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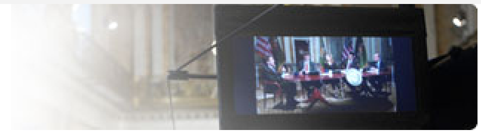

# Remarks by Assistant Secretary Jan Eberly before the Anuual Conference of the Governor's Illinois Housing Authority

4/17/2012

**CHICAGO -** Thank you for that kind introduction, Director Kenney.  It is such a pleasure to be back in Chicago and an honor to be part of the Governor’s Illinois Housing Development Authority’s annual conference.  A year ago, I was enjoying spring here in Chicago, on my way from Northwestern to join the Obama Administration and to join all of you in public service – to try to do what we can to serve and support our country and our economy.  Since coming to Treasury, I have focused a tremendous amount of energy to tackling the multitude of issues facing our economy and the housing market.  This experience has led me to develop a deep appreciation for the critical work that so many of you do on a daily basis, developing and implementing policies to help people and to fix the problems that we face here in Chicago and throughout the state of Illinois.

**Economic Context and Recovery**

Before I discuss housing specifically, let me first line up housing with the broader national economy.  Much has been said and written recently about uncertainty and its effect on the economy.  This topic is one of my specialties as I’ve spent several decades thinking about and working in this area.

I’ll return to this later, but as an introduction to how I think about the economy … we always face uncertainty: in the late 1990s there was the internet bubble and the East Asian Financial Crisis.  In 2001, the terrorist attacks of 9/1l occurred, and we questioned whether these and future attacks would undermine the stability of our financial and transportation systems.  Whenever we face an event that is outside the range of the data and experience we know, it creates uncertainty, because it’s difficult to translate what we know into what we should do.  The recent recession and financial crisis are an extreme example – the U.S. has not experienced a true financial crisis since the Great Depression.  Its aftermath has left us with a series of challenges well outside our own experience.  But what we know from the Depression and from other countries is that recoveries from financial crises are different than recoveries from cyclical recessions.  Zarnowitz’ rule, named after Victor Zarnowitz, a respected business cycle researcher, showed that more severe recessions are usually associated with more robust recoveries: a severe recession results in a “bounce back” recovery.  But this does not occur following financial crises.  In that case, the recoveries take longer and are more uneven than Zarnowitz’ rule would suggest.

The mechanisms behind this slower, more uneven recovery are surely familiar to you, who are in the field in housing markets.  We can’t compare this recovery to previous recoveries without taking into account the tremendous loss of wealth due to the once-in-a-generation decline in the value of home prices.  This decline had a tremendous impact on middle- and working-class families for whom their home is their largest asset.  In addition, there was damage to the financial infrastructure and other features that are unique to this recession, but are common remnants of financial crises.  With that perspective, and, to be honest, much benefit from hindsight, our economic experience since 2007 is less puzzling and uncertain.

Turning that lens to the current macro data:

In the last few months we’ve seen a general improvement in the tone of the incoming economic measures.  On average, employment grew by over 210,000 jobs per month in the first quarter, an increase from the 164,000 averaged during the fourth quarter of 2011.  The unemployment rate has fallen nine-tenths of a percentage point, from 9.1 percent to 8.2 percent since last August –and, while this is still too high, it represents a broad-based improvement across a wide variety of industries and demographic groups.  This decline is largely a result of people leaving unemployment for employment and is not a quirk of measurement nor driven by declining participation in labor markets.  Overall, more than 4 million people have found jobs and rejoined the active labor force since December 2009.

The business sector has been a source of relative strength in the recovery to date, with over 30 percent growth in investment in equipment and software since the trough of the recession, and an18 percent increase in business fixed investment more broadly, an increase of almost 25 percent in exports, and an increase in corporate profits to a six-decade-high level of profitability.  The initial improvements we are seeing in the labor market are a natural next step, as hopefully hiring will continue to follow the growth we have been seeing in both profits and investment.

The household sector has yet to exhibit the kind of resilience we have started to see in businesses, in part because of the stubborn problems that still remain in residential real estate.

**Challenges in Housing**

This is certainly a group that understands the dynamic interaction between the housing market and the labor market.  Indeed, challenges in the housing market greatly impact the lives of working families.

And while the trend has been positive, continued challenges in the labor market have impacted the housing market.  When homeowners are unemployed or underemployed, they may have difficulty making their mortgage payments or refinancing their mortgages.  When credit conditions change sharply, individuals – who had previously expected to be able to get a mortgage – may now find that homeownership is out of reach.

Other data reaffirm these housing market challenges.  On average, house prices have fallen by 33 percent from their 2006 peak; housing wealth has fallen by over $6 trillion.  This has led to 11 million homeowners who owe more on their mortgages than their homes are worth, an amount totaling about $700 billion.  However, some data in recent months suggest that the housing market is firming; for example, existing home sales have risen almost 7 percent over the last five months.

Residential investment is usually an important contributor to economic recovery, but that was not the case until the fourth quarter of 2011, when residential investment rose by 11.6 percent and contributed¼ percentage point to GDP growth.

Despite these signs of firming, home prices have yet to rebound. While the monthly FHFA home price index rose over the last two months of 2011, it slipped slightly in January, leaving the index down about 0.8 percent in the past twelve months. The Case-Shiller 20-City price index fell for a fifth straight month in January, though only half of the twenty cities showed a decline. Chicago was one of the cities posting a decline, and January's drop was the fifth in as many months, taking prices to a new low.

Homes available for sale decreased for the last six months of 2011, ending the year with an inventory of 2.5 million homes, a 6.3-month supply. However, inventories rose again in February as sales sagged. Most analysts estimate that, due to the large number of distressed mortgages and the slow rate of foreclosure sales, it would take more than 2 years to clear the "shadow inventory" of properties that are not yet on the market but will eventually face resale.

These conditions in the housing market reflect a varied set of challenges. Even homeowners who are not in acute financial distress have lost a great deal of housing wealth. This affects their consumption and saving choices, and hence feeds back to the broader economy. The decline in housing wealth has also made it more difficult for many borrowers to refinance. Other homeowners are in financial distress and struggling just to stay in their homes. Still others are seeking affordable rental housing, either because they had to or chose to, due to falling housing prices and changing credit conditions. As more people opt for rental housing, rents rise. Simultaneously and ironically, as the foreclosure crisis continues, communities are confronting the challenges that come with vacant or abandoned properties.

Against this backdrop, working families face a very challenging set of conditions, including rising rents and falling home prices. While the Case-Shiller index shows home prices are falling in Chicago, the Zillow rent index shows that rents in the Chicago metro area rose by 8.6 percent over the past twelve months. With average hourly earnings in real terms falling last year and rents rising, rental housing is becoming less affordable.

**Housing Policies and Impact**

Because of these many challenges in the housing market, no single policy or even several can confront all of them. The financial crisis caused terrible damage to the housing market and the broader economy that will take time to fully heal. But even though we can't address everything with a single sweeping program, it is simply wrong to conclude that the only option is to sit back and wait, paralyzed, for the housing market to resolve itself. The Administration has launched a varied set of housing programs, aimed at different dimensions of the existing challenges that, when coupled with overall improvement in the economy, are helping to stabilize the market.

I will briefly highlight a few of these programs, which I believe have been more successful than generally understood. I will then turn to what more we need to do and in conclusion make the case for why what we are doing together is so critically important, not only to improving our economy today but also to ensuring a path forward that includes prosperity and opportunity for this generation and for future generations.

**Helping More Americans Refinance their Mortgages**

As you know, mortgage rates are at an all-time low. Typically, when rates fall – as they have in recent years – homeowners flock to refinance their mortgages. This has positive effects on households' spending and on the macroeconomy, and is one of the ways that lower interest rates usually operate to support an economic recovery. Since 2006, however, less refinancing has occurred than the fall in rates would suggest. For example, from 2000 to 2003, mortgage rates fell about 3 percentage points and refinancing increased by a factor of seventeen; by contrast, since 2008 – a period over which mortgage rates have fallen by 2 percentage points – the pace of refinancing has only tripled. Despite flat to slightly increasing mortgage rates, refinancing volumes remained strong from 2003 through 2006 primarily due to "cash out" refinances in which borrowers increased their mortgage balances. In 2006, 86 percent of refinances extracted home-equity, and over half of refinances actually increased the mortgage rate. Needless to say, cash out refinances are rare now and many homeowners instead are having difficulty refinancing at all, often because they are underwater or face other frictions.

The Home Affordable Refinance Program (HARP) was designed to lower barriers to refinancing. HARP has helped nearly one million homeowners with Fannie Mae or Freddie Mac mortgages to refinance at historically low rates.

Recently, changes were made to the program to extend its reach to additional homeowners. These include removing the loan-to-value limit, lowering fees, and other measures to remove the "underbrush" of frictions that make refinancing costly and difficult. These changes should allow even more GSE borrowers to refinance, especially those who are deeply underwater and had so far been locked out of refinancing. So far, survey evidence suggests about 300,000 initial applications into the new program, and underwater borrowers in the HARP program represent a rising share of refinance applications.

In addition, the President has also recently proposed broader access to refinancing to non-GSE borrowers who are current on their mortgage payments, recognizing that the ability to refinance should not depend on whether or not your loan happened to end up with the GSEs. Borrowers who have so far been ineligible for refinancing because they are underwater on their mortgages – trapped paying higher interest rates, costing them thousands of dollars per year – would be able to refinance.

**Mortgage Modifications**

Other homeowners are struggling just to stay in their homes. Difficult labor market conditions or other financial stresses have made it challenging for many borrowers to continue to make their mortgage payments. This has led to record rates of delinquency and foreclosure. Today, one out of eight homes with a mortgage is either in foreclosure or is seriously delinquent. While this is an improvement from the height of the crisis when this figure reached one out of seven, it is still far above the pre-crisis average of around one in twenty.

The Administration has designed its primary mortgage modification program, HAMP (the Home Affordable Modification Program), to make mortgage payments affordable for struggling borrowers. In addition to helping families, avoiding foreclosure benefits lenders and investors. Moreover, neighborhoods benefit from avoiding foreclosures and the collateral damage to communities. Foreclosures have been shown to substantially reduce the values of surrounding homes and perpetuate the problems facing individual homeowners and borrowers into a community-wide issue.

The HAMP program was recently extended through 2013, and included an expansion of the number of eligible homeowners. The incentive for reducing principal balances has been tripled on underwater mortgage loans. The program has directly implemented nearly one million permanent modifications, where just 15 percent of modifications have defaulted out of the program after 12 months; note that these borrowers all entered the program as delinquent, many underwater, so this is a substantial success rate. By setting affordability standards and a framework for how mortgage servicers should work with delinquent homeowners, HAMP has helped catalyze over two and a half million proprietary loan modifications. It is worth noting that the recent settlement between state attorneys general and the largest servicers also relies on the HAMP structure for principal reduction initiatives by banks.

The state of Illinois has also received funds through Treasury's Hardest Hit Fund to design and implement programs for homeowners to prevent avoidable foreclosures (note for Jan: IHDA implements this for the state). And this coming Monday, the Administration is sponsoring a free event for struggling Chicago-area homeowners where they can meet one-on-one with their mortgage company and a HUD-approved housing counselor. Moreover, these direct initiatives have been supplemented by other programs, including forbearance for those who have lost their jobs, and a disposition program for foreclosed properties held by banks, that will help homeowners to weather difficult times and to move properties forward to rental conversions when they can't.

**Our Challenges in the Perspective of the Past and the Future**

The conditions in which we are working in the housing market now are without precedent in the U.S. – certainly on a national scale – and it's important to keep these challenges in perspective.

If we look back only a dozen years or so – and we are (mostly) old enough to have been paying attention – it's worth thinking about the economic situation that we faced then and the choices that were made.  Real GDP increased 19 percent between 1996 and 2000, an annual growth rate of 4.4 percent.  Median family income, adjusted for inflation, gained almost 10 percent during this period.  This was the fastest sustained growth in real median family income seen in a generation.  Unemployment fell below 4 percent, while productivity growth was 2.8 percent per year between 1996 and 2000.  Inflation did not get out of hand, averaging 2.4 percent.

The government ran a surplus for the first time in over 25 years, reaching $236 billion (2.4 percent of GDP) in 2000.  Imagine that only twelve years ago, Congress debated how we would spend the budget surplus, and financial markets were concerned about managing life with too little government debt.

It's hard not be a little wistful at the "quality problems" we faced then, and also hard not to be concerned at the choices that followed.

We know the story that follows all too well.  The approximately six trillion dollars in cumulative surpluses expected over the 10-year budget window beginning in 2001 swung to six trillion dollars in cumulative deficits over the actual experience of that 10-year period.  The CBO estimates that about a quarter of the swing was due to deterioration in the economy during the two recessions over the last decade, while 60 percent was due to tax cuts early in the decade and expenditures on two wars.  About 12 percent was due to efforts to stabilize the economy in the Recovery Act, the payroll tax cut, and other legislation.

But as important as it has been to fight the financial crisis and support the economic recovery, an even more important question and the one that worries me now, is what choices we are making for the next generation and what legacy will we leave for them?

Think for a minute about the statistics I just gave on the change in the economic standing of American households.  When real income rises at the growth rate that prevailed in the late 1990s – 2.4 percent – median income doubles every 30 years, roughly each generation, and each generation has a materially improved standard of living compared to the previous one.

When real income rises at the growth rate that prevailed in the mid 2000s, rising at 0.3 percent growth, it takes 230 years for income to double, which is almost 8 generations, or roughly the time from the birth of this country to where we are today.

In general, it is pointless to look backwards over what we wish had been done differently – those decisions are made, the past is the past.  However, we have critical choices to make which can and will be the difference between stealing from the future and investing in it.

**Our Commitment**

As I mentioned at the outset of my talk, my work before coming to government has focused on exactly these kinds of decisions, in the context of long-run investment decisions for private firms facing uncertainty.  An important feature of those investments is that they are costly to undo.  This approach to decision-making recognizes that we can't go back and reverse our choices – we have to live with the consequences.

Knowing that, we make decisions differently.  We take into account the long-run, we carefully measure our assessment of the future, both what we expect to happen on average and where the upside opportunities and downside risks lie, but – importantly – we are not paralyzed by them.  Being afraid to leave the house is not an option.  We face similar challenges as a nation in making choices today, while facing uncertainty about the future.  And these choices can fundamentally affect our long-term economic trajectory.

Looking back, as a country, we have made far-reaching choices in similar situations: this is the country that initiated the high school movement and land-grant universities, polio vaccinations, food safety regulation – begun by Harry Truman's 1947 signing of the Federal Insecticide, Fungicide, and Rodenticide Act of 1947,and continuing to the Safe Drinking Water Act of 1974 (Ford) and the Food Quality Protection Act of 1996 (Clinton) – the National Park System, and the Eisenhower interstate highway system.  These were all investments made knowing that they had potential long-run consequences, and were also made under great uncertainty about their outcomes.

Facing the evolution of the housing market in the United States in a manner consistent with preserving and expanding affordability is one of those investments, and one of the choices we face as a country.  Since we face many such choices, in each case we should ask: i) is this important? and ii) what is the case for and role of government?

First – given the facts I just discussed about the rise in costs, plus challenges in the availability of credit (despite low mortgage rates), affordability is clearly an issue.  Moreover, if we as a country are committed to mobility, then housing affordability is not only an economic issue, it is also an opportunity issue.  Access to education, once the road to economic mobility, is inextricably linked to access to housing because of the way school financing works in the United States.  Any parent who aspires for their children thinks about the schools where they live; we should always think about improving schools, and we should also always think about access to quality education for everyone.

Second, if this is an important issue – and I believe it is – what is the role for government?

I am an economist, so I have a deep respect for economic incentives and the markets that form and express them.  As President Obama recently said, "I believe the free market is the greatest force for economic progress in human history." And I also believe in what a prior great President from Illinois, Abraham Lincoln said: "That through our government, we should do together what we cannot do as well for ourselves."

Affordable housing is difficult for communities to implement on their own, and even more so for individuals to manage, in the institutional environment we face today.  That is why we come together on this issue, not only for dignity and affordability, but also for opportunity and long-run prosperity.

This is a challenging time to address these issues, not only because of budget difficulties, but because of long-run changes in our country and our economy.  Research shows that support for long-run investments, such as infrastructure, and schools and housing, declines when there are more seniors in our communities and less homogeneity in communities.  While many things are uncertain, the aging of our society and our increasing diversity are certainly well-known.  These demographic trends make it all the more important to remember the future in addition to the past, and to keep our focus on investing in the future that we all share.

Indeed, it is our struggle to more clearly define that future which implores us to make smart investments today.  The manifestation of these choices is apparent: in education, for example, we see it in the more than 8 million low-income students per year that will receive additional college funding from the President's Pell grant expansion, or the more than 9 million families that used the American Opportunity Tax credit to support educational investments in their children in 2011.  These choices will make education accessible and affordable, just as housing should be.

**Conclusion**

I share the concern that I suspect many of you in the audience have: there is so much more to be done and there appears to be little emerging consensus on how to do it.  But I am reminded of Churchill's famous quote: "Americans can always be counted on to do the right thing...after they have exhausted all other possibilities."

While I am not sure that all other possibilities have been exhausted quite yet, we are eager to implement good policy for now and for the future.  That is the life’s work of the people in this room –to make lives better and to make opportunity more accessible.  That is the compact between citizens and their government - the compact between current generations and future generations.  We face challenges, but we are stronger than the forces that would fracture those essential connections.  We look forward to working with you on this, our collective life’s work.

Thank you.

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