NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

500 New Jersey Avenue, N.W.

Washington, DC 20001-2020

Charles McMillan
CIPS, GRI
President

Dale A. Stinton
CAE, CPA, CMA, RCE
Chief Executive Officer

GOVERNMENT AFFAIRS DIVISION
Jerry Giovaniello, Senior Vice President
Gary Weaver, Vice President
Joe Ventrone, Vice President
Jamie Gregory, Deputy Chief Lobbyist

TESTIMONY OF CHARLES MCMILLAN, CIPS, GRI PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS

ENTITLED:

"ECONOMIC RECOVERY: TAX STIMULUS ITEMS THAT BENEFITTED SMALL BUSINESS AND A LOOK AHEAD"

JULY 15, 2009

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

EQUAL HOUSING OPPORTUNITY

Introduction

Madame Chairman and Members of the Committee. I am Charles McMillan, 2009 President of the National Association of Realtors. I am a real estate broker from Dallas, Texas. I am here to testify on behalf of more than 1.1 million REALTORS® who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others who are engaged in all aspects of the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS.

The NATIONAL ASSOCIATION OF REALTORS deeply appreciates Congress's efforts in seeking solutions to the housing crisis that has had such a negative impact on the economy since 2007. Not only did the 2009 stimulus legislation contain helpful relief, but other tax bills in enacted in 2007 and 2008 also included provisions that all contribute to the stabilization of housing markets. Those 2007 and 2008 provisions were also refined and/or extended in the 2009 stimulus bill, so let me enumerate the helpful things that Congress has done.

Mortgage Cancellation Relief

Until Congress changed the law in 2007, homeowners who sold their houses for less than they owed on the mortgage found that they actually had to pay tax on their loss. Under the rules in effect until 2007, when a lender forgave any portion of a mortgage debt, the amount forgiven was treated as ordinary income to the seller and taxed at ordinary rates. So, at the time of sale, these unfortunate borrowers suffered what, for most, would have been the biggest economic loss of a lifetime, left the settlement with no cash at all and then had to pay additional taxes. Fortunately, until 2007 very few homeowners experienced this sad outcome.

Over the past thirty years, some housing markets have experienced downturns. These occurred in the early 1980's (Texas and Oklahoma), late 80's (the Northeast), the early 1990's (Los Angeles). These downturns were always highly localized and were the result of downturns in particular industries. When those local industries stabilized, housing rebounded quickly. The experience of a national downturn such as we have experienced in the past three years, however, has been unknown since the Great Depression.

In 2007, Congress enacted a relief provision so that when a person sold his/her principal residence for less than the amount of the outstanding mortgage balance, any amount that the lender forgave would NOT be treated as taxable income, so there would be no tax burden. Chairman Rangel and his staff were very helpful in crafting a very workable rule that nonetheless maintained adequate anti-abuse rules. Homeowners receive no relief for any cash-out refinancing or for home equity lines of credit. We are satisfied that this is a fair result.

The 2007 relief provision was originally slated to be in effect from January 1, 2007 through December 31, 2009. When it became apparent that the housing crisis would persist beyond 2009, Congress used stimulus legislation to extend the provision through December 31, 2012.

This provision has proven invaluable to sellers and has eliminated at least one obstacle to the time-consuming burden of completing a short sale (one in which there are insufficient funds to pay off existing mortgages). Sellers in short sales are relieved of the challenge of figuring out how to pay taxes on the phantom income generated by the forgiven debt. While we believe this relief should be a permanent provision in the Code, we recognize the difficulties Congress has in scoring and paying for tax law changes. We are pleased that it will be in effect for an additional three years.

First-time Homebuyer Tax Credit

Early in 2008, within weeks of the enactment of the mortgage cancellation debt relief, it was apparent that the housing crisis would deepen. At that time, a group of about fifteen of NAR's opinion leaders met to review several ideas for shoring up the housing market, establishing a floor for falling prices and clearing an overhang of excess inventory of homes for sale. The group discussed a variety of possibilities, including special above-the-line deductions for mortgage interest and/or property taxes, expansion of mortgage revenue bond eligibility, investor incentives (including suspension or relaxation of the passive loss rules) and tax credits for the purchase of a home.

The group agreed that the most immediate bump would come from creating a tax credit for purchasers of a principal residence. An optimal credit could be monetized so that purchasers could, in effect, apply the credit toward a downpayment and closing costs. An optimal credit would be refundable so that overpayments of tax could actually generate some funds for improvements when the purchase was complete. An optimal credit would also be a fairly significant amount of money, perhaps as much as the $15,000 proposed by Senator Johnny Isakson in early 2008. In all events, a credit should be sufficiently generous that it would be perceived as a genuine incentive.

The group recognized, as well, that a credit limited to first-time purchasers would provide the best mechanism for clearing over-abundant inventory of homes for sale. At the same time, the group also believed that a credit available to all purchasers would generate more transactions and thus enhance the perception that markets were active. In the end, the 2008 version of the tax credit was a $7500 refundable credit limited to first-time purchasers of a principal residence, scheduled to be effective between April 2008 and June 30, 2009. The credit was finally enacted July 30, 2008. Thus, much of the active summer buying and selling season had passed. Regrettably, Congress was unable to devise a workable mechanism that would allow lenders to monetize the credit in advance of purchase. (We note that at least 15 state housing agencies have devised programs that enable purchasers to monetize the credit. We salute their efforts.)

The 2008 credit was part of a "paid-for" tax bill. NAR accepted that reality and agreed to the pay-for provisions that were drawn from the housing industry. (These included the repayment feature of the credit and a limitation on the $500,000 capital gains exclusion for individuals who converted a vacation home or rental property to a principal residence and then later sold the converted home.) One flaw in those pay-fors was evident even before the credit was enacted.

The 2008 $7500 tax credit included a requirement that the credit amount be repaid, starting with the 2010 tax returns that would come due in 2011. Thus, what was created as an incentive was, in reality, simply an interest-free loan. Accordingly, homebuyers did not embrace the credit as eagerly as we would have hoped. Our members reported that prospective purchasers perceived the credit as a debt.

First-time homebuyers are, by definition, less familiar with the day-to-day or month-to-month financial flows inherent in homeownership. Our members found that potential buyers simply did not want to incur a 30-year mortgage and an additional 15-year, $500 annual debt load. Uncertainty about the 15-year repayment requirement was exacerbated by the fact that no one, including the IRS, could describe the mechanics for making the annual payments. To date, no guidance has been issued to clarify the compliance mechanisms for the repayment.

By the end of 2008, financial markets and, to a lesser extent, the housing market were in free-fall. Thus, the tax provision in the 2009 stimulus that most directly assisted the housing market and real estate business operations was an increase and an extension of the $7500 tax credit. The 2009 stimulus increased the amount of the credit to $8000, retained its refundable feature and extended the duration of the credit from June 30, 2009 to December 1, 2009. The extension of the duration of the credit was especially helpful, as it includes the more active summer and fall sales periods.

Notably, the 2009 version of the tax credit does NOT include any repayment requirement. Consequently, our members consider ongoing requirement to repay the 2008 repayment as particularly unfair. Some have even called it a bait and switch. Certainly it is an anomalous result to leave 2008 purchasers saddled with repayments while 2009 buyers receive a larger tax credit that is not repaid. While Realtors and consumers understand that everyone who qualified for the credit in 2008 knew the rules, they still view the repayment of the 2008 credit as unfair.

We also question the merits of the repayment from the perspective of sound tax administration. We do not believe it is in the best interest of either those who used the credit or of the IRS to maintain a 15-year repayment and/or recapture program for a provision that was in effect for only eight months. We ask that Congress consider eliminating the repayment requirement for 2008 purchasers.

Realtor anecdotes indicate that the 2009 tax credit has been widely embraced. Also, our staff continues to receive many calls seeking clarification of various applications of the credit and our website devoted to the credit continues to receive a steady volume of hits. We are unable to either

make a guess or to report any official data, however, about how many individuals and families have *actually* used either the 2008 or the 2009 tax credit. The only source of this information will be the IRS.

The credit for both 2008 and 2009 purchases is claimed on a 2008 tax return (or is yet to be claimed on either an amended 2008 return or a 2009 return filed in 2010). Thus, only the IRS will have accurate data specifying how many taxpayers took advantage of this important provision. Not surprisingly, the IRS has not yet compiled even preliminary 2008 data on the credit, as those returns are still being filed. Additional amended 2008 returns claiming the credit will be filed throughout the year, and some 2009 purchasers will opt to claim the credit on their 2009 returns. Thus, no official information on credit utilization is likely to become available until late in the year or even some time next year.

We can tell you some things about the performance of the market, however. Historically, between 35 and 40 percent of the home sales in any particular year are purchases by first-time homebuyers. During the first quarter of 2009, however, *more than half* of the purchases in 134 of the 152 metropolitan markets we track were made by first-time buyers. Moreover, the gradual but steady uptick of existing home sales between March and June of this year suggest a direct correlation between enactment of the stimulus and awareness and utilization of the tax credit. Our Research Department is working to compile additional information about first-time buyers, and we will be pleased to share those profiles with you as we gather information.

We also point out that the borrowing patterns of these purchasers suggest a greater likelihood of market stability going forward. In 2006, 71% of all mortgages were fixed-rate instruments. By 2008, this portion had climbed to 91%. During 2006, 23% of borrowers had some form of adjustable rate mortgage. (Much of the so-called subprime crisis arose because of ill-advised adjustable rate mortgages.) In 2008, only 6% of mortgages carried adjustable rates. In addition, most lenders are again requiring downpayments. Even the FHA program now requires a 3.5% downpayment. During the boom the FHA had products available that required no downpayment whatever. We believe, again based on anecdotes, that some lenders have returned to the long-ago standard of requiring downpayments closer to 10% to 20%. All this suggests a commitment from both borrowers and lenders for greater stability and accountability in home purchases.

Ground zero of the housing crisis has been in Nevada, California, Arizona and Florida. We note that these are the very markets that experienced the greatest increase in transaction volumes in the past quarter, though prices have remained low. This increased activity suggests that consumers perceive that prices have stabilized and that it's a good time to buy real estate. Certainly there is more entry-level housing available right now than there has been for more than a decade. That's not good news for sellers, but it certainly has enhanced the first-time buyer market. NAR's Chief Economist has noted that today's market is really two separate markets – one in which purchases of

foreclosures and short sales dominate, and a second, more traditional market, where prices and performance have been more stable.

With respect to prices, we emphasize, as we have throughout this ordeal, that market performance depends completely on where you live and the manner in which your community experienced the 2003 – 2006 boom. Nonetheless, the numbers tell a harsh story. Compared with a year ago, the median price of an existing home across the nation has declined nearly 17%. Compared to 2006, the decline in prices for existing homes is 22% nationally. The following chart shows regional declines between the May 2008 and May 2009 as well as declines between May 2006 and May 2009.

Declines in Median Price of Homes – National, Regional

Time Period	**U.S. Median Decline**	**Northeast Decline**	**Midwest Decline**	**South Decline**	**West Decline**
May 2008 – May 2009	16.8%	12.5%	10.4%	9.9%	30.6%
May 2006 – May 2009	22%	10%	13%	14.3%	42.3%

Note that median prices are significantly and unduly depressed because many buyers, including investors, have sought deeply discounted distressed sales – foreclosures and short sales. These below-market transactions accounted for nearly half of all transactions in the first quarter of this year. This weighed down median prices, sometimes to the point that homes were sold for less than it would cost to construct a similar replacement property.

We should point out that in the fall, as we approach the scheduled December 1 expiration of the homebuyer tax credit, more and more consumers will be hard-pressed to complete their transactions, particularly if they are trying to purchase a home out of foreclosure or in a short sale. Short sales transactions in particular take a very long time to close because the lenders involved are understaffed and also slow to make decisions. It would be a shame if individuals who entered into timely contracts to purchase in good faith, anticipating the benefit of the tax credit, were barred because they were unable to close their transactions because the lenders in short sales or foreclosures failed to act in a timely manner.

To avoid this problem and to continue to move the housing market forward, NAR urges that Congress extend the tax credit's December 1 expiration date through next year. An optimal tax credit provision would eliminate the repayment requirement for 2008 credits and extend the 2009 credit through 2010. Many Realtors also support increasing the amount of the credit to something between $10,000 and $15,000 and making the credit available to all purchasers.

Special Property Tax Deduction for Non-itemizers

The 2008 housing legislation that created the homebuyer tax credit also included a provision that allowed taxpayers who do not itemize deductions to take a special deduction for property taxes of up to $500 ($1000 on a joint return) paid in 2008. This provision was extended to include 2009 property tax deductions in the Emergency Economic Stabilization Act enacted in October 2008.

While we have some general policy concerns about the advisability of blurring the distinction between itemizers and non-itemizers, we do acknowledge that this special deduction was in fact a tax cut that likely put additional money in the pockets of homeowners at a time of great economic disruption. Certainly tax cuts of any type were welcome in late 2008 and will remain important to homeowners whose homes have or will continue to lose value during 2009.

Nonetheless, we are hopeful that the tax-writing committees will not adopt additional provisions that blur the boundaries between itemizing deductions and using the standard deduction without a careful review. The standard deduction is an important simplification mechanism that benefits all taxpayers. A provision like this special property tax deduction adds complexity. Additional complexity is always an undesirable result.

Looking Ahead

One useful provision of the stimulus legislation was not specifically a tax rule, but could be clarified if the Small Business Administration (SBA) incorporated a tax-based definition as it implements stimulus provisions within its jurisdiction. The stimulus provided fee waivers for some of its programs, raised the guarantee to 90% on another and created a new loan program. However, when implementing these programs the SBA's often deems independent contractors ineligible for its programs. Their justification is that most independent contractors are not subject to adequate affiliation and control and may not be of adequate size to assure that they are in fact going concerns.

Moreover, when SBA does assess whether an independent contractor might be eligible for SBA programs, the evaluation standards are unevenly applied among the SBA regions. When independent contractors are denied access to SBA programs, the justification is often that independent contractors are not subject to adequate affiliation and control and are not of adequate size to assure that they are in fact going concerns. In addition, SBA often finds that real estate agents are affiliated with and controlled by brokers and are not independent businesses. In fact, real estate sales agents are autonomous businesses.

Real estate sales agents, however, follow a business model that addresses the concerns of affiliation and control. Internal Revenue Code Section 3508 allows broker/owners to treat their sales agents as independent contractors so long as the agent (a) has a valid real estate license, (b) has a written contract with the broker/owner that stipulates the independent contractor arrangement and (c) is

compensated solely on a commission basis and not on the basis of hours worked. This business model is standard practice throughout the real estate sales industry. Section 3508 has been in effect since 1983. Compliance with its standards is high, and NAR provides periodic reminders to broker/owners to be sure that they have written agreements in place with their agents.

Accordingly, we believe that the SBA should make it clear that independent contractor real estate sales agents who have complied with Internal Revenue Code Section 3508 are eligible for SBA loans. Real estate sales agents are affiliated with brokerages and have great autonomy, but must nonetheless satisfy certain quality standards that the broker/owner might impose. Real estate sales agents need capital for their businesses. Even though they are not responsible for providing bricks and mortar for a business, they must still provide much or all of their electronic equipment (cell phones, pagers, GPS and similar voice and text devices) and office equipment that might include copiers, scanners, fax machines and similar devices. Every real estate sales agent must have a car (or sometimes two) in order to show property to their clients. Accordingly, sales agents' capital requirements are genuine and can be quite substantial expenses, particularly when business is slow.

We believe that it is in the best interest of the SBA in administering its programs consistently across the US to provide explicit guidance that real estate sales agents who satisfy the standards of Code Section 3508 will be eligible for SBA loans. In terms of affiliation and control, the relationship of a sales agent to the broker/owner is analogous to the relationship between a franchisor and franchisee. Franchisees are eligible for SBA loans. We believe that the sales agent/broker relationship is simply a smaller scale version of the franchisor/franchisee relationship.

NAR is surveying its membership to learn more about their experiences with the SBA and SBA loan programs. We will be pleased to share our findings when our survey work is complete.

Conclusion

NAR appreciates this opportunity to provide comments about the stimulus package. Congress has been responsive and creative in seeking tax solutions and in enhancing FHA and other federal housing programs.

Historically, housing has led the country into every recovery following a recession. Certainly this recession will be no exception. In fact, our view, shared by many, is that this recession *cannot* end until housing markets recover. The most effective action in Congress would be an extension of the homebuyer tax credit through 2010. This is our highest priority with respect to the tax credit. In the interest of fairness to consumers and in the furtherance of better tax administration, we also urge Congress to eliminate the credit repayment requirement for purchasers who bought in 2008 and utilized the $7500 tax credit. Other changes, including increasing the amount of the credit and/or expanding the universe of eligible purchasers would be useful enhancements, as well.

Finally, to help real estate sales professionals facilitate the sales that will help end this recession, we ask you to encourage the SBA to provide explicit guidance clarifying that real estate sales agents who satisfy the requirements of Code Section 3508 are eligible for SBA loan programs, just as the nation's other small businesses have always been.

NAR collects and analyses extensive data about the performance of the housing market. We would be pleased to answer questions that the Committee might have.