 for single filers and \$150,000 for joint filers.

After analyzing the housing market and limited data available, it is our informed view that the tax credit has resulted in increased sales activity at the lower end of the market, as well as increasing demand for FHA loans from first-time homebuyers seeking to take advantage of the credit in conjunction with low down payment requirements. However, ending the tax credit in November will leave the market vulnerable to a major drop-off in demand. In order to continue to stimulate the recovery of the housing market, the tax credit should be extended through September 30, 2010, and

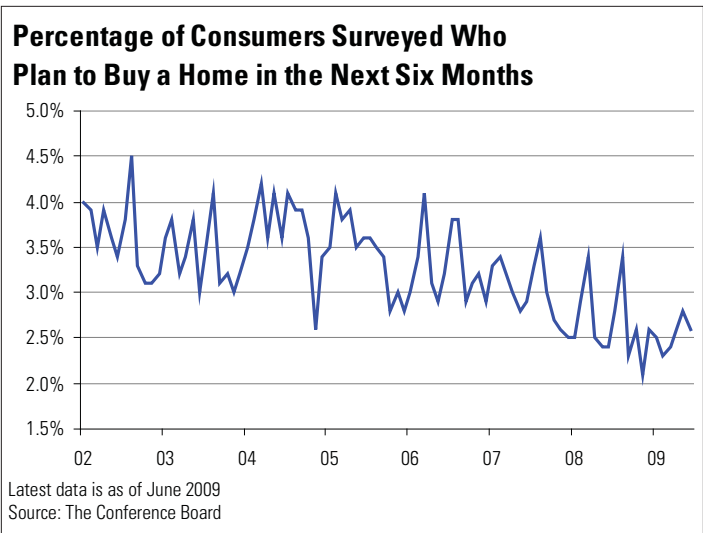
monetization of the credit should be made more widely available so that households can use the funds upfront toward down payment and other purchase costs.

Improvement in Demand Due to Tax Credit

Housing market conditions have generally improved since year-end 2008 and the introduction of the 2009 federal tax credit for first-time homebuyers. The tax credit has spurred buyer demand, though until 2009 income tax returns are filed, it will be difficult to determine how many families applied for the credit. By examining the large number of claims for the 2008 refundable tax credit of \$7,500 from the IRS, it can be assumed that buyers are even more eager to take advantage of the 2009 non-repayable tax credit. The National Association of Homebuilders estimates that as many as 160,000 additional home purchases will occur with the implementation of the tax credit in 2009. Additionally, according to a Realogy (parent company of several of the largest residential real estate brokerage firms) survey of Realtors nationwide, 45% of respondents reported that the current tax credit has “significantly increased” or “somewhat increased” the number of sales this year, providing further evidence that the tax credit is spurring demand.

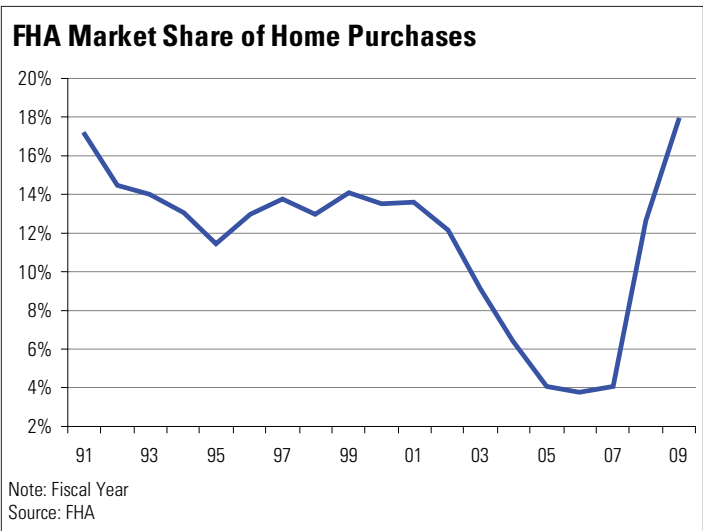
The improved sales activity helped to stabilize the national homeownership rate between the first and second quarters of 2009, at 67.4%, against the greater trend of declining homeownership since 2006. However, homeownership among minority groups has lagged the rest of the U.S. population, and minority homeowners have been impacted by the housing crash to a greater degree. Through the second quarter, the Hispanic homeownership rate declined to 48.1%, 150 basis points lower than the second quarter of 2008. The Black homeownership rate fell to 46.5%, down 130 basis points from one year ago. Among Asian/Pacific Islanders, Native Americans, Alaskans, Hawaiians and mixed-race heads of households, the homeownership rate was 57.6%, 80 basis points less than the previous year. Although the tax credit has begun to stabilize homeownership, the improvement among minority groups has lagged the national trend.

According to The Conference Board’s monthly survey, 2.6% of consumers polled in June planned to buy a home within the next six months, and most planned to buy an existing home. This was up from a low of 2.1% in November 2008. Consumers tend to respond positively to the prospect of purchasing a home when the incentive to do so is present, both in the form of low interest rates and prices and tax credits. The current tax credit is likely a substantial contributing factor to the recent increase in the number of respondents who plan to buy a home in the next six months.



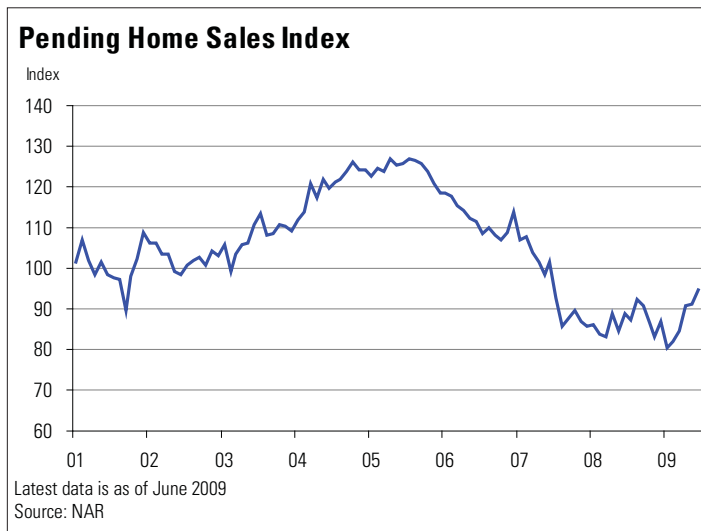
Consumer sentiment toward purchasing a home increased in recent months from a record low in November.

Demand for FHA loans has increased since the end of easy conventional mortgage credit. Given the rise in down payment requirements for conventional mortgages, households are increasingly turning to FHA loans, which have minimum down payments of just 3.5%. The low down payment requirement of an FHA loan attracts many first-time homebuyers, as most of these buyers are unable to afford a 20% down payment. In fiscal year 2009, FHA loans accounted for 17.9% of the mortgages issued, up from 3.8% in 2006, when low down payment mortgages were widely available outside of FHA loans.

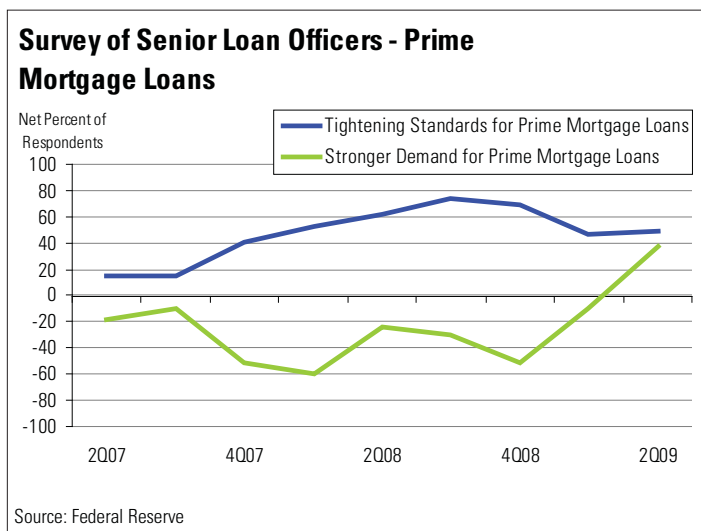


Demand for FHA loans increased dramatically in the past 18 months as aggressive conventional mortgage lending dried up.

Existing home sales reached nearly 4.8 million on a seasonally adjusted annual basis during the second quarter of 2009. Pending home sales have been increasing on a monthly basis since January 2009, according to NAR, with the index reaching 94.6 in June. June's pending home sales index result exceeded the previous month's reading by 3.6%, and outpaced June 2008's by 6.7%, indicating there is marked improvement in demand for single family homes, in part as a result of the tax credit. Additionally, the July issue of the Federal Reserve's *Beige Book* indicated that demand for residential mortgages increased in many districts, and that home sales were particularly strong for homes in lower price tiers. According to a survey of Senior Loan Officers by the Federal Reserve Board, 36.7% of respondents claimed that demand picked up for residential mortgage loans following the implementation of the federal tax credit.

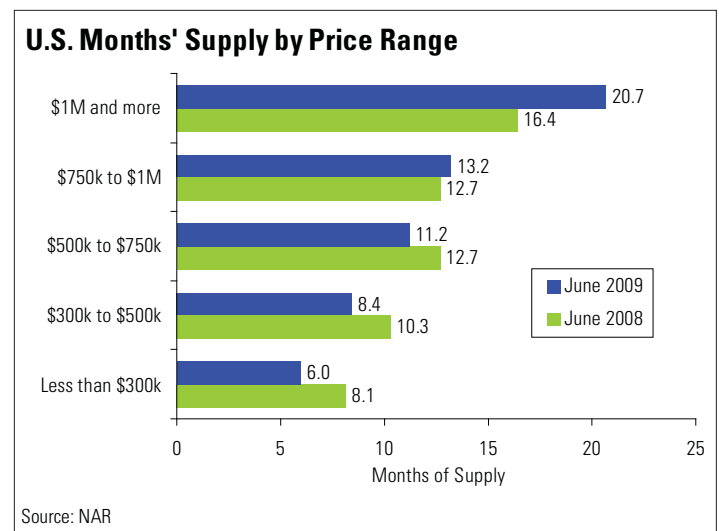


The pending homes sales index shows significant improvement, as more buyers take advantage of the tax credit and low prices and interest rates.



Increased demand for homes is creating more demand for FHA loans amid tighter credit standards.

One of the most significant effects of the tax credit has been to bolster sales volumes, especially in the lower-priced "starter home" category, although some of the increase may be attributable to the large number of distressed and short sales. Although the *Beige Book* reported stronger residential sales in most districts on a monthly basis, sales volume in all price ranges are still down significantly from a year ago, and higher-priced homes are not selling as rapidly as homes in the lower price tiers. According to NAR, homes priced at less than \$300,000 and those priced within the \$300,000 to \$500,000 range had 6.0 and 8.4 months of supply in June 2009, respectively, representing a decline of 25.9% and 18.4% from the same period a year ago. Because the credit is limited to first-time buyers and is phased out based upon income, demand is concentrated in the lower price tiers. Lower-priced homes are typically in demand from first-time buyers who may be unable to afford a larger home until they build up equity in their first homes. On the other hand, the months' supply of homes priced at more than \$1 million reached 20.7 months in June, up 26.2% from a year ago. The months' supply of homes priced between \$750,000 and \$1 million reached 13.2 in June, representing a 3.9% increase from the previous year. While home sales are improving on an overall basis, the bulk of sales appears to be in the lower price tiers because the tax credit is only available to first-time buyers who typically buy homes in that category. **This differential performance by price range is probably the strongest piece of evidence of the effectiveness of the focused tax credit.**



Demand for homes is strongest in the lower price tiers as a result of the tax credit being limited to first-time buyers.

Public homebuilders also report that first-time buyers are making up the bulk of demand for single family homes. According to second-quarter earnings results, a handful of homebuilders reported that more than half of buyers were first-time buyers, and some homebuilders, including KB Home, MDC Holdings, and Lennar, reported that as many as 80% of buyers were first-time buyers. The current boost in sales for both existing and new homes is very likely a result of

the current tax credit, and many buyers may not have chosen to buy in the current economic climate without it.

The effect that the tax credit is having on demand for homes is similar to the effect that the “Cash for Clunkers” program is having on demand for fuel-efficient new cars and trucks. Both credits are providing consumers with financial incentives that are driving them to make these large purchases, despite the weak economy, by effectively lowering their prices. The first-time homebuyer tax credit of \$8,000 covers 4.4% of the cost of a median-priced home, although this proportion is significantly higher for lower-priced homes or if the tax credit is used in conjunction with state and local credits. The “Cash for Clunkers” program’s maximum credit of \$4,500 covers a significant percentage (15.5%) of the purchase price of the median-priced new car (\$29,061 as of the first quarter of 2009), and likewise is even more attractive for lower-cost cars. In both the housing and vehicle markets, the credits are boosting sales and broader economic activity. The homebuyer tax credit has the added benefit of reducing the excess inventory caused by the surge in foreclosures – a critical component of bringing housing supply and demand back into balance and restoring economic stability.

Stimulus Purchase Incentives

Cash For Clunkers

| | |
|---------------------------------|----------|
| Average New Vehicle Sales Price | \$29,061 |
| Incentive | \$4,500 |
| Percentage Covered | 15.5% |

First-Time Homebuyer Tax Credit

| | |
|----------------------------|-----------|
| Median Existing Home Price | \$181,800 |
| Incentive | \$8,000 |
| Percentage Covered | 4.4% |

Notes: Assumes maximum credit in both scenarios. Average new vehicle sales price as of 1Q09, median home price as of June 2009.

Sources: NAR, Auto Exec Magazine, RCG

Both the first-time homebuyer tax credit and the “Cash for Clunkers” vehicle credit are boosting demand by effectively lowering prices.

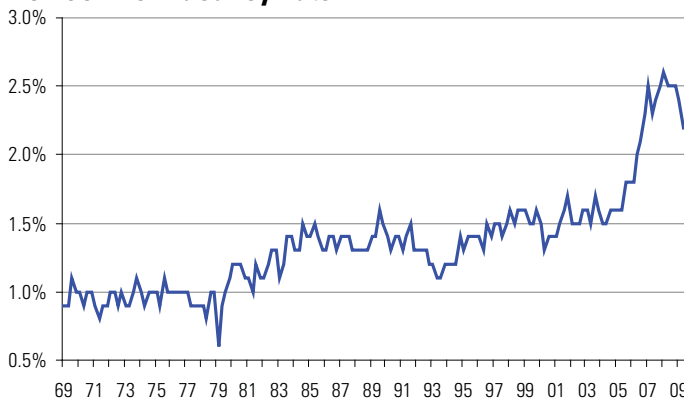
Improvement in Supply

Although much improved, the housing market remains in a state of oversupply. Homebuilders began pulling back on construction activity in early 2006, as price appreciation began slowing and sales volume fell. Despite the slowdown in building activity, the market remained oversupplied for much of 2008. The improvement in supply conditions during the first half of 2009 occurred since the introduction of the

tax credit for first-time homebuyers. Currently, rising sales volumes, fueled not only by the tax credit but also by high affordability levels and low mortgage rates, are correcting supply levels. Nonetheless, continued job losses and still-tight credit continue to threaten a housing recovery from the demand side, making the extension of the tax credit or other economic incentives geared at stimulating demand imperative going forward.

The homeowner vacancy rate for one-unit structures began increasing during the housing boom and reached a peak during the first quarter of 2008 at 2.6%. Previously, the homeowner vacancy rate was relatively steady, staying in the mid-to-high-1% range. In the second quarter of 2009, the homeowner vacancy rate came down to 2.2%, indicating that some inventory has been removed from the market and that building activity has remained subdued. On the state and MSA level, the homeowner vacancy rate is reported for all for-sale units, not just single-unit structures. The states with the highest total homeowner vacancy rates were also areas where the use of exotic mortgages was the most commonplace and speculative product was concentrated. As of the second quarter, Nevada, Florida, and Arizona had the highest homeowner vacancy rates, at 5.2%, 4.0%, and 3.9%, respectively. On the MSA level, similar patterns persisted. Orlando had the highest homeowner vacancy rate, at 7.3% as of the second quarter, followed closely by Greensboro, Las Vegas, Sacramento, and Bakersfield.

Homeowner Vacancy Rate



Note: Single-unit structures

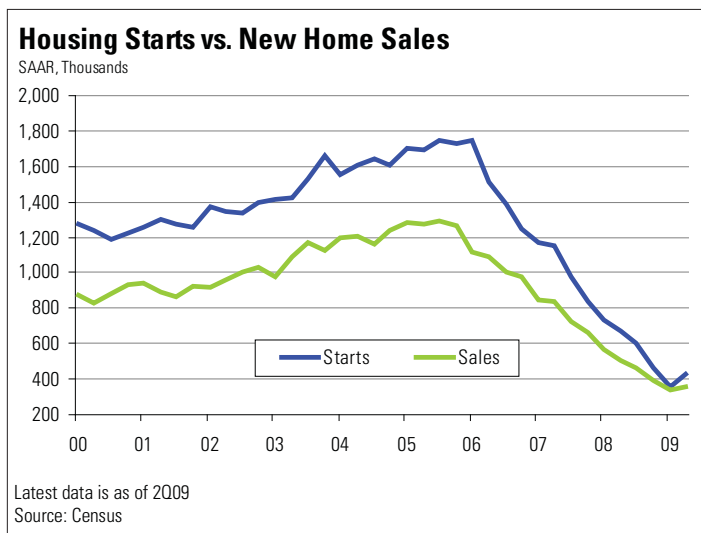
Latest data is as of 2Q09

Source: Census

A decline in the homeowner vacancy rate indicates growing demand and a correction in the oversupply of housing.

During the first half of 2009, the inventory of new homes has come down rapidly, nearly matching the levels now seen in the re-sale market. As of June, the inventory of new single family homes stood at nearly 8.8 months, compared with 7.9 months of supply of existing homes. By comparison, new home inventory peaked at 12.4 months of supply in January 2009. In a six-month period, the months’ supply

of new homes dropped by almost 4 months, the largest and fastest change in new home inventory during this decade. Additionally, building activity has remained at depressed levels, with single family housing starts dropping to a seasonally adjusted annual rate of 423,000 units in the second quarter of 2009, compared with a peak of more than 1.75 million units in the third quarter of 2005. It is likely that building activity will remain at these low levels absent much stronger buyer demand than current levels. Should demand rise at a faster rate, fueled by the tax credit and other factors incentivizing home purchases, inventory levels should continue to decrease and market conditions should once again justify homebuilding activity, providing a boost to the national economy. However, the homebuilding industry is not likely to have the capability to increase production quickly. Capacity within the industry has already shrunk with many homebuilders exiting the business during this downturn. Additionally, a lack of capital and credit covenants is likely to curtail expansion by the homebuilding industry in the near term.



Builders responded quickly to falling housing demand by cutting new supply.

Monetizing Tax Credit

Low-end buyers provide the greatest potential for increased demand resulting from the tax credit. These households are the least likely to be able to afford to make a down payment, but are in a unique position to do so when monetization of the tax credit is available. Accordingly, targeting low-end buyers by monetizing the tax credit is an important key to increasing demand, as many of these households can comfortably afford to make mortgage payments, just lack the necessary upfront funds for homeownership. Whereas tax credits and low mortgage rates help to stimulate interest among households that can afford to cover the down payment, those without upfront access to funds may not be able to purchase a home regardless of these incentives. The framework for monetization enacted by HUD

in recent months has increased the effectiveness of the tax credit. By allowing the tax credit to be used in conjunction with FHA loans, HUD has helped to promote increased usage of the program. Making the tax credit available to cover upfront costs is vital to maximizing the benefit of the stimulus to the greatest number of households, particularly lower income and young families that would not be able to purchase otherwise. Combined with dramatically strengthened underwriting guidelines and credit qualifications, monetization is a responsible and helpful tool in stimulating homeownership.

Monetizing the tax credit provides avenues to homeownership among low- and middle-income households, which traditionally have trouble saving for down payment and closing costs, but often have the income needed to make mortgage payments. In many cases, low- and middle-income communities also have large populations of minorities that historically have had low levels of homeownership. By offering monetization programs, more low- and middle-income and minority households would be able to purchase homes, particularly given the decline in home prices during the last few years. The benefit of increasing homeownership in low- and middle-income communities is twofold, also helping to stabilize neighborhoods and increase community involvement. Monetization of the tax credit also opens up homeownership to young families that may lack the years of savings required to purchase a home, but already have the income necessary to afford monthly payments.

For many households, the size of the required down payment is the key element in the decision to purchase a home, if they can already afford to make the monthly payments. In the current environment, conventional loans require a 20% down payment, which is out of reach for many households seeking homes at the low end of the market. On the \$181,800 median-priced home in June, a 20% down payment would be \$36,360, which is beyond the means of most renter households. In order to afford the monthly payment of \$995 in this scenario, a family would need a yearly income of \$36,171, assuming a loan-to-income ratio of 33%, \$481 in annual homeowner insurance, and \$1,818 in annual property taxes. However, the median renter income was just \$30,473 in 2007. With this income, households can afford a payment of \$838 per month, assuming the same loan-to-income ratio of 33%. If a family with this income can afford to put 20% down, they can purchase a home valued at \$151,968, assuming annual homeowner insurance of \$481 and annual property taxes of \$1,520. Nonetheless, with the \$30,393 necessary for a down payment, most renter households cannot afford the upfront costs of homeownership, despite the ability to keep up with monthly payments.

Purchasing Median-Priced Home

| | Median-Priced Home |
|-------------------|---------------------------|
| Home Price | \$181,800 |

Conventional

| | |
|----------------------------------|----------|
| 20% Down Payment | \$36,360 |
| <i>Estimated Monthly Payment</i> | \$995 |
| Approximate Income Needed | \$36,171 |

FHA

| | |
|----------------------------------|----------|
| 3.5% FHA Down Payment | \$6,363 |
| <i>Estimated Monthly Payment</i> | \$1,160 |
| Approximate Income Needed | \$42,195 |

Notes: Estimated payments assume 5.25% interest, 33% loan-to-income ratio, annual property tax of \$1,818, annual insurance of \$481.

Sources: CNN Money, RCG

In order to afford the median-priced home with a conventional loan and 20% down, families need an annual income of \$36,171.

Although conventional loans can be acquired in the current lending environment with 10% down, these loans are difficult to come by. For those households able to get loans with less than 20% down, private mortgage insurance is required, creating an additional cost. Many households at the low end of the market instead turn to FHA loans, which require just 3.5% down and provide their own mortgage insurance. On a median-priced home, the down payment with an FHA loan would be \$6,363, which could be covered with the \$8,000 tax credit if made available upfront. Likewise, a household with the median renter income could afford to make the monthly payments on a \$129,487 home with a 3.5% down payment of \$4,532, putting homeownership within reach of households with direct access to the tax credit. Regardless of whether a household uses a conventional or FHA loan, making the \$8,000 tax credit available at closing goes a long way in helping to cover down payment and other purchase expenses, making homeownership possible for more households.

Purchasing Home with Median Renter Income of \$30,473

| | Conventional, 20% Down | FHA, 3.5% Down |
|----------------------------------|-------------------------------|-----------------------|
| Home Price | \$151,968 | \$129,487 |
| Down Payment | \$30,393 | \$4,532 |
| <i>Estimated Monthly Payment</i> | \$838 | \$838 |

Notes: Estimated payments assume 5.25% interest, 33% loan-to-income ratio, annual insurance of \$481. For 20% down, annual property tax of \$1,520. For 3.5% down, annual property tax of \$1,295.

Sources: CNN Money, FHA, RCG

Monetizing the \$8,000 tax credit provides substantial assistance to a critical segment of the market.

Despite improving saving patterns in response to the slow economy, the average family does not have a large amount of liquid savings, which in turn limits the number of households that can afford down payments without assistance. According to the Federal Reserve, in 2007, just 56.5% of families reported saving at all during the year. Among families with assets, the median dollar amount held in transaction accounts was \$4,100 in 2007. Moreover, among renters, the median amount held in transaction accounts was even lower, with a median amount of just \$1,200. Both of these figures are in keeping with historical trends. Transaction accounts include checking, savings, money market deposit accounts, money market mutual funds, and call or cash accounts at brokerages, thus reflecting the majority of liquid household funds that can be used for down payments. Consequently, most households lack the funds necessary to cover the 3.5% down payment on a FHA loan, let alone the traditional 20% on a conventional loan. Providing households with the \$8,000 tax credit up front helps to bridge this gap.

Approximately 15 states presently offer monetization programs that allow homebuyers to take out a bridge loan to use the tax credit for the down payment or closing costs before the close of escrow. In Missouri, for example, buyers are given a tax-credit bridge loan of up to \$6,750 that converts into a second mortgage with a 10-year term and a 1.5 percentage-point higher interest rate than the first mortgage if the buyer does not repay by the given deadline in 2010. Demand for these bridge loans has been strong and similar programs exist throughout the country that are helping to ease the fear of first-time buyers and make homeownership possible for households that otherwise would not be able to come up with the funds to cover the initial costs of purchase.

According to the National Association of Homebuilders, these existing state monetization programs will likely result in 40,000 home purchases in 2009 that would not have occurred otherwise. If monetization were made more widely available, even more home purchases would result from these programs, not to mention the additional families able to buy a home with an extension of the tax credit into 2010 coupled with a monetization policy. As the Washington Association of Realtors concluded, half of would-be first-time homebuyers in the state do not have enough saved for down payments and closing costs, but do have incomes high enough to afford average monthly mortgage payments, demonstrating the potential for a huge market of untapped demand with the spread of tax-credit monetization. Whereas Washington already offers a bridge-loan program apart from the tax credit to assist buyers with down payments, state officials and organizations are pushing for an expansion of the existing program, as well as a nationwide plan.

Even though the monetization of the tax credit is available nationally through HUD in conjunction with FHA loans, this program is only available after homebuyers come up with the required 3.5% down payment, effectively excluding households that do not have access

to sufficient funds. The state programs differ by allowing buyers to use the credit toward the 3.5% down payment, but these programs are not available in every state, leaving many potential homebuyers without the tools necessary to take advantage of the tax credit and purchase a home. Expanding the monetization program nationally to include the 3.5% down payment would create an important source of additional homeowners, helping to stabilize prices and clear foreclosures from the market. It is also critical that monetization be accessible nationally for conventional loans, in order to appeal to the greatest number of potential homebuyers.

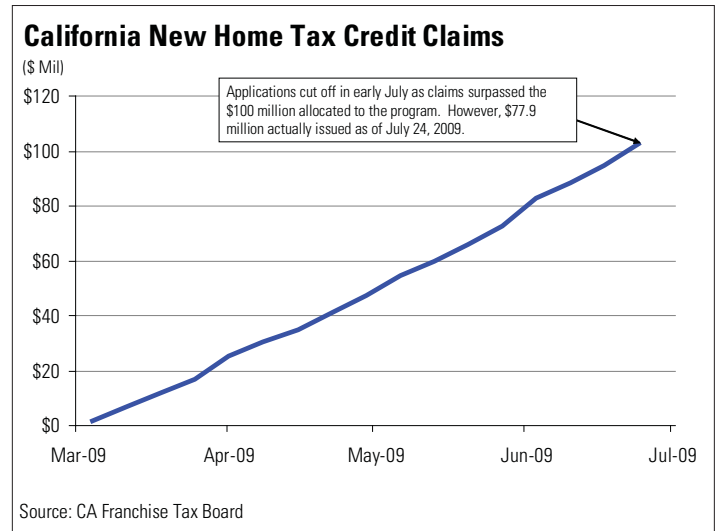
State Programs

In addition to the tax credit monetization programs that exist in more than a dozen states, some local and state housing agencies provide additional incentives that when partnered with the first-time homebuyer tax credit provide great stimulus to the overall housing market. Accordingly, it is crucial that any extension or modification of the tax credit continues to allow for partnership with these programs. Likewise, it is important that local programs be encouraged to partner with the federal tax credit, as opposed to requiring exclusionary use of just one or the other like some local programs currently demand. Coupling the tax credit with programs offered locally provides the opportunity to appeal to an even greater pool of potential homebuyers that otherwise would be unable to purchase or are on the fence about committing to a home in the present economic environment.

California provides a good example of how multiple programs can work together to stimulate activity. In California, homebuyers were able to claim a \$10,000 tax credit, up to 5% of the value of the house, for purchasing a new home, which could be combined with the \$8,000 federal credit if they were also a first-time homebuyer. The combined \$18,000 went a long way in helping to cover the down payment on a new home. In May, the median house price for a new home in California was \$326,000, which would require an \$11,410 down payment with an FHA loan, or \$65,200 on a conventional loan with 20% down. In neighborhoods attracting first-time homebuyers in California, new homes are available at around \$200,000, bringing the down payment to \$7,000 on an FHA loan and \$40,000 on a conventional loan with 20% down. Therefore, the combined tax credits more than covered the down-payment amount on the typical new home purchased by a first-time buyer using an FHA loan and covered nearly half of the down payment on a conventional loan, greatly expanding the pool of potential buyers.

The state program, which started in March of this year, was hugely successful, with nearly 71% of the allocated funds for the program already issued as of July 2009. The \$100 million allocated to the fund was expected to last until March of 2010; however, the program was oversubscribed by July 2009, leaving the state to refuse new applications and scramble to come up with additional funds to keep the program going. Nonetheless, as much as 30% of the allocated funds may go unused because the program did not provide a refund,

just a credit toward the state taxes owed over the next three years, leaving some households with lower tax liabilities unable to take advantage of the full credit. Accordingly, the state is considering a bill to expand the credit and begin accepting applications again.



In response to strong demand, claims are no longer accepted for California's new home tax credit.

In addition to this tax credit offered in California, the California Housing Finance Agency (CalHFA) provides first-time buyers with down payment assistance as well as loan programs with reduced interest rates and a maximum combined loan-to-value ratio of 102%. These programs are gaining in popularity, demonstrating the strong demand for homebuyer assistance in the current market. In 2008, the volume of loans insured by CalHFA increased 20% year-over-year to more than \$3.1 billion. The combination of these programs and the \$18,000 in available tax credits for first-time buyers have helped to clear a large amount of inventory in the lower price range from the market, with the months' supply of homes for sale under \$300,000 declining to 2.8 in June 2009, from 9.2 a year earlier. Likewise, the credits have helped to increase first-time homebuyer sales activity. During the second half of 2008, the share of first-time homebuyers increased to 38%, up from 19% a year earlier, according to the California Association of Realtors. Whereas this increase was in response to the \$7,500 tax credit, the current federal credit is having an even greater impact, appealing to a wider range of buyers now that it does not have to be repaid.

Beyond the programs offered at a state level, some metropolitan areas also provide residents with homebuying incentives that can be combined with the federal tax credit to further encourage buyers to enter the market and make home purchases. However, some of these local programs cannot be combined with the federal tax credit. In Washington D.C., for example, first-time buyers can claim up to a \$5,000 tax credit, but cannot also claim the federal tax credit simultaneously. If this program were opened up to allow both credits to be claimed on the same purchase, an even greater number of home

buyers would likely emerge, particularly if some of this money could be used upfront for the down payment or closing costs. As such, it is important that federal and local programs work together to allow homebuyers the maximum benefit. By opening up homeownership to more households, these programs help to stabilize the housing market and the greater economy.

Extending Existing Credit

The current \$8,000 tax credit has spurred demand for single family homes by increasing the number of households able to afford homes by indirectly or directly reducing the down payment constraint on households. By stimulating home sales, the tax credit has reduced the inventory of homes for sale and thus curbed the fall in home prices. The tax credit has been instrumental in countering the negative market environment and creating an incentive for first-time homebuyers to move off of the sidelines and purchase a home.

An extension of this credit through September 2010 should prolong and amplify these effects, as many households have not yet taken advantage of the current tax credit during 2009. In particular, families that could not accumulate the funds for a down payment before the expiration of the current credit would have more time to do so and thus realize their goal of owning a home. Households that have been waiting on the sidelines because of uncertainty over their economic future will also be more likely to take advantage of the credit in 2010. As job losses begin to slow, the overall economy begins to show some signs of recovery, and consumer confidence begins its slow ascent, potential buyers will feel more secure in their decision to purchase a home, especially as home prices stabilize. Therefore, the potential pool of buyers will increase significantly by extending the credit through September 2010 by including more risk-averse households, as well as those who simply needed more time to amass the financial resources to buy a home.

Evidence is also mounting that as the economy has slowed its downward spiral in recent months, the rate of household formation has accelerated and demand for housing has thus increased, while the supply of new homes has decreased sharply. Year-over-year as of June 2009, the rate of household formation was 0.8%, as compared with 0.1% at the beginning of the year. Approximately 606,000 households were formed in the year through June 2009, while at the same time the number of total housing starts fell to 288,600 – a supply-side shortfall of approximately 317,400 or nearly 635,000 at an annualized rate. Granted, a backlog of excess single family supply still exists and there is declining demand for multifamily housing; however, household formation trends are improving. By extending the tax credit, we can capitalize on these trends and help speed the recovery of the U.S. economy.

Furthermore, many minority neighborhoods have been more heavily impacted by foreclosures and recovery is likely to be delayed as few local residents are able to take advantage of the current tax credit. Therefore, it is necessary for an extension to be enacted in

order for these neighborhoods to benefit from increased demand for housing. For example, the homeownership rate within the Hispanic population did not stabilize in the second quarter as it did for the overall population. As foreclosures and job losses are hurting this group disproportionately, it will take more time for the tax credit to have a positive effect. By promoting homeownership among minority groups, the tax credit for first-time homebuyers could have important effects on the long-term economic health of these population groups. Tax incentives for homeownership were arguably important for the creation of a middle class. The current tax credit could have a similar effect for minority groups, which traditionally have had low homeownership rates.

An extension of the current first-time homebuyer tax credit will help counter the effects of new foreclosures by increasing home sales, lowering inventory and thus stabilizing home prices, with an end result of more families able to stay in their homes. Additionally, these effects have the potential to reduce future foreclosures as declining home prices are one of the leading causes of lender repossession. With stabilized home values, homeowners are much less likely to fall “underwater” with their mortgage, meaning that they owe more to the bank than the home is worth, or at least stabilized values should curtail the increase in negative equity. Stabilized home prices would also generate a positive feedback loop, meaning that fewer foreclosures would lead to higher prices which would lead to fewer foreclosures and so on, again resulting in more families keeping their homes.

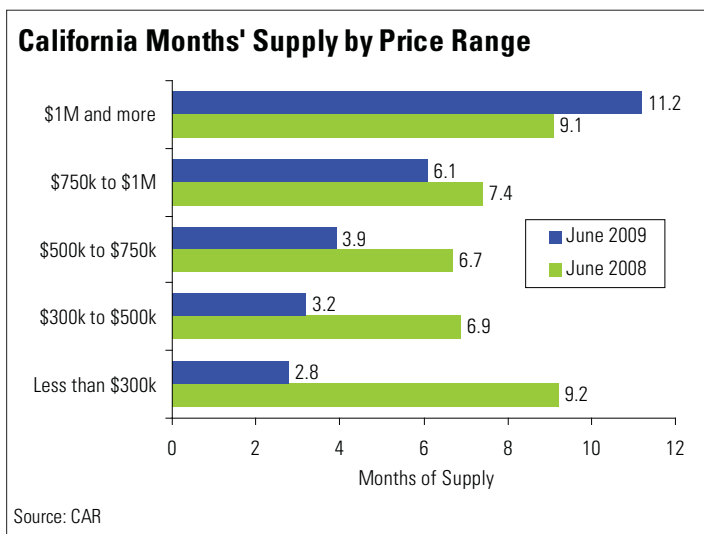
While the first-time homebuyer tax credit has showed signs of helping generate a housing market recovery, we believe that the deadline of November 30, 2009 does not provide enough time for the tax credit to make a sufficient impact. With this deadline, buyers have only a few more months to buy a home. Allowing the tax credit to expire threatens to offset any positive gains made thus far by encouraging homeownership among first-time homebuyers, including disruption of price stabilization trends, leading to a potential rise in foreclosures and further decreases in housing-related employment and subsequent tax revenues. Furthermore, the positive results generated by in-place state and local programs are apparent. A signal that the first-time homebuyer tax credit is to be extended will spur additional states to enact programs, thus making the tax credit an even more beneficial tool in increasing homeownership.

Expanding Tax Credit to Existing Homeowners

Extending the period for which the tax credit can be applied and monetizing the down payment would both foster demand for single family homes and help stabilize the housing market. Additionally, providing the credit to all potential buyers (who meet the income limitations), not just those considered first-time homebuyers, would help to promote homeownership across a wider range of price points, as well as accelerate the economic recovery. In the same vein, it would benefit the overall market if the tax credit were expanded to include higher income families, particularly in markets where aver-

age home prices are far beyond the national median price. In doing so, more households would be able to take advantage of the tax credit, thus further stabilizing prices through a wider range of price points. Increasing the income phase outs to \$125,000 for individuals and \$250,000 for married households, which according to the White House constitute the upper thresholds for middle-class income levels, would allow more families to take advantage of the credit, and thus further support a stabilizing housing market.

First-time homebuyers typically buy entry-level properties – smaller homes priced below the reported median price. While the current tax credit benefits the housing market in terms of stabilizing prices and reducing inventories, it is limited to first-time buyers, and is therefore boosting demand for entry-level homes. Once again, we can use California to highlight this trend. According to the California Association of Realtors, first-time buyer demand has increased markedly since the implementation of the tax credit. As buyers were required to repay the 2008 credit of \$7,500, we expect even more families to take advantage of the 2009 credit, which does not require repayment. However, the increased demand from first-time buyers is creating a disparity in the distribution of sales by price, as evidenced by the sharp decline in the inventory of homes priced below \$300,000. Some of the reduction may be attributable to an increase in short sales and distressed property sales, but we believe it is largely a result of the federal tax credit spurring demand for first-time buyers. On the opposite end of the spectrum, the months' supply of homes priced above \$1 million increased 23.1% year-over-year in June.



Demand for lower priced homes picked up substantially as a result of the tax credit for first-time buyers.

If the benefit of the tax credit were expanded to all existing buyers, the demand for homes would extend to a higher segment of the housing market. Of course, the income restrictions on the tax credit will still concentrate its effects on the lower-to-middle portion of the housing market. However, if the credit were phased out at higher income levels as mentioned above, demand for homes would extend to more expensive housing markets, such as those located in coastal areas, and thus spur demand on a wider scale. By expanding the credit to all households, growing families would be able to take advantage of the tax incentive to purchase a larger home, creating an additional entry-level home on the market for a first-time homebuyer to purchase. The larger home purchased by the move-up buyer would be made available because the previous owner also decided to purchase an even larger, more valuable home, and so on. More movement in the market would facilitate a supply and demand balance that would likely result in stabilization throughout the lower and middle part of the price spectrum. Additionally, if the income limits were increased to include the upper threshold of middle-income families, the increased demand in coastal markets would facilitate stabilization of the housing market for medium price tiers, which are particularly prevalent in coastal markets.

With prices more stable across more price points, and possibly appreciating, lenders would likely have more confidence in extending credit to potential buyers, as well as extending credit to existing homeowners who are looking to refinance. The additional home equity created with appreciating prices in a stabilized housing market would likely mean additional consumer spending on home improvement projects, home goods, and other discretionary purchases. Typically, home furnishing and appliance sales increase when housing market activity increases, which is a boon for overall retail sales since those items are usually more valuable than most other retail goods. Consumer spending contributes to approximately two-thirds of GDP, and in order for more consumers to feel comfortable spending, the housing market, the credit market and the job market all need to exhibit stability and the potential to grow. By extending the tax credit to all families regardless of previous ownership, we believe house prices would stabilize more quickly and a more rapid housing market recovery would strengthen the overall economy.

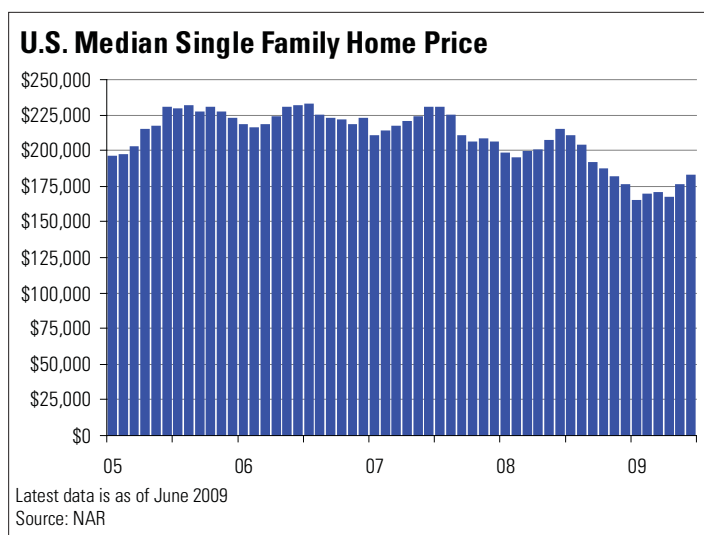
Conclusion: Benefits of Tax Credit

Extending the current tax credit until September 2010 and expanding it to include more buyers will benefit not only the housing market, but also the broader economy. The housing sector's recovery has led the nation out of recession during nearly every economic downturn of the last 40 years. Therefore, the continued stabilization of the housing market, driven by the demand created by the tax credit, is a crucial component of the economic recovery and rebound in job creation.

The following are some of the most important positive effects that we believe the expansion and extension of the tax credit will have on the housing market and broader economy.

Reduction in Foreclosures

By increasing sales activity at the lower end of the market, the tax credit is removing some of the inventory of bank-owned properties available for sale, leading to price stabilization. In many markets, 50% to 70% of completed home sales are resales of lender-owned properties, demonstrating the strong demand for these discounted properties. First-time homebuyers are a major driver of these sales because of the tax credit, as well as increased affordability and low mortgage rates. The increase in sales activity at the lower end of the market is causing home prices to stabilize, even as foreclosures continue to be added to for-sale inventory.



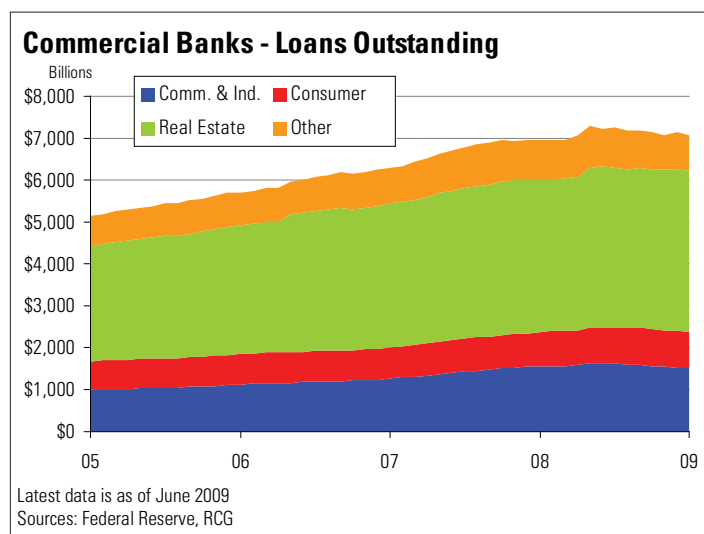
Home prices are showing early signs of stabilization, especially at the low end of the market.

Keeping American families in their homes is another reason why providing incentives to buyers is important. Without adequate sales activity, prices once again will drop, resulting in a decline in home equity. This decline creates the potential for far more defaults as homeowners walk away from underwater mortgages, creating a secondary downward force on the housing market. According to

a joint study released in June by the University of Chicago Booth School of Business and the Northwestern University Kellogg School of Management, 26% of existing defaults are strategic. Moreover, an estimated 17% of households will default if the equity shortfall declines to 50% of the value of the house, even if the family can afford to make the payment. As long as prices continue to decline, more families will cut their losses and default on their mortgages, which in turn will prolong the housing downturn. The boost in demand created by the continuation of the tax credit would help to further stabilize home prices, therefore reducing the number of families walking away from their homes.

Increase in Banks' Ability to Lend

Because of the glut of foreclosures that remains on financial institutions' books, the credit markets remain tight and financial institutions are still writing down billions of dollars worth of assets. Thus, the mortgage-lending burden has fallen on entities such as Fannie Mae and Freddie Mac, which have seen their portfolio caps dramatically increased during this crisis.



Commercial banks have decreased the amount of loans to businesses and consumers on their books during 2009.

If home prices were effectively stabilized and demand for homes increased through the extension of the tax credit, banks would be able to both decrease their inventories of REO homes, as well as feel comfortable resuming mortgage and commercial lending. A resumption of lending throughout all sectors is essential to re-starting the nation's economic engine. Increased private lending to businesses would allow for investment in efficient and productive sectors of the U.S. economy, with the potential to save and create many jobs. Stability in the single family housing market should also open up credit markets to consumers, helping families pay their bills as well as driving demand for consumer goods, thus preserving jobs in the retail and other services sectors.

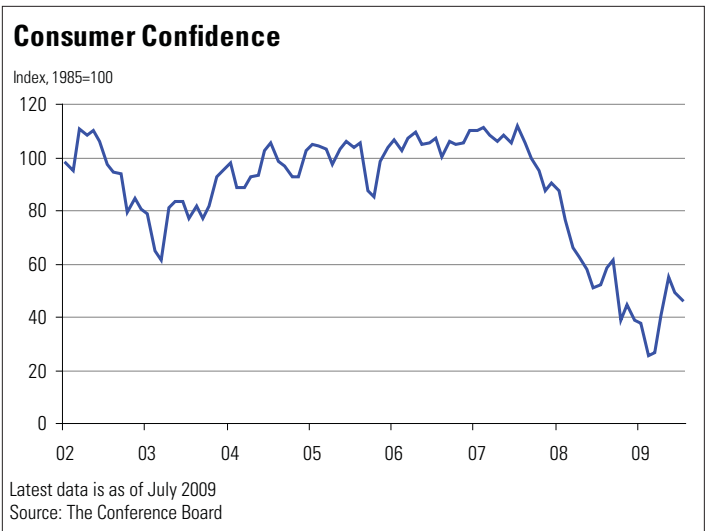
Stabilization of Communities

The effects of the continued stabilization of homes prices and reduction in the number of foreclosures through the extension of the tax credit are far-reaching, benefiting not only the families utilizing the credit, but also their neighborhoods and communities. For example, the effects of foreclosure on neighboring property values would be mitigated, helping even financially-stable homeowners with no plans to relocate feel comfortable with the value of what is likely their largest asset – their home – and thus improving consumer confidence. Additionally, by keeping families in their homes, there are many intangible benefits such as a stabilized community and avoidance of the blight and crime that can accompany abandoned properties, which benefits both renters and homeowners. These trends should lead to increased financial security for many more individuals than just those who are new home buyers or currently at-risk for foreclosure; it should lead to preserved wealth and financial stability for all homeowners.

Improved Consumer Confidence and Retail Sales Growth

With the implementation of the federal tax credit, many households have been afforded the opportunity to purchase a home for the first time, which we believe has had a positive effect on consumer confidence. According to The Conference Board's index, consumer confidence rose from 25.3 in February – the lowest reading on record – to 46.6 (preliminary) in July. Nonetheless, the index remains low by historical standards, as the severe economic recession is weighing heavily on many consumers, especially given the large number of job losses and the threat of foreclosure to some households.

We believe the economy will not begin to show signs of recovery until at least late 2009, and it is likely that consumer sentiment will not improve until job growth resumes. GDP is largely comprised of consumer spending, and thus it is vital to instill confidence in the consumer in order to jumpstart the economy. Although not all households will be able to purchase a home with the tax credit, the increase in homeownership and purchasing ability could convince consumers that economic conditions are improving, and that the floor has been reached. If consumers believe that the economic freefall has begun to reverse, or at least reached bottom, then economic activity would likely improve in concert.



Consumer sentiment is near an all-time low, but slowly improving.

The recent increase in home sales activity has not only benefited the housing market, but may also be contributing to a slight improvement in retail sales for home-related goods. Typically, new homeowners will invest in new furniture, home improvements, or necessary maintenance for their homes, and such activity usually boosts retail sales in home-related goods, as well as benefits workers who offer home-improvement or repair services. A 2003 report by the Joint Center for Housing Studies at Harvard University found that homeowners accounted for more than 75% of home improvement and remodeling purchases in 2001. Although retail sales overall continue to be quite weak, there was a slight monthly increase of 0.4% in home furnishings and home electronics/appliances sales in June, indicating that the freefall in sales activity has reached a bottom. With the extension of the tax credit, increased demand for homes should spur retail sales activity for home-related goods.

Employment – Housing-Related Industries

Job losses in real estate-related industries have been dramatic in this recession. Year-over-year in June, total employment contracted by 4.0%, while employment in the construction sector contracted by 13.7%, or a loss of slightly less than one million jobs. In addition to construction-related jobs, home sales activity supports employment related to housing including brokers, lenders, and appraisers, as well as retail sales and manufacturing of homebuilding materials. Year-over-year in June, the real estate, rental, and leasing employment subsector declined by 6.8%, while the retail trade sector posted a decline of 3.9%. The manufacturing of durable goods, which includes wood, metal, and furniture manufacturing, lost nearly 1.3 million jobs year-over-year in June, or a decline of 15.0%. Home sales activity is a major component of the economy, with an economic impact estimated to contribute anywhere from \$1.34 to \$1.62 to GDP for every dollar spent, according to the NAR. Because of its significant economic impact, real estate-related job losses have had

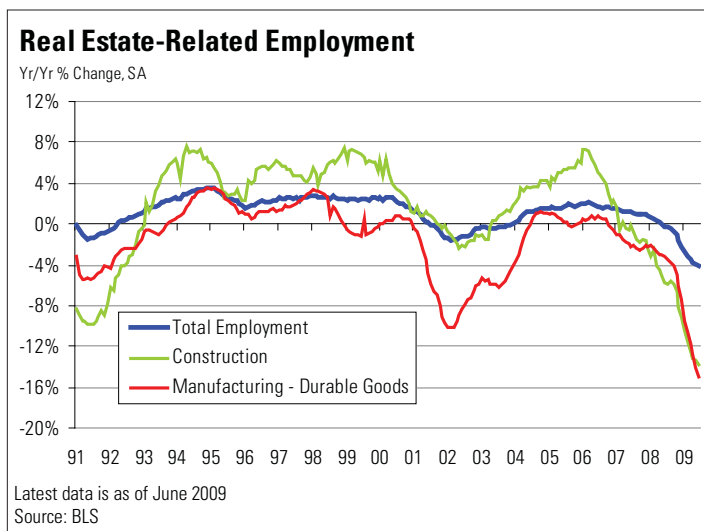
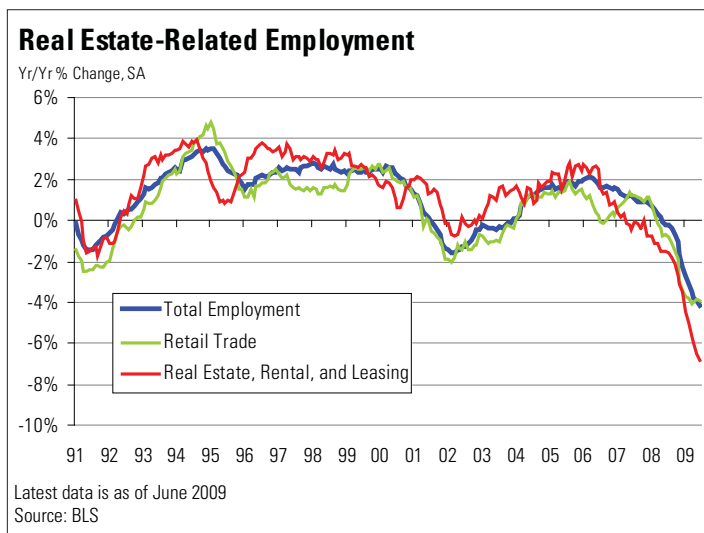
a devastating effect, particularly in areas where the local economy was heavily dependent on real estate. By supporting and creating additional demand, the first-time homebuyer tax credit should help spur job creation in industries that are dependent on real estate.

ing the tax credit would accelerate the recovery in real estate- and construction-related industries, boosting job growth in those sectors, as well as mitigate job losses in the government sector.

State and Local Tax Revenue

A large share of local government revenue comes directly from taxes levied on real estate, via property taxes, development fees and transfer taxes. As property values have declined, tax revenues have taken a hit. Besides real estate taxes levied on homeowners, property taxes from rental properties, commercial properties, and land have also declined as the economy has soured. According to a survey by the National Association of Counties, 76% of large counties were anticipating lower tax receipts in 2009 due to falling property values. To counteract the decline in revenue, cities and counties are forced to cut costs elsewhere. In a related survey, 80% of respondents were planning on implementing employment freezes in order to address the budget shortfall, while 30% of respondents also said they were planning layoffs. Similarly, 60% of respondents were planning on service delivery cutbacks and other miscellaneous budget cuts.

Particularly in light of large budget losses stemming from the housing market downturn, state and local governments stand only to gain from extending and expanding the first-time homebuyer tax credit. The recovery in prices, sales, and development, all of which provide major revenue streams for government through property taxes, transfer taxes, and development fees, will put local municipalities back on healthy fiscal footing. Additionally, boosted retail sales and job growth would also add to local tax revenue with additional income from retail sales and income taxes.



Employment in most real estate-related sectors has declined dramatically.

With the up-tick in demand for housing in recent months, however, there is some light at the end of the tunnel. Particularly if extended through September 2010, the tax credit could spur development activity, and thus job creation in real estate-related sectors. The NAR estimates that every home sold at the median price generates an economic impact of approximately \$63,000, accounting for all aspects of the home buying process, including broker fees, inspections, moving expenses and average remodeling costs. Another example comes from California, where, according to the California Building Industry Association (CBIA), the California new-home tax credit has resulted in increased development activity and created jobs. The CBIA estimates that each new home built generates two to three jobs as well as an average of \$16,000 in tax revenue. Therefore, extend-