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housing policy in the United States

The most significant and most expensive housing policy in the United States is the treatment of owner-occupied housing for tax purposes. This treatment of housing under the tax code is analogous to that in many other countries (for example, Sweden), but certainly not in all developed countries (for example, Canada). Federal subsidies to US renter households are much smaller. Policy has evolved from programmes in which the government built, owned, and managed dwellings to programmes emphasizing housing demand through vouchers and rent certificates awarded to eligible households.

Public concern over housing arises from three sources. First, housing is the single largest expenditure item in the budgets of families and individuals in most modern economies. The average household in western Europe and the United States devotes more than one quarter of its income to housing expenditures. Thus, increased efficiency in the provision of housing services or reduced occupancy costs can have a large impact on non-housing consumption and household well-being. Second, consumers' housing and location choices condition many other aspects of the quality of urban life. For example, the transport, schooling, and neighbourhood opportunities of urban households are themselves greatly affected by the housing opportunities available to them. Third, it is widely presumed that there are significant externalities in housing consumption. These external effects range all the way from the consequences of the social and physical isolation of those living in low-income residential neighbourhoods to the presumed benefits of the 'social capital' and the increased political participation of households who own their homes.

In the United States, important policies providing subsidies to housing consumers are made by the central ('federal') government. Other policies governing housing – the regulation of house-building, service provision, and occupancy – are determined by local governments. At the national level, subsidies provided to selected housing consumers and producers are implemented by two government agencies: the Internal Revenue Service (IRS) and the Department of Housing and Urban Development (HUD). The policies administered by the IRS are clearly more important quantitatively, and they have large welfare effects.

The federal tax code

The IRS administers two housing subsidy programmes: the tax expenditures to owner-occupants for housing consumption specified in the personal income tax code, and the tax expenditures for builders of rental housing under the Low Income Housing Tax Credit programme specified in the Tax Reform Act of 1986. This latter programme is small, having originated in the Tax Reform Act of 1986. The former programme is large, and has existed in its current form since the personal income tax was established in 1915. Indeed, the benefits to homeowners under these tax policies are among the most generous in the developed world. (But the form of these subsidies is certainly not unique to the United States. See Englund, 2003, for a comparative discussion.)

Consider an individual who chooses between an investment in owner-occupied housing and an equivalent investment in some other asset – common stocks, say. The investment in owner-occupied housing offers three

distinct tax advantages. First, under the US Internal Revenue Code, the returns on the investment in owner-occupied housing are untaxed (these returns are in the form of the housing services consumed in any year). In contrast, the dividends yielded by common stock are reported as income and are taxed in the year accrued. Second, capital gains arising from the housing investment can be deferred indefinitely. Moreover, a large capital gains exclusion is available to those over the age of 55. In contrast, capital gains in the stock market are taxed in the year they are realized. Third, some of the expenses associated with homeownership, notably property taxes and mortgage interest payments, can be itemized as deductions in computing federal tax liability under the personal income tax. No other interest payments are deductible as personal expenses under the Internal Revenue Code. This favourable treatment also extends to personal income taxation under the laws of all of the 50 states.

The net effect of these provisions of the US tax law is to reduce the price of homeownership, relative to renting, by a sizeable amount. Moreover, as a result of these policies, the relative price of homeownership varies by income level and the level of inflation.

It is useful to think of the price of homeownership as the cost of using the stock of residential capital. The rent R for using a unit of capital V is merely

$$R = iV, \tag{1}$$

where i is the real interest rate. i is simply the price of using a unit of capital V for a year. Housing is subject to local property tax at effective rate t. Annual expenditures of $100d$ per cent are required to maintain the property and to offset depreciation. The owner can expect real capital gains at a rate g. Let π be the rate of inflation. For housing, the user cost relationship is thus

$$R_1 = [(i + \pi) - t - d - (g + \pi)]\ V, \tag{2}$$

where the term in square brackets is the user cost of residential capital. Note that, in the absence of tax considerations, the user cost is insensitive to the level of inflation π. Now suppose nominal capital gains are untaxed and that mortgage interest payments and property taxes are deductible from gross income. Suppose net income is taxed at the rate of T per cent. Under these circumstances the user cost relationship is

$$R_2 = ([i + \pi][I - T] + t[I - T] + d - [g + \pi])\ V, \tag{3}$$

or

$$R_2 = R_1 - T(i + \pi + t)\ V. \tag{4}$$

The system of taxes leads to a reduction in the net price of housing capital by the amount of the second term. Note that the after-tax cost of homeownership declines with the value of the house, the real interest rate, the property tax rate, and the marginal income tax rate.

If federal tax rates increase with income or if higher-income households live in jurisdictions with higher property tax rates, the cost of homeownership declines with income. More important, as long as housing is a normal good with a positive income elasticity, the net cost of homeownership declines with income. Furthermore, a given level of inflation in the economy reduces the user cost more for higher-income than for lower-income homeowners.

More generally, the analysis shows that the costs of homeownership are sensitive to macroeconomic stabilization policies and to the structure of income tax rates. The marginal tax rates of the highest-income US households fell from 70 per cent to 30 per cent and then rose to 40 per cent during the

1980s and 1990s, before falling again in 2001. At the same time, the inflation rate plummeted from 15 per cent to less than 3 per cent. These changes have meant that the implicit policy toward housing and homeownership varied substantially.

For example, at reasonable values of the variables in eq. 4 (say, $i = g = 3\%$, $t = d = 2\%$, $T = 30\%$), then as inflation declines from 6 per cent to 1 per cent, the after-tax user cost of residential capital roughly doubles. Similarly, at reasonable values of the variables (for example, $\pi = 3\%$ and, as before, $i = g = 3\%$, $t = d = 2\%$), then, as income tax rates decrease from 40 per cent to 20 per cent, the after-tax cost of owner occupancy increases by more than one-third. These are substantial price changes induced entirely by taxation and macroeconomic considerations which may be completely unrelated to any objective of housing policy.

These reductions in the user cost of housing capital may be expected to increase housing consumption; reductions in the price of owning relative to renting may be expected to increase homeownership. But econometric research suggests that the demand for housing is moderately price-inelastic. It also appears, at least for the United States, that the elasticity of homeownership with respect of the relative price of homeownership is quite small. Thus, the effects of these large subsidies on housing outcomes are quite small.

In contrast, the magnitude of the implicit subsidy arising from the personal income tax code is large and extremely regressive. The subsidy is available only to owners, who are typically more affluent than renters, and only to those who find it advantageous to itemize their deductions in computing their tax liabilities. (Under US tax law, households may claim a 'standard' deduction for expenses or they may list deductions separately. The propensity to itemize deductions separately increases with income.) Finally, as noted above, for those owners who do itemize deductions, the magnitude of the subsidy increases with income.

The second programme administered by the IRS, the low-income housing tax credit, was established in 1986 and expanded in 2001. Under this programme, tax credits are remitted to each state in proportion to population. These credits are awarded by states to developers who propose new construction of housing reserved for low-income tenants who pay 30 per cent of their incomes in rent. The credits, in turn, are sold to firms and high-income individuals, and the proceeds are invested in the designated projects.

The IRS monitors the compliance of these projects with the tax law requiring occupancy by low-income tenants for a 15-year period after construction.

The revenues forgone by the federal treasury as a result of these programmes are routinely estimated by the Joint Committee on Taxation of the Congress. The revenue costs of these subsidies are large. In 2005, for example, it is estimated that tax expenditures for owner-occupied housing totalled about \$147 billion – \$69 billion for the mortgage interest deduction, \$33 billion for the capital gains exclusion on home sales, \$28.6 billion for the exclusion of imputed rent, and \$16.6 billion for the property tax deduction. It is estimated that more than half of the benefits of the tax expenditures for homeowners accrue to the top 15 per cent of the income distribution.

In contrast, in 2005 the tax expenditures arising from the low-income housing tax credit were about \$4.8 billion (in present value terms). Presumably much of this benefit accrues to low-income renters.

A more relevant benchmark for the costs of these tax expenditures may be a comparison with the housing programmes managed by HUD, whose principal beneficiaries are low-income households. Direct expenditures under

these programmes are currently $41 billion, or about 28 per cent of the tax expenditures on behalf of owner occupants.

Subsidies for renters

Federal housing policies for renters administered by HUD provide subsidies to about a third of low-income households. These programmes have evolved from those providing housing owned and managed by government to those providing direct cash assistance for deserving renters. The Public Housing Program was established in 1937 to subsidize local governments in building housing for those temporarily unemployed and also in providing construction jobs for unemployed urban labour during the Great Depression. Until the end of the 1970s, the programme subsidized virtually all of the capital costs of designated public housing dwellings and none of the operating costs. Since rent rolls were fixed at 25–30 per cent of tenant income, project managers who chose to serve households with the lowest incomes faced severe budgetary problems. Changes in the subsidy formulas helped local managers avoid this Hobson's choice, but the legacy of the original subsidy formula, the overcapitalization of projects to economize on maintenance expenses, is still manifest in the long-lived capital produced by the Public Housing Program.

The private sector was first induced to build, manage and provide rental dwellings for low-income tenants in the 1960s, through generous depreciation allowances provided to limited dividend corporations (under programmes such as Section 235 of the Housing Act of 1968). But it was not until 1974 that the subsidy provided to deserving tenants was divorced from the cost of supplying newly constructed housing.

The innovation in Section 8 of the Housing Act of 1974 was a programme of project-based housing assistance based upon long-term contracts in which the federal government guaranteed that participating landlords would receive the average rent in the local housing market (rather than the cost of building new housing). Low-income households pay 30 per cent of their incomes to a participating landlord and the difference, up to the 'fair market rent' in the housing market, is supplied under federal contract.

The radical departure to subsidize directly the demanders of low-income housing rather than the builders and suppliers of that housing was thoroughly tested by the Housing Allowance Experiments of the 1970s and 1980s, the most expensive social experiment in history, and the results were incorporated over time into the current Housing Choice Voucher Program which allocates vouchers or certificates to local authorities for distribution to low-income households. Under this programme, a qualifying household receives a voucher which pays the difference between 30 per cent of tenant income and the 'fair market rent'. This programme is administered by Local Housing Authorities, who screen applicants and certify eligibility. Under current practice, households with incomes below 80 per cent of the area median income are eligible for vouchers, but three-quarters of the vouchers are reserved for very low-income households, those whose incomes are below 30 per cent of the area median income. In principle, the voucher is completely portable. It can be used anywhere by a recipient to enter into a rental contract within 90 days of issue.

Vouchers offer several clear advantages over the alternative supply oriented housing subsidy programmes. First, they are considerably cheaper per household served than programmes linking subsidies to construction costs, including the Public Housing Program, but also the Low Income Housing

Tax Credit Program. Second, they remove questions about the location of dwellings occupied by low-income subsidized households from the local political process. Third, they preserve the anonymity of the low-income recipients of these subsidies. Fourth, they foster the spatial decentralization of the low-income population, reducing the concentration of disadvantaged households in particular neighbourhoods. Fifth, they better facilitate the operation of the labour market by encouraging recipients to live closer to actual or potential worksites.

Although new commitments by HUD for subsidies to low-income renters are concentrated in the voucher programme, the legacy of past programmes will remain for a considerable period. For example, in the last year for which complete data are available (1998), 1.3 million units of government-owned public housing were used to provide housing subsidies, as were 1.0 million units of Section 8 project-based housing and 750,000 units of housing produced by other supply-oriented programmes. In contrast, 1.4 million households were subsidized by tenant-based voucher programmes.

Local housing regulations impose a potentially serious impediment to the efficiency of vouchers as a vehicle for housing subsidies. With local property taxes as the basis for local service provision, it is often in the fiscal interests of individual governments to limit the construction of new housing and to restrict the construction of high-density housing. The land-use regulations of individual jurisdictions are not well coordinated regionally in the United States, and the resulting regulatory pattern may make the housing supply relatively inelastic. This may lead to higher housing prices in response to increases in demand throughout the market, and it may mean that housing may be less available to voucher recipients in some metropolitan areas.

Despite these real concerns, the most important factor keeping the rent-to-income ratio of the poor high is the limited availability of housing subsidies. In 2001, it was estimated that almost 14.5 million renter households paid more than 30 per cent of their incomes on rent, and more than 7 million paid more than half of their incomes on rent. In contrast, only about 5 million renter households received subsidies from all federal government housing programmes.

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See also

< xref = H000161 > housing supply and markets;
< xref = xyyyyyy > local public finance;
< xref = U000035 > urban economics;
< xref = U000063 > urban housing demand;
< xref = R000099 > rent control;
< xref = R000233 > residential real estate and finance.

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Index terms

Great Depression
homeownership
housing
housing costs
housing expenditures
housing externalities
housing finance
housing policy in the United States
housing subsidies
housing tax credit
income tax
inflation
interest rates
Internal Revenue Service (IRS)
land-use regulation
rent control
social capital
tax expenditures
taxation of capital income

Index terms not found:

housing costs
housing externalities
housing finance
rent control
taxation of capital income