HOME OWNERSHIP WITHIN A NATIONAL
HOUSING POLICY

THESIS

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MASTER OF ARTS

By

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Inclusion of home ownership in national housing policy indicates that home ownership should be available to everyone. National housing policy is assumed by the author to be contained in the Housing Act of 1949: a decent home and suitable living environment for all Americans.

Findings are that preferential treatment of homeowners embodied in the U.S. tax and financial structure conflicts with restrictive monetary policy and with a full employment fiscal policy. Home ownership does not meet the needs of contemporary lifestyles or of low income families. Fiscal zoning restricts access to housing for low income families.

The conclusion of this thesis is that home ownership is not available to all Americans under the present federal housing programs, and therefore should not be included in national housing policy.
# TABLE OF CONTENTS

**LIST OF TABLES** ................................................................. iv

**Chapter**

I. NATIONAL HOUSING POLICY ORIENTED TOWARD HOME OWNERSHIP .......... 1
   
   Preference for Home Ownership ........................................ 1
   Summary of Chapters .................................................. 4

II. PREFERENTIAL TREATMENT OF THE HOMEOWNER ....................... 7
   
   Exclusion of Imputed Income ........................................ 8
   Property Tax Deduction .............................................. 12
   Mortgage Interest Deduction ........................................ 14
   Deferred Capital Gains ............................................... 16
   Conclusion ............................................................... 17

III. MORTGAGE TERMS FOR HOMEOWNERS .................................... 22
   
   Mortgage Insurance and Guarantees ................................. 22
   The Secondary Market for Mortgages ................................. 25
   Conclusion ............................................................... 26

IV. GROWTH AND STABILIZATION OBJECTIVES ............................... 30
   
   Introduction ........................................................... 30
   Monetary Policy ....................................................... 32
   Fiscal Policy .......................................................... 38
   Conclusion ............................................................... 42

V. CONTEMPORARY HOUSING CONSIDERATIONS ................................ 45
   
   Changing Lifestyles ................................................... 46
   Discretionary Housing Programs .................................... 49
   Low Income Families .................................................. 52
   Fiscal Zoning ........................................................... 53

VI. CONCLUSION ................................................................. 60
   
   National Housing Policy .............................................. 60
   Income Subsidies ...................................................... 61

**BIBLIOGRAPHY** ............................................................... 64
# LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Tenure of Non-Farm Housing Units, 1890 to 1970</td>
<td>9</td>
</tr>
<tr>
<td>II. Federal Revenue Loss of Allowing Homeowner Deductions for Mortgage Interest and Real Estate Taxes, 1979 Law, 1979 Levels</td>
<td>15</td>
</tr>
<tr>
<td>III. Terms and Yields in Primary and Secondary Mortgage Markets, 1979</td>
<td>23</td>
</tr>
<tr>
<td>IV. Mortgage Debt Outstanding in 1979</td>
<td>28</td>
</tr>
<tr>
<td>V. National Employment by Industry, 1979</td>
<td>41</td>
</tr>
<tr>
<td>VI. Gross National Product and Income, 1979</td>
<td>41</td>
</tr>
<tr>
<td>VII. Federally Subsidized Housing Production, Fiscal Year, 1979</td>
<td>50</td>
</tr>
</tbody>
</table>
Prefers for Home Ownership

If a preference of ownership in housing tenure is included in a national housing policy, then there should first be a definite preference expressed through political channels, culminating in a coherent housing policy. If the American people prefer home ownership to rental, there should be a policy expressed by congress or a president in favor of home ownership.

President Reagan expressed his preference for home ownership when he appointed a twenty-two-member presidential commission in June, 1981, to propose options for the national housing policy. The chairman of the new presidential commission is William McKenna, and former Housing and Urban Development Secretary Hills will serve as vice chairman.

"Home ownership is a symbol of the family unit and neighborhood and is essential if we're to have social and economic stability in our land," said President Reagan (2, p. 10). Two constraints given by the President limit the commission's work. First, the commission is to develop
housing mortgage finance options strengthening the ability of the private sector to maximize the opportunities for home ownership. Second, the commission's options must be consistent with and contingent upon the President's programs for economic recovery.

The U.S. Congress has been more circumspect about expressing a preference for home ownership in its legislation of housing programs. In the Housing Act of 1949, Congress declared that the chief aim of a national housing policy should be a decent home and a suitable living environment for every American family. While these goals are still referred to today, there is no formal preference for a specific housing tenure expressed in the Act. In fact, owner occupancy was excluded from federal low-income housing programs until 1965. The impetus for a limited ownership program for the poor came from Congress.

In 1965, Congress enacted a direct subsidy program in the form of rent supplements. It authorized direct payments to the landlord on behalf of low-income tenants who live in projects owned and operated by nonprofit or limited-dividend organizations. Under this program, the closest approach to ownership in housing was that available through the cooperative form of nonprofit organization (4, p. 242).

In 1966, Representative Sullivan proposed a home ownership program. Instead of confining loans to housing project
mortgages, which limit individual participation to rental or coorporative forms of ownership, it extended the loans to individuals to help them purchase their own homes.

There is little evidence of a coherent national housing policy in federal housing goals or programs. Aaron states that at no time has a congress or a president publicly attempted to develop a housing strategy (1, p. 163). Fishman concurs with Aaron and describes the national housing policy as

The nation's housing laws today are a complex maze of accumulated authorizations for over 60 programs, embodied in hundreds of pages of statutes, and conflicting objectives, and a total lack of a coordinated structure or overall design (3, p. 482).

It is difficult to reconcile the position of a presidential commission with the functions of Congress and HUD in developing a national housing policy. The new presidential commission appears to be usurping functions from Congress and from the HUD secretary. Congress reviews existing federal housing policies and programs and develops legislative programs. The function of the HUD secretary is to recommend policies for the legislative programs, to coordinate HUD programs with the economic and fiscal policies of the federal government, and to advise the president on policy. The chairman of the new presidential commission, William McKenna, stresses the fact that the commission is not to make policy recommendations but rather to set out policy options for the President and the HUD secretary to
consider. Unless the purpose of the commission is to contribute to the executive legislative initiative, it is difficult to determine the function of the commission.

The priority to the President, Congress and the HUD secretary should be to coordinate housing programs with housing goals. Unless all federal programs, including those embodied in tax and financial systems, are examined with regard to specific goals, the impact of federal housing programs will be distortion of the housing market.

Summary of Chapters

National housing policy is assumed by the author to be contained in the Housing Act of 1949: a decent home and a suitable living environment for all Americans. Further, if home ownership is included in national housing policy, then ownership of a home should be available to everyone. The author's thesis is that home ownership is not available to all Americans under present federal housing programs, and therefore should not be included in a national housing policy. After introductory material given in this chapter, the author presents arguments in Chapters II through V to back conclusions outlined in Chapter VI, which support the thesis.

Chapter II contains an examination of the origin of four U.S. federal income tax measures which give preferential treatment to homeowners. The exclusion of imputed rent and capital gains for homeowners results from a cash
accred definition of personal income. Deduction of real estate taxes from the federal personal income tax for homeowners is part of a tax policy to encourage use of the property tax for state and local revenues.

Federal government intervention in the home mortgage market through mortgage guarantees and insurance and through secondary mortgage market operations is examined in Chapter III. The purpose of the federal government's initial housing legislation in 1934 was characterized by Aaron as "primarily to help restore prosperity to the construction industry and the general economy and only secondarily to promote other changes in housing markets" (1, p. 77).

The potential conflict of public support of home ownership as a goal of national housing policy with monetary policy and fiscal policy objectives in controlling inflation and providing full employment in the economy is examined in Chapter IV.

Contemporary housing problems are discussed in Chapter V. Home ownership is examined in the context of meeting the housing needs of contemporary lifestyles and low income families. Fiscal zoning or competition by local governments for tax revenues represented by homeowners' property taxes is also discussed. The conclusions of the paper are presented in Chapter VI.
CHAPTER BIBLIOGRAPHY


CHAPTER II

PREFERENTIAL TREATMENT OF THE HOMEOWNER

Today, the largest housing subsidy is favorable tax treatment of homeowners. The tax law provisions favoring ownership result in benefits estimated by the Treasury Department at a total of fifteen billion dollars each year in the 1980s (8, pp. 5-31).

The preferential treatment of homeowners in the tax system is a product of four diverse measures ((1) exclusion of imputed income, (2) deduction of mortgage interest, (3) deduction of property taxes, and (4) deferred capital gains) which were not meant as a housing policy to encourage home ownership. In Chapter II, the origin of the four measures in the federal personal income tax is discussed. The author's assessment of the use of the four tax measures in the federal personal income tax as a housing program is that the tax measures benefit middle-income homeowners, not all homeowners.

The rise in personal income tax rates during World War II gave significant tax benefits to homeowners. The proportion of housing stock which is owner-occupied rose from 41.1 per cent in 1940 to 50.8 per cent in 1945, as is shown in Table I on page 9. At the same time, the lowest marginal
rate level on taxable income rose to about 23 per cent, compared with 4 per cent in 1939 (2, p. 18).

Rosen and Rosen (5) made an empirical study of the determinants of the rental-home ownership decision, focusing on the changes in the personal income tax laws. Their conclusion was that federal tax laws have statistically significant and quantitatively important impacts on the percentage of homeowner households. According to Rosen and Rosen, the exclusion of imputed rent and the deductibility of property taxes and mortgage interest payments have a substantial influence on the decisions of households to own or rent housing.

This chapter examines preferential treatment of homeowners in the federal personal income tax, which consists of exclusion of imputed income, deductions for property tax and mortgage interest, and deferred capital gains on owner occupied housing.

Exclusion of Imputed Income

The preferential treatment of homeowners stems from the lack of inclusion of imputed rent into Adjusted Gross Income (AGI). Moving from Gross National Product to AGI, income is defined by Musgrave (4, p. 248) for federal personal income tax purposes: capital consumption or depreciation is deducted; indirect business taxes are deducted; interest payments by the government (not a part of Gross National Product) are included; corporation taxes and
TABLE I

TENURE OF NON-FARM HOUSING
UNIT S, 1890 to 1970*

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Per Cent Owner Occupied</td>
<td>36.9</td>
<td>36.5</td>
<td>38.4</td>
<td>40.9</td>
<td>46.0</td>
<td>41.1</td>
<td>50.8</td>
<td>53.4</td>
<td>61.0</td>
<td>62.0</td>
</tr>
<tr>
<td>Per Cent Renter Occupied</td>
<td>63.1</td>
<td>63.5</td>
<td>61.6</td>
<td>59.1</td>
<td>54.0</td>
<td>58.9</td>
<td>49.2</td>
<td>46.6</td>
<td>39.0</td>
<td>38.0</td>
</tr>
</tbody>
</table>


Retained earnings are subtracted; government transfer payments are excluded; elements of income-in-kind and imputed income are not included; and capital gains are partially added.

Imputed income is best defined by Groves as

a 'flow of satisfactions from durable goods owned and used by the taxpayer, or from goods and services arising out of the personal exertions of the taxpayer on his own behalf.' Familiar examples are the rental value of owner occupied homes, the services of housewives, and the wages and profits of subsistence farming (2, p. 237).

The owner occupant of a residence obtains imputed rent or a beneficial income stream from an asset, equal to the return he could obtain by renting the house. Imputed income and imputed rent are used interchangeably if the consumer product being discussed is housing services in relation to rental services.
The definition of income base of individual income tax is the taxpayer's income from all sources, which is combined into a single, or "global," measure of income. Under the accretion principle, AGI is then defined by Musgrave (4, p. 248) as an increase in net worth plus consumption. Ideally, this definition would include imputed consumption values in the AGI. Imputed income is not included in AGI because non-cash income is omitted in practice. The taxable income base is then reached by allowing for certain deductions and exemptions.

Deductions and exemptions are made for the purpose of measuring the economic ability of a person to pay taxes, or to encourage certain types of economic behavior considered beneficial to the general welfare. Since the ability of a person to pay is being measured in regard to the personal income tax, the measurement refers to a taxpayer's income as defined by the Internal Revenue Service and not personal income as defined in the Gross National Product accounts.

Imputed rent is not included in AGI because non-cash income is omitted in the definition of AGI. Non-cash income is, for example, deferred capital gains and imputed income. Some people hold earning assets that bring cash income; others hold durable consumer goods that earn imputed income. In a narrower sense, AGI is defined in terms of cash income accretion to net worth.

The exclusion of the imputed income from home ownership in the definition of income under the accretion
principle could be due either to technical difficulties which permit only an approximation or to a policy intent of granting preferential treatment.

Alternative methods of measuring the costs of owner occupied housing in the Consumer Price Index were studied by Gillingham (1, p. 31) in 1980. Under the aegis of the Bureau of Labor Statistics, Gillingham advocated the rental equivalence approach to measuring the cost of owner-occupied housing. Since it is impossible to directly measure the market value of the shelter services consumed by homeowners, an indirect measurement technique can be used. Two alternative approaches are rental equivalence and user cost. The conclusion of the study by Gillingham is that the rental equivalence approach has a substantial operational advantage as a measure of shelter costs for homeowners. The housing component of the CPI for renters and homeowners can be measured by the cost of a household's consumption of the flow of shelter services provided by a house. This approach focuses on consumption and abstracts from investment aspects of home purchase decisions.

Since the difficulties of estimating imputed income from consumer durables are not insurmountable, it is assumed that the preferential treatment of homeowners is a tax and housing policy. An exclusion or deduction for the purpose of tax preference can be considered a subsidy or tax expenditure. While the benefit stream or imputed rent
from home ownership is not treated as part of the resident's AGI, the negative income stream, or the cost of securing the benefit, is deducted from AGI. Examples of deductions which are costs of earning the imputed income to the homeowner are mortgage interest and property taxes.

A tax expenditure should be a deliberate policy intended to give incentive to the consumption of housing in general or toward home ownership in particular. The omission in the federal personal income tax of imputed income to homeowners is significant because, starting in the 1940s, marginal tax rates were raised to pay for World War II and to pay for increases in federal expenditures generally.

Property Tax Deduction

Deductions, as well as exclusions, may be used to make taxable income a better measure of economic capacity of the individual to pay taxes. Inappropriate use of deductions may give preferences and distortions. The deduction of taxes is appropriate where they are a cost of doing business. If imputed rental income were included in personal income, property taxes would be deductible expenses in calculating net rent. Property taxes are expenses of obtaining taxable income from rental properties, businesses, and farms.

In the case of forced reduction of income, deductibility of property tax is appropriated because the ability of
the taxpayer to pay is reduced. The situation differs from that of private uses of one's income. Taxpayers must pay the tax; while they have a vote in the local government district in which they establish residence, they do not have a veto. Through the voting process, local taxpayers have a political choice, of the type and quantity of local public services, but an individual cannot veto a local political decision or decide not to pay a tax assessment. Musgrave (4) offers a rationale for allowing a deduction of state and local property taxes from the federal personal income tax even though the deduction is not a business expense.

The case for deductibility of the property tax is weakest where taxes are in the nature of benefit charges. Although the taxpayer receives the benefit of public services, the stream of benefits from public services is not included in the federal personal income tax base. Most of the property tax revenue is used to finance general outlays, as opposed to those directly relating to housing services. The property tax was 58.5 per cent of total city government revenue nationwide in 1978. Expenditures for education in 1978, nationally, were 10.3 per cent of the total city expenditures (6, p. 312).

The main reason for allowing a deduction for homeowner's property taxes is to encourage the use of property taxes by state and local governments, particularly the latter.
The termination of deductibility for homeowners' property taxes would present a problem for local governments since property taxes on homes are the major source of revenue for municipalities, counties, and especially school districts.

**Mortgage Interest Deduction**

Deductions are made from federal income taxes for interest payments on consumer goods. The largest single item in housing expenses is usually debt service; therefore, the benefits from tax deductions are accordingly greater as income brackets are higher. Tax brackets vary with income levels, not housing prices. Table II enumerates the amount of tax savings which relates to specific income levels from the deduction of mortgage interest and real estate taxes. The Office of the Secretary of the Treasury estimated for 1979 that these deductions decreased federal tax liabilities by $17.2 billion. The sum of the two tax deductions used separately is greater than the two combined, because if either were deleted, more taxpayers would use the standard deduction instead of itemizing. The mortgage interest deduction alone in 1979 would have been $11.2 billion, and the real estate tax deduction alone would have been $7.0 billion (7, p. 2).

As with state and local taxes, a distinction must be drawn between interest paid as a cost of doing business and interest paid on consumer debt. The deduction of interest paid on consumer debt, such as mortgage interest, is a
### TABLE II

**FEDERAL REVENUE LOSS OF ALLOWING HOMEOWNER DEDUCTIONS FOR MORTGAGE INTEREST AND REAL ESTATE TAXES, 1979 LAW, 1979 LEVELS**

<table>
<thead>
<tr>
<th>Income Level (thousands of dollars)</th>
<th>Returns with Tax Savings</th>
<th>Average Tax Savings (dollars)</th>
<th>Total Revenue Loss (millions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of Returns (thousands)</td>
<td>Per Cent of All ReturnsFiled in Class (per cent)</td>
<td></td>
</tr>
<tr>
<td>Under 5,000</td>
<td>83</td>
<td>0.4</td>
<td>104</td>
</tr>
<tr>
<td>5,000-9,999</td>
<td>1,083</td>
<td>5.8</td>
<td>172</td>
</tr>
<tr>
<td>10,000-14,999</td>
<td>2,553</td>
<td>17.6</td>
<td>254</td>
</tr>
<tr>
<td>15,000-19,999</td>
<td>3,955</td>
<td>33.3</td>
<td>331</td>
</tr>
<tr>
<td>20,000-29,999</td>
<td>8,153</td>
<td>51.7</td>
<td>536</td>
</tr>
<tr>
<td>30,000-49,999</td>
<td>5,924</td>
<td>73.9</td>
<td>1,023</td>
</tr>
<tr>
<td>50,000-99,999</td>
<td>1,658</td>
<td>82.9</td>
<td>2,048</td>
</tr>
<tr>
<td>100,000 and over</td>
<td>375</td>
<td>85.6</td>
<td>3,320</td>
</tr>
<tr>
<td>Total</td>
<td>23,785</td>
<td>25.6</td>
<td>724</td>
</tr>
</tbody>
</table>


A series of cost payments. The benefit stream, in the form of imputed rent from home ownership, is not treated as part of the resident's taxable income.

Hellmuth (3, p. 193) concludes that deductions for mortgage interest and for homeowner's property taxes are part of broader policies to deduct interest payment on consumer debt and to encourage the use of the property tax at the state and local level have been in effect since the inception of the federal personal income tax.
Deferred Capital Gains

Capital gains, accruing to residential property, are not included in AGI. AGI is defined in terms of cash income accretion to net worth, a definition which undermines the global principle that the taxpayer's income from all sources should comprise the tax base of the federal personal income tax (4, p. 248).

The Internal Revenue Code does not require the recognition of a capital gain on the sale of an owner occupied residential property if the homeowner purchases another primary residential property of equal or greater value within a specified time period. Therefore, any income tax due for such capital gain is again deferred, as unrealized capital gain, until time of resale. In addition, a taxpayer who has reached age fifty-five and over can exclude from taxable income the first $100,000 of gain on the sale of a residence. The total reduction in tax liabilities from the deferral and exemption of capital gains on home sales was estimated to be $1.5 billion in 1979 (7, p. 3).

Deferral of taxes on capital gains is a result of a narrow interpretation of the definition of the personal income tax base. The relevance of deferral of taxes on capital gains for housing policy is that it is a subsidy to the homeowner by virtue of the deferred equity accumulated housing property. The equity or value in a property in excess of claims against the property is not included in the federal personal income tax base.
Conclusion

Two conclusions follow from the discussion of preferential treatment of the homeowner in the federal personal income tax. The first conclusion is that the tax expenditures in the federal personal income tax are not subject to review by congressional appropriations committees. Second, the tax expenditures benefit middle-income homeowners, not all homeowners, as is stipulated in national housing policy.

There has been no periodic review of tax policy to determine whether homeowner preferences are contributing to a national housing goal of a decent home and a suitable living environment for all Americans. The only review of the tax expenditures which give preferential treatment to homeowners is under the Congressional Budget and Impoundment Control Act of 1974, in which the president's annual budget contains a report on tax expenditures.

Legislative control over the fiscal policies of the federal government is divided between appropriations committees and tax committees. Expenditure planning would be more efficient if subsidy programs were voted on by the relevant appropriations committees instead of by tax committees which have no particular expertise in specific expenditure areas.

Using the federal income tax as a housing policy measure to encourage the consumption of housing in general and homeownership in particular is unwise. There is no review of policy and the redistributive function of the federal personal income tax is impeded, due to a reduced tax base.
According to Musgrave (4, p. 10), there are three basic functions of fiscal policy: allocation, distribution, and stabilization. Redistribution is achieved by progressive tax finance or the provision of social goods on an "ability to pay" basis independent of the benefits from social goods. The federal personal income tax is the major tax in the federal tax system; the universality of its application to all income on a fair basis is significant. The income tax base should be defined globally, in order to give equal treatment to all components of net worth. Income, defined as accretion equals net worth plus consumption, is a comprehensive measure of ability to pay. The taxable base should include income from all sources, earned and unearned, realized and deferred capital gains, after all costs of earning the income are deducted. Otherwise, the tax base of the most equitable tax in the U.S. tax system is diminished. With a reduced tax base, rates must be higher to sustain revenue.

Musgrave (4, p. 17) noted that the tax preference for homeowners became increasingly important to middle-income taxpayers as they moved into higher tax brackets. As federal budgets increased relative to national income, since the inception of the federal personal income tax in 1913, additional tax revenue was drawn more from middle- and lower-income groups, and the redistributive function of the federal personal income tax was diminished. Previously, when federal government budgets were small, the burden was placed upon high-income taxpayers, according to Musgrave.
Termination of the tax subsidies to homeowners (exclusion of imputed income, deduction of mortgage interest and property taxes, and deferred capital gains) would make the federal income tax base closer to a measure of net income and the tax more equitable.

As a housing measure, the tax preference causes inequities between homeowners who itemize deductions and those who take the standardized deduction. Taxpayers in higher income brackets benefit more than those in lower income brackets. Some homeowners, generally those in higher income brackets, find it advantageous to itemize their housing-related expenses. Consequently, taxpayers in higher tax brackets benefit relative to those in lower tax brackets, who use the standard deduction. The tax preference fails to distinguish between homeowners with mortgages who itemize interest deductions and other homeowners.

Homeowners receive a subsidy determined by the value of the housing services they consume and by their marginal tax rate. Generally, new homeowners have large mortgages and relatively little equity, making large interest deductions and small imputed net rents. With the rates of interest relatively high on new mortgages in recent years, the value of interest deductions has increased in relation to the value of imputed net rent.

This form of tax assistance favors high-income taxpayers because the tax savings from such deductions vary with the tax
of the taxpayer. Table II on page 15 above shows that the taxpayers who benefitted most from mortgage interest and real estate tax deductions in the federal personal income tax in 1979 were in $30,000 and over income levels. Persons with lower incomes receive no direct benefit from the deductions if they pay no tax.
CHAPTER BIBLIOGRAPHY


CHAPTER III

MORTGAGE TERMS FOR HOMEOWNERS

Federal intervention in the home mortgage market was originally intended in the 1930's economic depression, to support employment in the residential construction industry, and to restore vitality to the general economy (1, p. 77). The discussion in Chapter III demonstrates that the significant contribution of federal intervention in the home mortgage market is the general relaxation of terms on home mortgages by lenders. Benefits of the liberalized home mortgage market accrue to all homebuyers and to lenders.

Mortgage Insurance and Guarantees

The congressional record in federal housing legislation began with the National Housing Act of 1934, which created the Federal Housing Administration (FHA). Mortgage insurance was not generally available before the FHA offered low-cost mortgage insurance to private lending institutions. The FHA default protection enabled prospective homebuyers to enter the housing market with adequate income but little savings. The FHA programs were authorized to insure mortgages on homes up to 80 per cent of the purchase price, provided the amortization was completed in a 20-year period. Conventional mortgage
terms on new homes in 1979 were 73.9 per cent of the purchase price for a 29-year maturity. Comparative terms and yields in mortgage markets are shown in Table III. Terms on conventional mortgages on new homes, in Table III, are weighted averages based on sample surveys of mortgages originated by major institutional lender groups.

TABLE III
TERMS AND YIELDS IN PRIMARY AND SECONDARY MORTGAGE MARKETS, 1979*

<table>
<thead>
<tr>
<th>Mortgage Markets</th>
<th>Terms**</th>
<th>Yield Per Cent Per Annum</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary Markets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase Price (thousands of dollars)</td>
<td>74.4</td>
<td></td>
</tr>
<tr>
<td>Amount of Loan (thousands of dollars)</td>
<td>53.3</td>
<td></td>
</tr>
<tr>
<td>Loan-to-Value Ratio (per cent)</td>
<td>73.9</td>
<td></td>
</tr>
<tr>
<td>Maturity (years)</td>
<td>28.5</td>
<td></td>
</tr>
<tr>
<td>Contract Rate (per cent per thousand)</td>
<td>10.5</td>
<td></td>
</tr>
</tbody>
</table>

| Secondary Markets                     |               |                          |
| FHA Mortgages                         | 10.9          |                          |
| GNMA Securities                       | 10.2          |                          |
| Conventional Loans                    | 11.8          |                          |


**Terms on conventional mortgages are weighted averages based on sample surveys of mortgages originated by major institutional lender groups.
The Servicemen's Readjustment Act of 1944 guaranteed approved lending institutions against losses encountered from approved loans made to veterans. The implicit subsidy through Veterans Administration (VA) loans is a guarantee to veterans who are homeowners, rather than renters. The reason that the subsidy is implicit or implied is that the loan guarantee reduces the risk to the lender, thereby granting the veteran homebuyer a reduction in downpayment and a longer mortgage amortization period. The subsidy would be explicit if the veteran received a direct federal payment toward amortization of housing debt. The benefits from VA guarantee persist if a non-veteran buyer assumes the home loan.

Although the protection provided against default on home mortgages by the FHA and VA created subsidies to homeowners, the major contribution of the regulations was the general liberalizing of the market for home mortgages. Lenders were willing to offer more generous mortgage terms in exchange for insurance covering the principal of the loan. The resulting increase in the loan-to-value ratios and repayment periods lowered the downpayment required on homes.

Prior to these government guarantees, bankers were unwilling to extend mortgage terms to long periods of repayment and to high loan-to-value terms. The amount of the downpayment and the term of the mortgage both substantially affect the risk on principle which the insurance absorbs. The higher the ratio of the loan to value, the less likely the selling
price is to cover the outstanding debt in the event of foreclosure.

The Secondary Market for Mortgages

The three financial institutions, the Federal National Mortgage Association, the Government National Mortgage Association, and the Federal Home Loan Bank, have the potential to influence the level and flow of mortgage credit through secondary market operations. In 1933, the Home Owners Loan Corporation was authorized to aid homeowners who needed refinancing. From a system established by the federal government in 1932 to sustain the viability of savings and loan associations, the Federal Home Loan Banks (FHLB) have developed into a member-owned instrument for regulating and aiding its membership.

To encourage lenders into the federal mortgage programs, an institution which later became the Federal National Mortgage Association (FNMA) was created in 1938. If the market for FHA-insured mortgages disappears, the lender might find his principal locked in until the term expires or the homeowner sells. The main function of the FNMA was to provide a secondary market for FHA-insured mortgages.

FHA-insured mortgages may sell well even though other mortgages have a more attractive mortgage interest rate, due to a lesser risk. If interest rates on other mortgages increase, the market for FHA-insured mortgages contracts. Despite the more attractive interest rate, FHA mortgages must
compete with conventional mortgages because the original lender gets the profit from a flat service charge imposed when the mortgage is taken, and consequently may not be willing to hold the mortgage until maturity.

In 1968, congress transferred the special assistance program, and management and liquidation of the existing portfolio of FNMA to the newly created Government National Mortgage Association (GNMA). GNMA pays more than market prices, 99.5 per cent to 100 per cent, thereby offering implicit subsidies to borrowers or lenders. The subsidies are not direct expenditures, therefore the subsidies are implicit or implied (1, p. 97).

Conclusion

The effective result of federal intervention in the market for home mortgages is a two-part underwriting of risk. First, the FHA and VA guarantee and insure mortgage loans; and second, GNMA guarantees whatever uncovered risks still remain. As a result of the GNMA guarantee, purchasers of mortgages in the secondary market do not need the expertise of mortgage specialists.

The contention of the chapter is that a bias toward home ownership is supported in the federal intervention in the market for home mortgages. The significance of the federal intervention is in the availability of credit for homeowners.

The subsidies offered the homeowner by providing FHA guarantees and VA insured loans are small in comparison with
the effects of liberalizing mortgage terms through federal institutional support of the secondary market in home mortgages. Only $1,274 million was held in mortgage debt outstanding in 1979 by FHA, as compared with savings and loan association holdings of $475,797 million. Table IV lists the mortgage debt outstanding in 1979 according to type of holder and type of property.
TABLE IV
MORTGAGE DEBT OUTSTANDING IN 1979*

<table>
<thead>
<tr>
<th>Type of Holder, Type of Property</th>
<th>Mortgage Debt Outstanding (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Holders</td>
<td>$1,324,856</td>
</tr>
<tr>
<td>1-4 Family</td>
<td>875,874</td>
</tr>
<tr>
<td>Multifamily</td>
<td>129,261</td>
</tr>
<tr>
<td>Commercial</td>
<td>237,205</td>
</tr>
<tr>
<td>Farm</td>
<td>82,516</td>
</tr>
<tr>
<td>Major Financial Institutions</td>
<td>938,676</td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>245,187</td>
</tr>
<tr>
<td>Mutual Savings Banks</td>
<td>98,908</td>
</tr>
<tr>
<td>Savings and Loan Associations</td>
<td>475,797</td>
</tr>
<tr>
<td>Life Insurance Companies</td>
<td>118,784</td>
</tr>
<tr>
<td>Federal and Related Agencies</td>
<td>97,293</td>
</tr>
<tr>
<td>Government National Mortgage Association</td>
<td>3,852</td>
</tr>
<tr>
<td>Farmers Home Administration</td>
<td>1,274</td>
</tr>
<tr>
<td>Federal Housing and Veterans Administration</td>
<td>5,764</td>
</tr>
<tr>
<td>Federal National Mortgage Association</td>
<td>51,091</td>
</tr>
<tr>
<td>Federal Land Banks</td>
<td>31,277</td>
</tr>
<tr>
<td>Federal Home Loan Mortgage Corporation</td>
<td>4,035</td>
</tr>
<tr>
<td>Mortgage Pools or Trusts**</td>
<td>119,278</td>
</tr>
<tr>
<td>Government National Mortgage Association</td>
<td>76,401</td>
</tr>
<tr>
<td>Federal Home Loan Mortgage Corporation</td>
<td>15,180</td>
</tr>
<tr>
<td>Farmers Home Administration</td>
<td>27,697</td>
</tr>
<tr>
<td>Individual and Others***</td>
<td>169,609</td>
</tr>
</tbody>
</table>


**Outstanding principal balances of mortgages backing securities insured or guaranteed by the agency indicated.

***Other holders include mortgage companies, real estate investment trusts, state and local credit agencies, state and local retirement funds, non insured pension funds, credit unions, and U.S. agencies for which amounts are small or separate data are not readily available.
CHAPTER BIBLIOGRAPHY

CHAPTER IV

GROWTH AND STABILIZATION OBJECTIVES

Introduction

Public support of home ownership in national housing policy can conflict with restrictive monetary policy efforts to reduce inflation and with fiscal policy efforts to provide full employment through growth in the economy. If home ownership is a preference included in national housing policy, housing will claim a larger share of national resources. A small proportion of total labor is employed in the residential construction industry, but a much larger number of employees are involved in housing service industries, such as real estate, insurance and financial areas. Capital resources directed to residential construction and financing are a considerable part of national capital resources. If public funds are diverted into the ownership of homes for all Americans, then national housing policy objectives should be clearly stated and housing programs to accomplish home ownership objectives should be subject to political review.

The extent of the conflict between a national housing policy, which includes the objective of home ownership for all Americans, and federal monetary and fiscal policies will depend upon prevailing economic conditions. Measurements of
the impact of U.S. federal personal income tax provisions and mortgage credit terms and availability which result in preferential treatment of the homeowner, upon the federal government's monetary and fiscal policies is beyond the scope of this thesis.

A measurement of the structural factor presented by the two major housing programs, specifically the bias toward homeownership, depends upon the influence of the programs on the housing market. In order to measure the influence of the two major housing programs on the housing market, one would have to know the extent to which the homeowners' decision is affected by tax preferences and availability of credit. Second, the tax subsidy would be measured by either the subsidy to personal income or the tax revenue foregone by the federal government. Measurement of the availability of credit would be in the terms of credit offered to the homeowner. Third, the influence of the two major housing programs on the housing market would be affected by the local property tax rates. The increase or decrease in the local property tax depends upon the amount of federal aid to the local tax entity.

Another major influence on the housing market, included in the measurement of the structural factor presented by the two housing programs, is the preference of the homeowner. Consumer and investor preferences in housing depend upon inflation in the economy, personal income, and the cost of energy. These preferences are expressed as choices among
price, quality, and neighborhood environment characteristics of housing.

Monetary Policy

Preferential treatment of homeowners in the U.S. tax and financial systems conflicts with monetary policy in two ways. First, if the object of monetary policy is to restrict the money available for credit in the economy, then tax and financial measures which make credit available to homeowners and the residential construction industry conflict with federal monetary policy. Second, if the object of monetary policy is to reduce inflation, then tax and financial measures which make credit available to homeowners and result in higher housing prices conflict with federal monetary policy.

Without an explicit housing policy, open to review by a congressional appropriations committee, there is little control over government programs which divert resources into housing production. The subsidized demand by homeowners results in a diversion of resources into housing production beyond population needs and can be reflected in higher housing prices.

The diversion of capital resources into housing production is based upon housing demand. The following discussion of housing demand, the housing consumption decision is not separate from the housing investment decision. The result of the major housing programs can be a trading-up process due to indebtedness as a choice of payment. Since the major housing
programs are built into the tax and financial structure, there is little control by federal administrators to adjust the programs in relation to current economic conditions.

Several studies support the view that the quantity of housing demand rises with a decline in price. According to these studies, estimates of price elasticity of -1 to -1.5 would mean that a reduction in homeowners' costs due to tax subsidies of 10 per cent to 15 per cent (the effect of deduction of mortgage interest and property taxes) would increase demand for owner occupied housing by 10 per cent to 20 per cent. The amount of increase in the price of housing in the 1970s ranged between 10 per cent and 15 per cent for the majority of taxpayers in the $10,000 to $25,000 income brackets (2; 5, pp. 529; 190).

The effect of the subsidy to homeowners, in the form of deductions from the federal personal income tax, is an increase in the consumer's purchase of housing services, since the subsidy acts like a reduction in the price of housing services (6, p. 102).

Homebuyers would be encouraged to trade up to larger and more expensive houses as their families increase in size if the decision is seen in the light of a substitute for savings rather than a substitute for rent. In an inflationary economy, equity, or value in excess of claims, in a home accrues faster than in savings accounts. There is also less incentive to relinquish housing when the need for space declines.
The cost of housing diminishes over time as the debt is amortized, providing lower cost housing in retirement.

A study by Fisher in 1951 (4, p. 61) found that the degree of indebtedness as a percentage of the estimated home value by the owners had been rising, as a result of the change in federal financial support of the home mortgage market. The study covered the period from 1890 through 1948. In the majority of cases studied, Fisher found in 1951 that a portion of the funds was borrowed, that this portion was increasing, and that the loan-to-value ratio was increasing.

Savings and loan associations offered mortgage terms in the 1920s which averaged 42.6 per cent of estimated property value and averaged from 5- to 11-year amortization periods. By 1940, after the inception of the FHA program in 1934, Fisher found that the degree of indebtedness as a percentage of estimated home value by the owners had risen to 52.4 per cent. In 1979, the loan-to-price ratio averaged 73.9 per cent for maturity periods averaging 28.5 years, as indicated in Table IV.

Incentives in the U.S. federal personal income tax to use interest bearing credit methods of payment encourage persons to become homeowners. The option to buy a home on credit means that large savings are not necessary for a downpayment and more people can afford homeownership. The choice among different methods of payment--immediate payment, non-interest-bearing credit, and interest-bearing credit--is
influenced by the deductibility of interest for tax purposes. Interest deductions for credit purchases of consumer durables (housing, cars, appliances, and furniture) are allowed from federal personal income tax liabilities.

With an increase in demand for housing for ownership tenure, the price of housing would rise, making housing a more attractive investment. More homebuyers would be apt to use large mortgages to finance their purchases. Even when homebuyers have other financial assets, they take out mortgages for a higher per cent of value due to the high visibility of the mortgage interest deduction. An increase in demand for housing can lead to an increase in the price of housing.

Federal credit institutions have promoted stability in the residential construction industry through a regulation of the flow and volume of credit for home mortgages. Federal intervention in the financing of home mortgages insulates the residential construction industry to an extent from restrictive monetary policy. The construction industry is sensitive to interest rates because housing services (real estate, mortgage financing, and insurance), as opposed to housing structure, are capital intensive. Resources move in and out of the industry in response to monetary conditions (5, p. 190). Although the production of structures is relatively labor-intensive, the production of housing services is highly capital-intensive (1, p. 49).
To the extent that federal intervention can provide availability of credit for home mortgages, as it has in liberalized mortgage terms, and by support of the secondary mortgage market, the residential construction industry is accorded special treatment by the federal government. Otherwise, the residential construction industry would tend to act like a sponge to absorb dislocations in the economy. Due to fragmented organization of construction, the custom nature of its production, and the dependence upon weather conditions, the construction industry is unstable compared with the manufacturing industry.

Members of the FHLB system must maintain reserves adequate to assure "meaningful and flexible liquidity . . . which can be increased when mortgage money is plentiful . . . and reduced to add to the flow of funds to the mortgage market in periods of credit stringency" (l, p. 97).

Federal agencies package bundles of mortgages from primary lenders and resell them or sell securities backed by them. The resulting standardization relieves lending institutions from administrative services to the borrowers. As federal insurance is included in the packaging, risk is reduced. Therefore, lenders are not locked into long-term mortgage holdings because the secondary market is active. The federal agency securities are as liquid as any other long-term security.
It is possible that a substantial number of FNMA bonds are paid for by the sales of assets other than mortgages or from cash hoards. In private financial markets, FNMA bonds closely resemble bonds of the federal government and blue chip corporations. FNMA bonds are a substitute federal government and blue chip bonds and capable of attracting the flow of private money to FHA insured mortgages.

Nevertheless, conditions on the private money market limit the extent to which the flow of capital can be regulated. Olson (7, p. 5) states that "interest rates for home mortgage loans have been rising very rapidly since 1978 because of an increasing integration of the home mortgage market with other financial markets." Lenders are willing to accept longer mortgage terms and lower down payments in exchange for federal insurance guarantees. Lenders are not willing to accept lower interest rates, because mortgage holdings could not be sold if the interest rate on guaranteed mortgages were lower than for conventional mortgages.

The FHA has consistently raised the permissible interest rates on its standard programs such as the single-family housing program. Interest rates on FHA insured and VA guaranteed home loans generally move with the yields established in the secondary market for these loans. During 1978 and 1979, the maximum interest rates on FHA and VA loans were increased on three occasions (2, p. 78).
Fiscal Policy

If the objective of federal fiscal policy is to ensure full employment through growth in the economy, then the argument can be made that diverting resources to residential housing construction is investment in foregone growth capital. Before-tax and after-tax rates of return from housing and other investments would be comparable if the tax preferences for housing were removed. The rate of return on housing would drop relative to other investments, and a shift of resources would be made. The market system, then, would be more important relative to the tax system in determining investment decisions. This argument does not compare current interest rates; it is a means of comparing rates of return on investment choices.

Numerous forms of capital investment require more knowledge and sophistication than investment in home ownership. In addition, households have more leverage available in the real estate market. Because of federal mortgage insurance and secondary market support, the homebuyer is able to borrow seventy-four per cent or more of the purchase price of a new home, as shown in Table IV, describing terms on conventional mortgages. By comparison, only thirty per cent can be borrowed toward the purchase of securities, and that ratio must be maintained regardless of price changes.

Homeowners who realize a capital gain, but reinvest in a more expensive house are allowed to defer the tax on the gain;
whereas, those who invest in securities are not allowed to
deferr tax on capital gains. The savings from the deferred
tax is the equivalent of an interest-free loan.

Housing is a relatively riskless investment, attractive
to middle-income households, especially since housing ser-
vice are included. Both tax and financial measures at the
federal level tend to divert capital resources into long-term
commitments in home mortgages. Mortgages were 33 per cent of
all debt instruments used to raise funds in U.S. credit mar-
kets in 1979. Home mortgages were 76 per cent of mortgage
debt outstanding in 1979 (3, p. A39). The recirculation of
housing capital is tied to the sale of a home.

The savings and loan association are required to hold 75
per cent of their capital in mortgage loans. The associa-
tions are the most important source of mortgage credit in the
United States. Savings and loan associations held over 50
per cent of mortgage debt outstanding of all major financial
institutions in 1979. Of the $475,797 million which savings
and loan associations held in outstanding mortgage debt in
1979, $384,439 million was in outstanding mortgage debt on 1-
to 4-family homes (3, p. A48).

The gain to society from the stabilization of the resi-
dential construction industry in terms of growth policy ob-
jectives is the decrease in unemployment. However, the num-
bbers employed in residential construction were small compared
with those employed in other areas of the construction industry and in the manufacturing industry in 1979. Table V presents the number of employees in the residential construction industry, 727 thousand workers. There were 4,257 thousand employees in other areas of construction activity. In comparison with the workers in the residential construction industry, there were 121,192 thousand workers employed in the manufacturing industry in 1979. Workers who benefit from government support for the residential construction industry are not included in the above figures. Those in real estate, insurance, title transfer, and financial intermediaries benefit from the residential construction industry to a greater or lesser degree.

Some measure of the importance of the capital resources diverted into residential housing is the value of new residential construction which was 43 per cent of the total value of U.S. construction in 1979. Home mortgages, held in the same year, were 33 per cent of total debt instruments in the private domestic non-financial sector (3, pp. A48; A42). Residential construction represented 29 per cent of gross private domestic investment in 1979, as indicated in Table VI.

The loss to society, in terms of economic growth, is the loss of risk investment in new products and processes which are considered essential to national economic growth, and consequently to full employment.
### TABLE V

NATIONAL EMPLOYMENT BY INDUSTRY, 1979*

<table>
<thead>
<tr>
<th>Industry</th>
<th>Employees (thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>4,984</td>
</tr>
<tr>
<td>General Building Contractors</td>
<td>1,402</td>
</tr>
<tr>
<td>Residential Building Construction</td>
<td>727</td>
</tr>
<tr>
<td>Non Residential Building Construction</td>
<td>587</td>
</tr>
<tr>
<td>Operative Builders</td>
<td>88</td>
</tr>
<tr>
<td>Heavy Construction Contractors</td>
<td>1,000</td>
</tr>
<tr>
<td>Special Trade Contractors</td>
<td>2,580</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>21,192</td>
</tr>
</tbody>
</table>


### TABLE VI

GROSS NATIONAL PRODUCT AND INCOME, 1979*

<table>
<thead>
<tr>
<th>Account</th>
<th>Dollars (in billions)</th>
<th>Per Cent of Domestic Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Private Domestic Investment</td>
<td>415.9</td>
<td>100</td>
</tr>
<tr>
<td>Fixed Investment</td>
<td>398.3</td>
<td>96</td>
</tr>
<tr>
<td>Non Residential</td>
<td>279.7</td>
<td>67</td>
</tr>
<tr>
<td>Structures</td>
<td>96.3</td>
<td>23</td>
</tr>
<tr>
<td>Producers' Durable Equipment</td>
<td>183.4</td>
<td>44</td>
</tr>
<tr>
<td>Residential Structures</td>
<td>118.6</td>
<td>29</td>
</tr>
<tr>
<td>Non Farm</td>
<td>113.9</td>
<td>27</td>
</tr>
<tr>
<td>Change in Business Inv.</td>
<td>17.5</td>
<td>04</td>
</tr>
</tbody>
</table>

Conclusion

Since government policy is a planned rather than a market choice, the national housing policy should be explicit and open to review. Otherwise, conflicts or national goals are obscured, impacts of housing problems are difficult to measure, and adjustment to current economic conditions are difficult to make.

As a vehicle of housing policy, the federal personal income tax is neither a coherent housing program nor subject to review as a housing program. Homeowner preferences in the U.S. financial system are explicit and subject to review as FHA and VA housing programs. However, these programs do not have the impact on the housing market of the federal financial housing institutions (FNMA, GNMA, and FHLB), and impact which is not open to review as housing policy.

The two housing programs, discussed in Chapters II and III, direct housing production into middle income homeowner preferences and can result in an increase in housing price rather than in meeting population needs. Single-family homes accounted for ninety-four per cent of all owner-occupied housing in 1976 because middle income homeowner preferences generally directed resources into this type of housing (5, p. 190).

Sixty-six per cent of all mortgage debt outstanding in 1979 was allotted to the one- to four-family type of residential property (3, p. A39). The national housing policy goal
is expressed as a goal to stabilize aggregate housing production to meet aggregate household demand, but there is no control over production and housing quality in the two major housing programs.

Monetary and fiscal policy goals emphasize control of inflation and full employment in the economy. Support of housing production through tax and financial measures has resulted in the stabilization of the residential construction industry to the extent that residential construction has kept up with housing demand in the past decade. (Housing production is discussed in Chapter V.) Credit is made available to the housing industry despite restrictions on the flow of capital to other sectors of the economy, which presents a conflict of policy intent. Growth in the economy is a means by which the federal government can provide full employment. However, investment in a relatively riskless asset such as residential housing is in opposition to investment in a new product or process which is associated with national economic growth.
CHAPTER BIBLIOGRAPHY


The filtering process, which is the thrust of the major federal housing programs, is not reaching all Americans, and the ownership form of housing tenure is not the choice of all Americans. There are options which may compensate for the privacy afforded in a single-family dwelling, the desirable attribute conferred by residential property ownership. In the past, people have been willing to trade off privacy for access to jobs and environmental amenities.

Muth (9) modeled the choice of residential location as a choice between a low price of housing and access to the central business district. In contrast, Jones (7) changed the definition of urban space, contending that privacy or an adjustment in space requirements is a major factor in housing demand. Housing, according to Jones, is not only a bundle of goods or services but includes the dwelling structure, the neighborhood environment and the location.

Diamond (3) expanded the definition of access to the central business district to include locational amenities. An amenity is something which is conducive to comfort or to convenience. In the example of housing, an amenity is a site-specific public good, for instance, air quality, an
absence of noise, public safety, a view, or a variety of factors which may influence the choice of residence. Diamond included locational amenities in the utility function of the household, rather than in the budget constraint, since there is no explicit market price attached to amenities.

Changing Lifestyles

Home ownership has been largely a choice of families in their child rearing years. Demographic and social change suggest a trend away from the choice of single-family detached dwellings on a large lot. The post-World War II baby boom generation is entering the 25 to 44 years of age category, which will increase in size by 16.0 million people between 1976 and 1985 (12, p. 4). These households are tempering their need for space and privacy for a growing family with a choice for amenity environments.

The costs of suburban living are represented by the costs of access to jobs versus privacy. Westcott (17, p. 7) found that most workers have jobs in the geographic area (urban or suburban) in which they live. Nevertheless, commuter flows are significant. In 1975, approximately one-third of all persons traveled to a work site outside of their geographic area of residence. Suburban residents accounted for the largest percentage of commuters (forty-five per cent), whereas seventeen per cent of persons residing in the city commuted to jobs in the suburbs.
There is a tendency to trade off the privacy afforded by low density living with urban densities which support public transportation, access to job markets, low maintenance dwelling units, and day care facilities. The low-density characteristics of suburban development are orientation to the automobile, and detached single-family houses on relatively large lots.

Husband-and-wife families, which accounted for three-quarters of American households in 1960, had declined to below two-thirds by 1976 (12, p. 43). The baby bust generation, following the postwar baby boom, is the consequence of declining fertility rates after 1957. Between 1976 and 1985, the 18- to 24-year category will contract by about 6.4 million people (12, p. 4).

There is another change in the American family structure which could change the family choice of housing style. The American household is undergoing social change, as the divorce rate has more than doubled while the marriage rate has declined in the last 5 years. Families headed by females, as a consequence of high divorce rates, increased by 33.4 per cent after 1970 (14, p. 1). There is an indication that young women are postponing marriage in increasing numbers. In 1960, 15.0 per cent of married women 44 years of age and under were childless; by 1976, the equivalent was 18.8 per cent (12, p. 43).
People have become more mobile as they become increasingly independent of wage and salary incomes. Beyers (1, p. 35) found that in the period from 1950 to 1975, wage and salary plus proprietor's income decreased from 82 per cent to 71 per cent as a fraction of total national personal income. In the same period, dividends, personal interest income, transfer payments, personal contributions for social insurance, and the rental income of persons increased from 18 per cent to 29 per cent of total personal income. By 1980, wage and salary plus proprietor's income was 68 per cent of total national personal income. Dividends, personal interest income, transfer payments, personal contributions for social insurance and the rental income of persons increased to 34 per cent of total national personal income (4, p. A51).

Constraints on choice of location may be dominant in the demand for housing by certain groups. Muth (9) assumed that the constraint over the household utility function was the budget constraint, or income. Older persons may be tied to housing location due to dependence upon the low cost of home ownership. The elderly have tended to use investment in housing as an insurance against the lower income received in later years. Owner occupation shifts the cost of housing to the early years of the family life cycle, resulting in a transfer of wealth from the early to later years of a homeowner.
Discretionary Housing Programs

Congressional support for low-income housing programs has vacillated. There are programs for subsidies to low-income renters, through low rent public housing, subsidies to low- and middle-income renters and homeowners, and subsidized loans to rural homeowners.

Although the supply and quality of housing has been adequate to aggregate household formation, for 1971 through 1979, low-income families cannot afford housing without spending a disproportionate amount of income on housing services. The major housing programs, implicit tax subsidies to homeowners, mortgage insurance and guarantees, and measures to improve the flexibility of mortgage operations by lending institutions, have underwritten the production of housing.

Table VII gives the total federally subsidized housing production in 1979. The emphasis of federal housing programs is on new construction starts, which totalled 236,603 units in 1979 as opposed to only 40,645 rehabilitated units. New construction starts on both single- to four-family units and multifamily units were eighty-five per cent of total federally subsidized housing in 1979. Current housing needs in the United States, to replace housing stock losses, to provide a reasonable vacancy rate for mobility purposes, and to meet the net increase in household formation, are estimated at between 2.0 million and 2.4 million units per year (15, p. 52).
TABLE VII
FEDERALLY SUBSIDIZED HOUSING PRODUCTION
FISCAL YEAR, 1979*

<table>
<thead>
<tr>
<th>Size of Unit</th>
<th>Total Units of Subsidized Prod.</th>
<th>New Construction Starts in Units</th>
<th>Rehabilitated Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>One- to Four-Family</td>
<td>74,113</td>
<td>60,621</td>
<td>13,514</td>
</tr>
<tr>
<td>Multifamily</td>
<td>203,113</td>
<td>175,982</td>
<td>27,131</td>
</tr>
<tr>
<td>Total</td>
<td>277,248</td>
<td>236,603</td>
<td>40,645</td>
</tr>
</tbody>
</table>


New housing production exceeded household growth by approximately 1.0 million housing units from 1971 through 1973, and reached 3.0 million units per year (16, pp. 5-25).

Housing starts were 2.0 million units in 1979 (15, p. 12).

The quality of residential housing has been maintained by zoning and building restrictions. Quality has been measured in relation to the structural facilities provided. Today, virtually all owner-occupied units in cities have complete plumbing systems and almost 98 per cent of rental housing stock has complete plumbing facilities. Because of major increases in the stock of central city housing in the 1960s and early 1970s, one in every five central city units has been built since 1965 (16, pp. 5-2). Outlays for
federally subsidized housing for low income families are minimal compared with the subsidies to homeowners from preferred treatment in the federal personal income tax.

Hellmuth (6, pp. 193-194) compared discretionary budget outlays by HUD and subsidies to homeowners in the federal income tax structure. Direct budget outlays for subsidized housing accounted for one-fifth of federal housing expenditure in 1977. Expenditures for the major housing programs of HUD were estimated at $3 billion. In the same year there were tax subsidies to homeowners estimated by Hellmuth of $5.4 billion for deductibility of property taxes, and $890 million from the deferral of tax on capital gains from sales of the principal residence.

From the passage of the Housing Act of 1937 through the end of the first four years of the Kennedy-Johnson Administration, public housing and related subsidy programs accounted for less than five per cent of housing starts and were frequently subject to reduction by Congress. In 1960, the Housing and Urban Development Act included the numerical goal of twenty-six million new and rehabilitated homes and apartments to be constructed over a ten-year period.

During the Nixon Administration, the emphasis upon federally assisted starts increased to over twenty-five per cent of total residential construction. In a four-year period, the aggregate production record of the previous thirty-two years was equalled (2, p. 1802).
National housing production goals, established in 1968, were never realized. The explanation for the failure was attributed to inflationary cost increases. The National Low Income Housing Coalition charged that it is inconsistent and unjust to control only those housing expenditures which benefit low-income people (14, p. 12).

Whatever the evaluation of low-income housing programs may be, the assertion does indicate that there are in effect two levels of housing policy. A discretionary level is associated with congressional legislation of housing programs for low-income families. The other housing programs are a part of the U.S. tax and financial structure, and less subject to change by congress.

Low-Income Families

Home ownership does not meet the needs of low-income families. The attributes of home ownership are that tenure promotes self reliance, affords greater privacy and control over one's immediate environment, and gives the family a stake in community affairs. An attribute to a middle-income family may be a liability to a low-income household. Home ownership is a form of tenure which the household may well be willing to trade for a better quality of local public services or access to jobs. The choice of housing as an investment may be unattractive to low-income families because capital appreciation in declining neighborhoods is unlikely, and older housing units are more expensive to maintain.
Krasnowiecki (8) noted under the Housing and Urban Development Act of 1968, that participants paid at least one-fifth of their adjusted income toward mortgage amortization. Some buyers did not know that in addition to making mortgage payments, they had to pay maintenance and utility expenses. Others were unable to cope with simple maintenance and repair jobs. Krasnowiecki observed that many low-income purchasers require counseling and assistance as homeowners. He stated that

Although we can expect a growing trend in favor of ownership housing for the poor, it is well to recognize that our system of ownership with its built-in complications of title, closing costs, credit references, foreclosures and so forth, is not designed to cater to those who are scrouged by instability in income and family structure (8, p. 244).

Federal housing programs are oriented toward production and structural quality in housing. Homeowner preferences embodied in major federal housing programs influence middle-income household choices in housing. The result is inflexible patterns in housing, both in location and type. While middle-income households can adapt residential housing patterns to prevailing economic conditions, lower-income groups do not have the means to adapt. Fiscal zoning further exacerbates economic segregation by income levels.

Fiscal Zoning

The two major housing policies of the federal government have accentuated the shift into home ownership, making the homeowner an asset as local property taxpayer. One effect of
the federal housing program, associated with mortgage financ-
ing, has been to protect the quality of new construction through local zoning and building restrictions. Therefore, families who are unable to afford middle-income housing are effectively excluded from the suburban areas, where housing production has been the greatest in recent years.

As long as local government entities find it necessary to protect the tax base through fiscal zoning, certain community services, education for example, will be limited to residents. Lack of access to public services further exacerbates the problems of housing for low-income families.

Even though housing and living environments are fixed in location, if people can move to a different location, they can improve or change their housing accommodation and type of local public services. Local public services represent the quality of life in a community for the purpose of this discussion.

Tiebout (13) maintains that through migration, households can purchase a different public goods package by moving to a different community. Constraints over the choice of locality may be through zoning, as well as lack of income. Gronberg (5) asserts that the household utility function includes services by local governments (police, fire, sanitation, education) which the constituent may vary through migration or the voting process. According to Gronberg, the maximum utility of the household depends upon the price of
housing, income net of commuting costs, and the local public goods bundle.

Substantial segments of the population have a limited ability to migrate because of low-income. The ability of low-income families in urban areas to afford decent housing is increasingly limited. Poverty is defined as an annual income for a family of four that is inadequate to purchase a specified minimum market basket of goods and services. The poverty line is a sliding income scale which varies between rural and urban locations according to family size. The level for an urban family of four—which is regarded as typical—was approximately $7,000 in the late 1970s. More than 10 per cent of the total population is classified as poor. The majority of the poor are urban dwellers (11, p. 286).

The poverty level in the central cities is increasing, in contrast to declining poverty levels in smaller cities, and the suburbs. Median family income in central cities has failed to keep pace with inflation, in contrast to family income in the suburbs. Between 1969 and 1977, central city family incomes increased 57.1 per cent, while the Consumer Price Index rose 65.3 per cent. Suburban family incomes rose by 65.6 per cent in the same period, keeping pace with increasing inflation rates (16, pp. 4-16).

A high urban concentration of poor families, unable to migrate, implies high public service burden in the form of education, welfare, and crime. The fiscal problem of the
cities is the result of a mismatch between local government functions and revenue-raising powers. As central cities lose population which can sustain a certain level of revenues, there is an increased outward movement of the middle-income residents to communities with a higher level of public services.

Property taxes are the primary source of local taxes. Since housing property values serve as the tax base for property tax assessments, they are a major determinant of the level of expenditure on local public services. The property tax is responsive to population change. Each 1.0 per cent change in the rate of population growth is associated with a 2.0 per cent to 2.7 per cent differential in the rate of growth of the real property tax base (16, p. 6-12).

Competition to preserve the tax base has become a strategy of local governments. The adoption of restrictive zoning ordinances is designed to exclude households which would spend relatively little on housing and therefore contribute little to the tax base which provides the level of public services. The best financial strategy, according to a study by Smith (10, p. 449), would be to promote the construction of upper-income housing and to exclude low-revenue-producing stores, factories, and households.

An argument can be made for federal aid to the local tax base in order to relieve the burden and fiscal zoning caused by reliance upon the property tax. If a local government is
responsible for all local public finance, then the services offered are in a direct relation to the tax base. While the resident can and should have a vote to determine the mix of community services, the level of community services should be comparable to the level of community services in other states, especially in the areas of housing, education, and health.

Redistribution of public goods is ideally a function reserved to the federal level of government to assure an equitable distribution of benefits among community residents. The province of local government is the allocative function of providing police, fire, and sanitation services. The issue of provision of local public services which determine living environment is one which has been ignored in major federal housing programs. The two major housing programs, discussed in Chapters II and III, are oriented toward the filtering strategy to provide housing for low-income families. Those federal housing programs which support home ownership, assume that all American have access to a decent home and a suitable living environment.
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CHAPTER VI

CONCLUSION

National Housing Policy

The conclusion of this thesis is that home ownership should not be included in national housing policy. Ownership is not a goal of all Americans, as far as housing tenure preferences have been revealed in the number of those who rent or own their own home. Housing tenure preferences of the American public, as expressed in congressional housing legislation, did not include ownership of homes until 1958. Home ownership was not the original intent of federal tax and financial measures which provide the largest subsidies to homeowners. The preferential treatment of homeowners in the U.S. tax system was a product of four tax measures that were part of non-housing tax policies at their inception. Federal intervention in the home mortgage market, which makes credit available to homeowners, was originally intended to reduce the unemployment of the 1930s depression.

Public support of home ownership, as a goal of national housing policy, can conflict with monetary policy and fiscal policy objectives to control inflation and provide full employment in the economy. Home ownership does not meet today's need of changing lifestyles or low-income families. Home
ownership makes an attractive target for fiscal zoning, which further exacerbates the problem of housing low-income families.

If home ownership is included in national housing policy mainly through homeowner preferences in the U.S. tax and financial systems, then non-housing subsidies to income would be a solution to low-income housing. The solution to the inequitable distribution of housing and public services is to aid low-income families to become more mobile through non-housing income subsidies. This approach does little to provide alternative housing options to the emerging household formations, evident in single-parent families and unrelated householders.

Income Subsidies

Subsidies to low-income families which are tied to housing, in the form of mortgage assistance, are too costly to administer, are not reaching most low-income families, can result in upward pressure on housing prices, and will not necessarily improve the housing environment. The Housing and Urban Development Act of 1968 provided direct federal subsidy in the form of interest reduction payments on mortgage loans and the first step toward home ownership for low-income families in a housing program. The maximum subsidy was 50 per cent by 1970, it was raised to 60 per cent of the mortgage payment. The program did not reach low-income households
because they were required to pay at least one-fifth of their adjusted income toward mortgage amortization (1, pp. 136-137).

Rent vouchers were introduced in the Housing and Urban Development Act of 1965 to help low-income families afford better housing. The Housing and Urban Development Act, 1965, enabled HUD to agree with a contractor to make rent supplement payments at a stipulated maximum per year for forty years. Rent supplement payments started only after units were completed and occupied, and were provided for housing programs for the elderly and handicapped and for lower-income families (1, p. 135). However, there is no assurance that the demand-side subsidies will exert an upward filtering into better housing. The increased demand could raise housing prices.

Unless low-cost housing is introduced into the suburbs, aid to low-income families toward home purchase is pointless. Neighborhoods in the central cities are deteriorating and the cost of new single-family homes in the cities is too high for low-income families to afford.

Aaron (1, p. 167) suggest that administrative costs and pressure on housing prices would be minimized if income subsidies are not tied to housing. He says that the administrative costs of a loosely administered housing assistance plan, with spot income verification and untied benefits, could be as low as fifteen dollars to twenty dollars per household.
If one accepts the premise that home ownership is not the choice of the society in general, then government housing programs which support home ownership for a segment of the population are inequitable. Government programs which allocate resources into home ownership are inefficient unless ownership is a housing goal for all Americans. Many Americans have preferences in housing characteristics which they are willing to trade off for ownership, and under present local fiscal conditions, the option for home ownership for everyone is not only limited but extremely expensive for the federal government to underwrite. The recommendations of this thesis are reform in the U.S. tax structures, and end to preferential treatment of homeowners in the federal personal income tax, and less dependence of local government on the property tax.
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