Distribution of Federal Housing Benefits: Rebalancing the Federal Role in Housing Finance

David Rosen, PhD
Principal
David Paul Rosen & Associates
1330 Broadway, Ste 937
Oakland, CA 94612
510-451-2552
David@DRAConsultants.com
www.draconsultants.com

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DRA
DAVID PAUL ROSEN & ASSOCIATES
DEVELOPMENT, FINANCE AND POLICY ADVISORS

SUBMITTED BY:

David Paul Rosen & Associates

1330 Broadway, Suite 937
Oakland, CA 94612
510-451-2552
510-451-2554 Fax
david@draconsultants.com
www.draconsultants.com

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Introduction: Rebalancing the Federal Housing Finance Role

The federal role in federal housing credit markets is vast. In today's enduring mortgage crisis, this remains true at unprecedented levels.

This federal role exceeds $7 trillion in capital commitments for housing. The scale of this involvement is fiscally costly, representing a material contribution to the federal deficit. It is severely regressive in its distribution of subsidies to households by income, and sharply disfavors the one-third of American families who rent.

DRA's analysis of the distribution of federal housing tax and spending policy by income and tenure makes plain an imperative need to rebalance the federal housing finance role.

Consider:

- Total actual and projected federal tax expenditures for the period FY 2007 through FY 2011 for real estate-related investments exceed $910 billion. Of this five-year total, 71.6 percent ($652 billion) was expended on the mortgage interest deduction, property tax deduction and capital gains exclusion for homeownership alone. (See Table 1.)

- The total combined mortgage portfolio of Fannie Mae and Freddie Mac (GSEs) as of September 2010 stood at $5.4 trillion, 47 percent of the total housing mortgage debt outstanding in the United States at the end of the first quarter 2010, $11.5 trillion. Of this total, the GSEs' single-family mortgage portfolio also stood at 47 percent of total single-family mortgage outstanding in the nation, $10.7 trillion.

- Total multifamily housing debt in the nation stood at $825 billion (Federal Reserve Statistical Data, First Quarter 2010). Multifamily mortgages constitute only 7 percent and 5 percent of Fannie Mae and Freddie Mac's total mortgage portfolio respectively, but 35 percent of total outstanding multifamily mortgage debt (National Multifamily Housing Council).

- Actual and projected appropriations for HUD from FY 2007 through 2011 total $201 billion, which is 22 percent of real estate-related tax expenditures during the same period, and only 30.8 percent of tax subsidies for the mortgage interest and real estate tax deductions, and capital gains exclusion alone. Of the total HUD appropriations for that period, $162.9 billion, or 81 percent, is concentrated in rental assistance and public housing support for poverty level and near poverty level households. (See Table 2.)

- FHA's outstanding principal balance of insurance-in-force (IIF) stood at $757.2 billion at the end of 2009, 92 percent of which comprises single-family programs. This IIF constituted a 42.4 percent increase over the prior year, 2008, and represents a striking indication of FHA's critically important counter-cyclical role in the current mortgage crisis. By contrast, 2009 multifamily originations totaled $5.1 billion from FHA lenders, plus an additional $311 million through FHA's risk sharing program.

- FHA's stated mission is to "contribute to building and preserving healthy communities" and to "maintain and expand homeownership, rental housing and health care opportunities." Additionally, FHA must "stabilize credit markets in times of economic disruption." This last component of FHA's mission has assumed great importance in today's housing market. FHA single-family has captured approximately a one-third share of the mortgage origination market, representing a dramatic reversal where FHA single-family market share dipped to under 2 percent in 2006, after peaking at approximately 24 percent in 1970, and reaching as high as 12 percent in the mid-1900s.

- USDA's Rural Development (RD) direct loan and guaranteed loan programs for homeownership similarly dominate the RD portfolio: $58.5 billion in projected 2011 outstanding principal balance with less than $1 billion projected in 2011 rental assistance programs. RD loan program OPB for Rural Electrification and Telecommunication is projected to be $46.3 billion in 2011.

- Consolidated obligations outstanding of the twelve Federal Home Loan Banks totaled $853 billion as of June 30, 2010. These obligations are overwhelmingly invested in single-family home mortgages.

- Key, and large, federal infrastructure programs from DOT, EPA, and Treasury are largely indifferent to the capital needs of underserved markets.

Table 1:
Federal Real Estate-Related Tax Expenditures, FY 2007 - 2011

($ billions)	2007	2008	2009	2010	2011	2007 - 2010 Total
Deduction for mortgage interest on owner-occupied residences (sec 163 (h))	73.70	67.00	86.40	103.70	119.90	450.70
Deductibility of state and local property tax on owner-occupied homes (Sec 164)	16.80	24.60	25.10	16.40	24.90	107.80
Capital gains exclusion on home sales	28.50	16.80	15.30	15.30	17.40	93.30
Single-family mortgage revenue bonds	1.10	1.10	1.40	1.40	1.50	6.50
Multifamily mortgage revenue bonds (Sec 141)	0.70	0.80	0.80	0.90	1.00	4.20
Low Income Housing Tax Credit (Sec 42)	5.10	5.40	8.30	5.00	5.10	28.90
Estimated LIHTC investment volume	8.40	5.50	4.50	NA	NA	NA
Historic Tax Credits (Section 47 20% credits)	0.40	0.40	0.40	0.50	0.60	2.30
10% credit for rehabilitation of non-historic structures	0.15	0.15	0.15	0.15	0.20	0.80
Depreciation of rental housing in excess of alternative depreciation system	4.30	4.20	4.40	5.00	4.90	22.80
New Market Tax Credit (Section 45D)	0.70	0.90	0.70	0.70	0.70	3.70
Empowerment Zones tax incentives	0.60	0.80	0.70	0.50	0.20	2.80
Renewal Communities tax incentives	0.70	0.70	0.50	0.20	0.20	2.30
State and local small issue private activity bonds (excluding bonds for airports, docks and mass-commuting facilities)	0.40	0.40	0.40	0.40	0.50	2.10
Government purpose bonds	27.80	26.40	27.80	28.80	29.90	140.70
Build America Bonds	0.00	0.00	1.30	2.20	3.00	6.50
Like-kind exchanges (Section 1031)	4.30	4.10	2.00	2.10	2.50	15.00
5-year MACRS for qualified energy property	0.00	0.20	0.30	0.30	0.20	1.00

Table 1:
Federal Real Estate-Related Tax Expenditures, FY 2007 - 2011

($ billions)	2007	2008	2009	2010	2011	2007 - 2010 Total
Renewable Energy ITC (Section 48)	<.05	<.05	<.05	<.05	<.05	<0.25
Energy Efficient Commercial building deduction (Sec 179d)	<.05	<.05	0.10	0.20	0.20	<0.60
Credit for Qualified Energy Conservation Bonds (QECB)	0.00	0.00	<.05	<.05	<.05	<0.15
Credit for Clean Renewable Energy Bonds (CREB)	<.05	0.00	<.05	0.10	0.10	<0.30
Tax exempt private activity facility bonds for green Buildings (Section 142(l))	<.05	<.05	<.05	<.05	<.05	<0.25
Expensing of environmental remediation costs	0.20	0.20	0.20	<.05	-0.20	<0.45
Total	**173.85**	**159.65**	**180.75**	**183.85**	**212.80**	**910.90**

Source: Joint Committee on Taxation. Estimates of Federal Tax Expenditures for Fiscal Years 2007-2011, Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012, and Estimates of Federal Tax Expenditures for Fiscal Years 2002-2013, Ernst & Young.
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Table 2:
HUD Annual Appropriations, FY 2007 - 2011
($ billions)

	2007	2008	2009	2010	2011	Total
HOME	1.76	1.70	1.83	1.83	1.65	8.76
HOME supplement	0.00	0.00	2.25	0.00	0.00	2.25
CDBG	3.77	3.87	3.90	4.45	4.38	20.37
CDBG supplement	0.00	3.00	1.00	0.00	0.00	4.00
CDBG/NSP	0.00	0.00	2.00	0.00	0.00	2.00
Project-Based Rental Assistance	5.98	6.38	7.10	8.56	9.37	37.38
PBRA supplement	0.00	0.00	2.03	0.00	0.00	2.03
Tenant-Based Rental Assistance	15.88	15.70	16.23	18.18	19.55	85.54
Public Housing Capital Fund	2.44	2.44	2.45	2.50	2.04	11.87
Public Housing Capital Fund Supplement	0.00	0.00	4.00	0.00	0.00	4.00
HOPE VI/Choice Neighborhoods	0.10	0.10	0.12	0.20	0.25	0.77
Public Housing Operating Fund	3.86	4.20	4.46	4.78	4.83	22.12
Total	**33.79**	**37.39**	**47.36**	**40.49**	**42.07**	**201.09**

Source: HUD Budget Summaries for FY 2009, 2010, and 2011. 2010 and 2011 numbers reported as estimates.
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The Distribution of Federal Housing Tax and Direct Spending Benefits

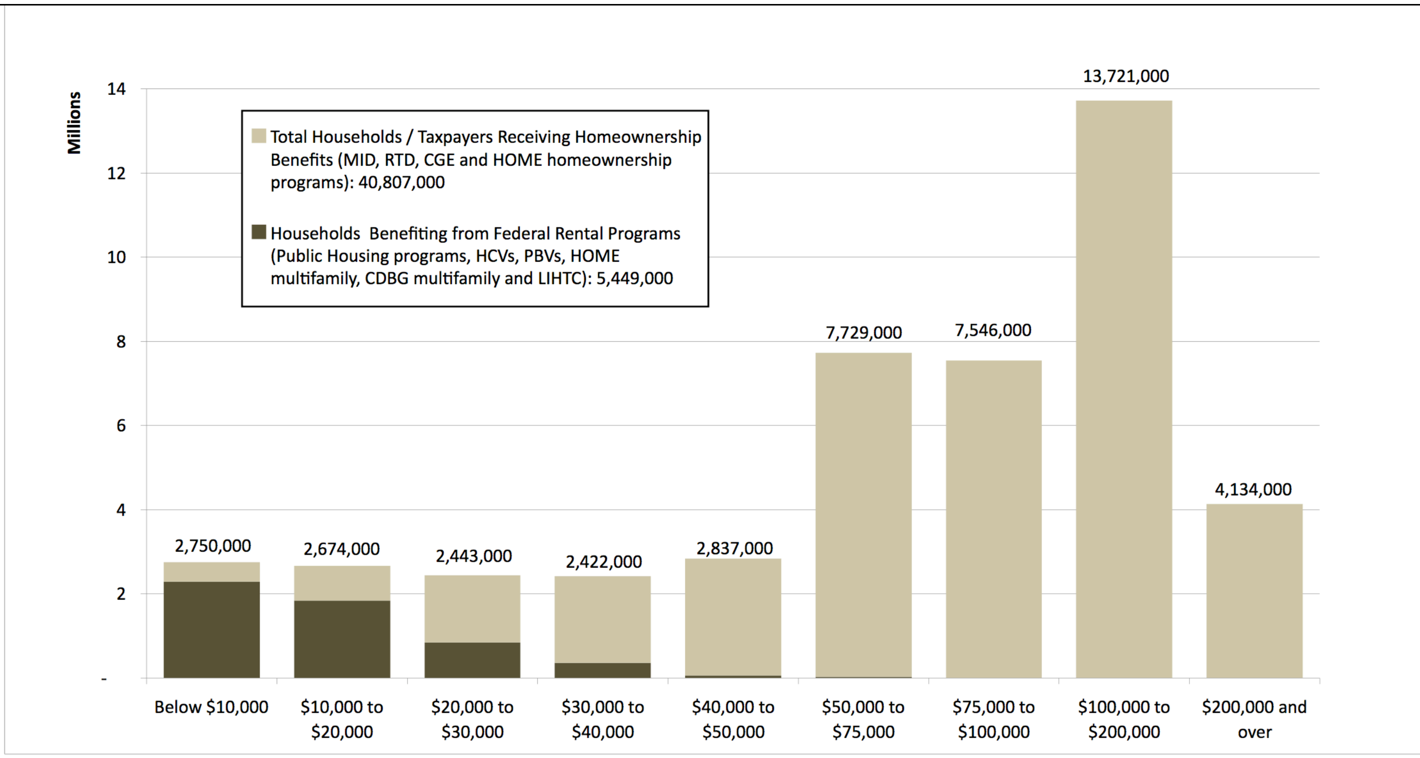
DRA has analyzed the distribution of combined federal tax expenditures and direct appropriations for housing by tenure and by income. We find federal housing policy regressively distributed and, for tax and spending programs, severely underinvested in rental housing. Figures 1 through 4 illustrate the sharp concentration of benefit to high income households for federal housing tax and spending subsidies.

This is plainly shown in Figure 3, Average Housing Subsidy per Household/Taxpayer, 2008. Combining federal housing tax expenditures with direct spending on housing programs, in 2008 the average housing subsidy per US household/taxpayer is estimated at $1,055. However, taxpayers earning more than $200,000 received an annual average subsidy of $6,253.

This contrasts sharply, for example, with taxpayer households earning $30,000-$40,000, who received an annual average federal housing subsidy of $265. Households experiencing extreme poverty, below $10,000, received an average annual subsidy of $853. Thus, federal housing subsidies for taxpayer households earning more than $200,000 were 25 times those received by households in the $30,000-$40,000 bracket, and more than seven times the assistance received by households earning less than $10,000.

Figure 4 shows an even sharper regressivity in the utilization rates of federal housing subsidies by household income. While the average use rate was 29 percent, only 10 percent of the poorest households received federal housing subsidies, while 72 percent of those above $200,000 in income received subsidies.

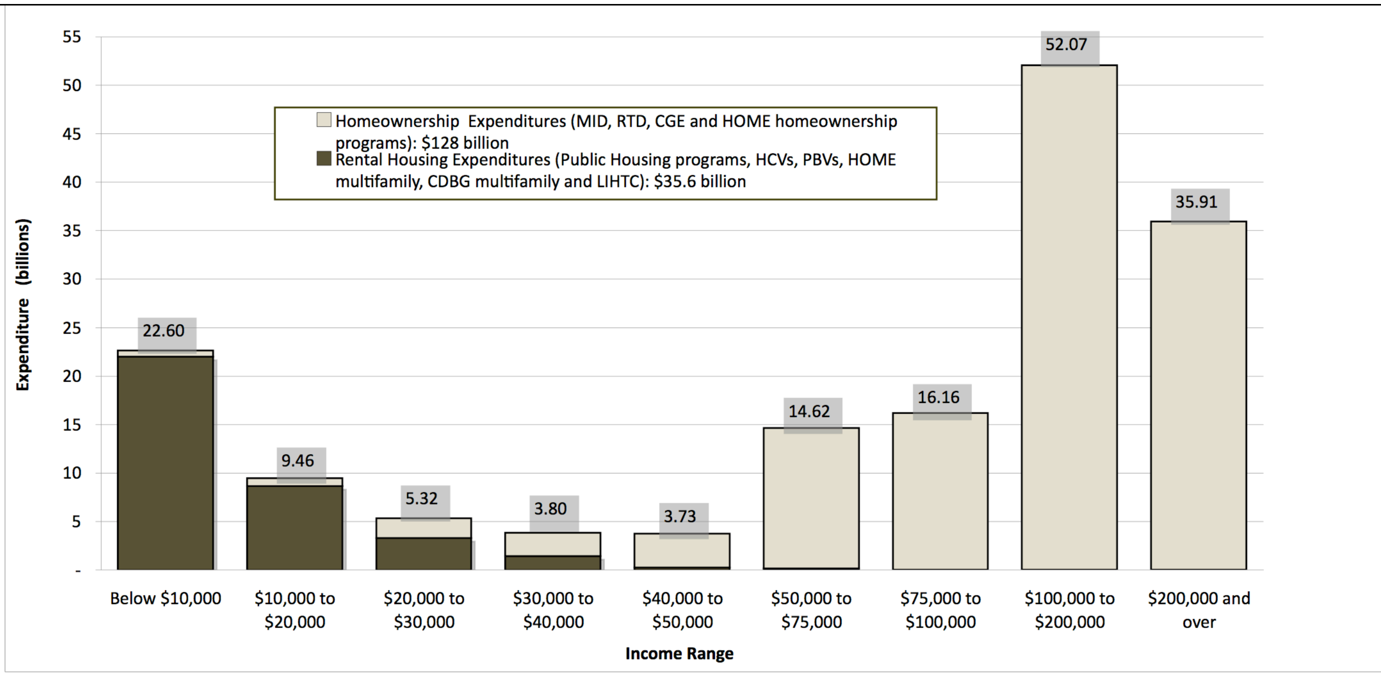
Figure 1:
Estimated Distribution of Federal Housing Subsidies among Households/Taxpayers by Income and Tenure, 2008[1]



[1] Source: Joint Committee on Taxation, HUD, DRA. Homeownership Tax expenditures include the mortgage interest deduction (MID), real estate tax deduction (RTD), the capital gains exclusion (CGE) and HOME homeownership programs. Rental Housing Expenditures include appropriations for public housing programs, project-based and tenant-based Section 8 programs, and HOME and CDBG rental housing programs. Also included in the rental housing category are tax expenditures under the Low Income Housing Tax Credit (LIHTC) program.

Excludes accelerated depreciation for rental housing, private activity bonds.

Figure 2:
Estimated Distribution of Federal Housing Tax Expenditures and Spending Programs, 2008[1]



[1] Notes: Homeownership Tax expenditures include the mortgage interest deduction (MID), real estate tax deduction (RTD) and the capital gains exclusion (CGE). Data source for MID and RTD: Joint Committee on Taxation (JCT), *Estimates of Federal Tax Expenditures for Fiscal years 2009-2013*. Tax figures reflect 2008 JCT MID and RTD estimates, which JCT distributes by income. JCT does not provide a CGE income distribution. DRA estimated the CGE distribution.

Rental Housing Expenditures include appropriations for public housing programs, project-based and tenant-based Section 8 programs, HOME and CDBG. Also included in the rental housing category are tax expenditures under the Low Income Housing Tax Credit (LIHTC) program.

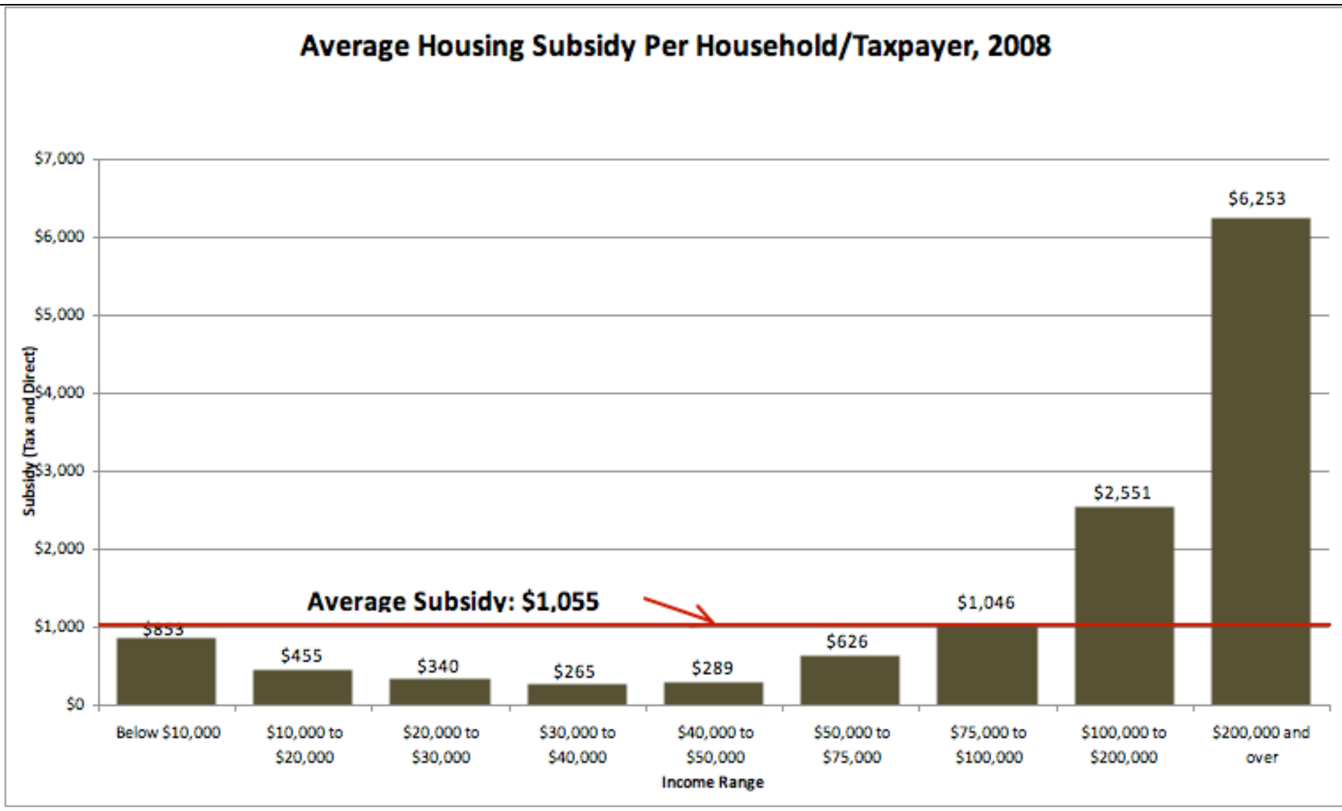
LIHTC income distributions have been estimated based on a review of surveys conducted by GAO in 1997 and Abt Associates, Inc., in 1999. Public housing and rental assistance program estimates are based on October 21, 2010 Residents Characteristics Report. http://www.hud.gov/offices/pih/systems/pic/50058/rcr/. Subsidy levels have been adjusted for income.

HOME income distributions estimates and allocations between rental and for-sale housing are based on data published in the HOME Program National Production Report: June 30, 2009. CDBG income distribution estimate are based on LIHTC estimates. Estimates of CDBG allocation to multifamily housing are based on CDBG expenditure reports.

Excludes accelerated depreciation for rental housing, private activity bonds.

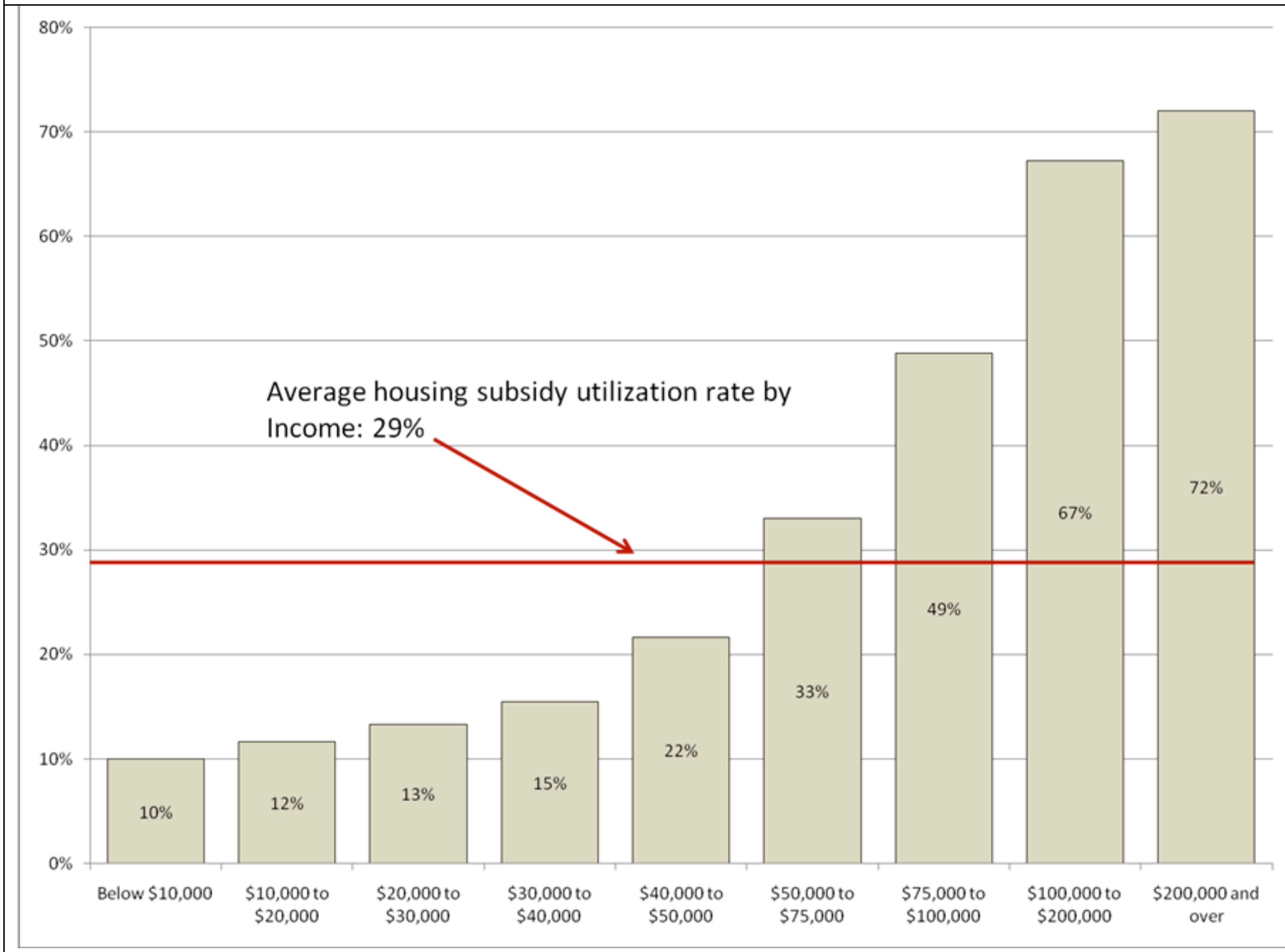
Sources: JCT, GAO, HUD, Abt Associates, DRA

Figure 3:
Estimated Average Housing Subsidy per Household/Taxpayer, 2008[1]



Source: JCT, AHS, HUD, GAO, DRA.

Figure 4:
Estimated Housing Subsidy Utilization Rate by Income, 2008



Source: JCT, HUD, GAO, DRA.

This highly regressive distribution of federal housing benefits arises from the favorable tax treatment of owner-occupied housing. These benefits, the mortgage interest deduction (MID), real estate tax deduction (RTD) and capital gains exclusion (CGE), increase in value to taxpayers (and in cost to the federal government) with increases in income and home price. Popular belief holds that the MID exists to promote homeownership. However, no evidence suggests that this was Congress' intent in 1913 when it created MID as a byproduct of the original federal income tax. Most current research suggests that the MID does not increase homeownership, but rather increases the cost of housing, encourages more borrowing, and stimulates demand for larger homes and more land (Gale, et al, 2007; Glaeser and Shapiro, 2003; Mann, 2000). By reducing the after tax cost of housing for households that itemize, the MID and RTD increase demand for ownership housing. This increase in demand affects both the price of housing and growth patterns:

- In growth constricted areas, such as mature built-out urban areas with an inelastic supply of housing, housing price will increase; and,

- In areas where growth is not constrained, such as suburban fringe areas where the supply of housing is elastic, the MID and RTD encourage sprawl by spurring demand for larger homes and lot sizes (Gyourko and Voith, 1997; Mann, 2000).

By providing a higher relative subsidy to higher income upper tax bracket households, the MID and RTD make the development of low-density, high-income communities more profitable, creating an incentive for exclusionary zoning (Voith). By inflating home prices and encouraging exclusionary zoning, the MID and RTD act as barriers to homeownership by increasing the cost of ownership for low and moderate income households, particularly those who do not itemize their taxes.

DRA's analysis of the distribution of tax and direct spending housing benefits by income and tenure makes plain an imperative need to rebalance federal housing finance policy. This becomes even more important as the resolution of GSE conservatorship compels a debate on the emergent future roles of the GSEs, but also on the roles of FHA, Ginnie Mae, Rural Development and the FHLB.

Reforming the federal housing finance role, huge as it is, occurs at a time of unprecedented strain in US mortgage markets. Today it is estimated that 11 million mortgages, nearly 1 in 4, have outstanding principal balances in excess of the underlying home value. This presents continuing risk to the US economy as a whole, and represents a wrenching experience for homeowners and communities facing foreclosure and widespread devaluation. State and local municipal budgets suffer as the property values on which they largely rely continue to erode.

Tables 3 through 7 below provide more detail on the distribution of federal tax and spending housing subsidies to households by income and tenure, based on DRA's analysis.

Table 3: Distribution by Income of Mortgage Interest Deduction Subsidies, 2008				
Income Class	**Returns Claiming MID**	**Distribution of returns claiming MID by income**	**MID Tax expenditure by income**	**Distribution of MID Benefits**
Below $10,000	3,000	0.01%	-	0.00%
$10,000 to $20,000	247,000	0.67%	75,000,000	0.09%
$20,000 to $30,000	732,000	2.00%	358,000,000	0.42%
$30,000 to $40,000	1,478,000	4.03%	944,000,000	1.10%
$40,000 to $50,000	2,426,000	6.62%	1,836,000,000	2.15%
$50,000 to $75,000	7,033,000	19.18%	8,370,000,000	9.79%
$75,000 to $100,000	7,044,000	19.21%	10,136,000,000	11.86%
$100,000 to $200,000	13,622,000	37.15%	36,278,000,000	42.45%
$200,000 and over	4,082,000	11.13%	27,468,000,000	32.14%
Total	36,667,000	100.00%	85,465,000,000	100.00%
Source: JCT, GAO, HUD, DRA				

Table 4: Distribution by Income of Real Estate Tax Deduction Subsidies, 2008				
Income Class	**Returns Claiming RTD**	**Distribution of returns claiming RTD by income**	**RTD Tax expenditure by income**	**Distribution of RTD Benefits**
Below $10,000	3,000	0.01%	-	0.00%
$10,000 to $20,000	151,000	0.41%	17,000,000	0.07%
$20,000 to $30,000	604,000	1.63%	113,000,000	0.45%
$30,000 to $40,000	1,321,000	3.56%	276,000,000	1.10%
$40,000 to $50,000	2,425,000	6.54%	602,000,000	2.40%
$50,000 to $75,000	7,405,000	19.96%	2,772,000,000	11.07%
$75,000 to $100,000	7,633,000	20.57%	3,485,000,000	13.92%
$100,000 to $200,000	14,611,000	39.38%	12,042,000,000	48.09%
$200,000 and over	2,949,000	7.95%	5,732,000,000	22.89%
Total	37,102,000	100.00%	25,039,000,000	100.00%
Source: JCT, GAO, HUD, DRA				

Table 5: Distribution by Income of Combined MID and RTD Subsidies, 2008		
Income Class	Combined MID & RTD Subsidies by Income	Percent Distribution of Combined MID & RTD Subsidies
Below $10,000	-	0.00%
$10,000 to $20,000	92,000,000	0.08%
$20,000 to $30,000	471,000,000	0.43%
$30,000 to $40,000	1,220,000,000	1.10%
$40,000 to $50,000	2,438,000,000	2.21%
$50,000 to $75,000	11,142,000,000	10.08%
$75,000 to $100,000	13,621,000,000	12.33%
$100,000 to $200,000	48,320,000,000	43.73%
$200,000 and over	33,200,000,000	30.04%
Total	110,504,000,000	100.00%
Source: JCT, GAO, HUD, DRA		

Table 6: Rental Programs: Expenditures by Income, 2008						
Income Class	Public Housing	Housing Choice Vouchers	Project-Based Section 8	HOME Rental	CDBG Rental	LIHTC
Below $10,000	4,729,565,000	11,112,442,000	4,676,942,000	286,272,000	85,052,000	1,080,000,000
$10,000 to $20,000	1,677,635,000	3,850,512,000	1,493,477,000	314,899,000	93,557,000	1,188,000,000
$20,000 to $ 30,000	331,424,000	565,342,000	163,031,000	286,272,000	140,336,000	1,782,000,000
$30,000 to $40,000	376,000	166,895,000	48,550,000	66,797,000	80,799,000	1,026,000,000
$40,000 to $50,000	-	6,809,000	-	-	17,010,000	216,000,000
$50,000 to $75,000	-	-	-	-	8,505,000	108,000,000
$75,000 to $100,000	-	-	-	-	-	-
Total	6,739,000,000	15,702,000,000	6,382,000,000	954,240,000	425,259,000	5,400,000,000
Source: HUD, GAO, DRA						

Table 7: Rental Programs: Households by Income, 2008						
Income Class	**Public Housing**	**Housing Choice Vouchers**	**Project-Based Section 8**	**HOME Rental**	**CDBG Rental**	**LIHTC**
Below $10,000	603,000	940,000	632,000	11,000	4,000	16,000
$10,000 to $20,000	348,000	760,000	471,000	12,000	5,000	17,000
$20,000 to $30,000	162,000	215,000	99,000	11,000	7,000	26,000
$30,000 to $40,000	35,000	80,000	37,000	3,000	4,000	15,000
$40,000 to $50,000	12,000	5,000	-	-	1,000	3,000
$50,000 to $75,000	-	-	-	-	-	2,000
$75,000 to $100,000	-	-	-	-	-	-
$100,000 to and over	-	-	-	-	-	-
Total	1,160,000	2,000,000	1,239,000	37,000	21,000	79,000

Source: HUD, GAO, DRA