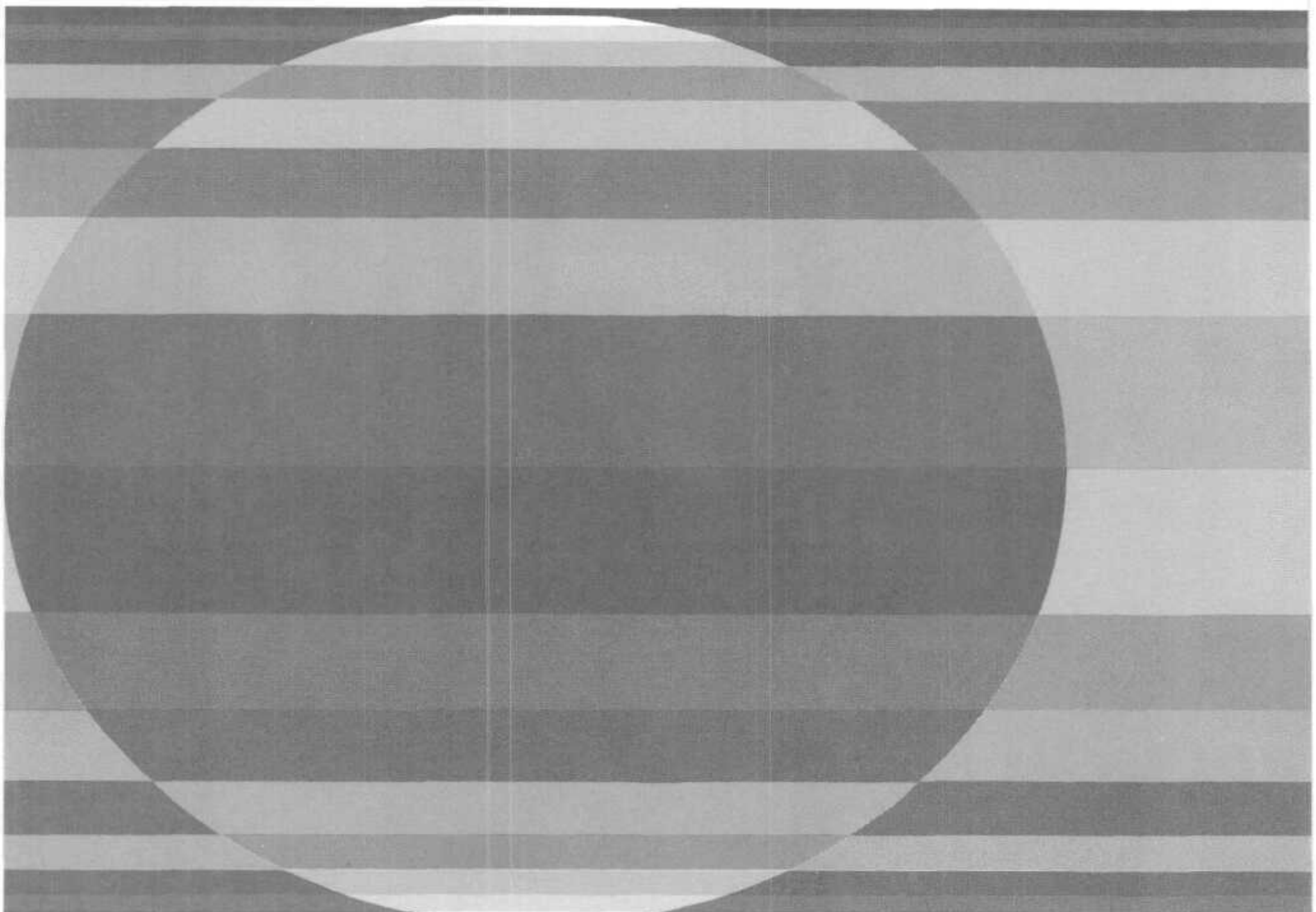
BACKGROUND PAPER

Federal Housing Policy: Current Programs and Recurring Issues

June 1978



Congress of the United States
Congressional Budget Office

FEDERAL HOUSING POLICY: CURRENT PROGRAMS AND RECURRING ISSUES

The Congress of the United States
Congressional Budget Office

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PREFACE

Each year, the Congress faces a number of recurring issues concerning the funding, design, and operation of federal housing programs as well as specific proposals for altering current housing policy. This paper, prepared at the request of the Senate Budget Committee, presents an overview of federal housing policy to provide a background for addressing those issues and evaluating specific budgetary and programmatic proposals.

Martin D. Levine of CBO's Human Resources and Community Development Division prepared this paper under the general supervision of Robert D. Reischauer and David S. Mundel. Paul Warren provided technical assistance in completing the data analysis. A large number of individuals contributed useful comments on earlier drafts, including Donald Campbell, Michael Deich, John W. Ellwood, John Korbel, Brent Shipp, and James M. Verdier. The paper was edited by Marion F. Houston. Jill Bury patiently and expertly typed the several drafts of the paper and, with Toni Wright, prepared the manuscript for publication.

In accordance with CBO's mandate to provide objective and impartial analysis, this paper contains no recommendations.

Alice M. Rivlin
Director

June 1978

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SUMMARY

Each year the Congress faces a number of recurring issues concerning the funding, design, and operation of federal housing programs. The complexity of current housing programs, the numerous policy objectives and changing housing needs they are intended to address, and uncertainty as to their effectiveness contribute to the occurrence of these issues and make it difficult for the Congress to deal with them conclusively.

POLICY OBJECTIVES AND CURRENT HOUSING NEEDS

Among the objectives of federal housing policy are: reducing the incidence of substandard housing and overcrowding, and alleviating excessive housing costs; increasing residential construction and reducing cyclical instability in the home building industry; expanding access to mortgage credit and encouraging homeownership; encouraging residential integration and deconcentration of lower-income households; providing housing for individuals with special needs due to age or disability; and promoting community development, and neighborhood preservation and revitalization. Progress towards those objectives has been uneven. Improvements in one area have sometimes been at the expense of gains in other areas, creating shifting policy concerns. Available evidence regarding current housing needs and persisting problems reveals that:

- Substandard housing and overcrowding are much less common today than in the past, but large numbers of lower-income families remain ill-housed. Between 1940 and 1970, the proportion of all occupied housing units that were dilapidated or lacked complete plumbing facilities declined from 49 to 7 percent and the proportion of all families living in units with more than one person per room dropped from 20 to 8 percent. Nevertheless, in 1976, 13 percent, or 3.9 million, of all families with incomes low enough to qualify them for federal low- and moderate-income housing assistance were living in units needing rehabilitation; 7 percent, or 2 million, lived in units with more than one person per room.

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- The share of family income allocated to housing has increased in recent years, and housing cost burdens are especially great among lower-income families. Between 1950 and 1976, the proportion of all cash renters paying one-fourth or more of their income for housing increased from 31 percent to 47 percent. In 1976, 61 percent of all renters with an income below $10,000 were paying more than one-fourth of their income for housing; 19 percent were paying greater than one-half. Among homeowners with an income of less than $10,000, 39 percent were devoting more than one-fourth of their income for housing, and 10 percent were paying more than one-half.

- Despite--or, perhaps because of--numerous federal interventions, the residential construction industry remains highly cyclical. Between 1967 and 1976, the annual number of construction starts for privately owned housing has varied from 1.2 to 2.4 million units, and swings of 30 percent or more in a single year have been common.

- The overall rate of homeownership is high, and it has continued to grow, even in the face of sharply rising costs; however, the rate of increase has begun to slow, as first-time homebuyers are having to spend an increasing share of their income on housing. In 1976, 65 percent of all households were owner-occupants, and nearly half of all families with an annual income of less than $10,000 owned their own home. Among renters who bought homes in that year, the median proportion of income devoted to homeownership was 22 percent; for first-time buyers with an income below $10,000, the median housing cost was 34 percent of income.

- Despite federal prohibitions against discrimination in the sale and rental of housing and in mortgage lending, racially discriminatory practices persist. Partly as a consequence of this discrimination, there are significant disparities in the housing conditions of black and white families with similar incomes.

- Reports of undesirable neighborhood conditions are common among higher- as well as lower-income households, in both urban and non-urban locations. Recent data show no improvement in neighborhood conditions paralleling the improvement in the physical adequacy of the housing stock. Data on the social viability of neighborhoods, an issue of increasing concern, are not available.

CURRENT HOUSING PROGRAMS

Unmet housing needs are currently addressed through a variety of direct housing assistance programs, housing-related community development programs, mortgage credit activities, tax provisions, and regulatory activities (see Summary Table 1). During fiscal year 1978, direct federal expenditures for housing will total over $5 billion, and more than twice that amount will be lost in revenues because of housing-related tax benefits.

Housing Assistance Programs. Housing assistance programs provide lower-income families with physically adequate housing and reduce their housing costs to between 15 and 30 percent of their income. Most programs benefit renters only, permitting lower-income families and elderly or handicapped individuals--those whose income is 80 percent or less of the median in their area of residence--to live in predesignated projects or in existing housing in the private market while paying only a fixed percentage of their income for rent and utility expenses. Homeownership assistance programs reduce mortgage interest costs for families with incomes of up to 95 percent of the area median. Because of funding limitations, however, housing assistance programs serve only a small portion of the income-eligible population. As of the end of of 1977, approximately 2.5 million households were receiving assistance; in fiscal year 1978, federal outlays for assisted housing are expected to total $4 billion.

Community Development Programs. Several community development programs subsidize housing rehabilitation by lowering the cost of the units or by providing below-market interest rate financing. Community development programs may also fund local building code enforcement and neighborhood revitalization projects and may be used to provide relocation assistance to persons displaced through government action. Housing-related community development programs may benefit persons at a higher income level than those eligible for direct housing assistance. In fiscal year 1978, outlays for community development programs affecting housing are expected to exceed $700 million.

SUMMARY TABLE 1. PROJECTED COST OF PRINCIPAL FEDERAL HOUSING PROGRAMS, FISCAL YEAR 1978: IN MILLIONS OF DOLLARS

Program Description	Projected Fiscal Year 1978 Outlay or Revenue Loss
Housing Assistance Programs	
Low-Rent Public Housing. Pays development costs and annual operating subsidies for rental projects owned and managed by local public agencies and rented to lower-income tenants at reduced charges.	
Section 8 New Construction/Substantial Rehabilitation. Subsidizes rents of lower-income households occupying public and privately developed projects. Federal payment per unit equals the difference between government-established Fair Market Rent and one-fourth of tenant income.	
Section 8 Existing Housing. Provides assistance on behalf of households occupying physically adequate, moderate-cost rental housing of their own choosing in the private market. Federal payment per unit similar to Section 8 new construction/substantial rehabilitation.	3,687
Section 235 Homeownership Assistance. Provides mortgage interest subsidies to lower- and middle-income households purchasing new or substantially rehabilitated homes.	
Section 236 Rental Assistance and Rent Supplements. Section 236 subsidizes mortgages for rental housing projects. Rent supplements make subsidy payments to the owners of private rental housing on behalf of lower-income tenants; generally used in conjunction with mortgage subsidy projects.	
Section 202 Housing for Elderly and Handicapped. Provides direct loans for the development of rental housing for the elderly and and handicapped. Projects also receive Section 8 subsidies.	320

(Continued)

SUMMARY TABLE 1. (Continued)

Program Description	Projected Fiscal Year 1978 Outlay or Revenue Loss
Housing-Related Community Development Programs	
Community Development Block Grants. Provides grants to local governments, allocated by needs-based formulae. About one-fourth of all CDBG funds go towards housing rehabilitation, building code enforcement, and relocation assistance.	662 b/
Urban Development Action Grants. Funds development projects involving both private and public investment. Available to distressed cities only.	
Section 312 Rehabilitation Loans. Provides 3-percent interest loans for the rehabilitation of privately owned housing for occupancy by limited-income households.	43
Urban Homesteading. Makes federally held homes available at nominal expense to limited-income persons willing to rehabilitate and occupy units.	c/
Mortgage Credit Activities	
Direct Loan Programs. Farmers Home Administration provides market-rate and subsidized home loans in credit-deficient rural areas. Veterans Administration provides market-rate mortgages to qualifying servicemen and veterans.	339
Mortgage Insurance Programs. Federal Housing Administration insures market-rate single-family and multifamily mortgages and subsidized mortgages on assisted housing projects. Farmers Home Administration and Veterans Administration guarantee privately written mortgages in credit-deficient areas.	704

(Continued)

SUMMARY TABLE 1. (Continued)

Program Description	Projected Fiscal Year 1978 Outlay or Revenue Loss
Credit-Market Interventions. Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association purchase and resell mortgages to encourage use of capital for housing and provide limited financing subsidies. Federal Home Loan Banks provide advances to financial institutions to make up temporary credit shortages and stimulate additional lending.	-225 d/
Housing-Related Tax Expenditures	
Homeownership Incentives. Permit deduction of mortgage interest and property tax payments for owner-occupied housing; allow deferral of capital gains on the sale of homes under certain circumstances; and exclude capital gains taxation on the sale of residences by elderly homeowners.	10,655 e/
Promoting Rental Housing Development. Accelerated depreciation allowances for rental housing and the favorable treatment of construction-period interest and property tax payments for developers.	1,010 e/ f/
Tax Benefits for Financial Institutions. Preferential bad-debt deduction allowances for financial institutions that serve as primary sources of residential mortgage credit.	705

(Continued)

SUMMARY TABLE 1. (Continued)

Program Description	Projected Fiscal Year 1978 Outlay or Revenue Loss
Housing and Credit Market Regulations	
<u>Guaranteeing Equal Housing Opportunities</u>. Prohibitions against discrimination in the sale and rental of most housing and in mortgage lending.	NA
<u>Controlling Supply and Cost of Mortgage Credit</u>. Regulations govern maximum interest rates paid on deposits in financial institutions and dictate minimum shares of assets applied to home loans.	NA

a/ Includes expenditures for public housing operating subsidies.

b/ Estimated share of expenditures to be allocated to housing.

c/ New initiative proposed for fiscal year 1979; funded as a demonstration with outlays of $15 million in fiscal year 1978.

d/ Cost of Government National Mortgage Association Special Assistance Functions Fund and Emergency Mortgage Purchase Assistance program only. Operations of Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal Home Loan Banks are off-budget.

e/ Simple arithmetic sum of separate tax expenditures. Because of overlap and interactions among separate expenditures, the total shown does not represent the amount of additional revenue that would be raised if all provisions were repealed simultaneously.

f/ A substantial portion of this amount applies to nonresidential real estate.

Mortgage Credit Activities. Federal direct loan and mortgage insurance programs expand the access of homebuyers to credit and, in certain cases, reduce the cost of home financing. Other mortgage credit activities are designed to increase private lending by providing secondary markets for disposing of residential mortgages. Selected secondary market activities also provide interest subsidies for privately developed assisted housing and for residential development in distressed areas. Still other federal programs directly allocate credit to housing through advances to financial institutions that use the funds for home loans. As of the end of fiscal year 1977, in excess of 900,000 direct federal loans were outstanding, and an additional 8.8 million federally insured or guaranteed home loans were in force. Outstanding advances to financial institutions totaled $17 billion.

Tax Provisions. The federal tax code encourages homeownership by permitting taxpayers to deduct mortgage interest and property tax payments, by allowing persons selling homes to defer taxation on the capital gain if they purchase a new residence, and by excluding some or all of the capital gain on sales by elderly homeowners. Other provisions encourage rental housing development by allowing developers favorable depreciation deductions and permitting them to deduct certain development costs as ongoing business expenses. Preferential bad-debt allowances decrease the tax rate of financial institutions, which serve as the principal sources of mortgage financing, to a level less than half that of other corporations. All of these provisions primarily benefit middle- and upper-income taxpayers. Together, they will account for more than $10 billion in lost revenues during fiscal year 1978.

Housing and Credit Market Regulations. In order to promote equal housing opportunities and expand the access of all homebuyers to credit, federal laws and regulations prohibit discrimination in the sale or rental of most housing and in mortgage lending. Other federal regulations affect the supply and cost of mortgage credit. By governing the types of loans that certain financial institutions may make, regulations assure that a large share of all credit goes towards housing; by controlling the interest rates that financial institutions may pay on deposits, they indirectly control the rates those institutions will charge when they lend funds for mortgages.

RECURRING POLICY ISSUES

The Funding of Housing Assistance Programs. Each year, the Congress must determine the level of funding to be allocated to lower-income housing assistance. Most housing assistance programs involve 15- to 40-year federal commitments funded in advance, and the annual funding decision, therefore, requires both a normative judgment as to the number of additional households to be assisted and an estimate of the spending that will be needed to subsidize their housing costs over extended periods of time. Although spending authority presumed to be sufficient to pay the long-term federal expense is set aside the first year in which a subsidy commitment is to be made, the actual federal obligation is generally to pay the difference between the operating expense of the housing unit, including debt-service costs, and a fixed percentage of the occupants' income. Both of those factors increase over time and are difficult to estimate for years in advance; thus, it is impossible to determine with certainty what initial authorization will prove adequate over the life of a subsidy commitment. The history of federal housing assistance efforts has been one of substantially underestimating their actual long-term costs, making it necessary to authorize additional spending in subsequent years to support prior commitments.

The principal housing assistance programs since 1975 have been Section 8, whose long-term costs are especially difficult to predict, and public housing, which has required substantial annual operating subsidies since the 1960s. New public housing commitments to be entered into during fiscal year 1979 will almost certainly require operating subsidies in the future. Additional funding may also be required in subsequent years to pay the long-term federal obligation associated with Section 8 subsidy commitments. Options for dealing with these long-term funding uncertainties could include:

- o requiring that alternative procedures be used to estimate expected long-term program costs for all programs; and

- o employing alternative funding procedures that would not involve advanced funding.

The Choice of Types of Housing Assistance. In setting the level of funding for housing assistance and the number of households to receive aid, the Congress can also specify the mix

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of new, rehabilitated, and existing housing to be assisted. New construction and substantial rehabilitation programs add to the total supply of housing but may merely substitute for private development. Existing housing aid does not contribute to construction but may improve long-term maintenance. Existing housing assistance also expands the housing opportunities of the families receiving assistance by allowing them to choose where they wish to live. By contrast, new construction and rehabilitation programs limit persons to designated projects, and the contribution of such programs to racial and economic integration therefore depends on the location of the housing projects. Rehabilitation programs may contribute to neighborhood revitalization by targeting development on areas where substandard housing is located. Because of differences in allowable rents, existing housing assistance is less than half as costly per unit as assistance involving either new construction or substantial rehabilitation.

The Adminstration's proposed fiscal year 1979 budget calls for 110,000 additional units of Section 8 new construction, 70,000 units of Section 8 substantial rehabilitation, 56,000 newly built or rehabilitated units of public housing, and 164,000 additional commitments under Section 8 existing housing, including 39,000 units for a new moderate rehabilitation program.

<u>Providing Lower-Income Homeownership Assistance</u>. For each of the past several years, the Congress has provided mortgage assistance enabling a limited number of lower-income families to purchase homes. Both the number of recipients and the extent of the mortgage subsidy have been recurring issues. The Administration has proposed increasing the number of additional families to receive assistance under Section 235 from 30,000 in fiscal year 1978 to 50,000 in fiscal year 1979 and the number of subsidized Farmers Home Administration (FmHA) homeownership loans from 67,200 to 75,000. In addition, proposed changes in Section 235 would allow the program to serve lower-income persons than those who may currently receive assistance, and the Administration has proposed a new FmHA homeownership program for very low-income persons.

Other options available to the Congress for assisting lower-income homeownerships include: expanding eligibility in the Section 8 existing housing program to homeowners; and providing a refundable tax credit for a portion of mortgage interest and property tax payments instead of the current deduction, which benefits mostly higher-income persons. These options would assist both current and potential homeowners. Homeownership tax credits could also extend aid to families with incomes too high to qualify for present housing assistance programs but too low to be benefited by current homeownership deductions.

Encouraging Home Building and Stabilizing Residential Construction Activity. The federal government has sought to encourage residential construction since the enactment of the first housing programs in response to the Depression. In recent years, this concern has focused on stimulating particular types of residential development and reducing the severity of cyclical declines in the homebuilding industry. Tax reforms proposed for fiscal year 1979 would reduce the potential profitability of rental housing but would leave housing relatively more attractive than nonresidential investments and would continue to provide especially favorable tax treatments for lower-income rental housing. Other proposals would phase down certain tax benefits enjoyed by banks and savings and loan associations, thereby reducing the profitability of these primary sources of mortgage credit. This year, the Congress is also considering extending the access of certain types of mortgage lenders to federally controlled secondary mortgage markets--a proposal intended to expand the supply of credit for housing.

The Use of Housing Programs to Encourage Community Development. In recent years, there has been increasing concern that housing programs promote community development as well as housing policy objectives. As part of this thrust, a new program providing limited mortgage interest subsidies for the development of private multifamily rental housing in distressed urban areas is being implemented in fiscal year 1978. The Federal Home Loan Banks will also begin providing funds this year to savings and loan associations that will enable them to lend money for housing rehabilitation at rates below those that would otherwise be possible. HUD has also proposed that a fixed percentage of all Federal National Mortgage Association mortgage purchase commitments be made in inner city areas. Significant expansions in several housing rehabilitation programs proposed for fiscal year 1979 are also likely to promote community revitalization.

CHAPTER I. INTRODUCTION

In fiscal year 1978, the federal government will spend more than $5 billion on housing and will lose more than twice that amount in revenues as a result of housing-related tax provisions. Despite its significant effect on the federal budget and on a major sector of the private economy, housing policy remains among the most confusing and the least understood areas of federal involvement. This confusion is not surprising, for federal housing policy encompasses a complex set of direct housing assistance and community development programs, mortgage credit activities, tax expenditures, and regulations governing housing and mortgage credit markets. Together, these programs address an equally complex set of policy objectives. In addition, federal housing programs are administered by numerous agencies and are funded through numerous budgetary accounts and financing mechanisms.

The scope and complexity of current housing policy, the multiple and often contradictory objectives that policy is intended to address, the difficulties in assessing the effectiveness of often overlapping housing programs, and the changing nature of U.S. housing conditions and needs give rise to a number of recurring issues concerning the appropriate type and mix of housing programs and the distribution of resources among them. This paper seeks to provide the Congress with an overview of the wide range of current federal housing programs and housing-related activities, and an understanding of recurring housing policy issues. Chapter II describes the objectives of federal housing policy, assesses current housing needs, and considers the degree to which federal programs have been responsible for progress already made. Chapter III examines existing housing and community development programs, credit market activities, tax expenditures, and regulatory actions affecting the supply, price, and distribution of housing. Chapter IV describes the budgetary framework of housing policy and program costs. Chapter V examines several housing policy issues, discusses proposals that are likely to be considered by this Congress, and outlines several longer-term policy options.

CHAPTER II. THE OBJECTIVES OF FEDERAL HOUSING POLICY AND CURRENT HOUSING NEEDS

Among the sometimes explicit but often only implicit objectives of federal housing policy are:

- o Ensuring the availability of adequate and affordable housing, particularly among lower-income households;
- o Increasing residential construction and reducing cyclical instability in the home building industry;
- o Increasing the availability of mortgage credit;
- o Encouraging homeownership;
- o Providing equal housing opportunities and encouraging racial and economic integration;
- o Providing housing for individuals with special needs due to age or disability; and
- o Encouraging community development and neighborhood preservation and revitalization.

In the years since federal involvement in housing began, attention has shifted among these objectives, in part because of changes in housing conditions brought about by federal policies. At times pursuit of some of these objectives has been at the expense of gains in another area. This chapter examines the degree to which each objective has been realized, assesses the extent to which federal programs have been responsible for progress already made, and notes current policy concerns.

ENSURING THE AVAILABILITY OF ADEQUATE AND AFFORDABLE HOUSING

A central objective of federal housing policy is to reduce the incidence and severity of housing needs, including: (1) physically substandard housing and hazardous or unhealthy conditions in the immediate environment, (2) overcrowding, and (3) excessive housing costs. When the first federal housing assistance efforts began some 40 years ago, substandard housing and overcrowding were prevalent and were the principal policy concerns. As those problems diminished, interest in addressing the increasingly common problem of excessive housing costs has grown.

Substandard Housing

The incidence of substandard housing has declined dramatically in recent decades. Between 1940 and 1970, the proportion of all occupied housing units 1/ lacking complete plumbing facilities decreased from 45 to about 5 percent; by 1976, the rate had fallen to less than 3 percent. During that same 30-year period, the frequency of dilapidated housing declined from 18 to less than 4 percent of all occupied housing units. 2/ Applying

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1/ The term "housing unit" refers to a house, apartment, group of rooms, or single room occupied or intended for occupancy as separate living quarters. Separate living quarters are those in which the occupants--or intended occupants in the case of vacant units--do not live and eat with any other persons in a structure and which have either (1) direct access from the outside of the building or through a common hall which is used or intended to be used by the occupants of another unit or by the general public or (2) complete kitchen facilities for the exclusive use of the occupants.

2/ The only measures of physical inadequacy available for nationally representative samples of housing units over an extended period of time are those provided by the decennial censuses: the absence of some or all plumbing facilities, and the designation of a unit as "dilapidated." Since 1950, "complete plumbing facilities" has been defined as the presence of hot and cold piped water inside the structure as well as a flush toilet and a bathtub or shower inside the structure for the exclusive use of the occupants of the unit; for the 1940 census, hot running water was not required. The definition of dilapidation has varied over time and has not been applied uniformly to all units during any given decennial count. For the 1960 census, a unit was to be (continued) a more recent and more comprehensive indicator of housing adequacy--one that includes 15 separate variables measuring physical condition--in 1976, only 8 percent of all occupied units were found to need rehabilitation (see Table 1). 3/

Improvements in housing conditions have been especially pronounced among lower-income households. 4/ In 1950, 57 percent of the poorest two-fifths of all households--a population corresponding roughly to the population eligible for federal low- and moderate-income housing assistance programs--were living in units that were dilapidated or lacked complete plumbing; by 1970, the proportion had declined to 14 percent. 5/ Despite these gains, lower-income households remain significantly less well-housed than higher-income persons. As of 1976, approximately 13 percent of all households with annual family

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2/ (continued) classified as dilapidated if it had one or more "critical" defects or two or more "intermediate" defects that rendered the unit "no longer... safe and adequate shelter." For a more complete discussion of measures of housing quality, see Congressional Budget Office, Patterns of Housing Quality (March 1978).

3/ The measure of need for rehabilitation was developed by CBO using data from the Annual Housing Survey, which has been conducted jointly by the Bureau of the Census and the Department of Housing and Urban Development since 1973. See Table 1, footnote b, for the criteria used in classifying a unit as needing rehabilitation.

4/ The term "household" refers to occupants of a single housing unit. The term "family" refers to the head of a household (as designated by the household members) and any person living in the same housing unit who is related to the head by blood, marriage, or adoption. If the head of household lives alone or with nonrelatives only, he or she is considered to be a "primary individual," but not a family. Thus, a household may consist of any combination of individuals, families, or subfamilies sharing a single housing unit.

5/ Unpublished data provided by the Bureau of the Census.

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TABLE 1. TRENDS IN THE PHYSICAL ADEQUACY OF HOUSING, 1940-1976

Criteria of Physical Adequacy	1940	1950	1960	1970	1976
Percent of All Occupied Housing Units					
Lacking some or all plumbing facilities	44.6	34.0	15.2	5.1	2.6
Dilapidated a/	18.1	9.1	5.8	3.7	NA
Lacking some or all plumbing facilities and/or dilapidated	48.6	35.4	17.0	7.4	NA
In need of rehabilitation b/	NA	NA	NA	NA	7.8

SOURCE: Unpublished Census data and CBO analysis of 1976 Annual Housing Survey.

a/ Census definition of dilapidation has varied over time.

b/ A unit was classified as needing rehabilitation if it had at least one of the following conditions: (1) the absence of complete plumbing facilities; (2) the absence of complete kitchen facilities; (3) the absence of either a public sewer connection, a septic tank, or cesspool; (4) three or more breakdowns of six or more hours each time in the sewer, septic tank, or cesspool during the prior 90 days; (5) three or more breakdowns of six or more hours each time in the heating system during the last winter; (6) three or more times completely without water for six or more hours each time during the prior 90 days; (7) three or more times completely without a flush toilet for six or more hours each time during the prior 90 days; and/or if the unit had two or more of the following conditions: (1) leaking roof; (2) holes in interior floors; (3) open cracks or holes in interior walls or ceilings; (4) broken plaster over greater than one square foot of interior walls or ceilings; (5) unconcealed wiring; (6) the absence of any working light in public hallways for multi-unit structures; (7) loose or no handrails in public hallways in multi-unit structures; (8) loose, broken, or missing steps in public hallways in multi-unit structures.

incomes low enough to qualify them for federal housing assistance lived in units needing rehabilitation, as compared with only 4 percent of all middle- and upper-income households. 6/

These gains in housing adequacy have been due largely to increases in real income, which have enabled more persons to afford adequate shelter and to spend more of their income on housing. In addition, during most of the past three decades, the rate of housing production has far exceeded growth in the number of households, resulting in the replacement of large numbers of substandard units. More recently, however, the rate of new construction has declined relative to growth in the number of households. Thus, today, a greater share of the continuing gains in the physical quality of housing has been the result of improvements in existing units, the conversion of nonresidential structures, the renovation of abandoned units, and other means exclusive of new construction.

Federal policy has contributed to overall gains in the availability of adequate housing through its mortgage credit programs and tax provisions, which have increased housing demand and indirectly subsidized the production of new housing. It is not possible, however, to determine how many new housing units would have been built without federal financing or insurance, nor is it possible to measure the net effect of the tax incentives on housing production. Indeed, if these programs have stimulated housing production in areas with an excess supply of adequate units, they may actually have encouraged the abandonment and decay of still-standard structures.

Federal programs designed specifically to improve the housing conditions of lower-income persons have also generally involved the production of new units. Again, however, the net effect of subsidized housing construction on the supply of housing cannot be determined. For one thing, the degree of

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6/ Derived from the 1976 Annual Housing Survey. Eligibility for low- and moderate-income federal housing assistance varies with family size: Individuals with incomes less than or equal to 50 percent of the median for the area may be eligible; the maximum allowable income for families ranges from 64 percent of area median for a family of two to 100 percent of the area median for a family of eight or more.

substitution of assisted housing units for privately built housing is not known. In addition, units constructed specifically for occupancy by low- and moderate-income persons may represent less enduring additions to the housing stock than privately developed housing. In contrast to the many programs encouraging new construction, only a small portion of all direct federal expenditures and tax benefits has gone to the rehabilitation of existing housing.

With severely substandard housing less common today than in the past, attention has shifted to reducing less serious physical deficiencies and the undesirable neighborhood characteristics often associated with marginal housing. This shift in concern has been accompanied by a growing interest in programs that improve existing housing and enable persons to remain in their present dwellings as an alternative to programs that improve housing by replacing inadequate units with new housing and requiring households to relocate.

Overcrowding

A significant reduction in overcrowding has accompanied the improvement in the physical adequacy of housing. Between 1940 and 1976, the proportion of all households with more than 1.5 persons per room declined from 9 percent to 1 percent. The proportion of households with more than 1 person per room decreased from 20 to 5 percent during that same period (see Table 2). Today, overcrowding is uncommon, even among lower-income families. In 1976, only 2 percent of all individuals and families poor enough to qualify for housing assistance were living in units with more than 1.5 persons per room; only 7 percent were living in units with more than 1 person per room. 7/

Many of the same factors that led to improvements in the quality of housing helped reduce crowding. The growth in the average size of housing units and the decline in the average household size have also alleviated overcrowding. Thus, concern in this area currently focuses on assisting large families, for whom crowding remains a problem. 8/

7/ 1976 Annual Housing Survey.

TABLE 2. TRENDS IN OVERCROWDED HOUSING, 1940-1976

Criteria of Overcrowding	1940	1950	1960	1970	1976
Percent of All Households with:					
More than 1.5 Persons Per Room a/	9.0	6.2	3.6	2.0	1.0
More than 1.0 Persons Per Room a/	20.3	15.7	11.5	8.0	4.6

SOURCE: U.S. Department of Commerce, Social Indicators: 1976 Table 3/2, p. 89. Bureau of the Census, Series H-150-76A, Annual Housing Survey: 1976, Part A, General Housing Characteristics, Table A-1, pp. 1-9.

a/ Rooms counted include whole rooms used for living purposes, such as living rooms, dining rooms, bedrooms, kitchens, finished attic or basement rooms, recreation rooms, permanently enclosed porches suitable for year-round use, lodgers' rooms, and rooms used for offices by a person living in the unit.

Excessive Housing Costs

As substandard housing and overcrowding have become less common, the incidence of excessive housing costs has increased. Between 1950 and 1976, the proportion of all renters paying one-fourth or more of their income towards housing increased from 31 to 47 percent. 9/ In 1976, 22 percent of all homeowners

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8/ Of the 2 million low- and moderate-income households with six or more members, 17 percent were living in units with more than 1.5 persons per room in 1976 and 64 percent had more than 1 person per room.

9/ These figures exclude all renters paying no cash rent. Many of these persons perform services for the landlord in lieu of monthly cash payments.

were paying one-fourth or more of their income for housing (see Table 3). Among poorer persons--for whom high housing costs are more likely to represent a real hardship and for whom they are more often a matter of necessity than of choice--heavy housing cost burdens are especially common. In 1976, 61 percent of all renters with an annual income of less than $10,000--including those paying no cash rents--were paying more than one-fourth of their income on housing; 19 percent were paying more than one-half of their income for shelter. For homeowners with an income below $10,000, the comparable figures were 39 and 10 percent. The incidence of excessive housing costs drops off sharply for families and individuals with an income of $10,000 or more (see Table 4).

TABLE 3. PERCENT OF HOUSEHOLDS PAYING 25 PERCENT OR MORE OF ANNUAL FAMILY INCOME FOR HOUSING, BY TENURE: 1950-1976 a/

Tenure	1950	1960	1970	1976
Renters b/	30.8	35.2	39.6	46.6
Homeowners c/	NA	NA	NA	21.7

SOURCE: 1950-1970 Censuses of Housing and 1976 Annual Housing Survey.

a/ Housing costs for renters include rent payments due the landlord, plus utility and fuel costs not included in the rental payment. Housing costs for homeowners include principal and interest payments on the mortgage, real estate taxes, property insurance, utilities, fuel, and garbage and trash collection.

b/ Excludes households paying no cash rents and all others for whom rent-to-income ratios are not computed or reported by the Bureau of the Census.

c/ Limited to owner-occupants of single-family homes on less than ten acres and with no business on the property.

TABLE 4. PERCENT OF SPECIFIED HOUSEHOLDS PAYING 25 PERCENT OR MORE OF FAMILY INCOME FOR HOUSING, BY ANNUAL FAMILY INCOME, 1976 a/

Ratio of Housing Costs to Income	Annual Family Income $0–$9,999	$10,000–$19,999	$20,000 or more	All Households
Renters b/				
More than 0.50	18.5	0.3	0.1	10.8
More than 0.35	37.8	2.0	0.2	22.6
More than 0.25	61.1	10.9	1.3	39.0
Homeowners c/				
More than 0.50	9.7	0.4	d/	3.0
More than 0.35	23.1	3.2	0.3	8.0
More than 0.25	39.0	15.4	3.9	19.3

SOURCE: CBO analysis of 1976 Annual Housing Survey.

a/ All percentages expressed as a proportion of total number of households for whom a ratio of housing cost to income is reported.

b/ Excludes renters residing in single-family homes on ten acres or more.

c/ Limited to single-family homes on less than ten acres and with no business on the property.

d/ Less than 0.05 percent.

A number of federal programs are designed to reduce housing costs, with different programs benefiting different income groups. Federal tax provisions that permit homeowners to deduct mortgage interest payments and state and local property taxes from their taxable income benefit principally middle- and upper-income taxpayers. Direct loan and mortgage insurance programs reduce the housing costs of large numbers of moderate-income homeowners by providing somewhat more favorable financing than would otherwise be available. Relief for lower-income households is provided primarily through housing assistance programs, which generally reduce participants' housing costs to between 15 and 25 percent of their income, but serve only a small fraction of all eligible persons. 10/

In the past, when the supply rather than the cost of standard housing was the more salient issue, subsidizing the construction of units that would be available to only a small proportion of those in need was not considered to be a serious shortcoming of housing assistance programs. With recent increases in the supply of physically standard units, however, attention has shifted from producing more housing towards making existing housing affordable to more persons. It has thus been argued that the funding needed to subsidize construction of a limited number of new units, at considerable expense per assisted household, can assist many more families occupying already existing units. In addition, the limited availability of funds for housing assistance, the large number of lower-income families paying extremely high proportions of their income for housing, and the increased level of housing costs among all households have led some to question the appropriateness of maintaining the 25 percent rent-to-income ratio required of tenants in most federally assisted housing. If that ratio were increased, the federal cost per assisted household would be reduced, more persons could receive assistance for the same level of funding, and the gap in housing costs between recipients and nonrecipients would not be as great as it is today. On the other hand, of course, the benefit per assisted household would be lower than it is now.

10/ As of October 1977, fewer than 3 million households were receiving assistance under lower- and middle-income housing assistance programs administered by the Department of Housing and Urban Development (HUD) and the Farmers Home Administration (FmHA). That number represents less than 10 percent of the income-eligible population. (Data on number of assisted households provided by HUD and FmHA; the estimate of the eligible population is based on CBO analysis of the 1976 Annual Housing Survey.)

INCREASING RESIDENTIAL CONSTRUCTION AND REDUCING INSTABILITY IN THE HOMEBUILDING INDUSTRY

Since the Great Depression, there has been a continuing presumption that federal policy should encourage residential construction and mitigate the cyclical declines that characterize the industry. The cyclical instability of residential construction has obvious short-term costs for housing producers and their employees as well as long-term costs for housing consumers, who are forced to pay the premium charged in an uncertain market. Still, despite numerous federal interventions, cyclical swings have persisted and have shown no signs of diminishing in severity. Over the past ten years, annual shifts of more than 30 percent in the production of multifamily housing have been common (see Table 5).

TABLE 5. PRIVATELY OWNED SINGLE-FAMILY AND MULTIFAMILY HOUSING CONSTRUCTION STARTS: CALENDAR YEARS 1967-1976, UNITS IN THOUSANDS

	Single-Family Housing		Multifamily Housing	
Year	Number of Units Started	Percent Change from Prior Year	Number of Units Started	Percent Change from Prior Year
1967	844		447	
1968	900	+ 6.6	608	+ 36.0
1969	811	- 9.9	656	+ 7.9
1970	813	+ 0.2	620	- 5.5
1971	1,151	+ 41.6	900	+ 30.1
1972	1,309	+ 13.7	1,047	+ 16.3
1973	1,132	- 13.5	913	- 12.8
1974	888	- 21.6	450	- 50.7
1975	892	+ 0.5	269	- 40.2
1976	1,163	+ 30.4	374	+ 39.0

SOURCE: U.S. Department of Housing and Urban Development, 1976 Statistical Year Book.

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Many factors can affect the level of residential construction. Some are sector-specific--such as the availability and price of construction materials and labor or temporary imbalances between supply and demand in local housing markets--and some are common to the economy as a whole--such as the availability and cost of credit. Most federal programs designed to encourage private housing production focus on assuring an adequate supply of mortgage credit, increasing the demand for housing, or increasing the profitability of real estate investments. In addition, the federal government subsidizes the construction and operation of privately and publicly owned assisted housing for lower-income persons. Few federal housing programs are operated specifically as countercyclical devices.

Direct financing and loan guarantee programs can increase the overall supply of mortgage credit but they have not been notably successful in affecting credit availability during periods of tight money. Federal regulations and tax preferences giving certain types of financial institutions a competitive edge in attracting investments are also intended to increase the supply of mortgage credit, but they are generally not specifically designed as countercyclical tools. Programs involving the purchase and resale of privately written mortgages and the direct allocation of credit to mortgage lenders are especially amenable to use as countercyclical devices because of their short-term controllability; however, many of these programs have been only recently implemented. Federal tax expenditures subsidizing homeowership and increasing the profitability of investments in certain types of rental housing also stimulate construction. But because these tax benefits are available on an entitlement basis--that is, they are available to every eligible taxpayer who chooses to avail himself of them--the government cannot turn them on and off over short periods of time, which limits their utility as countercyclical devices.

Federally subsidized housing built specifically for lower-income persons contributes to overall residential construction, but assisted housing represents a small fraction of total production and may merely substitute for construction that would have occurred in any event. In addition, the lead time required between a federal subsidy commitment and a construction start limits the usefulness of assisted housing programs as countercyclical tools. Discontinuities in the administration of assisted housing programs have also reduced their effectiveness as mechanisms for stabilizing housing production. 11/ Nonetheless, pressure to use assisted housing programs for that purpose has historically been great.

EXPANDING ACCESS TO CREDIT

Expanding prospective homebuyers' access to mortgage credit in order to increase homeownership and to counter discriminatory aspects of private credit markets is another objective of federal housing policy. The difficulty of obtaining mortgage credit in sparsely populated rural areas or in racially concentrated and economically declining urban areas has been of particular concern.

The government allocates credit directly to housing through a number of home loan programs. Some provide financing, on terms preferable to those available in the private market, to lower-income persons who could not qualify for conventional mortgages. Other mortgage credit programs subsidize the interest on privately written home loans to lower-income borrowers. The government also guarantees or insures large numbers of unsubsidized privately written home loans. Through those activities, the federal government is a major force in the mortgage credit market. Of the $558 billion in outstanding mortgage debt on nonfarm, one- to four-family houses at the end of 1976, 14 percent was held by some agency of the U.S. government and 24 percent was government-insured. During the past 15 years, the federally held share of the total mortgage debt has grown while the share that is federally guaranteed or insured has decreased (see Table 6).

Barriers to credit in rural areas have been dealt with primarily through direct loan programs administered by the Farmers Home Administration. Credit barriers in urban areas have been addressed through a combination of high-risk mortgage

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11/ From 1968 through 1972, federally subsidized housing starts averaged 182,000 units and constituted 23 percent of all multifamily housing starts each year. In January 1973, a moratorium was imposed on additional subsidy commitments; during the years 1973 through 1975, the number of subsidized housing starts declined to 56,000 annually, or 10 percent of the yearly production.

insurance for privately written loans in declining areas and regulations governing the practices of private lending institutions.

TABLE 6. AMOUNT AND PERCENT OF OUTSTANDING MORTGAGE DEBT ON NONFARM ONE- TO FOUR-FAMILY HOMES, FEDERALLY HELD OR FEDERALLY INSURED OR GUARANTEED, 1960-1976: IN BILLIONS OF DOLLARS

Calendar Year	Total Debt Outstanding End of Year	Federally Held a/		Federally Insured or Guaranteed b/	
		Dollars	Percent of Total	Dollars	Percent of Total
1960	141.3	7.1	5.0	56.6	40.1
1965	212.9	6.4	3.0	73.1	34.3
1970	280.2	22.1	7.9	97.2	34.7
1971	328.9	29.9	9.1	105.2	32.0
1972	372.8	35.2	9.4	112.9	30.3
1973	416.9	40.7	9.8	116.2	27.9
1974	449.9	52.0	11.6	121.3	27.0
1975	491.6	66.0	13.4	127.7	26.0
1976	558.4	77.6	13.9	133.5	23.9

SOURCE: 1976 HUD Statistical Yearbook, p. 297.

a/ Includes mortgages held by Federal Housing Administration, Federal National Mortgage Association, Farmers Home Administration, and Veterans Administration.

b/ Includes mortgages insured by FHA or guaranteed by VA.

ENCOURAGING HOMEOWNERSHIP

Related to the federal goal of expanding access to mortgage credit is the broader objective of encouraging homeownership. Partly as a consequence of federal incentives and subsidies, the rate of homeownership in the United States is high and it has risen steadily for the past four decades. As of 1976, 65 percent of all households owned their own homes; nearly half of all households with annual incomes of less than $10,000 are owner-occupants.

Despite the increasingly high rates of homeownership, sharp increases in housing costs in recent years have given rise to concerns about the ability of would-be homebuyers--of lower-income and young families, in particular--to purchase homes. Data on the effects of rising costs on the rate and affordability of homeownership are mixed. In the years between 1970 and 1976--when homeownership costs as measured by the Consumer Price Index increased by 49 percent in comparison to a 52 percent increase in the median family income--the rate of homeownership continued to grow, but at a slower pace than during the two preceding decades. The homeownership rate among households with incomes low enough to qualify for federal homeownership assistance--generally less than 95 percent of the median income for the area of residence--actually declined slightly between 1974 and 1976, from 53.5 percent to 52.4 percent. Rising costs have apparently not deterred young families from becoming homeowners. The rate of homeownership among husband-wife households in which the head of household is less than 30 years old increased from 39 percent in 1970 to 48 percent in 1976. 12/ Regarding affordability, although it is true that recent first-time homebuyers are allocating an increasing share of their income to housing, the housing cost burden for most such buyers remains within, or only slightly above, the guidelines reflected in federal assistance programs. The median proportion of income devoted to housing for all renters who bought homes in 1976 was 22 percent, up by one percentage point from 1974; for buyers with an annual income of less than $10,000, the median ratio of housing costs to income was 34 percent, reflecting a considerably greater burden (see Table 7).

Federal programs facilitating or subsidizing homeownership include tax provisions that primarily benefit middle- and upper-income households; loan insurance and loan guarantee programs, which facilitate homeownership for many moderate-income households; and mortgage subsidy programs, which aid a small number of lower-income homebuyers. There are, however, no large-scale programs designed specifically to reduce housing costs for lower-income persons who have already purchased homes.

12/ 1976 Annual Housing Survey.

TABLE 7. DISTRIBUTION OF RATIOS OF HOUSING COSTS TO INCOME AMONG RENTERS BUYING HOMES IN 1976, BY ANNUAL FAMILY INCOME

Annual Housing Costs as Percent of Annual Family Income a/	Annual Family Income			All Renters Buying Homes
	$0 - $9,999	$10,000- $19,999	$20,000 or more	
Less than 20	16.0	36.0	74.4	45.9
21 to 30	29.0	44.1	22.4	33.9
31 to 40	20.8	15.5	2.9	12.0
41 to 50	16.9	2.6	0.3	4.3
Greater than 50	17.4	1.9	—	3.9
Total	100.0	100.0	100.0	100.0
Median Ratio of Housing Costs to Income	0.34	0.24	0.17	0.22

SOURCE: CBO analysis of 1976 Annual Housing Survey.

a/ Housing costs include principal and interest payments on mortgage, real estate taxes, property insurance, utilities, fuel, water, and garbage and trash collection for unit purchased.

PROVIDING EQUAL HOUSING OPPORTUNITIES

Assuring equal housing opportunities is another explicit objective of federal policy. Federal statutes prohibit racial discrimination in the sale or rental of most housing and ban discrimination in mortgage lending on the basis of race, religion, national origin, sex, marital status, or age. The prohibition against discrimination has been expanded in federally assisted housing into a requirement that owners take affirmative action to encourage residential integration.

Despite de jure prohibitions against unfair sale, rental, and credit activities, discriminatory practices persist. 13/

13/ Housing and Development Reporter, vol. 5 (April 1978), p. 1115.

There is also evidence that residential segregation in metropolitan areas has been increasing, as recently as the 1960s. 14/ Partly as a result of that segregation, significant disparities in housing conditions exist between black and white households. As of 1976, black households with an annual income of less than $10,000 were more than twice as likely to live in units needing rehabilitation as were their white counterparts. Overall, black households were three times more likely than whites to live in inadequate units, reflecting the lower average income among blacks (see Table 8).

TABLE 8. PERCENT OF HOUSEHOLDS OCCUPYING UNITS IN NEED OF REHABILITATION, BY ANNUAL FAMILY INCOME AND RACE, 1976 a/

	Annual Family Income			
Race of Head of Household	$0 - $9,999	$10,000- $19,999	$20,000 or more	All Households
Black	24.9	11.5	7.1	19.6
White	10.6	4.7	2.4	6.4

SOURCE: CBO analysis of 1976 Annual Housing Survey.

a/ Need of rehabilitation defined in note to Table 1.

PROVIDING HOUSING FOR SPECIAL USERS

Another goal of federal housing policy is to provide assistance to persons with special housing needs due to age or disability. With nearly 20 percent of all households headed by a person aged 65 years or older and with estimates of the proportion of all handicapped persons running as high as 10 percent, the potential special housing need is great. Reliable data on the degree to which private market forces are already meeting this need are not available.

14/ See Ann B. Schnare, Residential Segregation by Race in U.S. Metropolitan Areas (The Urban Institute, 1977).

Federal direct loan programs subsidize the development of rental projects designed to accommodate the unique requirements of the elderly and handicapped. In addition, low-rent projects developed under other federally assisted housing programs may be designated for the exclusive use of the elderly or the handicapped, and a portion of all units in housing projects for the non-aged may be designed for handicapped individuals.

ENCOURAGING COMMUNITY DEVELOPMENT AND NEIGHBORHOOD PRESERVATION AND REVITALIZATION

In recent years, federal housing programs have also sought to support the broader objective of community development. The goal of community development has, in turn, been expanded to encompass not only the traditional notions of economic and commercial development but also that of socially viable neighborhoods. Although reliable measures of social viability are not available, data on neighborhood blight and inadequate services indicate that reports of undesirable neighborhood conditions are not limited to lower-income households or urban areas (see Table 9). Reports of undesirable neighborhood characteristics have increased slightly in the last few years, a trend that may reflect a greater sensitivity toward neighborhood amenities as well as an actual decline in conditions.

Federal housing programs seek to support community development and revitalization by encouraging higher-income households to relocate in currently low-income urban areas, by acting as a catalyst to commercial development in disadvantaged areas, by slowing the decline of marginal neighborhoods through the rehabilitation of deteriorating but salvageable housing, and by enabling lower-income families to maintain their homes in areas undergoing revitalization. But, to the extent that such federal assistance is used to preserve currently homogeneous neighborhoods, it conflicts, of course, with the objective of encouraging racial and economic deconcentration. Similarly, programs that encourage higher-income persons to move into economically distressed areas result in the displacement of lower-income persons and tend to increase the housing costs of those who remain.

TABLE 9. PERCENT OF HOUSEHOLDS REPORTING SELECTED UNDESIRABLE NEIGHBORHOOD CONDITIONS, BY ANNUAL FAMILY INCOME AND LOCATION, 1976

Location and Condition Reported	Annual Family Income: $0 - $9,999	$10,000- $19,999	$20,000 or more	All House- holds
Central Cities of Large Metropolitan Areas a/				
Litter, abandoned, or rundown but occupied buildings	34.1	28.4	23.3	30.1
Inadequate transportation	10.8	13.1	19.7	13.3
Inadequate shopping	13.4	9.8	8.7	11.3
Inadequate police protection	12.9	10.4	10.0	11.5
All Other Areas				
Litter, abandoned, or rundown but occupied buildings	23.0	21.1	16.6	20.7
Inadequate transportation	42.3	46.7	49.1	45.5
Inadequate shopping	16.0	13.6	11.5	14.1
Inadequate police protection	10.5	9.5	7.7	9.4

SOURCE: CBO analysis of 1976 Annual Housing Survey.

a/ Large metropolitan areas are Standard Metropolitan Statistical Areas with populations of 250,000 or greater in 1970.

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CHAPTER III. CURRENT HOUSING PROGRAMS

Numerous housing programs--varying widely in scope and design--have evolved over the years to respond to changing housing needs and to address the changing housing policy objectives of the federal government. This chapter describes current housing programs and discusses the effects of each on the policy objectives outlined earlier. The overlap among programs and objectives--with each program addressing several objectives and each objective served by many programs--makes it impossible, however, to determine the independent effect of each element of current policy. Table 10 summarizes the primary and secondary policy objectives of current federal housing programs.

HOUSING ASSISTANCE PROGRAMS

The Department of Housing and Urban Development (HUD) administers several programs designed to reduce the housing costs of lower-income persons and to provide them with physically standard housing. The principal federal housing assistance programs are: (1) low-rent public housing, (2) Section 8 new construction/substantial rehabilitation, (3) Section 8 existing housing, (4) Section 235 homeownership assistance, (5) Section 236 rental assistance and (6) rent supplements. For thirty years following its authorization in 1937, the public housing program served as the federal government's primary housing assistance mechanism. The Section 235, Section 236, and rent supplement programs were authorized during the late 1960s and were the most heavily utilized programs for several years thereafter. In 1973, activity under all of these programs was halted under a national moratorium imposed by the Nixon Administration. Housing assistance activity resumed with the passage of the 1974 Housing and Community Development Act, which authorized the Section 8 programs. Since then, Section 8, public housing, and a revised Section 235 program have been the most heavily used housing assistance devices. During fiscal year 1978, federal outlays for assisted housing are expected to total about $4 billion. Table 11 describes the status of the assistance programs as of 1977.

TABLE 10. PRIMARY AND SECONDARY OBJECTIVES OF CURRENT FEDERAL HOUSING PROGRAMS AND HOUSING-RELATED ACTIVITIES a/

Federal Housing Programs and Activities	Providing Adequate and Affordable Housing	Increasing or Stabilizing Residential Construction Activity	Expanding Access to Mortgage Credit	Encouraging Homeownership	Ensuring Equal Housing Opportunity	Providing Housing for Special Users	Encouraging Community Development and Neighborhood Preservation and Revitalization
Housing Assistance Programs							
Low-rent public housing	XX	XX			X	X	X
Section 8 new construction/ substantial rehabilitation	XX	XX			X	X	X
Section 8 existing housing	XX				XX		X
Section 235 homeownership assistance	XX	XX	XX	XX	X		
Section 236 rental assistance and rent supplements	XX	XX				X	
Section 202 elderly/handicapped housing	XX	XX	X			XX	
Community Development Programs							
Community development block grants	X						XX
Urban development action grants							XX
Section 312 rehabilitation loans	XX	X	X				XX
Urban homesteading	X			XX			XX
Mortgage Credit Activities							
FmHA direct loans	XX	XX	XX	XX			
VA direct loans		X	XX	XX			
FHA insured loans		X	XX	XX			
VA insured Loans		X	XX	XX			
FNMA, GNMA, FHLB and FHLMC secondary mortgage market activities		XX	XX	XX			

(Continued)

TABLE 10. (Continued)

Federal Housing Programs and Activities	Providing Adequate and Affordable Housing	Increasing or Stabilizing Residential Construction Activity	Expanding Access to Mortgage Credit	Encouraging Homeownership	Ensuring Equal Housing Opportunity	Providing Housing for Special Users	Encouraging Community Development and Neighborhood Preservation and Revitalization
Tax Expenditures							
Deduction of mortgage interest and property tax payments		X		XX			
Deferrals and exclusions of capital gains on sales of homes		X		XX			
Favorable depreciation for rental housing	X	XX					
Favorable treatment of construction-period development costs	X	XX					
Preferential treatment of real estate tax shelter	X	XX					
Tax benefits for financial institutions	X	XX	X				
Housing and Credit-Market Regulations							
Prohibitions against discrimination in sale/rental of housing and mortgage lending			XX		XX		
Regulation of financial institutions and mortgage credit markets		XX	XX	XX			

Note: XX = Primary Objectives
X = Secondary Objectives

a/ The classification scheme presented here is based on similar typologies developed by several housing analysts. It is meant to depict the key relationships between programs and policy objectives; it is not intended to be exhaustive of possible program effects.

TABLE 11. APPROXIMATE NUMBER OF ASSISTED HOUSING UNITS OCCUPIED AND IN PROCESS, BY PROGRAM, 1977 a/

Number of Housing Units	All Programs	Public Housing	Section 8 New Construction/ Substantial Rehabilitation	Section 8 Existing Housing	Section 235 Original Program b/	Section 235 Revised Program c/	Section 236 and Rent Supplements
Currently Occupied	2,448,300	1,147,700	30,000	327,800	287,300	7,500	648,000
In Processing Pipeline							
Available for occupancy but not occupied	188,400	29,400	12,900	146,100	---	---	---
Under construction	188,400	62,700	117,800	---	---	6,300	1,600
With initial commitments; construction not yet begun, subsidy contracts not yet executed	357,200	85,100	205,000	57,800	---	9,300	---
Without initial commitments	425,900	66,400	177,600	152,500	---	29,400	---
Subtotal	1,159,900	243,600	513,300	356,400	---	45,000	1,600
Total	3,608,200	1,391,300	543,300	684,200	287,300	52,500	649,600

SOURCE: HUD Budget Office.

a/ Data for Section 8 and the revised Section 235 program are as of December 31, 1977. Data for public housing, the original Section 235 program, Section 236, and Rent Supplements are as of September 30, 1977.

b/ Suspended in 1973.

c/ Initiated in 1975.

Although all assisted housing programs serve limited-income persons, each program assists a somewhat different group of families and individuals. Section 8, public housing, and rent supplements serve the poorest households, those with an average annual income between $3,500 and $4,500; Section 236 serves somewhat higher-income persons; the Section 235 program serves the highest-income persons among those receiving housing assistance (see Table 12).

Low-Rent Public Housing

The low-rent public housing program funds the construction or the purchase and rehabilitation costs (including financing expenses), and a portion of the operating expenses, of rental projects that are owned and managed by state or local government agencies and made available to lower-income tenants at reduced charges. Public housing is generally limited to low- and moderate-income families and to elderly, handicapped, or displaced individuals. Tenant rental and utility charges are limited to a total of not more than 25 percent of adjusted family income. As of the end of fiscal year 1977, nearly 1.2 million public housing units were available for occupancy, with more than 40 percent designated for elderly or handicapped persons. 1/

In addition to being designed as a mechanism for providing lower-income persons with physically standard low-cost housing, public housing is also viewed as a means of increasing housing production. Nevertheless, during the last 20 years, public housing construction and rehabilitation starts have averaged only about 36,000 units annually and that figure has exceeded 50,000 only four times during that period. 2/ Further, there is no way of determining the extent to which public housing construction may be merely substituting for private development. By building units specifically designed for the elderly or handicapped or for large families, public housing may, however, serve special housing needs inadequately met by the private market.

1/ HUD, Summary of the HUD Budget, Fiscal Year 1979, p. H-10.

2/ HUD, 1976 Statistical Year Book, p. 158.

TABLE 12. SELECTED CHARACTERISTICS OF RECIPIENT HOUSEHOLDS IN CURRENT MAJOR HOUSING ASSISTANCE PROGRAMS, 1977 a/

Household Characteristics	Section 8 New Const'n/ Substantial Rehab.	Section 8 Existing Housing	Public Housing	Section 235 Original Program	Section 235 Revised Program	Section 236	Rent Supple- ments
Average Family Income b/	$4,376	$3,506	$3,691	$8,085	$11,532	$6,285	$3,544
Annual Family Income (as a percent of all households)							
Below $3,000	27.7	37.3	35.4	NA	NA	NA	NA
$3,000 to $4,999	39.0	38.6	32.6	NA	NA	NA	NA
$5,000 to $6,999	21.6	16.0	15.4	NA	NA	NA	NA
$7,000 to $9,999	10.0	7.1	9.6	NA	NA	NA	NA
Above $10,000	1.7	1.0	6.9	NA	NA	NA	NA
Percent of All Households with Some Welfare Income	16.2	26.7	42.6	NA	NA	NA	NA
Percent with Minority Head	27.7	29.8	62.9	NA	23.0	NA	NA
Percent with Elderly Head	42.9	33.4	35.8	NA	2.1	26.0	31.0
Percent with Handicapped Member	2.0	2.3	1.2	NA	NA	NA	NA
Household Size (as percent of all households)							
Single person	43.1	36.0	33.3	NA	NA	NA	NA
2-4 persons	50.9	53.3	45.2	NA	NA	NA	NA
5-6 persons	5.4	8.4	14.6	NA	NA	NA	NA
7 or more persons	0.6	2.3	6.9	NA	NA	NA	NA

SOURCE: HUD Office of the Budget.

a/ Data for Section 8 are as of June 1977; data for public housing, the original Section 235 program, Section 236, and rent supplements are as of September 1977; data for the revised Section 235 program are as of December 1977.

b/ Figure reported is the mean family income for the original Section 235 program, Section 236, and rent supplements. Median family income is reported for Section 8, public housing, and the revised Section 235 program.

During the years of large-scale urban redevelopment, in the 1950s and 1960s, public housing was viewed as a tool for dealing with displaced households and encouraging the creation of heterogeneous neighborhoods in redeveloped areas. The program has been used more recently as a means of expanding the housing opportunities of lower-income families and minorities in areas previously closed to them. The overall record of the public housing program in promoting either redevelopment or residential integration has, however, not been good; in fact, some critics have argued that public housing has actually contributed to segregation and urban decay by accelerating the flight of whites and higher-income families from racially mixed and declining areas.

Section 8 New Construction/Substantial Rehabilitation

The Section 8 new construction/substantial rehabilitation programs provide assistance on behalf of lower-income households occupying newly built or significantly rehabilitated units that meet certain criteria as to cost, physical adequacy, and location. Under these programs, public agencies or private sponsors develop housing projects in which a portion of the units are made available to low- and moderate-income renters at reduced costs. The difference between the HUD-established allowable rent for each unit and the household contribution--limited to 15-25 percent of family income--is made up by regular payments from HUD to the project owner/manager. Assistance contracts between HUD and project sponsors cover five-year periods and are renewable at the owner's discretion for 20 to 40 years, depending on the type of sponsor and the kind of financing used. Income limits for Section 8 assistance recipients are set at approximately 80 percent of the area median. Only about 30,000 new construction/substantial rehabilitation units were occupied as of December 1977, but more than 500,000 units were in the processing pipeline. 3/

The brief time these programs have been underway precludes firm conclusions concerning their effects. Although they are intended to encourage the production of additional housing by guaranteeing an income stream to potential developers, interest

3/ Data provided by HUD Office of the Budget.

among private developers has not been strong during the initial implementation period. Further, concerns have been raised that the interest the developers have shown may merely reflect a desire to have a federal guarantee of rental income for units that will be made available to lower-income persons only if unassisted tenants cannot be found. 4/

The effect of the Section 8 new construction and substantial rehabilitation programs on racial and economic integration will depend largely on the location of Section 8 projects and the ability of project managers to maintain a demographic mix among tenants. Anecdotal evidence suggests that the new construction program may be somewhat more successful in locating projects in desirable neighborhoods than earlier subsidy programs have been. 5/ The designation of nearly all Section 8 new construction/substantial rehabilitation projects as 100-percent subsidized suggests, however, that the program may be less successful in maintaining economically mixed projects than had been expected. The substantial rehabilitation program may be especially useful in promoting neighborhood revitalization; it may also encourage economic integration, if the projects enable lower-income persons to remain in previously depressed areas undergoing housing cost increases.

Section 8 Existing Housing

The existing housing component of the Section 8 program provides assistance on behalf of lower-income households occupying physically adequate, moderate-cost rental housing of their own choosing in the private market. Public housing agencies

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4/ Despite a stated preference for economically mixed housing, most Section 8 projects currently in the processing pipeline involve a presumption of 100-percent occupancy by assisted households, indicating an apparent desire on the part of the developer for the maximum guarantee available. There is also some evidence of private sponsors withdrawing from tentative commitments.

5/ U.S. Department of Housing and Urban Development, Lower-Income Housing Assistance Program, Section 8: Interim Findings of Evaluation Research (February 1978).

under contract to HUD subsidize the housing costs of lower-income families by paying their landlords the difference between the tenants' rental fee and the tenants' contribution of 15 to 25 percent of their monthly income. All housing units must meet standards of physical adequacy, must be located within the jurisdiction served by the local agency, and must rent for an amount equal to or less than a HUD-established maximum. Beyond these restrictions, assisted households are free to select the location and type of housing, so long as the landlord is willing to enter into a lease with the tenant and a participation agreement with the administering agency. The reliance on the initiative of the household and the latter's freedom to choose from among existing rental units in the private market distinguish this program from all other federal housing assistance efforts. After some initial delays, implementation of this program has been quite smooth and much more rapid than has been the case with the new construction and substantial rehabilitation programs. As of December 1977, more than 300,000 households were receiving assistance under the Section 8 existing housing program. 6/

The most obvious effect of the Section 8 existing housing program has been on recipients' housing costs. Of households receiving assistance in October 1976, the average share of their income going towards housing before joining the program was in excess of 40 percent; after enrollment, that figure dropped to between 20 and 25 percent. The effect of the program on recipients' housing conditions has been less striking. About half of all households receiving assistance remained in their original units, only a minority of which had to be upgraded in order to enter the program. 7/ But studies of similar programs indicate that, in the absence of a requirement that households live in physically adequate units, many families living in standard housing would either move to substandard housing or allow their units to deteriorate. 8/

6/ Data provided by HUD Office of the Budget.

7/ HUD, Lower-Income Housing Assistance Program Section 8: Interim Findings of Evaluation Research (February 1978).

8/ Abt Associates, Inc., Housing Expenditures Under a Housing Gap Housing Allowance (Cambridge, Mass.: Abt, May 1977).

There is no evidence that the demand generated by an existing housing program is sufficient to induce the construction of new units. On the other hand, this type of program does not appear to inflate housing costs--a commonly expressed fear--even when assisted households constitute a substantially greater proportion of a local market than is now the case with Section 8 households. 9/

One of the arguments in support of this kind of program is that it can both promote racial and economic deconcentration and revitalize neighborhoods. Available evidence indicates that although it does not induce mobility, when minority-headed households receiving this type of assistance do move, they are indeed more likely to relocate in areas of lower concentrations of minority households. Its effects on neighborhood revitalization, on the other hand, appear to be minimal.

Section 235 Homeownership Assistance

The Section 235 program provides mortgage assistance to lower-income households purchasing new or substantially-rehabilitated homes. Families with an income of up to 95 percent of the area median may buy modest homes at a reduced rate of interest on the mortgage, with HUD making up the difference between the family's payment and the amount due the mortgagee.

The Section 235 program was first authorized in 1968 and was suspended in 1973 as part of the national moratorium on housing assistance programs. Because program rules permitted minimal downpayments and effective interest rates as low as 1 percent many families unable to handle the financial burden became homeowners under this program. In addition, many only marginally adequate or completely inadequate units were certified as eligible for the program. As a result, more than 15 percent of all the homes purchased under the original Section 235 program have already been acquired by HUD, often in barely

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9/ The Rand Corporation, Fourth Annual Report of the Housing Assistance Supply Experiment: Executive Summary (Santa Monica, California: Rand, March 1978).

salvageable condition. 10/ Section 235 was reinstated in 1975, with the minimum effective rate of interest to the buyer raised to 4 percent and the minimum downpayment set at 3 to 5 percent of the purchase price. The tighter restrictions, designed to reduce the problem of defaults, have limited program activity: in the two years since the reinstatement of the program, subsidy commitments were made for only about 23,000 homes. 11/

The principal effects of the Section 235 program have been on the level of residential construction and the incidence of homeownership among lower-income households. During the years in which the original Section 235 program was active, units built under the program represented as much as 6 percent of the annual number of single-family housing starts. 12/

Section 236 Rental Assistance and Rent Supplements

The Section 236 program, authorized in 1968, provides mortgage interest subsidies to developers of rental projects in which a portion of the housing units are made available to lower-income persons at reduced rates. The interest subsidy alone is sufficient to reduce tenant rental payments to an average of about 30 percent of family income. Additional subsidies are provided on behalf of the occupants of some of the units through rent supplement payments, Section 8 assistance, or "deep subsidy" payments specifically authorized for use in conjunction with Section 236. This piggybacking of those subsidies, which are paid to the project owner, permits tenants' rents for some units to be reduced to 25 percent of their income without jeopardizing the financial viability of the projects. Despite these multiple subsidies, Section 236 has been plagued by the defaults that characterized the original Section 235 program. More than 14 percent of the approximately 4,000 Section 236 mortgages written through 1976, had been assigned to HUD by the mortgagee or

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10/ HUD, Summary of HUD Budget, Fiscal Year 1979, pp. 52, 91, and 92.

11/ Data provided by HUD Office of the Budget.

12/ HUD, 1976 Statistical Yearbook, pp. 50 and 278.

foreclosed by the end of that year. 13/ A small number of new subsidy commitments are still being made under the program, utilizing spending authority released by the Congress before the 1973 housing moratorium.

The rent supplement program was authorized in 1965 to provide payments to the owners of private rental housing on behalf of lower-income tenants, but it has been used primarily to reduce rental charges in Section 236 and other mortgage subsidy projects. As of the end of fiscal year 1977, there were active rent supplement commitments for approximately 180,000 units.

Section 202 Housing for the Elderly and Handicapped

The Section 202 program provides direct federal loans to nonprofit organizations developing rental housing for the elderly and the handicapped. Under the original Section 202 program authorized in 1959, loans were written at a 3 percent rate of interest and the program primarily benefited persons with incomes too high to qualify for public housing. The program in that form was suspended in 1970, but it was reinstituted in 1974 with the interest charge raised to slightly above the yield on all outstanding Treasury obligations--an interest rate more nearly approximating that of conventional financing. Projects developed under the revised Section 202 program also carry a Section 8 subsidy, which enables the rents of lower-income families and individuals to be reduced to a maximum of 25 percent of their income. To date, the Section 202 program has been used primarily to build housing for the elderly. In recent years, an interest in developing a portion of all Section 202 projects for the exclusive use of the handicapped has been expressed. Through the end of fiscal year 1977, subsidy commitments under the revised Section 202/8 program had been made for about 55,000 units. 14/

13/ HUD 1976 Statistical Yearbook, p. 89.

14/ HUD Justification for 1979 Budget Estimates, Part 1, p. 14-23.

HOUSING-RELATED COMMUNITY DEVELOPMENT PROGRAMS

Several community development programs provide housing benefits to a wider range of income groups than are eligible for housing assistance programs. The principal housing-related community development programs are: (1) community development block grants, (2) urban development action grants, (3) Section 312 rehabilitation loans, and (4) urban homesteading.

The Community Development Block Grants (CDBG)

The CDBG program, authorized in 1974, provides grants to state and local governments to fund projects designed to promote viable urban communities. Most CDBG funds are allocated by means of needs-based formulae among cities within metropolitan areas with populations of 50,000 or more and urban counties with populations of 200,000 or more. Beginning in fiscal year 1978, two formulae are used to distribute these entitlement grants. Both consider the number of persons in the jurisdiction with incomes below the poverty line. One of the formulae also takes into account total population and the number of overcrowded housing units within the jurisdiction; the other formula considers lag in population growth relative to the national rate and the number of pre-1940 housing units. Communities that receive entitlement grants must also submit housing assistance plans that estimate the extent and nature of housing needs among low- and moderate-income persons residing or expected to reside in the jurisdiction and indicate how federal housing assistance will be used to address those needs. Communities that fail to provide lower-income housing assistance may forfeit their eligibility for the community development funds.

During fiscal year 1978, $3.6 billion are available for community development block grants; that sum is expected to fund approximately 3,200 grants, including as many as 637 grants to entitlement jurisdictions. About 26 percent of the funds to be expended in grants to entitlements cities during fiscal year 1977 are expected to be used for projects involving housing rehabilitation, building code enforcement, or relocation assistance for displaced persons. 15/

15/ HUD, Third Annual Report of the Community Development Block Grant Program (March 1978).

Urban Development Action Grants (UDAG)

The UDAG program was authorized in 1977 as an adjunct to block grants, and the program is being implemented for the first time in fiscal year 1978. UDAG funds are available only to distressed cities and they are to be used to support projects involving private investment as well as public funds. Current criteria for determining urban distress include: the proportion of the housing stock constructed before 1940, net increase in per capita income from 1969 to 1974, population growth between 1960 and 1975 relative to the national rate, the level of unemployment, the rate of growth in employment, the percent of the population below the poverty level, and unique local factors. More than 300 localities are eligible for UDAG funding under those criteria--a number that has been criticized by some as being too high and by others as too low.

During fiscal year 1978, $400 million are available for urban development action grants. Through April 1978, 50 projects, involving $150 million in federal funding, had been approved. The majority of the UDAG funds approved thus far are earmarked for commercial redevelopment. Subsequent grants are expected to focus somewhat more heavily on neighborhood-based projects.

Section 312 Rehabilitation Loans

The Section 312 loan program, authorized in 1964, provides direct financing for the rehabilitation of privately owned residential and commercial buildings in designated urban renewal, neighborhood-development, and code-enforcement areas. Loans bear a 3-percent interest rate, with a maximum repayment period of 20 years. Most of the approximately 58,000 Section 312 loans made through the end of fiscal year 1977 financed the rehabiliation of owner-occupied housing. The Section 312 program provides benefits to people with higher incomes than those who receive direct federal housing assistance. Less than 4 percent of the Section 312 funds lent to owner-occupants during 1977 went to families with an annual income below $4,000; nearly one-third of the funds went to families with an income of more than $15,000. 16/

16/ The Congress is currently considering legislation that could raise interest rate charges for higher-income borrowers to the Treasury borrowing rate.

Despite low levels of activity in the past, there has been considerable interest recently in expanding this program. For fiscal year 1978, $80 million is expected to finance 6,800 loans. The Administration's urban policy proposals, announced in March 1978, include a significant increase in funding for the Section 312 program.

Urban Homesteading

A small-scale urban homesteading demonstration program, under which federally held single-family properties are deeded to localities and sold by them at nominal cost to persons willing to rehabilitate and occupy them, has been operating since 1976. This program is intended to encourage residential reinvestment in distressed areas and to stimulate economic integration and neighborhood revitalization. In fiscal year 1978, 2,500 homes are to be conveyed to local governments for disposition under the program, at a cost to the Federal Housing Administration fund of $15 million. The HUD budget submission for fiscal year 1979 includes a proposal to make urban homesteading an ongoing program.

MORTGAGE CREDIT ACTIVITIES 17/

Through a number of mortgage credit programs, the federal government provides direct financing for residential construction, insures and guarantees private loans, and acts as a third-party broker in the mortgage market. These programs are designed to increase housing production, reduce cyclical swings in construction activity, increase access to mortgage credit, and expand homeownership opportunities. Table 13 summarizes the status of major federal direct loan and mortgage insurance and guarantee programs as of 1977.

17/ For a more complete discussion of mortgage credit programs see Congressional Budget Office, "Housing Finance: Federal Programs and Issues," Staff Working Paper (September 23, 1976).

TABLE 13. STATUS OF MAJOR FEDERAL HOME LOAN AND MORTGAGE INSURANCE AND GUARANTEE PROGRAMS, 1977

Program	Number of Loans Outstanding	Unpaid Principal Balance (in millions of $)
Direct Loans		
FmHA rural housing loans a/	825,608	13,713
VA home loans b/	80,087	486
Insured and Guaranteed Loans		
FHA b/	4,824,574	89,641
VA b/	3,956,751	70,120

SOURCE: Farmers Home Administration Budget Office; Veterans Administration Budget Office; HUD, Justification for 1979 Budget Estimates, Part 1, p. I-14.

a/ As of December 1977.

b/ As of September 1977.

Direct Loan Programs

The Farmers Home Administration (FmHA). FmHA--an agency of the Department of Agriculture--administers several direct loan programs that finance the purchase, construction, and improvement of homes in rural areas. Market-rate loans are made to persons who could qualify for conventional financing but for whom private credit sources are not available; loans with interest charges as low as 1 percent are made to persons with incomes that would disqualify them for private financing. FmHA also makes market-rate and interest subsidy loans to developers of multifamily rental housing. Interest-subsidy rental projects carry reduced rental charges, and rents can be further reduced through the use of Section 8 assistance or through rural rental assistance payments, an FmHA program similar to HUD's Section 8 existing housing program. During fiscal year 1977, FmHA made about 111,000 homeownership loans, of which approximately 64,000 were subsidized. During that same period, the agency provided rental housing loans for 32,000 units; almost all of those loans were subsidized. As of December 1977, more than 825,000 FmHA rural housing loans were outstanding, with an unpaid principal balance of $13.7 billion.

Veterans Administration (VA). The VA is a source of market-rate mortgages for qualified veterans seeking to buy, build, or improve single-family homes in rural areas, small towns, or credit-short urban areas. Maximum loan amounts are set by statute; the interest rate charged and other terms for the loans are fixed by regulation. About 80,000 VA loans are currently outstanding; approximately 2,700 direct VA loans were made during fiscal year 1977, and about 2,400 loans are expected to be made in fiscal year 1978.

Insured and Guaranteed Loans

Federal Housing Administration (FHA). The FHA, which was created by the National Housing Act of 1934 and is now an arm of HUD, is the largest single source of government mortgage insurance. Originally intended to encourage recovery of the housing construction industry from the Great Depression, the FHA is now viewed as a means of increasing the access of limited-income persons to credit as well as a way of promoting residential construction. The largest of some 40 active FHA mortgage programs, Section 203(b), provides insurance for single-family loans, with maximum interest rates, downpayment requirements, and loan amounts set periodically by statute and regulation. In addition to this and other relatively low-risk programs, the FHA administers a number of higher-risk single-family and multifamily loan programs, including a number of programs that provide mortgage insurance for lower-income assisted housing. Insurance premiums charged on standard single-family loans have generally covered losses under those programs; however, since 1975, high default rates in other programs have resulted in net losses to the FHA fund.

The Veterans Administration (VA). The VA guarantees and insures large numbers of privately written mortgages for eligible veterans and servicemen. Since the programs were initiated in 1944, the VA has guaranteed or insured more than nine million home loans, totaling in excess of $120 million. Nearly 4 million VA-guaranteed or -insured loans were outstanding as of the end of fiscal year 1977, and the VA expects to guarantee 382,000 additional loans in fiscal year 1978.

The Farmers Home Administration (FmHA). FmHA is authorized to guarantee privately written home mortgages in rural areas; however, this program has been largely inactive because of severe restrictions on the terms of eligible loans. Recent changes in the law allow the FmHA to guarantee a much wider range of mortgages, which will enable the agency to play a more active role.

Mortgage Market Interventions

Several government agencies and government-chartered private entities buy and resell privately written mortgages and mortgage-backed securities, thereby affecting the supply, cost, and distribution of credit for residential construction and home purchases. Specifically, these activities, maintaining a secondary mortgage market and dealing in that market, are intended to increase the availability of mortgage credit, reduce the severity of cyclical declines in the homebuilding industry, and encourage mortgage lending in credit-short areas. Other government-sponsored enterprises allocate credit directly to housing by advancing funds to financial institutions expected to use them for residential mortgages.

Federal National Mortgage Association (FNMA). FNMA is a government-sponsored private corporation that purchases and resells privately written loans. By offering lenders a means of liquidating residential mortgages, the credit market activities of FNMA (also referred to as "Fannie Mae") are intended to encourage the use of private funds for home loans. In particular, purchases of government-insured and government-guaranteed mortgages are meant to encourage lenders to make those kinds of loans. FNMA's activities are also intended to increase lending in urban areas where financial institutions may be reluctant to write loans that they would have to hold and service themselves. As of December 1976, FNMA's portfolio included more than 1.5 million mortgages, with a total unpaid principal of nearly $33 billion, or about 5 percent of the total residential mortgage debt outstanding at the time. 18/ During fiscal year 1977, FNMA purchased more than $4 billion in loans.

Government National Mortgage Association (GNMA). GNMA is an agency of HUD created in 1968 when the once-public FNMA was reconstituted as a private corporation. Like FNMA, GNMA ("Ginnie Mae") purchases government-insured and government-guaranteed mortgages. GNMA then sells securities backed by the pool of mortgages. In 1977, GNMA issued over $17 billion in such securities; by the end of the year, $43 billion in GNMA mortgage-backed securities were outstanding. GNMA is also authorized to purchase mortgages with interest rates as low as 7.5 percent and to resell them as market-yield instruments, absorbing the difference as an interest subsidy. Under the Emergency Home Mortgage Purchase Assistance program, this authority may be utilized on an ad hoc basis to stimulate private mortgage lending. This "tandem" financing can also be made available to private developers of assisted housing projects and it is now being heavily used by developers of Section 8 new construction/substantial rehabilitation projects, thereby providing a financing subsidy in addition to the rent subsidy which projects enjoy. Beginning in fiscal year 1978, tandem assistance will be used--in what is referred to as a "targeted tandem program"--for nonsubsidized residential construction in distressed urban areas.

Federal Home Loan Banks (FHLBs). The Federal Home Loan Banks are a system of twelve regional institutions that operate under the auspices of the Federal Home Loan Bank Board (FHLBB), the federal agency responsible for overseeing the nation's federal savings and loan associations and mutual savings banks. The Federal Home Loan Banks are empowered to make monetary advances to member institutions to cover net withdrawals during periods of tight money or to enable savings and loan associations to expand their lending activities. Since 1960, the volume of such advances has increased sharply, reaching a peak of $12.8 billion in net advances in 1974. As of the end of fiscal year 1977, $17.0 billion in advances were outstanding.

18/ HUD, Statistical Year Book for 1976, pp. 298 and 306.

Federal Home Loan Mortgage Corporation (FHLMC). The FHLMC ("Freddie Mac") is a federally chartered corporation under the control of the Bank Board. The FHLMC was created in 1970 to purchase mortgages from private savings and loan associations and to sell shares in those mortgages to individual investors. These secondary market activities are designed to encourage lending by enhancing the marketability of mortgages and, at the same time, increase the supply of capital available for home loans.

HOUSING-RELATED TAX EXPENDITURES

The tools of federal housing policy include a number of tax expenditures designed to encourage homeownership, to increase the production of certain types of rental housing, and to increase the supply of credit available for residential construction. Unlike direct spending programs, which serve only a fraction of the eligible population, housing-related tax expenditures are available to everyone who meets their criteria of eligibility.

Among the specific tax expenditures affecting housing are:

- The deductibility of mortgage interest and property tax payments for homeowners.
- The deferral of capital gains on the sale of a residence.
- The exclusion of a share of capital gains tax liability on the sale of residences by elderly homeowners.
- Favorable depreciation treatment for rental housing.
- Five-year amortization of the cost of rehabilitating low-income housing.
- Favorable treatment of construction-period interest and property taxes in rental housing development.
- Beneficial bad-debt deductions for financial institutions engaged in mortgage lending.

These tax provisions result in revenue losses far exceeding direct federal expenditures for housing, and their beneficiaries typically have higher incomes than do beneficiaries of either housing assistance or federal mortgage credit programs. Table 14 summarizes major housing-related tax expenditures in fiscal year 1977 and their distribution by income class.

Homeownership Tax Provisions

Deductibility of Mortgage Interest and Property Tax Payments for Owner-Occupied Housing. The federal tax code permits homeowners who itemize their deductions to subtract mortgage interest payments and state and local real estate taxes from their federally taxable incomes, thereby reducing the cost of owning a home relative to the cost of renting. Together, these provisions reduced tax revenues during fiscal year 1977 by more than twice the amount of funds expended on lower-income housing assistance programs. Because these provisions benefit only those who itemize their deductions, and because the benefit is greater for those in higher marginal tax brackets, the bulk of this tax savings goes to middle- and upper-income households. Nearly 40 percent of the $4.5 billion in revenue lost in fiscal year 1977 as a result of the deductibility of mortgage interest payments went to taxpayers with an annual income in excess of $30,000. Similarly, more than 50 percent of the $4.2 billion in tax expenditures resulting from homeowners' deduction of real estate taxes benefited those whose annual income exceeded $30,000.

Deferral of Capital Gains on the Sale of a Residence. Some or all of the capital gains realized on the sale of a home are deferred for tax purposes if the seller buys or begins building another home within 18 months of the sale. This tax provision subsidizes the ownership of increasingly expensive homes. To the extent that this encourages "buying up," it may contribute to inflation in housing costs. Further, through a series of such deferrals a homeowner can avoid paying any capital gains tax until a point late in life when his total income has declined, reducing his rate of taxation. About 20 percent of the nearly $900 million in revenue lost in fiscal year 1977 as a result of the deferral of capital gains taxes on home sales went to taxpayers with an annual income in excess of $30,000.

TABLE 14. DISTRIBUTION OF BENEFITS OF MAJOR HOUSING-RELATED TAX EXPENDITURES BY INCOME OF BENEFICIARY, FISCAL YEAR 1977: IN PERCENTS a/

Expanded Annual Income Class of Taxpayer b/	Deductibility of Mortgage Interest for Homeowners	Deductibility of Real Estate Taxes for Homeowners	Deferral of Capital Gains on Home Sales	Exclusion of Capital Gains on Sales by Elderly Homeowners	Accelerated Depreciation for Rental Housing	Favorable Treatment for Construction-Period Interest and Taxes
$0 to $9,999	2.1	1.9	4.0	2.5	2.2	2.0
$10,000 to $19,999	24.5	19.4	42.8	15.0	3.4	3.3
$20,000 to $29,000	35.9	28.4	33.7	17.5	3.8	4.0
$30,000 to $49,999	25.2	24.6	14.6	15.0	15.0	14.7
$50,000 to $99,999	10.5	16.1	3.4	22.5	22.8	22.7
$100,000 and over	1.8	9.6	1.5	27.5	52.8	53.3
Revenue Loss (millions of dollars)	4,490	4,205	890	40	320	150 c/

SOURCE: CBO Tax Analysis Division and Special Analyses of the Budget of the United States Government, Fiscal Year 1979 Budget, pp. 158-160.

a/ Revenue losses are for individual income taxes only.

b/ Expanded income is a broader concept than the "adjusted gross income" concept that appears on income tax returns. Expanded income includes the untaxed half of capital gains, percentage depletion in excess of cost, depreciation in excess of straight line, and other "tax preference" items included in the minimum tax; however, it excludes investment interest up to the amount of investment income. It therefore comes closer to "real" total economic income than does the adjusted gross income figure.

c/ A substantial portion of the amount shown for this tax expenditure is attributable to nonresidential construction.

Exclusion of Capital Gains Tax Liability on Sale of Primary Residence by Elderly Homeowners. Taxpayers who sell their homes after reaching the age of 65 may escape taxation on a share or all of the capital gains resulting from the sale. This provision is designed to benefit elderly persons who sell their homes and become renters. If this exclusion is combined with earlier deferrals, some homeowners may escape all or most of their long-term liability. Fully 65 percent of the benefits from this tax expenditure go to taxpayers with an annual income of $30,000 or more.

Rental Housing Tax Provisions 19/

A separate set of tax provisions complements the homeownership inducements described above by promoting the construction or rehabilitation of rental housing. However, instead of aiding the occupant of the housing unit directly--as do the homeownership tax provisions--tax provisions favoring rental housing benefit the developer primarily and the renter secondarily, if at all.

Favorable Depreciation Treatment for Rental Housing. Developers of new rental housing may depreciate the cost of the units for tax purposes at a 200-percent declining balance rate, involving deductions in the early years as much as twice those available to investors in other income-producing assets. A somewhat less favorable, but still advantageous, depreciation treatment is available to investors who acquire existing rental units. In addition, certain expenses incurred in rehabilitating rental units for lower-income households may be fully amortized within five years by deducting one-fifth of the cost of the work per year.

These tax benefits are intended to stimulate the development of rental housing by increasing its attractiveness as an investment. But, without a concomitant increase in the demand for rental housing, the extent to which those provisions result in the production of units that would have otherwise not been built

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19/ For a more complete discussion of tax expenditures affecting real estate investment, see Congressional Budget Office, Real Estate Tax Shelter Subsidies and Direct Subsidy Alternatives May 1977.

is arguable. The extent (if any) to which these tax provisions reduce tenant rents is also questionable. The net effect of these provisions may be simply to increase the profitability of rental housing as an investment, and to bid up development costs, as more investors compete for a limited number of investment opportunities.

Favorable Treatment of Construction-Period Interest and Property Tax Payments. Builders of rental housing have been permitted to treat interest and property tax payments made during construction as current business costs, deducting these expenses as they occur, rather than including them in the cost of construction and writing them off over the life of the building. As a result of the Tax Reform Act of 1976, these substantial front-end construction subsidies will be phased down as of 1978, for most rental housing, and for low- and moderate-income rental housing, as of 1982.

Preferential Treatment of Real Estate Investment as a Tax Shelter for Limited Partnerships. The Tax Reform Act of 1976 exempts limited partnership investments in rental housing and other forms of real estate from a new rule that prohibits individual investors from taking deductions for tax losses in excess of the amount they actually have at risk in a project. This exemption gives real estate investment an edge over other investment opportunities in competing for private capital.

Tax Benefits for Financial Institutions

The federal tax code gives preferential treatment to commercial banks, mutual savings banks, and savings and loan associations, the primary sources of residential mortgage credit. Although most businesses may deduct from their net income an allowance for bad debt losses that is based on actual losses in recent years, financial institutions are allowed bad-debt deductions considerably in excess of actual losses. These tax provisions increase the profitability of financial institutions relative to other businesses, and they may therefore affect the availability of mortgage credit by encouraging the formation and expansion of banks and savings and loan associations. Primarily as a consequence of favorable bad-debt allowances, in 1972--the latest year for which such data are available--banks and savings institutions paid taxes averaging 19 percent of income as compared with an average tax rate of 41 percent for all other corporations. 20/

HOUSING AND CREDIT MARKET REGULATIONS

The federal government directly affects the supply, cost, and distribution of housing and home financing by regulating various aspects of housing and credit markets. The cost of these regulatory activities and the distribution of their benefits are difficult to measure.

Prohibitions Against Discrimination and the Promotion of Fair Housing Opportunities

Federal statutes prohibit racial discrimination in the sale or rental of most privately owned housing. In addition, federal regulations require managers of federally assisted projects to take affirmative steps to ensure that the housing units are made available to minorities and that the projects promote racial and economic deconcentration. Regulations also favor siting assisted projects in locations that will induce deconcentration.

Federal statutes also prohibit discrimination in mortgage lending on the basis of race, color, national origin, sex, religion, marital status, or age. Until recently, attention in this area has focused almost exclusively on racial discrimination and, in particular, on redlining--the practice of systematically denying mortgage credit to certain geographic areas, usually older inner-city neighborhoods with large minority populations. Anti-redlining regulations currently prohibit denials of loans on the basis of the racial composition of the area in which the home is located or its age.

20/ U.S. Department of The Treasury, "Effective Income Tax Rates Paid by United States Corporations in 1972" (May 1978), p. 43.

The Regulation of Financial Institutions

The Federal Home Loan Bank Board and the Federal Reserve Board set maximum rates of interest that savings and loan associations, mutual savings banks, and federally chartered commercial banks are permitted to pay on deposits, affecting the cost of money for these institutions and thereby affecting the cost of mortgage credit to borrowers. These interest rate ceilings also give savings and loan associations and mutual savings banks--the primary sources of residential mortgage credit--a relative advantage over commercial banks in attracting deposits. But, the interest rate ceilings also place all banks and savings and loan associations at a relative disadvantage in attracting investments, thereby reducing the supply of mortgage credit during periods of tight money, when more attractive alternative investments are available.

Finally, Federal Home Loan Bank Board regulations prohibit member institutions from making many kinds of loans, which ensures that most funds are available for residential mortgages. In 1975, more than three-fourths of all savings and loan associations assets were in the form of residential mortgages and these institutions held more than 45 percent of all outstanding mortgages.

CHAPTER IV. THE BUDGETARY FRAMEWORK OF FEDERAL HOUSING POLICY

The housing programs described in the preceding chapter appear in a number of different accounts within the federal budget and are financed through a variety of different funding mechanisms. Furthermore, many of the programs are entirely off-budget. Housing-related tax expenditures are reported each year in federal budget documents but generally escape annual Congressional scrutiny. Regulatory activities affecting housing may be even less visible within the budget. This budgetary fragmentation makes it difficult for the Congress to obtain a comprehensive accounting of all funds expended on housing or to control that total.

This chapter first describes the budgetary framework of federal housing policy (see Table 15) and then examines current and projected program costs.

THE BUDGETARY FRAMEWORK

Housing Assistance Programs

The assisted housing programs administered by HUD all involve multiyear subsidy commitments on the part of the federal government. The estimated amount of budget authority--the authorization to expend federal funds--needed to subsidize a housing unit for the duration of the federal commitment is released in the year that the commitment is to be made. Outlays utilizing that authority are then spread out over a period of up to 40 years. Where the long-term spending authority proves to be insufficient to pay the full subsidy costs, additional budget authority may be released on a yearly basis in the form of operating subsidies, or further long-term spending authority may be provided to amend the initial subsidy commitment. In the case of public housing, budget authority expected to be sufficient to pay the full development and financing costs of a project is released at the outset of a commitment and expended in installments over 40 years. The federal government also pays annual operating subsidies for most public housing projects, with

TABLE 15. THE BUDGETARY FRAMEWORK OF FEDERAL HOUSING POLICY

Program	Budget Subfunction a/	Financing Mechanism
Housing Assistance Programs		
Low-rent public housing	604	Budget authority sufficient to pay development or purchase and rehabilitation costs is released in the year in which a new commitment is to be made; outlays liquidate long-term budget authority over the life of the subsidy commitment. Annual appropriations pay operating subsidies for most projects.
Section 8 leased housing assistance	604	Budget authority presumed to be sufficient to pay full multiyear rental assistance costs is released in the year in which a commitment is to be made; outlays liquidate long-term budget authority over the life of the subsidy commitment.
Section 235 homeownership assistance	604	Budget authority presumed to be sufficient to pay full multiyear interest-subsidy costs is released before a subsidy commitment is made. Outlays occur annually over the life of the subsidy commitment. New subsidy commitments since fiscal year 1976 are financed out of unutilized budget authority released prior to 1973.
Section 236 rental assistance	604	Funding procedure similar to Section 235. Since the program was suspended in 1973, new subsidy commitments are being made only for projects approved before 1973. New commitments are financed out of unutilized budget authority released prior to 1973.
Rent supplements	604	Funding procedure similar to Section 8. Most new subsidy commitments since 1973 are financed out of unutilized budget authority released in prior years and recaptured from terminated projects.
Section 202 housing for the elderly & handicapped	371	Projects financed out of revolving loan fund. Authority for cumulative outstanding Treasury borrowings of $3.3 billion created in 1976 subject to release in annual appropriations. All future Section 202 projects to carry Section 8 subsidy commitments as well.
Community Development Programs		
Community development block grants and urban development action grants	451	Grants funded through annual appropriations.

(Continued)

TABLE 15. (Continued)

Program	Budget Subfunction a/	Financing Mechanism
Section 312 rehabilitation loans	451	Loans financed through a revolving fund. Interest-subsidy costs covered by annual appropriations.
Urban homesteading	451	Financed through annual appropriations, which reimburse the FHA fund for properties transferred to local governments for disposition.
Mortgage Credit Activities		
Farmers Home Administration direct loans	371	Loans made from a revolving Rural Housing Insurance Fund financed through borrowings from the Treasury and sale of loans to Federal Financing Bank. Interest-subsidy costs covered by annual appropriations as costs occur.
Veterans Administration direct loans	704	Loans made from a self-financing revolving fund. Appropriations Act calls for transference of retained earnings to VA loan guaranty fund.
Federal Housing Administration insured loans	371	Insurance financed by borrowings from the Treasury and issuance of debentures. Occasional appropriations provided to cover insufficiencies.
Veterans Administration guaranteed loans	704	Loan guarantees financed from a revolving VA loan guaranty fund.
GNMA secondary market activities	371	Activities financed by borrowings from the Treasury and sales of participation certificates in the mortgage pool. Losses resulting from tandem financing activities carried as impairments against capital. Certain insufficiencies covered by occasional appropriations.
Federal National Mortgage Association, Federal Home Loan Banks, Federal Home Loan Mortgage Corporation		Off-budget public enterprises.

a/ Subfunction 371 = Mortgage Credit and Thrift Insurance; 451 = Community Development; 604 = Public Assistance and Other Income Supplements; and 704 = Veterans Housing.

budget authority for each year's operating subsidies released in the year in which those payments are to be made. Section 8 subsidy commitments obligate the federal goverment to pay the owner of the housing unit the difference between a fixed percentage of the tenant's income and the allowable rental charge, which is set by HUD. Budget authority expected to be sufficient to pay this difference for 15 to 40 years--depending on the development method used--is released in the year in which a subsidy commitment is to be made. The actual long-term cost to the federal government, however, will depend on initial tenant incomes and rent levels and on the relative rates of inflation in incomes and rents. Thus, it is by no means certain that the budget authority created in the first year of a Section 8 subsidy commitment will cover the eventual subsidy cost; amendments to the initial commitments may prove necessary in the future.

Community Development Programs

Community development block grants and urban development action grants are financed through annual appropriations, with each year's funds expended shortly after they are released. The Section 312 rehabilitation loan program is financed from a revolving fund, with budget authority created periodically to pay the cost of the interest subsidy. The ongoing urban homesteading program proposed for fiscal year 1979 would be funded through annual appropriations that would be used to reimburse the Federal Housing Administration fund for units transfered to local governments.

Mortgage Credit Activities

Most Farmers Home Administration direct housing loans are finaced through a revolving Rural Housing Insurance Fund. Losses resulting from the sale of below-market rate loans at market-rate yields are made up by annual appropriations over the life of the loans. Thus, in contrast to HUD assisted housing programs, budget authority to cover the costs of FmHA housing programs is released annually, as costs are incurred, rather than at the time the long-term commitments are made. Direct VA housing loans are made from a self-financing revolving fund.

FHA mortgage and loan insurance programs are financed through four separate funds. The primary sources of income for the FHA funds are insurance premiums and fees paid by mortgagors; expenses to the funds include operating costs, losses due to failures of mortgagors to meet their obligations, repayment of premiums under certain mutual insurance programs, and expenditures associated with maintaining acquired properties or preparing them for sale. To the extent that these expenses are not covered by premiums, fees, and income from property dispositions, the FHA funds may borrow directly from the Treasury or offer their own debentures. In fiscal year 1977, the FHA received an appropriation of $1.9 billion to cover a portion of its unrestored losses; an additional appropriation is being sought for fiscal year 1979. Veterans Administration loan guarantees are financed by a separate revolving fund; no premiums are paid by mortgagors, and losses from the fund are covered by occasional appropriations. The small-scale FmHA mortgage guarantee program is financed through the same Rural Housing Insurance Fund that finances direct rural housing loans.

The mortgage market activities of the Government National Mortgage Association are financed by borrowings from the Treasury; losses inherent in the purchase of below-market interest rate mortgages and their resale at a market yield are carried on the GNMA books as impairments against capital. Activities of the Federal National Mortgage Association are off-budget and they are generally self-financing. Credit market activities of both the Federal Home Loan Banks and the Federal Home Loan Mortgage Corporation are off-budget and are entirely self-financing.

Expected revenue losses attributable to housing-related tax expenditures are itemized by functional category within federal budget documents, but the actual amount of each such expenditure is not voted on directly by the Congress. Mortgage and other housing market regulatory activities do not appear as separate items in the budget.

PROGRAM COSTS

Table 16 describes the budget authority and anticipated outlays for federal housing programs during fiscal year 1978, estimates of the cost of sustaining current policy for the next five years, and the funding requested in the President's 1979 budget submission. Table 17 presents estimates of the revenue losses resulting from housing-related tax expenditures for fiscal years 1978-1983. In fiscal year 1978, total federal expenditures related to housing (including the portion of community development block grant and urban development action grant funds estimated to go towards housing) are expected to amount to approximately $5.5 billion. Outlays for assisted housing, including public housing operating subsidies, Section 202 interest-credit costs, and FmHA interest subsidy costs will account for nearly 80 percent of that total. Revenue losses resulting from housing-related tax expenditures in fiscal year 1978 are expected to amount to as much as $12.4 billion, with homeownership deductions accounting for more than four-fifths of that sum.

TABLE 16. BUDGET AUTHORITY AND OUTLAYS FOR HOUSING IN 1978, PROJECTIONS OF CURRENT POLICY FOR 1979-1983 a/, AND REQUESTED FUNDING FOR 1979: BY FISCAL YEARS, IN MILLIONS OF DOLLARS

	1978	1979	1980	1981	1982	1983
Housing Assistance Programs						
Public Housing, Section 8, Section 235, Section 236, Rent Supplements						
Current policy projection of budget authority and outlays						
Budget authority	31,523	28,111	36,903	39,072	41,252	43,533
Outlays	3,100	3,577	4,236	5,047	5,921	6,829
President's proposal						
Budget authority		24,691 b/				
Outlays		3,577				
Public Housing Operating Subsidies						
Current policy projection of budget authority and outlays						
Budget authority	685	724	790	873	971	1,072
Outlays	587	686	727	803	893	986
President's proposal						
Budget authority		729				
Outlays		686				
Section 202						
Current policy projection of budget authority and outlays						
Budget authority	750	800	874	932	995	1,062
Outlays	320	550	852	758	756	796
President's proposal						
Budget authority		800				
Outlays		713				

(Continued)

TABLE 16. (Continued)

	1978	1979	1980	1981	1982	1983
Housing-Related Community Development Programs						
Community Development Block Grants and Urban Development Action Grants (estimated share devoted to housing) c/						
Current policy projection of budget authority and outlays						
Budget authority	1,044	1,111	1,179	1,255	1,337	1,432
Outlays	662	764	945	1,149	1,286	1,373
President's Proposal						
Budget authority		1,083				
Outlays		732				
Section 312 Rehabilitation Loans						
Current policy projection of budget authority and outlays						
Budget authority	—	58	58	56	54	51
Outlays	43	56	55	54	51	48
President's proposal						
Budget authority		95				
Outlays		85				
Urban Homesteading						
New fiscal year 1979 initiative d/						
President's Proposal						
Budget authority		20				
Outlays		10				

(Continued)

TABLE 16. (Continued)

	1978	1979	1980	1981	1982	1983
Credit Market Activities						
FmHA Direct Loans						
Current policy projection of budget authority and outlays						
Budget authority	730	617	694	785	879	980
Outlays	414	588	666	759	853	951
President's proposal						
Budget authority		388				
Outlays		-128 e/				
VA Direct Loans						
Current policy projection of budget authority and outlays						
Budget authority	--	--	--	--	--	--
Outlays	-75	-73	-73	-69	-65	-64
President's Proposal						
Budget authority		--				
Outlays		-73				
FHA Insured Loans						
Current policy projection of budget authority and outlays						
Budget authority	705	465	482	483	495	424
Outlays	650	290	287	266	256	161
President's proposal						
Budget authority		451				
Outlays		221				

(Continued)

TABLE 16. (Continued)

	1978	1979	1980	1981	1982	1983
VA Guaranteed Loans						
Current policy projection of budget authority and outlays						
Budget authority	—	—	—	—	—	—
Outlays	54	27	64	76	88	97
President's proposal						
Budget authority		—				
Outlays		27				
GNMA Tandem Financing f/						
Current policy projection of budget authority and outlays						
Budget authority	8	396	2,094	1,540	860	875
Outlays	-225	389	474	483	386	390
President's proposal						
Budget authority		1,507				
Outlays		389				
Total						
Current policy projection of budget authority and outlays						
Budget authority	35,445	32,282	43,074	44,696	46,843	49,429
Outlays	5,530	6,854	8,233	9,326	10,425	11,567
President's Proposal						
Budget authority		29,764				
Outlays		6,239				

FOOTNOTES FOR TABLE 16

SOURCE: CBO calculations and Appendix to the Budget of the United States Government for Fiscal Year 1979.

a/ Current policy projections are calculated as of March 1978 and include projected inflation.

b/ Does not include $7,066 million of budget authority expected to be carried over from fiscal year 1978 and prior years.

c/ Estimated share of CDBG and UDAG funds devoted to housing is based on the proportion of CDBG funds to be used for housing rehabilitation, code enforcement, and relocation assistance by entitlement cities during fiscal year 1977.

d/ Operated as a demonstration program prior to fiscal year 1979.

e/ Negative outlay attributable to anticiapted sale of loans by the FmHA.

f/ Sum of Special Assistance Functions Fund activity and Emergency Mortgage Purchase Assistance program.

TABLE 17. ESTIMATED REVENUE LOSSES RESULTING FROM MAJOR HOUSING-RELATED TAX EXPENDITURES, a/ 1978-1983: FISCAL YEARS, IN MILLIONS OF DOLLARS

Tax Expenditure	1978	1979	1980	1981	1982	1983
Deduction of mortgage interest payments by homeowners	4,985	5,530	6,140	6,815	7,565	8,395
Deduction of property tax payments by homeowners	4,665	5,180	5,750	6,385	7,085	7,865
Deferral of capital gains on sale of home	935	980	1,030	1,080	1,135	1,195
Exclusion of capital gains on sale of home by elderly homeowners	70	70	70	70	75	75
Accelerated depreciation for rental housing	370	360	360	375	395	420
Favorable treatment of construction-period interest and taxes b/	640	615	700	750	820	875
Favorable bad-debt allowances for financial institutions	705	790	930	1,025	1,040	1,085
TOTAL c/	12,370	13,525	14,980	16,500	18,115	19,910

SOURCE: CBO Tax Analysis Division.

a/ Sum of corporate tax and individual income tax losses.

b/ A substantial portion of the amount shown for this tax expenditure is attributable to nonresidential construction.

c/ This is simply the arithmetic total of the listed tax expenditures. Because of overlaps and interactions among some of these tax expenditures and because potential changes in taxpayer behavior are not taken into account in the estimates, the totals shown do not represent the amount of revenue that would be raised if all of these tax expenditures were repealed.

CHAPTER V. RECURRING HOUSING POLICY ISSUES

Each year, the Congress faces a number of recurring issues concerning the funding, design, and operation of federal housing programs. The still unmet housing policy objectives, the sheer complexity of current housing programs, and uncertainty as to their effectiveness give rise to these issues and contribute to their recurring nature. This chapter discusses five such recurring housing policy issues, examines proposals contained in the Administration's 1979 budget and legislative program, and presents policy options available to the Congress for this and subsequent years. The issues considered are:

- What level of funding should be provided for housing assistance programs and how should they be financed?

- What should be the mix of new construction, rehabilitation, and existing housing assistance?

- What kind of housing assistance should be provided to lower-income homeowners, and should direct assistance be extended to higher-income families?

- What mix of programs is most effective in encouraging housing production and providing countercyclical aid to the home building industry?

- How should housing assistance programs be used to encourage community development?

THE FUNDING LEVEL OF HOUSING ASSISTANCE PROGRAMS

Each year, the Congress must determine the level of funding to be allocated to housing assistance programs. For each program, this requires separate judgments as to the level of funding required to finance new subsidy commitments and the additional spending authority needed, if any, to fulfill multiyear subsidy commitments made in the past. The complex funding procedures for different programs--and the inevitable uncertainties attending advanced financing--make it difficult, however, for the Congress to estimate accurately either the actual cost of new commitments over many years or the additional expenditures needed to meet underfunded prior commitments.

Current Funding Procedures and Proposals for Fiscal Year 1979

Funding mechanisms differ among the various housing assistance programs. Under the Section 8 program, assisted housing units are financed through release of the full amount of budget authority assumed to be necessary to pay the cost of the 15- to 40-year federal commitment. The current procedure for estimating that amount is to multiply the maximum allowable rent for the first year of a commitment--expressed as a yearly sum--by the maximum number of years the federal subsidy may run. (For example, if the allowable monthly rent for a unit is $300 and the federal commitment is for up to 30 years, the long-term budget authority set aside for that unit would be $108,000--$300 per month, times 12 months per year, times 30 years.) Yet, the actual federal obligation is to pay, not the allowable rent, but the difference between that and the independently determined tenant contribution. Both of those can be expected to rise over time. The actual long-term per-unit subsidy cost therefore will depend on the initial tenant income and the rates by which rents and tenant income increase over time, as well as on the initial rent level and the duration of the commitment. There is an assumption implicit in the current cost estimation procedure that tenant contributions in the early years of a long-term commitment will provide a large enough reserve to pay for the added cost of future rent increases.

If the present income distribution of Section 8 tenants proves to be representative of the income mix once the program is fully underway, if allowable rents increase at the same rate in the future as they have in the past, and if tenant incomes increase at rates similar to those observed in recent years for public housing, then existing Section 8 subsidy commitments will turn out to be seriously underfunded. Even under fairly optimistic assumptions concerning future increases in rent levels and tenant incomes, additional federal funding may be required to meet the full term of the subsidy commitments. On the other hand, however, if large numbers of commitments do not run their full course--either through financial failure or conversion of projects from subsidized to unsubsidized status by their sponsors--the amount of budget authority already released may prove to be excessive. No proposals for dealing with these Section 8 funding uncertainties are contained in the Administration's 1979 budget submission.

In the case of public housing, budget authority expected to pay the principal and interest costs for the building or purchase of new housing projects is released the year in which a new commitment is to be made. Once the commitment is entered into, the long-term federal expenditure is fixed as is the annual spend-out rate, which eliminates the uncertainty created by the Section 8 financing procedure. On the other hand, debt service payments for public housing are supplemented by annual operating subsidies--a feature absent from the Section 8 program. The amount of the operating subsidy for each public housing agency is calculated each year by means of a complex formula that takes into account tenant incomes and numerous project characteristics. In contrast to public housing debt service payments and Section 8 funding, budget authority for public housing operating subsidies is released the year in which they are to be paid, and there is no attempt to estimate long-term expenditures when a new subsidy commitment is made. As a result of these different funding procedures the per-unit cost of public housing appears considerably lower than the cost of Section 8 subsidy commitments of equivalent duration, where the full run-out cost is estimated at the outset. For fiscal year 1979, the HUD budget requests $729 million in operating subsidies to assist approximately 1.1 million units of public housing.

Additional uncertainty in the funding of Section 8 and public housing is created by the fact that in estimating per-unit costs of additional subsidy commitments to be made in different fiscal years, HUD budget submissions in recent years have included no provision for inflation. But development costs for new construction and rents for existing housing are both increasing, and the effect of this unrealistic assumption of no inflation is, therefore, to overestimate the number of units that can be assisted at any given level of funding. For fiscal year 1979, the HUD budget calls for the release of $24.7 billion in budget authority, which, together with $6.4 billion in unutilized authority expected to be carried over from fiscal year 1978, is to fund subsidy commitments for an additional 400,000 Section 8 and public housing units. If the estimated per-unit cost of additional Section 8 existing housing is inflated by 5.5 percent to reflect the projected increase in rents between fiscal year

1978 and fiscal year 1979, and the 7.6 percent projected rate of increase in residential construction costs is used to inflate the estimated per-unit cost of additional Section 8 new construction/ substantial rehabilitation and public housing commitments, then the proposed funding would support only about 375,000 units. Approximately $2.2 billion more budget authority would be needed--in addition to the $6.4 billion carryover--to fund the proposed 400,000 additional units.

In contrast to both Section 8 and public housing, budget authority to pay the long-term subsidy costs of the Farmers Home Administration assisted housing programs is released annually as those costs are incurred. When below-market interest rate rural housing loans are made, they are sold to the Federal Financing Bank in the form of certificates of beneficial ownership with market-rate yields. Annual appropriations then release enough budget authority to pay the yearly cost of the difference between the interest income and the interest expense of the Rural Housing Insurance Fund. Thus, the full cost to the government of interest credit loans may not become apparent for as long as 50 years, with increments of budget authority released each year over that period. The per-unit cost of additional subsidized rural housing loans will therefore appear to be much less than equivalent commitments for Section 8 or public housing units, which are funded for years in advance.

Comparisons of program costs are also complicated by the fact that the managers of the Rural Housing Insurance Fund have considerable discretion in deciding when to retain loans and when to sell them off, thereby affecting net outlays in any given year. By projecting high loan sales for fiscal year 1979, the FmHA budget submission shows a negative outlay that year, as compared with positive outlays of over $400 million in fiscal year 1978. This projected drop in outlays occurs despite the fact that, between fiscal year 1978 and fiscal year 1979, the proportion of loans made at below-market interest rates is projected to increase from 69 to 80 percent and total obligations are projected to increase by 6 percent.

Options Available to the Congress

Given such inconsistent financing procedures and the inadvertent uncertainties of estimating long-term costs, the Congress cannot be sure of either the number of households that will be assisted for any level of funding or the long-term cost to the government of assisted housing. Options available to the Congress for reducing those uncertainties include:

- o Requiring that Administration estimates of the long-term costs of Section 8 housing assistance be based on available data regarding current tenant incomes and rents and their projected increases rather than on initial rent levels only, as is now the case;

- o Requiring that HUD budget submissions include estimates of the long-term costs of operating subsidies for public housing, which would make the cost figures for public housing and Section 8 more comparable;

- o Requiring that estimates of budget authority requirements for new commitments under both Section 8 and public housing take into account projected increases in development costs and rents from commitments made in prior years;

- o Requiring that FmHA budget submissions include estimates of the long-term costs of rural housing loans comparable to those included in HUD budget submissions for Section 8 and public housing;

- o Establishing common financing procedures for all housing assistance programs.

THE APPROPRIATE MIX OF HOUSING ASSISTANCE PROGRAMS

The selection among types of housing assistance programs--those involving new construction, those entailing the rehabilitation of substandard units, and those subsidizing rents in existing standard units--is one of the most significant housing policy choices facing the Congress each year. Although these three kinds of programs have similar effects in reducing the housing costs of lower-income rental households, their impact on the housing sector of the economy, on nonparticipants, and on the community at large are very different. In addition, the programs differ greatly in their costs to the government.

Trade-offs Among Programs and Proposals for Fiscal Year 1979

Housing assistance programs involving new construction appear to contribute most heavily to the overall supply of housing while also aiding lower-income households. Nevertheless, rehabilitation programs may contribute at least as much to net housing supply as new cosntruction programs, for federally supported rehabilitation may be less likely to substitute for privately sponsored construction activity. Firm data on this question are, however, unavailable. Although existing housing assistance does not contribute to residential construction, it may improve the maintenance of previously built units and hence it may indirectly affect the supply of standard housing.

By focusing aid on areas with below-standard housing, rehabilitation programs may significantly affect community development and neighborhood revitalization. Existing housing programs are less likely to have significant neighborhood revitaliation effects, but they are more likely to result in some deconcentration among lower-income families. Subsidized new construction may have either of those effects, depending on the location of the projects; however, regardless of their location, if newly built assisted-housing projects are not viewed as community assets, they are unlikely to improve distressed areas or reduce concentrations of lower-income persons.

Widely varying rent levels result in great differences in program costs. Maximum allowable annual rents for Section 8 commitments entered into in fiscal year 1977 averaged $3,939 for new construction, $3,845 for substantial rehabilitation, and $2,133 for existing housing. Thus, for a family with a $4,000 income and a $1,000 annual contribution towards its own housing expenses (near the average for all Section 8 households), the annual subsidy cost in the first years of these long-term commitments will be more than twice as great for new construction and substantial rehabilitation as for existing housing. 1/

1/ Rent figures are adjusted to take into account cost differences among regions with different types of program activity. Existing housing subsidy cost includes an administrative fee paid by HUD to the local housing agency for each unit under lease; fee is equal to 8.5 percent of the allowable rent on a two bedroom unit.

By law, HUD must, to the extent practicable, allocate housing assistance among local communities in a manner consistent with their needs, as specified in housing assistance plans submitted by local governments. In accordance with the most recent local plans, the 1979 HUD budget request calls for a significant increase in rehabilitation programs and reductions in both new construction and existing housing assistance. The number of new subsidy commitments under the Section 8 substantial rehabilitation program is scheduled to grow from about 24,000 units in fiscal year 1977 to 56,000 units in 1978 and 70,000 in 1979. In addition, an allocation of 39,000 units is proposed for a new Section 8 "moderate" rehabilitation program in 1979, to be targeted on substandard units requiring between $1,500 and $5,000 of repairs to bring them up to standard. The proportion of additional Section 8 subsidy commitments for new construction is to be reduced from 47 percent of the total during 1977 to 38 percent in 1978 and 33 percent in 1979. Existing housing assistance is to decline from 45 percent in 1977 to 42 percent in 1978, and 34 percent in 1979. 2/

Options Available to the Congress

If the Congress wished to significantly alter the program mix for fiscal year 1979 or for any year thereafter, it might consider reducing or eliminating local discretion in determining the types of housing assistance and, instead, establish the mix of programs either for the nation as a whole or for different types of local markets. Specifying different program mixes for different kinds of housing markets would probably require more knowledge of housing market dynamics than currently exists. If the Congress chose to move in the direction of market-specific targeting, it could initiate studies to identify the relevant market characteristics and determine the relationship between market conditions and program effects.

2/ These proportions are exclusive of the share of Section 8 assistance applied to previously existing HUD-insured multi-family projects. HUD, Summary of the HUD Budget, Fiscal Year 1979, p.H-4.

If the Congress chose to place greater emphasis on new construction, longer-term options include reactivating the Section 236 mortgage-subsidy rental program or designing a similar alternative, and expanding tax benefits available to developers of new lower-income projects. Alternatives emphasizing rehabilitation include expanding participation in the Section 8 program to lower-income homeowners, thereby providing direct cash assistance for upgrading and maintaining homes; offering interest subsidies or federal guarantees for privately written rehabilitation loans; or providing additional tax expenditures to promote rehabilitation.

A longer-term policy option emphasizing the use of existing housing would be the enactment of a full-entitlement housing allowance program, which would provide direct cash assistance to all income-eligible families--homeowners as well as renters--on the condition that they occupy standard units in the private market. In contrast to the Section 8 existing housing program, housing allowance payments could be made directly to the recipient family or individual, eliminating the administrative burden on local agencies of acting as an intermediary between landlords and program beneficiaries. Furthermore, allowance payments could be set at the difference between 25 percent of family income and some benchmark cost for housing, with families allowed to rent units costing more than that amount at their own additional expense. This would appreciably expand the housing opportunities of recipient households. Finally, an allowance program could be financed through annual appropriations without resort to the advanced funding procedures currently used in Section 8. Because of its exclusive reliance on existing housing, an allowance program would be considerably less expensive per household than the current mix of housing assistance programs. Short of instituting such a comprehensive change in policy, the Section 8 existing housing program could be altered to more nearly resemble a direct cash assistance approach.

PROVIDING LOWER-INCOME HOMEOWNERSHIP ASSISTANCE

How and whether to help lower-income families become homeowners and maintain their own homes has been a recurrent policy issue for some years. Debate on the issue intensified when the problems with the original Section 235 program became apparent in the early 1970s. Recent sharp increases in the costs of homeownership focused further attention on this question and broadened the issue to include the housing needs of middle-income families ineligible for current limited-income homeownership assistance programs.

Proposals for Fiscal Year 1979

The Administration's budget submission for 1979 proposes significant increases in both the Section 235 program and rural housing interest credit loans benefiting lower-income families. Program changes that would increase the maximum subsidy provided to any homebuyer and would allow families with lower incomes to receive assistance are also proposed. None of the proposals directly address the housing-costs problem of lower-income persons who already own their own homes. And even with the increases proposed for 1979, existing programs will continue to serve only a very small share of the eligible population.

The 1979 HUD budget proposes an increase in additional Section 235 subsidy commitments from 4,719 new units in fiscal year 1977 to 30,000 in fiscal year 1978, and to 50,000 in 1979. The minimum effective mortgage interest rate for homebuyers under Section 235 would also be reduced from 5 to 4 percent and the downpayment requirement would be lowered from the current 3- to 5-percent level to 3 percent of the purchase price. Neither of these changes requires new authorizing legislation.

The Farmers Home Administration budget submission calls for increasing the number of subsidized home loans from 67,200 during fiscal year 1978 to 75,500 in fiscal year 1979. A new very low-income rural homeownership assistance program to serve families with incomes "much lower" than those that can currently be accommodated, even under FmHA's existing 1-percent interest mortgage program, is also being proposed. Under the new program, very low-income families would contribute 25 percent of their income towards their total housing costs--the principal and interest on a 1-percent loan, utility costs, maintenance expenses, property taxes, and insurance. In addition to absorbing the interest subsidy cost of the loan, FmHA would also pay the balance of the recipients' homeownership expenses. As with all FmHA subsidized loans, the full cost of the program would be spread out over the effective life of the mortgage. Provisions would be made under the new program for the FmHA to recapture at least a portion of the subsidy costs when the homes were sold.

But, because of the lower incomes of the borrowers, the risks of delinquency and default might be greater under the proposed program than under the current program. Over 20 percent of current interest credit home loans are delinquent, and more than one-third of those delinquencies are for more than three months. Approximately 3 percent of all homes on which interest credit loans were outstanding in fiscal year 1977 were acquired by the Farmers Home Administration during that twelve-month period.

Options Available to the Congress

Other options for providing assistance to limited-income homeowners include expanding eligibility in the Section 8 existing housing program to homeowners, and providing a refundable tax credit for a share of mortgage interest and property tax payments as an alternative to the current deduction, which benefits mostly higher-income persons. In contrast to current and proposed assistance programs, these options would both provide relief to low- and moderate-income persons who already own their own homes and encourage homeownership among lower-income renters. Neither option would entail federal liability in the case of mortgage delinquency or default. In addition, homeownership tax credits could be designed to benefit families with incomes too high to qualify for lower-income assistance programs but too low to be aided by current homeownership deductions.

ENCOURAGING RESIDENTIAL CONSTRUCTION AND STABILIZING THE HOME BUILDING INDUSTRY

Repeated downturns in housing production, despite--or, as some have argued, because of--various government interventions, have created a continuing concern over the appropriate role of the federal government in encouraging residential construction and stabilizing the home building industry. Proposals being considered for fiscal year 1979 in this area include changes in the tax code that would provide differential incentives for different kinds of construction and mortgage credit and tax provision changes that could affect the supply and cost of financing for residential construction.

Proposals for Fiscal Year 1979

The tax reform proposals submitted by the President in conjunction with the 1979 budget include a proposal to eliminate accelerated depreciation deductions on new nonresidential business properties and reduce the favorable depreciation treatment available for new multifamily rental housing. The proposed changes would reduce depreciation deductions on new nonresidential properties from the current 150-percent declining balance rate to a straight line rate. Depreciation on new multifamily rental housing, which can now be calculated on the basis of a 200-percent declining balance method, would be reduced to a 150-percent declining balance rate through 1982, and to a straight line rate thereafter. Depreciation deductions on new lower-income rental housing projects could be claimed at the 200-percent declining balance rate through 1982, but would be limited to a 150-percent declining balance rate after that. Stricter rules that would make it difficult for real estate investors to increase their depreciation deductions by claiming artificially short building lives for tax purposes would also be applied. If enacted, these changes would reduce the potential profitability of rental housing as an investment. Housing would nevertheless remain relatively more attractive than nonresidential investments until 1983, and, from a tax standpoint, federally subsidized lower-income housing would continue to be relatively more attractive than other residential investments.

Other 1979 tax reform proposals would prohibit the deduction of investment losses in excess of the amount for which an investor is personally liable, except for real estate investments, and, for tax purposes, would treat new limited partnerships with more than 15 members as corporations, except for those engaged in developing new low-income rental housing. Because most tax shelters operate as limited partnerships with "paper losses" passed through to members, the effect of these proposed changes would be to leave residential real estate as the major intact tax shelter opportunity, affording it a considerable relative advantage in attracting investments.

The President has also recommended that favorable bad-debt deduction allowances currently enjoyed by commercial banks be eliminated in 1979 rather than phased out by 1987, as current law provides. Bad debt deductions allowed by mutual savings banks and savings and loan associations (S&Ls) would be phased down over a five-year period, from the current level of 40 percent to

30 percent of net income. The President's proposals also call for phasing in a tax on credit unions, with their tax treatment becoming the same as that of mutual savings banks and S&Ls by 1983. If these changes are enacted, the profitability of all financial institutions would be diminished, but mutual savings banks and S&Ls, which write the vast majority of all residential mortgages, would remain relatively advantaged.

Two mortgage credit proposals that might affect housing production are being considered by the Congress this year. One would expand the authority of the Federal Home Loan Mortgage Corporation to permit it to purchase and resell loans held by mortgage bankers. Access to the FHLMC secondary mortgage market is currently limited to institutions regulated by the Federal Home Loan Bank Board. To the extent that such a change increasd the supply of credit or reduced its cost by generating competition among mortgage lenders, it might favorably affect the housing industry; however, by expanding access to secondary mortgage markets, one source of credit might simply be substituted for another.

The Congress is also being asked this year to extend the authority of the Government National Mortgage Association (GNMA) emergency mortgage purchase assistance program beyond its currently scheduled expiration date of October 1978. Under this program, GNMA may make commitments to purchase below-market interest rate conventional and government-insured mortgages on new and existing housing. Subject to the availability of mortgage purchase authority released by the Congress, the program may be activated any time there is a determination by the Secretary of the Department of Housing and Urban Development that unfavorable economic conditions are having a disproportionate effect on the housing industry and are causing a serious reduction in residential construction. The administrative flexibility of this program and the speed with which it can be triggered make it among the potentially most effective countercyclical housing policy tools, but its effectiveness is highly dependent on the judgment of the Secretary of HUD in determining when it ought to be activated.

Options Available to the Congress

The complex and overlapping nature of existing federal interventions in the housing sector make it difficult to estimate the net effect of any incremental change in tax or credit policy. Among the other options available to the Congress for stimulating overall housing production are: providing a real estate investment tax credit that would permit builders to deduct a portion of total development costs from their income tax liabilities; and offering direct construction grants that would provide front-end financial assistance to housing developers without reliance on either the tax system or the various credit markets. Options for providing countercyclical assistance to the housing industry include: mandating greater coordination among institutions that currently regulate the supply and price of credit--including overall monetary policy--so that they are not acting at cross purposes, as can now occur; and lifting maximum interest rate restrictions on short-term deposits in mutual savings banks and S&Ls, which would permit them to compete more effectively for deposits during periods of tight money.

HOUSING ASSISTANCE PROGRAMS AND COMMUNITY DEVELOPMENT

The Housing and Community Development Act of 1974, mandated some degree of coordination between housing assistance and community development program objectives. Actions being considered this year to increase the impact of housing assistance programs on community development focus on using federal credit market activities to target residential development on distressed areas and increasing the proportion of housing assistance funds being devoted to rehabilitation.

As a means of promoting neighborhood revitalization, the Administration has proposed using GNMA below-market interest rate mortgage purchase commitments in a new "targeted tandem" program to aid private multifamily rental projects in distressed urban areas beginning in fiscal year 1978. Loan purchase authority in the amount of $500 million is to be applied to this program in each of fiscal years 1978 and 1979, to permit the purchase of loans on 16,700 units during each year. In a related action, HUD has proposed that, in the future, at least some fixed percentage of all FNMA mortgage purchase commitments be made in inner city areas and a minimum number be applied to low- and moderate-income housing. HUD has contended that the Secretary of Housing and Urban Development has the authority to impose such a restriction under the charter which established FNMA as a private corporation; FNMA has disputed that contention. Neither of these proposed actions requires further Congressional authorization.

HUD Section 8 program regulations calling for the designation of specified "neighborhood strategies areas" in which housing assistance would be used to enable lower-income families to remain in areas undergoing revitalization can also be seen as a community development-related housing assistance initiative. Proposed expansions in housing rehabilitation assistance under both Section 8 and the Section 312 loan program are also likely to help revitalize decaying neighborhoods and promote economic integration in areas already undergoing change.