

A BUDGETARY FRAMEWORK FOR FEDERAL HOUSING AND RELATED COMMUNITY DEVELOPMENT POLICY

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A BUDGETARY FRAMEWORK FOR FEDERAL
HOUSING AND RELATED COMMUNITY DEVELOPMENT POLICY

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PREFACE

A Budgetary Framework for Federal Housing and Related Community Development Policy--is one of several reports on housing and community development activities prepared by the Human Resources and Community Development Division of the Congressional Budget Office to help the Congress during the fiscal year 1978 Congressional budget process. The paper was prepared at the request of the staff of the Senate Budget Committee. It was written by Arthur P. Solomon, a consultant to the CBO, under the supervision of David S. Mundel, with assistance by Roger Faxon, Neil Mayer, and Philip Sampson. The report was typed by Jill Bury.

In accordance with CBO's mandate to provide objective and impartial analyses of budget issues, this report presents no recommendations.

Alice M. Rivlin
Director

February 1977

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SUMMARY

The housing sector is an important component of the U.S. economy as well as a major consumption and investment activity for most households, and federal involvement in it is both extensive and complex. For fiscal year 1977, the Congress has provided for \$22.2 billion in budget authority, \$6.2 billion in outlays; and \$12.2 billion in tax expenditures for housing and related community development activities. In addition, some \$8.1 billion in budget authority and \$3.7 billion in outlays will be available for off-budget, housing-related agencies.

The complexity of federal involvement in the housing sector results from many goals, a wide variety of possible instruments or programs, and the number of departments and agencies that administer the government's activities.

Federal housing policy has developed in pursuit of four major goals:

- To assist low- and moderate-income households in occupying housing that is decent, safe, and sanitary;
- To encourage a stable and high level of growth in the housing stock, with concomitant stability in employment and production in the construction industry;
- To increase the proportion of families that own their own homes.
- Support for the creation and maintenance of viable neighborhoods and communities.

Five categories of federal activity are designed to further the achievement of these goals:

1. Mortgage Credit and Thrift Insurance (Budget Subfunction 401): programs designed to reduce the cost and increase the level and stability of mortgage credit availability. These programs primarily influence housing production goals.
2. Community Development (Budget Subfunction 451): programs and grants designed to encourage community-wide planning; investment in streets, sewers, access roads and other infrastructure; and neighborhood revitalization.
3. Housing Assistance (Budget Subfunction 604): programs designed to directly reduce the cost of housing and/or increase the quantity of decent shelter available to low- and moderate-income and elderly households. These programs largely affect substandard housing and excessive rent burdens.
4. Tax Expenditures: a range of tax deductions, exemptions, credits, and deferrals designed to make homeownership more affordable, to stimulate construction and to increase the availability of capital to the housing sector.
5. Off-Budget Housing and Mortgage Credit: programs and agencies created to increase the availability and stabilize the flow of mortgage credit to the housing sector and to encourage the construction of housing for the elderly and the handicapped.

Other specific nonhousing government policies also affect the housing market--e.g., the monetary policies of the Federal Reserve Bank, federal banking regulations, income assistance programs, and the forest management policies of the Departments of Agriculture and Interior. Thus, the responsibility for housing and related community development cuts across jurisdictional lines in both the Congress and the Executive Branch.

Six housing problems have been the objects of federal involvement. The first three, under the general heading of housing production, are

1. Overall level of housing construction
2. Cyclical instability of residential construction

3. Availability and cost of mortgage credit and other construction factors

The remaining three problems are grouped under housing consumption:

1. Excessive housing costs
2. Substandard shelter
3. Declining and slum neighborhoods

Several government programs impinge upon each of these problems. For example, the level of housing production is affected by mortgage credit and thrift insurance activities, which increase the availability and reduce the price of capital funds; by assisted housing programs, which utilize newly constructed units; and by several tax expenditure and off-budget activities. The complex of programs that affect these six problems above is represented in the following table. The boxes indicate the primary areas of impact of the classes of instruments.

The extent and complexity of federal involvement in the housing sector limit the establishment of a coherent overall federal strategy--both programmatically and budgetarily. A budget framework depicting the combination of problems and programs that structure the federal housing effort can help to overcome these limitations.

This framework can help to illuminate the pattern of federal housing policy. Its utility within the resource allocation process is somewhat limited, however, by uncertainties about the performance of alternate federal housing policies. It is relatively easy to specify which programs affect which problems, but assessing their impact (and sometimes their direction) is a difficult research task.

Uncertainties about the effectiveness of these programs are compounded by their interactions with private market behavior (do they induce, or simply substitute for, private activity?), and by the dependence of their performance on the overall state of the economy. Because several programs are often implemented in unison, assessment of their respective, independent effect is impossible.

Programs that influence more than one problem may seem desirable, but these multiple effects may actually be smaller than would result from single-focus instruments. In addition to the complexity of both the programs and the problems that they attempt to solve, the low level of research and program evaluation efforts contributes to our limited knowledge of program effects.

THE CONNECTIONS BETWEEN HOUSING PROGRAMS AND PROBLEMS
 "A Policy and Budget Framework for Federal Housing Policy"

Federal Housing Programs	HOUSING CONSTRUCTION PROBLEMS			HOUSING CONSUMPTION PROBLEMS		
	Level of Construction	Stability of Construction	Availability & Cost of Mortgage Credit (and Other Production Factors)	Excessive Housing Costs	Substandard Shelter	Declining and Slum Neighborhoods
I. On-Budget						
A. Mortgage Credit and Thrift Insurance (401)						
1. GAMA	XX		XX	XX		
2. FHA Fund	XX	X	XX	XX		
3. FMAA and Rural Housing Insurance	XX		XX	XX		
B. Community Development (451)						
1. Rehab. Loans	X			X	XX	XX
2. Community Development Block Grants				X	X	XX
3. JOL Comprehensive Planning						X
C. Housing Assistance						
1. Public Housing	XX			XX	XX	
2. Public Housing Operating Subsidies				XX	XX	
3. Section 8 New or Rehabilitated	XX			XX	XX	
4. Section 8 Existing				XX	XX	
5. Section 235 Revised	XX		XX	XX	XX	
D. Tax Expenditures						
1. Deduction: Mortgage Interest and Property Taxes	XX				XX	
2. Deferral of Capital Gains on Sale	XX					
3. Exclusion of Capital Gain for Elderly				X	X	
4. Excess Bad Debt Reserve: Thrifts	XX		XX			
5. Depreciation in Excess of Straight Line	XX		XX	X	X	X
6. Expensing of Interest & Taxes: Construction Period	XX		X			
7. State & Local Bonds	XX		XX	XX	XX	
II. Off-Budget						
1. Elderly and Handicapped Housing	XX		XX	XX	XX	
2. FHLMC	XX	XX	XX			
3. FHLBB	XX	XX	XX			
4. FMMA	XX	XX	XX			

Notes: XX = federal government program usually has an impact on the problem.
 X = federal government program sometimes has an impact on the problem.

CHAPTER I. INTRODUCTION

Federal housing and community development policy has developed in pursuit of four major goals:

- To assist low- and moderate-income households in occupying housing that is decent, safe, and sanitary;
- To encourage a stable and high level of growth in the housing stock with concomitant stability in employment and production in the construction industry;
- To support the creation and maintenance of viable neighborhoods and communities; and
- To increase the proportion of families that own their own homes.

In pursuit of these goals the Congress provided for \$22.2 billion in budget authority, \$6.2 billion in outlays, and \$12.2 billion in tax expenditures in the fiscal year 1977 budget and appropriation actions. In addition, approximately \$8.1 billion in budget authority and \$3.7 billion in outlays will be available for off-budget, housing-related agencies.

ISSUES FOR THE BUDGET PROCESS

The federal role in housing and community development poses a number of significant challenges to the budget process. First, the federal government uses a variety of policy instruments to pursue its goals thereby making it difficult to develop or to coordinate a coherent, overall national housing policy. Many federal government activities have an important, if not dominant, impact on the housing sector, although they are not typically thought of in the implementation of housing policies. The most important of these are the overall monetary and fiscal programs, which affect inflation, unemployment,

and the Gross National Product (GNP). Other federal government actions--such as national forest management, the Davis-Bacon labor regulations, energy research and investment, and public assistance--have an important influence on the condition of housing markets and the resulting need for and effect of specific housing policies.

Second, the responsibility for housing and related community development policy cuts across jurisdictional lines in both the executive branch and the Congress. While the U.S. Department of Housing and Urban Development (HUD) assumes major responsibility for federal housing policy, the Treasury and Agriculture Departments, as well as the Veterans Administration and the Federal National Mortgage Association (FNMA), also carry out important housing functions. Some federal government-sponsored financial agencies, such as the FNMA, the Federal Home Loan Bank Board (FHLBB), and the Federal Home Loan Mortgage Corporation (FHLMC), have significant effects on the housing credit market, but they are off-budget and thus not subject to annual Congressional and executive control. In the Senate, most housing legislation falls within the jurisdiction of the Banking, Housing, and Urban Affairs Committee; the Finance Committee and the Agriculture and Forestry Committee also have jurisdiction over some specific housing-related activities. In the House, housing legislation is primarily within the jurisdiction of the Committee on Banking and Currency, and its Housing and Community Development Subcommittee. The special tax exemptions, deferrals and deductions applicable in the housing sector are established by the House Ways and Means Committee.

Third, the Congressional Budget and Impoundment Control Act of 1974 (Section 601) requires, by fiscal year 1979, that budget allocations and tax expenditures for housing be tied to specific housing goals or missions. Yet current national housing goals are somewhat vague and nonoperational--oftimes conflicting--and the effect of current housing programs on these federal goals is poorly understood. Because of the distinction between budget authority and budget outlays, other issues arise concerning annual budgetary discretion, or control, and program comparisons. Since many housing assistance programs include multiyear subsidies (e.g., retirement of debt or subsidization of mortgage payments), the outlays in a given fiscal year are dominated by commitments from previous years.

Also, programs with the same annual budget outlay may require substantially different amounts of budget authority because of the length of time for which subsidy commitments are made.

THE BASIS FOR A POLICY AND BUDGET FRAMEWORK

The nature of the foregoing issues underscores the need to organize federal housing policy and budget decisions in a more systematic manner. If the Congressional budget process is to be an effective mechanism for resource allocation decisions, then there should be an analytical framework to serve the following purposes:

- Help to clarify the federal government's various housing missions.
- Provide a comprehensive, encompassing view of all federal government housing activities, both on- and off-budget.
- Relate budget allocation and tax expenditure decisions to specific housing missions.
- Facilitate the comparison of alternate budget options.

Before setting forth a possible policy and budget framework, it must be stressed that there is no single scientifically determinable federal housing framework. There are many possible frameworks. The one developed in this paper is organized around major housing goals or missions that are established, either explicitly or implicitly, with federal legislation and executive pronouncements. In most instances, these goals are stated in terms of eliminating or mitigating specific problems. A complication facing federal policy-makers, however, is that the character and size of these problems is not geographically uniform.

One of the most convenient ways to view the housing sector and its problems, is first to draw the distinction between housing production and housing consumption. It is then possible to organize the major issues of national housing policy into six problem areas: 1/

Under a general heading of housing production are these problems:

1. Overall level of housing construction
2. Cyclical instability of residential construction
3. Availability and cost of mortgage credit and other construction factors

Housing consumptions problems include:

4. Excessive housing costs
5. Substandard shelter
6. Declining and slum neighborhoods

Over the years the federal government has employed a broad range of policy instruments in order to deal with these production and consumption problems. The various federal housing approaches can be classified into five broad categories: (1) mortgage credit and thrift insurance, (2) housing assistance, (3) community development support, (4) tax expenditures, and (5) off-budget credit market activities.

The five classes of housing instruments and the six problem areas form a logical matrix for a possible budget framework.

1/ Although there are many potential problems in the housing sector that the federal government may choose to address, the six chosen for the budget framework subsume most of the frequently mentioned ones.

TABLE 1. THE FEDERAL HOUSING PROBLEM-HOUSING PROGRAM FRAMEWORK

	FEDERAL HOUSING PROBLEMS					
	HOUSING PRODUCTION			HOUSING CONSTRUCTION		
	Level of Construction	Stability of Construction	Availability/ Cost of Mortgage Credit	Excessive Housing Costs	Substandard Shelter	Declining and Slum Neighborhoods
<u>FEDERAL HOUSING PROGRAMS</u>						
<u>On-Budget</u>						
Mortgage Credit and Thrift Insurance (401)						
Community Development (451)						
Housing Assistance (604)						
Tax Expenditures						
<u>Off-Budget</u>						
Special Housing and Mortgage Credit						

The remainder of this paper is organized into four sections that describe the components and potential use of this framework. The first section (Chapter II) discusses the nature and causes of the major housing production and consumption problems; the discussion of each problem is designed to clarify the federal government's various, housing missions. The next section (Chapter III) briefly discusses federal housing programs and establishes the outlines of a budget framework. Chapter IV incorporates the housing programs and housing problems into a unified budget policy framework. The last section (Chapter V) sets forth program options which represent illustrative mixes of current and supplementary instruments for addressing two examples of the six housing problems.

CHAPTER II. NATIONAL HOUSING PROBLEMS

The more important housing production problems involve the level of residential construction, the stability of these levels, and the cost and availability of construction inputs, especially mortgage credit. Major housing consumption problems include excessive costs of rental housing or homeownership for some families, occupancy of substandard or overcrowded housing units, and residence in slums and other unsatisfactory neighborhoods.

PROBLEMS RELATED TO HOUSING PRODUCTION

Annual Volume of New Construction

The level of residential construction activity--"housing starts"--is one indicator of the current and future health of the housing sector. A level of construction activity that keeps pace with household formation rates and other new housing requirements (e.g., those created by losses from the existing stock) is necessary to provide an adequate aggregate supply, sufficient units for household mobility, and reduced inflationary pressure on the prices of existing rental and owner-occupied units. High construction activity also results in lower unemployment and higher profits in the construction industry.

A decade of annual production targets for new dwelling units was established in the Housing and Urban Development Act of 1968. The Act called for the production of 26 million new housing starts over a 10-year period (1969-1978) to help meet the nation's requirements, with 6 million units targeted for low- and moderate-income families. 1/ On the basis of this

1/ While the goal of 26 million new housing starts and rehabilitated units over the 10-year period has been maintained, the annual targets were revised and updated in the Second Annual Report on the National Housing Goals, 1970.

legislation the nation's housing production problem has been measured, in part, by any shortfall from the annual production target.

TABLE 2. NEW HOUSING PRODUCTION TARGETS AND ACHIEVEMENTS
1969-1975 (Thousands of Units)

	1969	1970	1971	1972	1973	1974	1975
National Housing Production Target <u>a/</u>	1,958	1,800	1,980	2,255	2,550	2,800	2,950
Actual Starts and Mobile Home Shipments <u>b/</u>	1,968	1,762	2,235	2,826	2,933	2,165	1,324
Annual Surplus or Deficit	+10	-38	+255	+571	+383	-635	-1,526
Cumulative Surplus or Deficit	+10	-28	+227	+798	+1,181	+546	-980

a/ Source: Derived from President of the United States, Second Annual Report on National Housing Goals (Washington, D.C., GPO) 1970.

b/ Source: Derived from U.S. Bureau of the Census, Construction Reports: Housing Starts, Series C-20, 1969-1975, and U.S. Department of Commerce, Construction Review, Vol. 22, No. 8, October 1976.

Some problems exist in estimates of the annual housing construction targets. In establishing the annual targets the President's Committee on Urban Housing (Kaiser Committee) failed to distinguish between the concept of social need--e.g., the housing deprivation of low- and moderate-income households--and the concept of effective market demand based on long-term demographic (e.g., new household formations) and economic activity. The desired level of production activity

depends on the levels of social need, the mode of government policy implemented to fulfill that need, and private market demands. Also, it may be unrealistic to set forth separate production estimates for each year: Inflation and unemployment rates, as well as growth in nonhousing sectors of the economy, continuously influence the competition for scarce resources. This is especially true in the capital market, where the sensitivity of the housing sector to the cost and availability of mortgage funds varies significantly with changes in the business cycle.

Because the current production targets include units needed to replace substandard dwellings, there is a question of whether or not rehabilitation activity should be included within production. To the extent that rehabilitation converts uninhabitable units to habitable ones, it adds to the stock and should be counted. Rehabilitation that converts substandard units to standard units lessens the need to construct new units and therefore, should be counted within the production targets and levels. ^{2/} To the extent that rehabilitation simply upgrades existing standard units, however, it does not add numerically to the stock. Of course, rehabilitation does, in each instance above, increase construction industry employment and other economic activity.

The utility and desirability of a simple numerical calibration of the housing production problem are not universally accepted. Some observers question whether the utility of aggregate numerical production targets for the housing sector. They suggest that other dimensions of housing production--location, structure type, number of rooms, price, tenure arrangements--should be built into the targets.

^{2/} The inclusion of rehabilitation that converts substandard to standard units in the current production targets, however, perpetuates the popular confusion between the economic concepts of stock and flow. New construction adds to the available stock of housing. On the other hand, the rehabilitation, repair and alteration of existing dwellings does not add to the available stock unless an uninhabitable unit is converted to one available for occupancy.

Another question asked about the national production targets is whether there is a federal government responsibility for solving the alleged problem. The housing sector is primarily a private one; low start rates may simply represent a new equilibrium between suppliers and consumers. For example, multifamily apartment and condominium construction starts have recently been below historical levels. This may be the result of lower demand caused by regional patterns of growth, by declines in the number of new renter households, or by excessive supply resulting from speculative overbuilding in earlier years. Primarily depending on its cause, production falling short of historical standards or current targets may, or may not, indicate a need for government involvement.

Another suggestion is that a production target should be set for an intermediate or longer period--5 to 10 years--rather than for each year. National projections of new construction requirements for the intermediate- to long-term can provide useful benchmarks for public and private investment, management, and employment decisions. Such a change would recognize that the cyclical nature of residential construction largely precludes the validity of annual production targets.

Cyclical Instability of Housing Construction

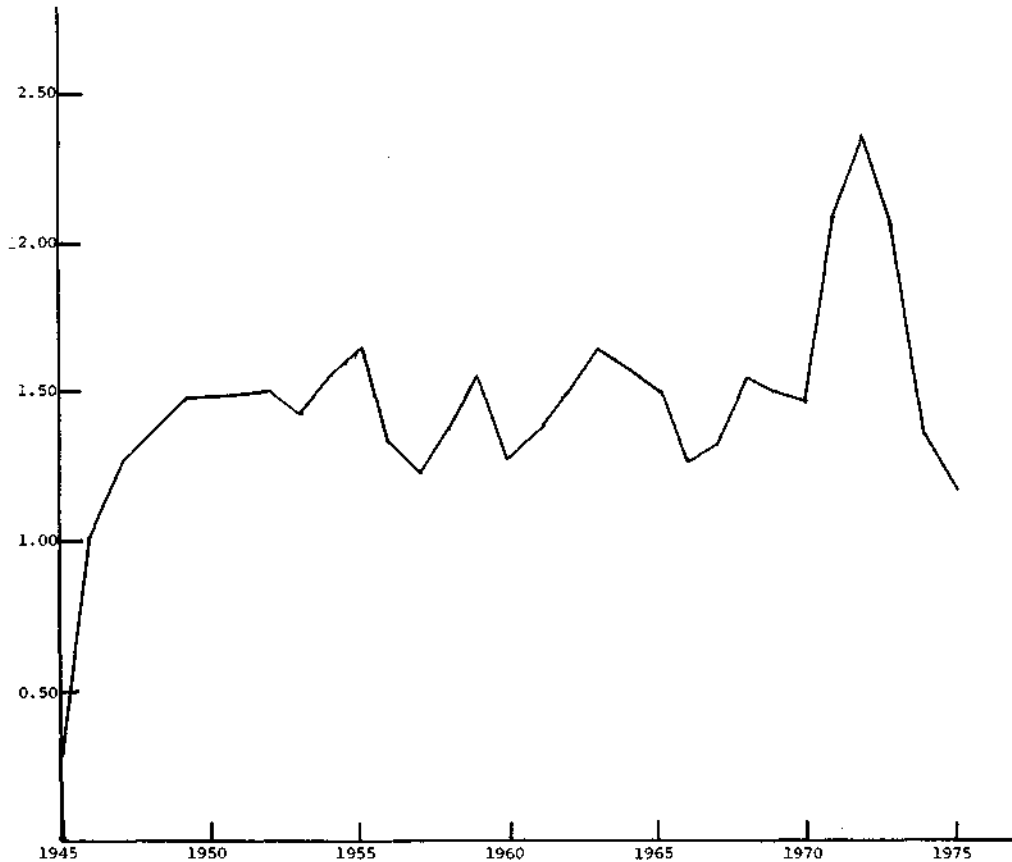
Residential construction is prone to extreme cyclical volatility. There have been seven major, increasingly severe cycles since World War II. Recently, housing starts fell from a peak annual rate of 2.5 million units in the first quarter of 1972 to a low of 953,000 in the second quarter of 1975. These cycles in the start rate run parallel to increases and decreases in the unemployment rate in the construction industry. The severity of the recent cycle is reflected in the construction unemployment rate which increased sharply from 8.1 percent (December 1973) to a high of 21.8 (May 1975). ^{3/} Unemployment in the construction industry remains substantially higher than in any other major sector of the economy. ^{4/}

^{3/} Seasonally adjusted rates.

^{4/} In the second quarter of 1975 the unemployment rate in the total labor force was about 8.9 percent in comparison to the 20.1 percent rate in construction alone.

FIGURE 1. CYCLICAL INSTABILITY IN RESIDENTIAL CONSTRUCTION
PEAKS AND TROUGHS (1945-1975)

Annual Housing Starts
(Excluding Mobile Homes)



Few disagree that residential construction suffers from efforts to attenuate the business cycle, or that restrictive credit conditions are a major cause of this cyclical volatility. There is less understanding, however, about the covert costs of residential construction instability. Severe and frequent housing slumps involve onerous losses--not only to the construction industry but to individuals and to society as a whole.

The construction industry's forced adaptation to these relentless cycles does not mean that it adjusts either easily or inexpensively. A housing policy that relies on residential construction as the balance wheel of the economy creates both short- and long-run costs in the construction sector.

In the short-run, low construction activity leads to significantly underutilized capacity, bankruptcies and severe unemployment. Output and employment in the construction industry fluctuate by as much as 30 to 35 percent. There is widescale bankruptcy among homebuilders and real estate developers, and substantial underutilization of plant and construction equipment.

In the long-run, the homebuilding industry is less efficient because of the wide fluctuations in production. With the constant need to adapt to cyclical fluctuations, the industry uses less efficient technology in order to minimize cost per unit over a wider range of output levels. It is less capital-intensive (to minimize fixed costs). It invests less in manpower training in order to avoid high costs of uncertain demand and turnover. It demands a higher rate of return on capital in order to overcome the reluctance of entrepreneurs to enter such a volatile industry. It adopts restrictive industrial relations rules that limit the craft and geographic mobility of its workers; and it incurs wages and materials prices in excess of those in an industry with more stable patterns of demand. While it is difficult to quantify these costs--either in human or financial terms--it is clear that the price Americans pay for housing is higher than it would be under more stable conditions. In fact, because relatively more housing is built during the peak of the demand cycle--when prices are at their highest--new homebuyers have to pay much of the premium for instability insurance through higher housing prices.

An Adequate Supply of Mortgage Credit
and Other Production Factors (Land,
Manpower and Building Materials)

Housing production faces perennial uncertainties as to sufficient amounts of mortgage funds, adequate supplies of usable land, sufficient pools of skilled construction workers and adequate capacities among building material suppliers to

meet the nation's requirements. A problem arises when bottlenecks or capacity shortages emerge in one of the factor markets that supply the major inputs for residential construction. The result is then production shortfalls, price increases, or both.

Mortgage Credit

A major cause of the short-run housing cycles described above is instability in the cost and supply of mortgage credit. ^{5/} During periods of monetary restraint, interest rates rise, and the supply of money available for housing construction and purchases falls. Dependence of the housing sector on mortgage credit, combined with institutional shortcomings in the housing finance system, causes short-run instabilities in housing production. When interest rates on short-term securities (e.g., 90-day U.S. Government Treasury bills) increase, the flow of funds dwindles to savings and loan associations and other thrift institutions that cannot pay the higher competitive interest rates for such funds.

Occasionally, this diminished supply results in a net outflow of funds. There are two institutional reasons why the thrifts, which provide two-thirds of all mortgage funds, cannot pay competitive rates for these funds. First, the thrifts have difficulty in retaining deposits because the yield of their portfolio, comprised primarily of long-term fixed interest rate mortgages, is too low to allow them to offer competitive rates to depositors who can seek higher yields on alternate investments. Second, even if some thrifts could afford to raise the interest rate on their passbook accounts, government regulations place ceilings on these rates (the so-called Regulation Q). These factors--along with FHA, VA and state ceilings on mortgage interest rates--contribute to the substantial volatility in the availability of credit for housing.

^{5/} For a detailed discussion of housing finance issues see "Housing Finance: Federal Programs and Issues," Staff Working Paper, Congressional Budget Office, U.S. Congress, September 1976.

The longrun availability and price of credit for housing is also a major issue facing federal policymakers. The proportion in the economy of the total pool of funds available to finance housing depends on the allocation of savings among financial intermediaries, and on the disposition of these savings. Some intermediaries, such as savings and loan associations, are induced to invest a large share of their portfolio in residential mortgages. The disposition of savings depends on the returns from mortgages vis-a-vis other investments.

Currently, the federal government supports several programs that attempt to increase the flow of credit into home mortgages. These programs seek to make mortgage investments more attractive by reducing the risk to the private lender through such devices as government insurance or guarantees, direct government lending, sale of mortgage-backed securities, 6/ and tax advantages to certain mortgage investors. Some legislative proposals currently under consideration at both state and federal levels, aim at reforming both the lending institutions and the mortgage instruments in the direction of liberalizing the availability of housing credit.

The Availability of Land, Manpower and Building Materials

As urbanization continues apace in the United States, there is a constant concern about the possible shortages of vacant land for future development, especially in or proximate to metropolitan areas. 7/ Estimates of the amount of metropolitan-area land available and suitable for residential construction are imprecise, partly because of conflicting definitions. The Urban Land Institute estimated that 10

6/ There is considerable controversy over the net effect of these sales because their purchase by depositors or financial intermediaries within the housing sector would not provide any additional credit for housing, but would merely relocate the funds within the same sector.

7/ For a recent survey of land use in the United States see H. Thoms Frey, Major Uses of Land in the United States, Agricultural Economic Report 247, (Washington, D.C.: Department of Agriculture, Economic Research Service, 1973).

percent of the urban land is developed. ^{8/} Another study found that roughly 75 percent of the total land area in selected "metropolitan areas" is still open space. Neither estimate included an assessment of how much land was unavailable for construction due to natural limitations or land use controls. All terminology aside, the supply of land available to accommodate future urban-type growth seems sizeable, especially since the rate of conversion to urban uses is relatively low--about 2.7 million acres or 1.6 percent available annually and throughout the 1960s. ^{9/}

Concern with construction manpower has focused on whether there is a sufficient (or excessive) supply of craftsmen with the requisite skills, to meet the nation's production requirements. ^{10/} Construction labor pool and construction activity levels are highly variable and localized, so it is difficult to estimate the size of the current workforce, let alone project the future availability of sufficient skilled workers. Overall unemployment rates have a substantial impact on the size of the construction labor force: jobless workers from other sectors often seek employment in construction activities. With relatively low wage levels and their substantial production instabilities, homebuilders have traditionally stood at the end of the employment queue to hire skilled craftsmen. Some studies have found that homebuilders have difficulty in recruiting

^{8/} See J. Thomas Black, "The Land Supply Variable," mimeographed (Washington, D.C.: Urban Land Institute, 1975), page 3 and the Report of the President's Commission on Urban Housing, A Decent Home, (Washington, D.C.: Government Printing Office, 1968), p. 138.

^{9/} See J. Thomas Black, op. cit., and Brian Berry, et. al. Land Use, Urban Form and Environmental Quality (Chicago, Illinois: Chicago University Press, 1974).

^{10/} For an excellent discussion of the conceptual and statistical difficulties see John T. Dunlop and D. Quinn Mills, "Manpower in Construction: A Profile of the Industry and Projections to 1975," in the Report of the President's Committee on Urban Housing, Technical Studies, Vol. 2.

their labor force whenever aggregate unemployment drops below 5 percent. 11/

Concern has also been expressed about the supply of building materials to meet construction requirements. The building materials industry (which harvests, manufactures and distributes myriad construction products) is very competitive as well as capable of modifying its capacity in response to changes in product demand. This industry is one of the least concentrated industries in the economy. The easy substitutability among building material products, plus the fragmentation of local markets, helps maintain this competitiveness. Thus, while some periodic shortages exist for specific products in particular market areas, it is unlikely that any national building material shortage would continue for long.

Lumber and wood, stone and clay, and fabricated metal products (e.g., plumbing fittings, heating equipment) account for over 45 percent of the dollar value of building material inputs, with lumber the largest single item. According to a recent study, the supply of building materials expanded in earlier housing booms with relatively small price movements (with the notable exception of lumber and plywood). 12/ The major problem involved in stepping up lumber and plywood production for residential construction is that supply of soft wood (e.g., fir, pine, cedar, hemlock), is largely concentrated on national forest land, which is harvested less intensively than commercial stands. To avoid supply bottlenecks and concomitant excessive lumber prices in the future, cutting rights and other forest management decisions could be closely coordinated with national housing policy decisions.

11/ See Craig Swan, "Labor and Materials Requirements for Housing," 1971:2 Brookings Papers on Economic Activity.

12/ See Craig Swan, op. cit.

PROBLEMS RELATED TO THE CONSUMPTION
OF HOUSING 13/

Housing conditions for the average citizen have steadily improved since the end of World War II, largely as a result of rising real incomes. The volume of new construction has far outstripped the growth in population and households. During this time, the concept of what constitutes "decent housing" has changed from the traditional "roof over one's head" to a unit with indoor plumbing, central heating, and full kitchen and bathroom facilities.

Middle- and upper-income households, in particular, have experienced much better housing conditions. While the private marketplace could provide most of these housing improvements, government policy has contributed significant subsidies for new construction and homeownership through mortgage guarantees as well as the tax deductibility of mortgage interest payments and real estate taxes. Despite the relatively high living standards enjoyed by the vast majority of families, many low- and moderate-income families and elderly households have serious housing problems. Also, while the last ten years have witnessed an improvement in the housing conditions of black families as a whole, nearly half the nation's black families continue to experience at least one form of housing deprivation. 14/

Primarily for lower-income families, who cannot afford minimum-standard housing on their own, the Congressional goal, "the realization, as soon as feasible, of . . . a decent home and suitable living environment for every American family," remains unreachd. Inherent in this goal are three standards:

13/ Housing consumption is here defined to include all housing-related goods and services a household receives when it rents or purchases a home: a particular location, neighborhood environment, and the specific physical structure are all defined as consumption items.

14/ See David Birch, et. al. America's Housing Needs: 1970 to 1980. MIT-Harvard Joint Center for Urban Studies: Cambridge, Mass., 1973.

of affordability; of health, safety, and sanitation; and of neighborhood quality. 15/

This definition of the housing consumption problem recognizes that many housing consumption problems reflect income deprivation rather than deficiencies in the housing stock, per se; and it limits itself to those households unable to obtain housing meeting today's minimum standards through their own resources in the private marketplace. Reflecting these facts, housing consumption problems can be divided into three parts:

- excessive housing costs (e.g., excessive rent burdens or declines in homeownership affordability)
- substandard shelter
- slums and unsuitable living environments

Excessive Housing Costs 16/

Over the last few years there have been rapid increases in housing costs, especially those associated with fuel costs, utilities and maintenance. This increase in housing costs for both renters and homeowners has raised a number of questions:

- Are American households assuming a greater financial burden for their housing? What fraction of their income, on average, is being spent on housing?

15/ In recognition of the limitations of this definition, HUD and the Bureau of the Census did not use the concept of substandardness in the 1970 Census. Instead, they listed several physical housing conditions and have now undertaken an Annual Housing Survey, designed to provide a more comprehensive definition.

16/ There are many conceptual issues involved in determining the appropriate definitions of income and housing costs. These issues will not be discussed in this paper, yet it should be noted that they constitute a considerable source of confusion in policy and budget decisions.

- What percent of potential homeowners are being priced out of the market? Can the average American household afford to purchase the average new home?

Embedded in these questions are a complex set of issues: some descriptive (what is), others normative (what should be), some related to the average household, others to the marginal household, and some conceptually clear, others ambiguous.

The trend in housing costs, per se, does not provide a basis for determining the existence of a housing problem. First, this trend must be seen in relation to the trends in incomes and general prices. Over the last decade, median family income has increased more rapidly than consumer prices in general and rental costs, and about as rapidly as homeownership costs. This increase in real purchasing power has enabled an increasing proportion of American families to improve their housing (substandard housing has declined) and to become homeowners. However, as Table 3 indicates, in the 1974-1976 period the claim of housing expenses on family budgets became more burdensome, especially for first-time homebuyers, the group most represented by the homeownership component of the Consumer Price Index.

TABLE 3. CHANGES IN HOUSING COSTS, GENERAL PRICES AND MEDIAN FAMILY INCOME

	Median Family Income <u>a/</u>	Consumer Price Index <u>b/</u>	Homeownership Cost <u>b/</u>	Rental Cost <u>b/</u>
1965	\$6,957	94.5	92.7	96.9
1970	9,867	116.3	128.5	110.1
1974	12,836	147.6	163.2	130.6
1976	14,500(est)	171.1	190.7	145.0
Percent Change 1965-76	105.6	81.1	105.7	49.0
Percent Change 1974-76	11.4	15.8	16.8	11.0

Source: a/ U.S. Department of Commerce, Bureau of the Census, Consumer Income, Current Population Reports, Series P-60.

b/ U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index--U.S. City Average.

Another aspect of the housing consumption problem relates to those low- and moderate-income groups experiencing excessive financial burdens in order to pay for housing. The concept of excessive housing expenditures reflects a subjective attempt to measure the number of families with incomes so low that they cannot afford to buy or rent housing at market prices without sacrificing other necessities.

One rule-of-thumb measure of excessive housing cost used in government programs is an expenditure which exceeds 25 percent of a family's annual net income (usually allowing some deductions from gross income for dependents, taxes, and work-related expenses). With this yardstick it was determined, from 1970 Census data, that more than 5.5 million households with standard housing had a high rent burden.^{17/} A number of additional families had both high rent burdens and substandard housing. Although the financial burden for homeowners is not included in these calculations, it does not substantially bias the estimate. Households generally do not become owners unless they can demonstrate to mortgage lenders at the time of purchase that they can afford the down payment and monthly costs. Thereafter, mortgage payments decline in real terms since monthly payments are normally fixed for the economic life of the mortgage.

Another often mentioned aspect of the housing problem is the possibility of a diminishing ability of U.S. families to afford to own their own home. Most people who are already homeowners have shared in the general appreciation of property values. This enables them to offset some of the inflationary rise in home prices if they choose to sell and move. Homeowners who do not move face increases only in operating costs, not mortgage payments, so their incomes have generally kept pace with costs.

For the first-time homebuyer, facing increases in the full range of capital and operating costs, there has been a

^{18/} See David Birch, et al., America's Housing Needs, 1970-1980, op. cit. (for detailed assumptions see footnote 23, page 24).

considerable decline in homeownership affordability. In the 1974-1975, period homeownership costs for first-time buyers rose faster than median family income. This was also true for the median income of families whose head was between ages 25 and 34--the major bracket of first-time home purchasers. 18/ Not only has the share of income required to operate the median-priced, new, single-family home risen to over 30 percent of median income, but the down payment requirement (averaging about 20 to 25 percent of the sales price) has increased as well. 19/

The increase in sales prices of both new and used homes has been the major cause of the first-time homebuyer problem. Even though sale prices and interest payments have increased less rapidly than fuel and utilities, maintenance, property taxes, and other operating costs, the capital costs still dominate the affordability problem because they determine down payments and account for such a large proportion of the rise in the annual costs.

Substandard and Overcrowded Housing

The Department of Housing and Urban Development (HUD) and the Bureau of the Census define substandardness along two dimensions: absence of plumbing facilities and degree of

18/ For a more detailed comparative analysis of the different cost pressures on first-time homebuyers, those buyers who already owned their own homes, and those who did not purchase other homes during the 1970-1975 period, see Neil Mayer, Homeownership: The Changing Relationship of Costs and Incomes, and Possible Federal Roles, Budget Issue Paper, Congressional Budget Office, January 1977.

19/ It would be more appropriate to use the sales price of existing, rather than new, homes for this type of calculation. The difference in down payment is usually about \$5,000 less for existing homes.

dilapidation. ^{20/} The Consumer Relations Office of HUD issued the following definition of substandard housing in 1967 in a report entitled You and Your Housing:

" . . . any dwelling in a dilapidated condition that endangers the health and safety of occupants or lacks private toilet, bath or hot running water."

Because structural deficiencies such as the adequacy of the heating system and the safety of the electrical system are not considered in official estimates, only a subset of the structurally substandard units are officially counted.

There are also conceptual problems with the official criteria used to measure adequacy of space. In government publications, such as the recent HUD report, Housing in the 1970s, an overcrowded unit is defined as one having 1.01 or more persons per room. The U.S. Census of Housing provides two standards of overcrowding--more than 1.01 persons per room and more than 1.51 persons per room. These two different standards for living space presumably reflect a distinction between "overcrowded" and "severely overcrowded" occupancy, respectively. These measures cover only one of the several dimensions of overcrowding, ignoring differences in the size and type of rooms in a unit. A better definition of overcrowding would establish standards for the amount and type of space necessary for families of different size, compositions, and age make-up.

^{20/} The degree to which a housing census understates the number of substandard units will depend on the level of correlation between the factors that are included and excluded. If units with poor electrical systems, unsound beams, or inadequate heat also lack plumbing or full kitchens, then the estimates of structural deprivation will approximate the actual total count. On the other hand, if the level of correlation is low, then the estimates will greatly understate the number of structurally substandard units.

Applying somewhat stricter than official criteria, 21/ A study of the 1970 Census of Population indicated that approximately 6.9 million households were living in substandard shelters, primarily in rural areas, and another 700,000 households had physically adequate shelter but were overcrowded. 22/

21/ For a detailed discussion of the deprivation measures and the basis for these findings, see David Birch, et. al., America's Housing Needs, op. cit. The study defined physical inadequacy as the lack of complete indoor plumbing facilities, the lack of central or built-in heating in colder parts of the country with more than a certain number of degree days, or the presence of an extreme state of physical disrepair. A household was considered overcrowded if it consisted of at least three persons and had 1.5 persons or more per room.

22/ Additional data on the full scope of housing deprivation were published in the Annual Housing Survey of 1973, sponsored by the U.S. Census and U.S. Department of Housing and Urban Development. This survey provided, for the first time, information on electrical and heating defects, the presence of plumbing facilities with frequent breakdowns, and other defects in the basic mechanical subsystems. Although the data could not be easily correlated with the other categories of substandard shelter, the Annual Survey probably adds several million additional households to the ranks. Moreover, the survey reported data on environmental and neighborhood characteristics. Because the survey did not indicate how many households report more than one problem, the figures cannot be totalled since there would be a considerable amount of double counting. But when asked to identify conditions on their streets that they considered serious enough to be disturbing, harmful or dangerous, 20 million households mentioned heavy traffic; 8 million, odors; 8.5 million, litter; 10 million, street repair; and 14 million, inadequate street lighting. Also, nearly 7 million reported signs of mice or rats in their homes. For a more complete documentation of this recent data from the HUD/U.S. Census Annual Housing Survey, see Bernard J. Frieden, "Housing" in Encyclopedia of Social Work, 17th edition, forthcoming.

Some of these latter households were also facing "excessive rent burdens." ^{23/}

Slums and an Unsuitable Living Environment

Slum neighborhoods are characterized by a concentration of poor residents, by substandard shelter and commercial space, and often by inadequate schools and playgrounds, and other substandard public facilities. Different levels of government have organized attempts to remove slums; millions of private and public dollars have been spent on the improvement of slum areas. While the character of slums has been adequately described, there is little agreement about the dynamics of neighborhood decline: its initial cause, its pattern, its complexity. Some believe that neighborhood decline and abandonment is the inevitable consequence of housing obsolescence, and retrograde neighborhood evolution. Others consider such decline to be the result of the alleged "red-lining" practices of real estate operators and mortgage lenders, plus the incentives toward new construction and suburban development created by government policy. Still others point to the reinforcing problems of poverty and discrimination. There is no universally accepted framework or theory which can adequately explain and predict neighborhood decline. This wide array of possible causes of slum neighborhoods suggests that a wide range of factors should be taken into account in designing neighborhood revitalization and development policies.

^{23/} Excessive financial burden was defined as a rental payment amounting to more than 25 percent of income for households of two or more people, with the head less than 65 years old or payment of more than 35 percent of income for single-person households and for households of two or more with the head over age 65.

CHAPTER III. CURRENT FEDERAL HOUSING PROGRAMS

Starting with the federal housing insurance and public housing construction programs of the 1930s, the history of federal housing policy has been characterized by oftentimes ingenious, ad hoc solutions to each housing problem. Today there are many extensive federal policy instruments, ranging from tax deductions for the interest and real estate tax costs of homeowners to community development block grants designed to assist the maintenance or revitalization of urban neighborhoods. The various federal housing activities can be classified into five broad categories--four on-budget and one off-budget.

On-Budget

1. Mortgage Credit and Thrift Insurance (Budget Subfunction 401): programs designed to reduce the cost and increase the level and stability and availability of mortgage credit. These programs primarily influence housing production goals.
2. Community Development (Budget Subfunction 451): programs and grants designed to encourage community-wide planning, investment in streets, sewers, access roads and other infrastructure, and neighborhood revitalization.
3. Housing Assistance Programs (Budget Subfunction 604): programs designed to directly reduce the cost of housing and/or increase the quantity of decent shelter available to low- and moderate-income and elderly households. These programs largely affect the substandard housing and excessive rent burden aspects of the housing consumption problem.
4. Tax Expenditures: a range of tax deductions, exemptions, credits and deferrals designed to make homeownership more affordable, stimulate construction and increase the availability of capital to the housing sector.

Off-Budget

5. Housing and Mortgage Credit Programs: programs and agencies created to increase the availability and stabilize the flow of mortgage credit to the housing sector and to stimulate the construction of housing for the elderly and the handicapped.

Mortgage Credit and Thrift Insurance Activities

Budget subfunction 401 includes a variety of programs that operate through credit market and mortgage insurance mechanisms. The federal government credit and insurance policies include: (1) the Government National Mortgage Association (GNMA) tandem plan and the Farmers' Home Administration (FmHA) interest credit for below-market-interest-rate, direct loans; (2) numerous insurance and loan guarantee programs, including Federal Housing Administration (FHA) insurance programs, and GNMA mortgage-backed securities; and (3) secondary market support through the purchase and sale of mortgages from primary lenders by GNMA.

FEDERAL MORTGAGE CREDIT AND THRIFT INSURANCE PROGRAMS

PROGRAM TITLE	PROGRAM DESCRIPTION/ MECHANISM	TYPE OF HOUSING	BENEFICIARIES
<u>FUNCTION 401</u>			
GNMA-Emergency Home Purchase Assistance	Provides funds for mortgages for new construction with effective interest rate of approximately 8 percent GNMA makes commitments to buy and then buys below-market interest rate mortgages at favorable prices, for subsequent resale at market prices.	New construction. Previously applied only to single-family housing. HUD now plans to make new commitments only for multi-family housing.	Purchasers of new homes. In FY 1975: \$32,000 average mortgage amount; \$3,200 average subsidy Homebuilders
FHA Fund	Programs in the fund insure mortgages in order to increase amount of lending and to improve terms to borrowers.	New construction or existing housing. Single- and multifamily.	Borrowers and lenders under the program. Under the major program (Section 203 Homeownership) median income in 1974: \$14,357, new home purchasers; \$13,819, existing home purchasers.
FmHA (Rural Housing Insurance Fund)	Programs in the fund make, insure, and service mortgages in rural areas and in some cases subsidize interest rates for low-income borrowers. Obtains funds by selling agency securities to the Federal Financing Bank	New construction or existing housing. Principally single-family but also multifamily.	Borrowers in rural areas. Interest subsidy program borrowers had \$5,500 median income in 1975.
Emergency Homeowner's Relief Fund	Standby authority to make or insure emergency loans to prevent mortgage foreclosures.	Existing housing. Owner-occupied.	Program has never been activated.

Community Development

The federal government supports several programs that directly or indirectly affect the development of viable local communities. The three most direct mechanisms are: (1) the community development block grants, which provide discretionary funds to state and local governments for a variety of physical investments; (2) comprehensive planning grants; and (3) rehabilitation loans and grants for homeowners in designated code enforcement or other areas.

COMMUNITY DEVELOPMENT PROGRAMS

PROGRAM TITLE	PROGRAM DESCRIPTION/ MECHANISM	TYPE OF HOUSING	BENEFICIARIES
<u>FUNCTION 451</u>			
<u>Housing Programs</u>			
Rehabilitation Loans	Below-market interest rate loans (currently 3 percent) to owners for the rehabilitation of residential and nonresidential properties in certain areas.	Existing properties. Single-family or multifamily housing.	Owners of properties in urban renewal or code enforcement project areas, or areas included in an approved Community Development Program or Urban Homestead program. Average loan amount is estimated at almost \$11,000 in 1976.
State Housing Finance and Development Agencies (Section 802)	Bond guarantee or interest subsidy payments to state housing finance agencies to support the development of housing for low- and moderate-income families.	Construction of housing projects.	State agencies are assisted in providing housing services to low- and moderate-income families.
<u>Related Programs</u>			
Community Development Grants	Direct grants to fund local community programs for the development of viable urban communities. Funds activities previously funded under urban renewal, model cities, water and sewer, and other community development programs.	Communities may choose to fund rehabilitation activities. In 1976, about 11 percent of the funds were used for rehabilitation activities.	In 1975, 64 percent of funds were targeted to areas populated predominantly by low- and moderate-income families. By law, about 80 percent of funds are distributed by formula to metropolitan areas.
Comprehensive Planning Grants	Direct grants to support state and local comprehensive planning and management programs related to urban and rural development.		State, local government, and area-wide planning organizations. In 1975, support went primarily to metropolitan areawide organizations and to state governments.

Housing Assistance Programs

The housing assistance part of budget subfunction 604 includes budget authority and outlays for HUD housing subsidy contracts under a variety of programs. Currently there are five principal programs with funding available for program expansion: (1) low-rent public housing debt service payments for construction bonds on local housing authority units; (2) operating subsidies for public housing, which allow a further reduction in rent; (3) Section 8 new construction/substantial-rehabilitation program, which subsidizes the rents of low- to moderate-income households in units constructed or rehabilitated under this program; (4) Section 8 existing housing program, which subsidizes the rent in an existing housing unit chosen by the participant; and (5) the revised Section 235 program, which subsidizes part of the mortgage payment for middle-income buyers of houses built under the program.

HOUSING ASSISTANCE PROGRAMS

PROGRAM TITLE	PROGRAM DESCRIPTION/ MECHANISM	TYPE OF HOUSING	BENEFICIARIES
<u>FUNCTION 604</u>			
<u>Major Housing Subsidy Programs</u>			
Low Rent Public Housing	Assist local public housing authority to provide rental housing for low-income tenants. HUD pays annual debt service required for 40-year, tax-free municipal bonds, with which local housing authorities build or rental housing.	Primarily new construction (96 percent of units assisted through 1975). Primarily multifamily.	Low-income families or elderly, handicapped or displaced individuals selected by local housing authority. In FY 1975: \$3,400 median annual income; 43 percent of households were elderly or handicapped; \$874 average subsidy, in FY 1976.
Operating Subsidies for Public Housing	Additional assistance to local public housing authorities to cover operating cost deficits.	Same as above.	Same beneficiaries as above. Average subsidy in FY 1976, \$388 per unit.
Section 8 New Construction/Substantial-Rehabilitation Program	Encourage production of lower-income rental housing by subsidizing rents in newly constructed or rehabilitated housing. Developer arranges financing, HUD pays difference between approved rent and tenant contribution of 15-25 percent of income. Contract period is 20 years for private developer, 40 years for projects assisted by state or local housing agencies.	New construction or rehabilitation. Multifamily housing.	Developer selects families or elderly, handicapped, or displaced individuals with income less than 80 percent of median income in area (adjusted for family size). 30 percent of initial tenants must have income less than 50 percent of median income in area. For a family of four with \$5,000 income, the average subsidy would be, approximately \$2,543 in FY 1976.
Section 8 Existing Housing Program	Subsidize rents of lower-income households in existing housing. Participants select existing housing units with rent up to HUD-determined maximum. HUD pays difference between market rent and tenant contribution of 15-25 percent of income. Administered by local public housing agency under 15-year contract with HUD.	Existing housing. Multifamily or single-family rental housing.	Same requirements as Section 8 new construction above, but local public housing authority selects participants. For a family of 4 with \$5,000 income the average subsidy would be approximately \$1,106 in FY 1976.

HOUSING ASSISTANCE PROGRAMS (continued)

PROGRAM TITLE	PROGRAM DESCRIPTION/ MECHANISM	TYPE OF HOUSING	BENEFICIARIES
<u>FUNCTION 604 (Continued)</u>			
Section 235 Revised	Encourages production of moderate-income, owner-occupied housing by subsidizing mortgage interest costs. HUD subsidy reduces homeowner's mortgage interest rate to as low as 5 percent. Homeowner pays 20 percent of adjusted income for mortgage, insurance, and tax payments.	New construction or rehabilitation. Single-family, condominium, co-operatives, or mobile homes.	Families and elderly, handicapped, or displaced individuals with income less than 95 percent of median income in area (adjusted for family size). Mortgage insurance and tax payments for a 5 percent mortgage cannot exceed 20 percent of income.
<u>Other Housing Subsidy Programs</u>			
Section 236	Encourage production of moderate income rental housing by subsidizing mortgage interest costs. HUD subsidy reduces effective mortgage interest rate to as low as 1 percent. Tenants pay "basic rent" or 25 percent of adjusted income whichever is greater.	New construction or rehabilitation. Multifamily.	Moderate-income families and elderly or handicapped individuals. Selected by developer. In FY 1975: 400,360 units; \$5,623 median annual income; 25 percent elderly.
Rent Supplement	Subsidize rent of low-income households. HUD pays difference between HUD-approved rent and 25 percent of tenant income up to maximum subsidy of 70 percent of rent.	Generally linked to multifamily housing units constructed under another HUD subsidy or FHA-insurance program.	Low-income households with members who are elderly, handicapped, in the armed forces, or displaced. In FY 1975: 148,000 households; \$3,157 median annual income; 28 percent elderly.

Tax Expenditures

The federal government has adopted a broad range of tax exemptions, deferrals, and deductions in order to stimulate housing production, to encourage homeownership, to increase the capital available to the residential sector, and to accomplish other federal housing objectives. Since these favorable tax mechanisms result in foregoing otherwise collectible federal tax revenues, they need to be included in a policy and budgetary framework along with direct expenditure activities.

TAX EXPENDITURES

PROGRAM TITLE	PROGRAM DESCRIPTION/ MECHANISM	TYPE OF HOUSING	BENEFICIARIES
Depreciation on Rental Housing in Excess of Straight Line	Tax saving accrues to taxpayers from calculating the depreciation on rental housing on an accelerated basis. The Tax Reform Act of 1976 tightens the recapture provisions.	Existing or newly constructed housing. Single- or multifamily.	Owners of rental housing. In 1974, 34 percent of the benefits were to taxpayers with adjusted gross incomes of over \$50,000; 49 percent to taxpayers with adjusted gross income between \$15,000 and \$50,000.
Deferral of Capital Gains on Home Sales	Gains on the sale of a home are not taxed as long as the costs of a new home (purchased within a specified time) exceeds the adjusted sales price of the old. The tax basis on the new home is reduced by the amount of the untaxed gain on the sale of the former home. Thus, the tax is deferred until the time of sale of the second home.	Existing housing. Single- or multifamily.	Primarily middle- and upper-income homeowners. In 1974, 57 percent of benefits went to taxpayers with adjusted gross incomes between \$15,000 and \$50,000; 12.5 percent to taxpayers with \$50,000 and over adjusted gross income.
Deductibility of Mortgage Interest and Property Taxes on Owner-Occupied Property	Taxpayers may take an itemized deduction for mortgage interest and property taxes paid on an owner-occupied home.	New or existing housing. Single-family or multifamily.	Benefits go to homeowners, with high income individuals receiving greater proportional benefits. In 1974, 66 percent of benefits to taxpayers with \$15,000 to \$50,000 adjusted gross income; 9 percent of benefits to taxpayers with \$50,000 and over adjusted gross income.

TAX EXPENDITURES (continued)

PROGRAM TITLE	PROGRAM DESCRIPTION/ MECHANISM	TYPE OF HOUSING	BENEFICIARIES
Exclusion of Capital Gains on House Sales if seller is over 65	Individuals 65 or over may exclude from taxable income some or all of the tax gain from the sale of a house used as a principal residence for at least 5 of the 8 years before the sale.	Existing housing. Single- or multifamily.	Benefits go to elderly taxpayers who sell their homes and do not purchase another home. In 1974, 30 percent of benefits went to taxpayers with adjusted gross incomes between \$15,000 and \$50,000; 40 percent to taxpayers with \$50,000 or more adjusted gross income.
Housing Rehabilitation: 5-Year Amortization	A 5-year rapid amortization of certain rehabilitation expenditures allowed in lieu of depreciation for rental housing for low- and moderate-income tenants. The provision covers actual expenditures or contracts made between July 24, 1969 and January 1, 1978.	Existing. Single- or multifamily.	Benefits go primarily to investors in projects. In 1974, 16 percent of benefits to taxpayers with adjusted gross income between \$15,000 and \$50,000; 76 percent to taxpayers with \$50,000 or more adjusted gross income.
<u>Expired Provisions</u> Credit for Purchasing New Home	A tax credit was allowed for 5 percent of the purchase price (or \$2,000 whichever was less), of a newly constructed principal residence purchased between March 12, 1975 and January 1, 1976.	New construction. Single- or multifamily.	Homeowners who purchased new home during the eligible period, and home sellers. Distribution of benefits not available.

Off-Budget Housing and Credit Market Activities

Four housing and credit programs having an important impact on the economy and on capital and housing markets are not included in the federal budget. The major off-budget program and government-sponsored agencies are: (1) the Section 202 housing program for the elderly and the handicapped; (2) the Federal National Mortgage Association (FNMA); (3) the Federal Home Loan Bank Board (FHLBB); and (4) the Federal Home Loan Mortgage Corporation (FHLMC). The latter three support the secondary mortgage market thereby increasing the capital available for housing and offsetting cyclical instability in housing production.

OFF-BUDGET HOUSING AND CREDIT MARKET PROGRAMS

PROGRAM TITLE	PROGRAM DESCRIPTION/ MECHANISM	TYPE OF HOUSING	BENEFICIARIES
Housing for the Elderly and Handicapped (Section 202)	Provides direct loans (of up to 50 years) to nonprofit sponsors of rental housing for the elderly and handicapped. The program is being used in conjunction with the Section 106(b) Loans to Nonprofit Sponsors and the Section 8 housing programs.	New construction or substantial rehabilitation. Multifamily housing.	Families, individuals 62 years and over, and individuals with permanent handicaps.
Federal Home Loan Mortgage Corporation	A federally-chartered corporation that purchases, sells, and otherwise deals in conventional mortgages on residential properties.	New construction and existing homes. Primarily single-family homes.	Individuals and families seeking conventional mortgage money.
Federal Home Loan Banks (Savings and Loans)	Make advances (loans) to member S&Ls to provide funds for mortgage loans to consumers.	New construction and existing homes. Single- and multifamily units.	Persons seeking mortgage money.
Federal National Mortgage Association (FNMA)	A federally-sponsored agency that issues commitments to purchase conventional mortgages and federally-assisted loans on a competitive basis. The largest secondary mortgage market mechanism.	New construction and existing homes. Single- and multifamily units.	Individuals and families seeking mortgage funds and low- and moderate-income families living in certain housing projects.

CHAPTER IV. A POLICY AND BUDGET FRAMEWORK

In order to illuminate the resource allocation problem it is necessary to combine into a single framework the major housing problems and the federal housing programs examined separately in the previous sections. If the performance of particular programs change, resources can be redirected toward more effective instruments. Such a framework can also help identify the entire range of policy instruments available to deal with specific problems and to delineate the direct, as well as indirect, effects of the various housing programs, tax expenditures, and off-budget activities. The framework can also show how several housing programs influence more than one problem. If the severity of the respective problems changes, resources then can be reallocated to reflect different priorities within the housing sector.

The utility of the framework is limited by uncertainties about the performance of alternate federal housing policies. It is relatively easy to specify which programs affect which problems, but assessing the size (and sometimes the direction) of their effects is a difficult research task. The uncertainties about program effectiveness are compounded by program interactions with private market behaviors (do they induce, or simply substitute for private activity?); by the dependence of their performance on the overall state of the economy; and by the use of several programs in unison, thus rendering assessment of each's independent effect impossible. Programs that influence more than one problem may seem desirable, but these joint effects may actually be less than would result from singly directed instruments. Another large impediment to assessing housing program effects is the relatively low level of program research and evaluation efforts devoted until now to making these assessments. Nevertheless, a framework that brings together housing problems and programs can be a useful component of the resource allocation and R&D policy processes.

As Table 4 (page 43) indicates, a variety of programs operate through credit market and mortgage insurance mechanisms. The major purpose of these programs is to provide additional sources of funds for new mortgages, and to stabilize over time

and to equalize over geographic areas the flow of mortgage funds. These programs increase the availability of mortgage credit needed to support construction starts. Also, through interest rate subsidies and mortgage insurance and guarantees, funds are sometimes made available to moderate-income borrowers. These programs also help to reduce the housing costs of low- and moderate-income households by providing mortgage funds and subsidies to developers of federally assisted housing projects.

The community development programs, especially the block grants, are used to support the development of viable urban neighborhoods as well as larger communities. The community development grants also fund activities previously supported under urban renewal, model cities, water and sewer and related programs. Although the block grants are not targeted exclusively to declining and slum neighborhoods, many communities continue to use these discretionary funds to provide loans to upgrade substandard housing and to support investments in parks, recreation areas and other community infrastructure.

The various housing assistance programs attempt to make housing more affordable, and to provide improved shelter for low- and moderate-income and elderly households. Most of these programs support either new construction or substantial rehabilitation for occupancy at subsidized prices. Only the Section 8 existing housing program is designed to subsidize rents in existing, private market housing units. Developers of newly-constructed, assisted housing projects often rely on federal mortgage credit, thrift insurance, and mortgage subsidies for their financing.

Real estate tax expenditures--creating popular tax shelters--also influence the flow of private credit into assisted housing activities. The various tax exemptions, deferrals, and deductions included in the tax expenditure category have been enacted for several different purposes. Their major goals are, first, to bring the cost of homeownership within the reach of additional households and, second, to increase the availability of mortgage credit for construction of private and publicly-assisted housing.

Finally, there are two types of off-budget activities. One is a special housing program that provides direct loans to nonprofit sponsors of rental housing for the elderly and the

handicapped. The second type of off-budget program is conducted by three government-sponsored, private financial agencies (FHLMC, FNMA, FHLBB) with the dual purpose of providing additional capital to the housing sector through secondary market activities and to moderate the cyclical shortages of mortgage credit.

If there were a simple, direct relationship between each housing program and each housing problem, or between the budget allocated to a program and the size of its impact, then policy and budget decisions would be straightforward. This is not the case, however. In actuality:

- Some housing programs impinge on more than one, problem. Through the GNMA tandem plan, for example, the government makes commitments to provide mortgage credit in order to stimulate additional housing starts, and to lower the cost of homeownership for borrowers through interest-rate subsidies.
- The attempt to design one housing program to solve several problems can reduce efficiency in solving any given problem. For example, providing subsidized housing for low-income people through new construction stimulates total construction activity as well, but it may substantially increase the cost of subsidies.
- Some housing programs are combined in order to have a larger impact on a single problem. In order to upgrade declining and slum neighborhoods, communities concentrate rehabilitation loans, Section 8 and Section 235 housing assistance, and community development block grants in the same geographic area.
- Some programs have a much smaller net effect on housing problems than anticipated. For example, the deduction of mortgage interest payments and property taxes from federal income tax liability does not accrue, primarily, to marginal homeowners. In fact, this type of tax expenditure is most beneficial to high-income homeowners in the highest marginal tax brackets, who purchase the

most expensive homes with the largest associated deductions taken on their federal income tax liabilities.

- The time lags between federal budget allocations and program impacts are often long and thus the status of any given housing "problem" may shift between resource decisions and program operations. These time lags result from federal and local decision processes, private sector planning requirements, and construction and financing activities and delays.
- Housing problems and housing markets differ across the country. Thus a policy designed for one area, or for the country as a whole, may not be appropriate (i.e., responsive to existing problems) or effective in some local housing sectors.
- Some housing programs work at cross purposes to others. Thus the effective performance of one instrument may depend on whether or not another program is implemented.

TABLE 4: THE CONNECTIONS BETWEEN HOUSING PROGRAMS AND PROBLEMS
 "A Policy and Budget Framework for Federal Housing Policy"

Federal Housing Programs	HOUSING CONSTRUCTION PROBLEMS			HOUSING CONSUMPTION PROBLEMS		
	Level of Construction	Stability of Construction	Availability & Cost of Mortgage Credit (and Other Production Factors)	Excessive Housing Costs	Substandard Shelter	Declining and Slum Neighborhoods
I. On-Budget						
A. Mortgage Credit and Thrift Insurance (401)						
1. GMAA	XX	X	XX	XX		
2. FHA Fund	XX		XX	XX		
3. FmHA and Rural Housing Insurance	XX		XX	XX		
B. Community Development (451)						
1. Rehab. Loans	X			X	XX	XX
2. Community Development Block Grants				X	X	XX
3. 701 Comprehensive Planning						X
C. Housing Assistance						
1. Public Housing	XX			XX	XX	
2. Public Housing Operating Subsidies				XX	XX	
3. Section 8 New or Rehabilitated	XX			XX	XX	
4. Section 8 Existing				XX	XX	
5. Section 235 Revised	XX		XX	XX	XX	
D. Tax Expenditures						
1. Deduction: Mortgage Interest and Property Taxes	XX				XX	
2. Deferral of Capital Gains on Sale	XX					
3. Exclusion of Capital Gain for Elderly				X	X	
4. Excess Bad Debt Reserve: Thrifts	XX		XX			
5. Depreciation in Excess of Straight Line	XX		XX	X	X	X
6. Expensing of Interest & Taxes: Construction Period	XX		X			
7. State & Local Bonds	XX		XX	XX	XX	
II. Off-Budget						
1. Elderly and Handicapped Housing	XX		XX	XX	XX	
2. FHLMC	XX	XX	XX			
3. FHLBB	XX	XX	XX			
4. FNMA	XX	XX	XX			

Notes: XX = federal government program usually has an impact on the problem.
 X = federal government program sometimes has an impact on the problem.

CHAPTER V. SOME ILLUSTRATIVE FEDERAL HOUSING
 BUDGET PROGRAM OPTIONS

While the preceding section emphasizes current federal housing programs, it is useful to consider the possibility of enacting alternate programs as well. In addition to changing the amount of support for current programs or reallocating the housing budget among them, other options would include enacting alternate programs, regulations and tax expenditures, and changing or repealing existing programs. An assessment of each alternative is beyond the scope of this paper but the delineation of program and budget options is designed to illuminate alternative approaches to the same problem. The available options are so numerous, however, that only two illustrative sets of possibilities are covered.

Options for the Reducing Cyclical Instability
and Increasing the Long-Run Supply of
Mortgage Credit ^{1/}

Currently, the federal government relies on four government financial intermediaries--the Federal National Mortgage Association (FNMA), the Government National Mortgage Association (GNMA), the Federal Home Loan Bank Board (FHLBB), and the Federal Home Loan Mortgage Corporation (FHLMC)--to stabilize the flow of funds to the mortgage and housing markets. Both FNMA and the FHLMC can increase (or reduce) the supply of funds available for mortgages by purchasing (or selling) mortgages on the secondary market. Also, by providing advance commitments FNMA and GNMA enable mortgage lenders to originate mortgages, even when their funds are low. The FHLBB can provide advances (loans) to savings and loan associations (S&Ls) in order to build up their reserve of loanable funds. And GNMA can increase the availability of funds through its guarantee of the value of mortgage-backed securities sold by

^{1/} These policies are more fully discussed in Housing Finance: Federal Programs and Issues, Staff Working Paper, Congressional Budget Office, September 1976.

lenders to institutional and individual investors as well as its "tandem plan" purchases. The Federal Reserve Bank's monetary policies also affect the flow of funds into mortgages. Additional program options that have been proposed or discussed include:

- (1) Interest rate subsidies
- (2) Direct allocations of credit to housing
- (3) Increased insurance and guarantees
- (4) Expanded secondary market support
- (5) New tax expenditures
- (6) Altered financial institution regulations
- (7) Nonstandard mortgage instruments
- (8) Expansions in sources of funds

1. Interest Rate Subsidies: There are several interest rate subsidy options, including improvement in the GNMA tandem plan and assistance to state housing finance and development agencies. For example, the tandem plan could be channeled to borrowers who would not have borrowed without the interest rate subsidy. Otherwise the tandem plan activities may bring little net additional mortgage credit into the housing market during tight credit periods but merely substitute for conventional mortgage sources. Similarly, the federal government could subsidize the interest rate on taxable state and local bonds used to finance residential development. This would enable state housing agencies to tap the previously inaccessible taxable bond market.

2. Direct Allocations of Credit to Housing: Some observers argue that the capital markets in the United States are so competitive that any attempt to reallocate capital to the housing sector through indirect institutional (rather than market) methods, such as financial institution or mortgage instrument reforms, will be offset by market forces. Thus, they claim the only effective method to stabilize the housing sector would be through direct rationing of financial resources. This type of direct rationing could be accomplished through a national development bank, through changes in GNMA activities, through differential or reserve requirements, or with selective tax incentives.

3. Increased Insurance and Guarantees: In order to increase the availability of mortgage credit in tight money periods, the federal government can provide insurance to cover potential income losses to lenders whenever short-term interest rates exceed prevailing mortgage rates. The government could offer this protection to lenders, either by insuring payment of the interest rate differential in exchange for a premium, or by offering lenders (at the time of mortgage origination) the option of exchanging the mortgages for obligations of the same amount but paying the prevailing short-term rates. Also, the federal government could offer reinsurance or coinsurance coverage for secondary market investors in order to enhance the ability of primary lenders to obtain funds in secondary markets.

4. Expanded Secondary Market Support: In addition to increasing the secondary market countercyclical activities of FNMA, FHLMC, and GNMA, the Federal Home Loan Banks could provide long-term loans in tight money periods. The proposed Financial Reform Act of 1976 provided for loans of up to 30 years to savings and loan institutions, mutual savings banks, credit unions and commercial banks in periods when credit is not readily available. The loans were to be financed by borrowing from the Treasury or the Federal Financing Bank. The funds would be targeted to moderate-income homebuyers.

5. New Tax Expenditures: There are a large variety of possible tax expenditures that can be used to alleviate both cyclical and long-term financial problems. Tax credits (for thrift institutions) on qualifying mortgage loans were recently proposed as part of the Financial Institutions Act (in lieu of the current bad debt reserve deduction) as a means to increase the combined flow of funds into mortgages from major lenders. Another method for increasing and stabilizing the flow of loanable funds would be to offer households special incentives to save for their first home purchase. Special savings accounts for housing could be established that would offer tax deductions or credits for households willing to save a specified amount per month for a period of several years.

6. Altered Financial Institution Regulations: This approach assumes that the basic problem of cyclical instability in mortgage and credit markets is the inability of

thrift institutions to compete for funds when short-term interest rates rise. Thus, the type of reform considered by the Congress includes allowing the thrifts to diversify their asset and liability structures, so that their maturities will match (thus eliminating the current practice of borrowing short and lending long). Expansion of the thrifts lending powers could include construction loans, community development loans, commercial paper, and some corporate debt, while expanded services could include checking accounts and consumer loans. Substantial consideration has also been given to the elimination of the Regulation Q ceilings on interest rates on passbook accounts.

7. Nonstandard Mortgage Instruments: This approach assumes that as long as thrift institutions rely on short-term liabilities as their major source of funds for long term, fixed interest rate investments, they cannot earn a return that allows them to be competitive with other short-term market instruments. Thus, the long-term, fixed-interest, standard mortgage could be supplemented by mortgage designs allowing the maturity, interest rate, and/or outstanding principal to adjust in response to changes in the cost of funds. These designs could include variable-rate mortgages, intermediate-term rollovers, and graduated payment mortgages. Some of these approaches, by reducing early-year mortgage payments by the borrower, could increase peoples' ability to purchase homes.

8. Expansions in Sources of Funds: This approach assumes that the most effective method to stabilize the flow of mortgage credit for housing is to increase the participation of pension funds and life insurance companies in the residential mortgage market. Unlike thrift institutions, which must compete for household savings on a continuous basis, the net flow of pension fund and life insurance reserves is more stable because it comes in on a contractual basis. The federal government could also use tax incentives and modified regulations to increase the funds that these institutions supply to the mortgage market.

Options for Reducing Excessive Housing Costs and Substandard Shelter

To a large extent the excessive cost problem and the structural quality housing problem are opposite sides of the same coin--poverty. A low-income family often must choose between paying an exceedingly high proportion of its annual income for housing, in order to occupy decent shelter or to live in substandard conditions because of its limited purchasing power. Historically, the United States has relied primarily on the trickle or filtering-down process of the private housing market to provide shelter for low- and moderate-income households. Under this process, most construction is for households in the upper income brackets who can afford to purchase newly constructed units; households of more moderate means then upgrade their housing by moving into units previously occupied by the higher-income families. This market-dominated process can be supplemented by a number of federal housing programs that either subsidize the cost of standard housing or assist low-income households to pay their rent. There are several available program options to deal with this two-sided problem. ^{2/}

1. Income assistance
2. Earmarked housing transfers: Section 8, housing allowances, rent certificates
3. Subsidized construction of low- and moderate-income housing
4. Rehabilitation grants and loans
5. Urban homesteading and self-help incentives

1. Income Assistance: Income assistance programs are designed, through unrestricted cash transfers, to enhance the purchasing power of low- and moderate-income families. This approach to increasing housing affordability assumes that the basic cause of housing deprivation (as with health, food, and other forms of deprivation) is poverty. Unrestricted cash

^{2/} For a comprehensive analysis of these options see Housing Assistance for Low- and Moderate-Income Families, Budget Issue Paper, Congressional Budget Office, 1976, in process and Arthur P. Solomon, Housing the Urban Poor (Cambridge, Mass.: M.I.T. Press, 1973).

transfers to recipients can upgrade their standard of living, including their consumption of housing. But the option of how to allocate the cash transfers among consumption items would be left to the individual consumer.

2. Earmarked Housing Transfers: If the federal government wants to enhance the consumption of housing among the poor, it could subsidize actual housing payments or provide a restricted cash transfer through housing allowances, rent certificates or rent vouchers. In this case, the transfer is earmarked, through some type of precondition, for housing expenditures. Substitution effects may dilute the effect of subsidies directed at increased consumption of a specific commodity or service.

3. Subsidized Construction of Low- and Moderate-Income Housing: The use of direct mortgage subsidies, land write-downs, and other construction cost subsidies has been the major approach used by the federal government since the Depression. All of these subsidies are aimed at reducing the price of the basic factors of housing production--land, labor, materials, and capital--in order to bring the monthly cost (rent or mortgage) of new units within reach of lower-income households.

4. Rehabilitation Grants and Loans: This approach would be aimed at upgrading substandard housing stock through the use of government grants, below-market loans, or tax credits to lower the cost of the postrehabilitation units. The program would be designed to preserve and upgrade the existing substandard housing stock without increasing monthly payments beyond the means of lower-income or elderly households.

5. Urban Homesteading and Self-Help: In this approach the government would assist low- and moderate-income households to become homeowners, primarily through their own labor or "sweat equity." The form of assistance could vary from low-interest purchase or rehabilitation loans and property tax abatements to technical assistance on construction methods. The basic notion is that individuals or groups of families would voluntarily build their own homes or purchase and rehabilitate existing homes, if the opportunities and financial incentives were available.