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Testimony of Owner of Warren Peterson Construction Inc, Warren Peterson, Before the FCIC 9-7-2010

Warren Peterson

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before the
Financial Crisis Inquiry Commission
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Thank you, Chairman Angelides, Vice Chairman Thomas and members of the Commission for this opportunity to present testimony at today's hearing.

My name is Warren Peterson. I am owner of Warren Peterson Construction Inc., a small, locally owned business whose forte is new-home construction here in Bakersfield. I am also a real estate broker and a general contractor. I am a second-generation resident of Bakersfield and have lived here my entire life, except for the four years when I attended the University of California at Santa Barbara, where I earned a bachelor's degree in economics.

I have been in real estate and construction in Bakersfield since 1978. I began my career with Karpe Real Estate, one of the oldest and most successful real estate businesses in this city. During my 32-year career, I have built or helped build hundreds of homes in the Greater Bakersfield area. In 2008, I served as president of the Bakersfield Association of Realtors.

My remarks today will focus on the impact of the financial crisis on my business and on the residential real estate market in the Greater Bakersfield area.

It is not a pretty picture.

Bakersfield ranks among the nation's worst cities for high foreclosure rates and high unemployment, following the collapse of the real estate market beginning in late 2005. Today, Bakersfield is a city of declining home values, empty and decaying properties, stalled housing developments and lost revenues. The damage has been seen and felt everywhere. Thousands of people connected to real estate – from agents to subcontractors to construction workers – are out of work. Thousands in related industries – such as title companies, building suppliers, carpet and furniture stores, just to name a few – have also lost their jobs.

As for me, I have built exactly <u>one</u> new home since late 2005. Compare that one home to the three to ten custom and semi-custom homes I built <u>each year</u> during most of my career, or the 20 to 30 houses I built <u>each year</u> at the height of the housing market boom between 2003 and 2005.

I place the major blame for this turn of events on three causes :

1) irresponsible credit policies that lowered lending standards, creating questionable lending practices and easy access to money;

2) the resulting flood of home buyers, which led to escalating home prices and skyrocketing land and building costs; and

3) well-meaning government programs that resulted in unintended – and negative – consequences.

In regard to my first point concerning irresponsible credit policies:

As a homebuilder, I have seen firsthand how lenders changed their time-tested policies and bank offerings. It's my contention that these changes stemmed from the push during the Clinton and Bush Administrations for every American to own a home. That's when federal policy started loosening credit.

Around 1999, I heard for the first time about new financing tools like non-conforming loans and stated income loans. Home builders traditionally had worked with private money because banks were adverse to the credit risks they saw in working with contractors. Banks were reluctant to lend to us. So, in the late 1990s, we welcomed many of these new financing tools. One in particular was called a "construction loan to permanent financing." Here's how it worked: If a person wanted to build a new home, he or she could apply for a construction loan at the bank based on their ability to borrow and their good credit. Under this "construction to perm" financing, a bank would pay out loan funds in phases. This would allow the new homebuyer to pay me in phases as I built their home. It provided me with the cash flow I needed for construction. This was a very good way for small business owners like me to operate.

Construction to permanent financing – a three-way operation between bank, homebuyer and home builder – was an excellent arrangement. That product is now gone. Credit availability has nearly vanished. Without financing, I cannot hire employees or grow my business.

In time, other -- and much riskier -- loan types emerged. Lenders took adjustable rate loans and morphed them into reckless, irresponsible products. They began offering negative amortization and interest-rate-only loans. Banks stopped scrutinizing potential borrowers about their ability to repay a mortgage. Relaxed lending practices and easy access to money fueled a "buy now" fever among home buyers. They were led to believe their home values would increase so dramatically, that in a year their homes would be worth 20 percent more. They were encouraged to borrow with interest-only loans. They were told they could refinance their mortgages a year to two down the road, and all would be well.

Of course, we all know the exact opposite happened: By late 2005, the boom was over. Home values plunged. Loans began to re-set – and new homeowners were left holding mortgage payments they couldn't afford. Many who found themselves in that position are not guilt-free. They made poor decisions about what they could afford. In some cases, they lied to lenders about their borrowing capacity. They let greed overshadow good judgment. In my opinion, blame also lies with them.

Regarding my second point: the resulting flood of home buyers that caused home prices to escalate and building costs to skyrocket.

Traditionally, new-home construction represented anywhere from one-third to one-half of real-estate sales in the Greater Bakersfield area. That meant that about 2,000 new homes could be built each year in our community. Local builders knew this and could plan accordingly. For decades, we met the supply and demand challenges of this market, and our industry took a conservative approach to buying and selling land for residential development.

But that changed when the national corporate builders entered the Bakersfield market around 2001. They saw opportunity in Bakersfield with the "buy now" mentality overtaking the market. National builders wanted to acquire land for their subdivisions, and they were willing to pay well above the market to get it. Locally, we were used to paying $10,000 to $30,000 an acre for land. But when national builders arrived, prices doubled and tripled almost overnight to $80,000, $90,000 an acre and more – even $120,000 an acre.

The result was good for some people. A few farmers received once-in-a-lifetime offers for their land from national builders. Developers who had land-banked property for future use accepted incredible offers from national builders. Overnight, people made fortunes. And who can blame those who had land to sell? My point, however, is that atmosphere significantly drove up prices for lots and land. In 2003, I was paying $35,000 to $40,000 for a 10,000 square-foot lot. By 2004, I was paying $120,000 for the same lot. And I had to pass those expenses on to consumers.

The escalating market created a buying frenzy. New home buyers were not only Bakersfield residents, but new arrivals from Los Angeles. People were fighting over homes. Fraudulent transactions were occurring in real estate firms, as some real-estate professionals and investors used various strategies to misrepresent the facts. They were taking out the maximum number of mortgages they were individually allowed to take, and then enticing others to put mortgages in their names for a cut of the profit. It was illegal but they did it. As long as the market was rising, people looked the other way.

People would use the equity in their homes to refinance. They would cash out their equity and use those monies to buy a new home, often walking away from the refinanced property.

Moreover, where Bakersfield once turned out 1,000 to 2,000 new houses a year, it was, by 2004, cranking out more than 4,200 homes. In 2005, building permits were issued for more than 5,200 single family homes.

Today, Bakersfield has more than 80,000 recorded lots in various stages of construction, according to the Kern County Planning Department. That is a staggering number -- an estimated 12-year inventory. Plenty of those lots are growing tumbleweeds right now.

In regard to my third point concerning well-meaning government programs that resulted in unintended – and negative – consequences.

The reason that banks loosened their credit policies was partly due to government rules that were written with well-meaning intentions. To enable more people to become homeowners, lenders relaxed underwriting guidelines. Lending criteria became less stringent. In time, however, financing tools were abused and mismanaged.

Fannie Mae and Freddie Mac may have provided a great service to American home owners, but where was the oversight of these agencies? I recently read in Time magazine that their eventual bailout in September 2008 cost more than $150 billion.

Some government efforts were simply short-sighted. One example is the Neighborhood Stabilization Program, or NSP. This new program from the Department of Housing and Urban Development (HUD) was designed to help communities deal with problems resulting from mortgage foreclosures and housing abandonment.

The County of Kern, where we are located, received $12 million from the NSP in 2009. The funds were to be used to stabilize and revive struggling neighborhoods and housing markets. One stipulation of the program, however, was that Kern County had to buy the properties at 1 percent below the appraised value. What that requirement did was drive down the resale values of other homes on the market. What was the rationale for that counter-productive stipulation? It seems to me that someone in Washington, D.C. had a well-intentioned idea that progressed into a major program – without local input or consideration of long-term effects.

In addition, as a small business owner, I find myself wondering why there are no programs for people like me, who now have limited access to credit. Our government is helping and subsidizing others who intentionally abused the system. It is trying to clean up the mess people made for themselves. I have a hard time seeing the value in that. What about the people, the small business owners, who made good decisions, work worked hard, paid their debts, who didn't walk away from their financial obligations? Is there a program to help them?

Today, we find ourselves in a financial and real estate crisis. This is still a declining market, which discourages people, especially first-time home buyers, from buying. Why buy today when the house you want might be worth $10,000 less a month or two or six from now? In my opinion, only when they hear that prices are climbing up again will they be motivated to buy.

These problems will be with us for a long time. In fact, I am not optimistic about my own prospects. In 2007, I shut down my real-estate brokerage office and merged with another firm. Of the eight people associated with my business, six have since found jobs. I had owned some real estate properties, which I was forced to sell. I had always kept six months of business expense reserves, but that dissolved as the market failed to improve and only worsened. Today, I'm supporting myself through remodeling homes. I will tell you, it's been a struggle.

But I can suggest some ideas that can get this industry back on the road to some sort of recovery.

What we need is not heavy-handed government intervention but solid, good financial products for people who want to buy – and build -- homes. That's key. It's unrealistic for the government to believe that the average real estate agent who's out there selling homes will bring the market back. We have to find a way to rebuild the credit market, and bring faith back to the market. Lenders need to take a closer look at potential borrowers and check their histories: Have they owned homes before? Have they paid back their mortgages, their credit cards? If they return to that kind of scrutiny, I'm in favor of banks providing 100-percent financing tools for mortgages and new-home construction.

Here's another suggestion: There are many small businesses like my home construction business set up as S Corporations. I'd like to see lenders make more financing available to <u>us</u>, based on our financial history.

Moreover, before our government agencies devise a new program, I urge them to seek local feedback. Instead of designing these programs in a vacuum, government needs better input from the people directly involved: the stakeholders – the local realtors, the property and home owners. Tap into the smart, experienced, successful people who work in those industries, and get ideas and workable solutions from us.

In conclusion, I want to thank the members of this Commission for this hearing, and for listening to us today. I hope you will <u>continue</u> to listen, and to work with us to ensure that the right steps are taken to get this industry back on track.

I would be happy to respond to any questions you may have.