Cato Handbook *for* Policymakers

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50. Housing and Urban Development

Congress should

- fully privatize Fannie Mae and Freddie Mac as it did for Sallie Mae in 1995;
- phase out the mortgage interest deduction;
- eliminate Federal Housing Administration guaranteed loans;
- eliminate urban renewal funds to states and municipalities; and
- abolish the Department of Housing and Urban Development and fold remaining HUD programs into the Department of the Interior (Indian housing), Department of Commerce (disaster relief), Department of Justice (Fair Housing Act), or other appropriate departments.

State legislatures should

- repeal any growth-management laws or similar legislation and restrict the ability of counties to control land uses; and
- repeal laws permitting municipalities to use tax-increment financing to fund urban redevelopment.

The Federal Government's Four Housing Programs

The Department of Housing and Urban Development (HUD) oversees or monitors four major programs: housing subsidies to the wealthy; housing subsidies to the poor; fair housing; and urban renewal (which usually involves construction of new housing). As administered by HUD, all of these programs suffer from such serious flaws that the nation is better off without them.

Housing subsidies to the wealthy—including Federal Housing Administration loan guarantees, Fannie Mae and Freddie Mac (which are moni-

tored by HUD), and mortgage interest deductions—are supposed to increase homeownership rates. But these programs actually have only minor effects on homeownership. Economists Edward Glaeser and Jesse Shapiro have shown that the mortgage interest deduction is "irrelevant" to homeownership rates in the United States.

Few other nations offer any of these subsidies and none have all three. Yet compared with other nations, American homeownership rates are average at best. Australia, for example, offers none of these subsidies to housing but has a higher homeownership rate and builds new homes that are larger, on average, than new American homes. Brazil and Mexico have significantly higher homeownership rates than the United States without any of these programs.

The mortgage interest deduction alone represents a benefit of at least $70 billion per year, three-fourths of which goes to homeowners with incomes above $100,000 per year. The other two programs are also unduly biased toward the relatively wealthy.

Congress should phase out the mortgage interest deduction over 10 years and replace it with a revenue-neutral, across-the-board tax reduction. Federal Housing Administration loan guarantees should be eliminated. Further, Fannie Mae and Freddie Mac should be fully privatized and subject to scrutiny by the Securities and Exchange Commission. If they fail, they should be allowed to go bankrupt like any other private business.

Federal housing subsidies to the poor are no more than a third of the size of those to the wealthy, totaling around $26 billion in 2015. Even so, these programs can be just as misdirected and useless as the subsidies to the wealthy. Federal low-income housing programs—including public housing, Section 8 vouchers, and Section 8 project-based assistance—reach only about 20 percent of the people who are eligible, and many of the remainder are on long waiting lists. Of the three programs, vouchers reach the most people (more than 5 million vs. 4.2 million for the other two programs combined), cost taxpayers the least, are least susceptible to corruption, and probably work the best in giving low-income families economic opportunities without trapping them in the welfare system.

One problem with many public housing programs is that they have been hijacked by supposedly nonprofit organizations that lobby heavily to maintain their subsidies even as they do little to correct real housing affordability problems. For example, an organization called Enterprise Community Partners gets most of its funds from federal grants and spent only 21 percent of its 2014 revenues on grants aimed at providing

affordable housing. Well over 60 percent of its revenues went to salaries, pensions, or professional service contracts. In 2014, it paid its chief executive nearly $900,000 and paid at least 16 other people more than $200,000. The U.S. government gets along with one vice president; Enterprise Community Partners has at least 23, many of whom were paid more than taxpayers paid Joe Biden in 2014, and all of whom were paid more than $160,000.

Affordable Housing Versus Housing Affordability

Whether at the federal, state, or local level, the job of providing affordable housing to the poor has become much more expensive thanks to the growing housing affordability crises in many urban areas and states. While "affordable housing" refers to subsidized housing for low-income people, "housing affordability" refers to the general level of housing prices relative to incomes. One standard measure of housing affordability is median home prices divided by median family incomes, or the value-to-income ratio.

A family buying a home that costs less than three times their income can devote 25 percent of their income to pay off the mortgage in less than 30 years. Since banks typically require that homebuyers spend no more than a quarter of their incomes on their mortgage, value-to-income ratios less than 3 are affordable, ratios greater than 3 are marginally unaffordable, and ratios greater than 4 are unaffordable.

By that measure, housing throughout America, except Hawaii, was all affordable in 1969. At the time, value-to-income ratios in major urban areas ranged from 1.5 in San Antonio to 2.6 in New York (and 3.2 in Honolulu). Today, most urban areas remain affordable, but median home prices in some major urban areas have climbed to more than five times median family incomes. As of 2014, the ratio in Santa Barbara, California, was a staggering 9.3. Ratios are particularly high in California, Hawaii, Massachusetts, New Jersey, New York, Oregon, and Washington state.

With the exception of New York, what these states have in common is growth-management laws that attempt to confine urban growth to certain areas using urban-growth boundaries, urban-service boundaries, greenbelts, or other restrictions. New York City housing is unaffordable partly because it is surrounded by New Jersey and Connecticut, both of which have growth-management laws, and because of rent control and other regulations that discourage the construction of new housing. Other urban areas in New York state are affordable. Hawaii was the first state to

pass a growth-management law—in 1961—which is why it was marginally unaffordable even in 1969.

In addition to these states, many urban areas have adopted growth-management plans that have made housing unaffordable. Boulder, Colorado, has purchased a large greenbelt around itself that has made it the least affordable urban area in the United States outside of California, Hawaii, and New York. Nearby Denver also has an urban-growth boundary. In all, about 40 to 45 percent of American housing is unnecessarily expensive due to state or local growth-management laws.

Advocates of growth management say it protects farms and open spaces, saves energy, and reduces pollution and greenhouse gas emissions. But the United States has a relative surplus of farms and open spaces: the Department of Agriculture says the nation has nearly 1.1 billion acres of agricultural land but grows crops on only a third of those acres. Moreover, the number of acres needed for croplands is declining because per-acre productivity of major crops, including wheat, corn, soybeans, and many others, is growing faster than the nation's population. As for open space, all of the nation's urban areas with populations greater than 2,500 cover just 3 percent of the nation's land. Even the most urbanized state, New Jersey, is more than 60 percent rural open space.

Saving energy and reducing greenhouse gas emissions might be more important, but growth management is not the way to achieve those goals. Based on an extensive literature review of the relationship between urban form and energy/emissions, University of California, Irvine, economist David Brownstone concluded that the connection between the two was "too small to be useful." There are far better ways of saving energy and reducing emissions that cost less and don't make housing expensive—for example, encouraging people to buy more fuel-efficient cars and homes.

Rather than fixing housing affordability problems by repealing growth-management laws and plans, local officials have elected to address the issue using affordable housing funds, thus putting pressure on the federal government to spend more money to make up for local economic mismanagement. Of course, affordable housing programs help only a small number of people, while the housing affordability issues created by growth-management programs make housing less affordable for all renters and

homebuyers and significantly increase the share of families suffering from housing distress.

In addition to leaning heavily on federal housing funds, many cities have adopted affordable housing policies that actually make the overall housing market less affordable. For example, some cities tax new homes to fund the construction of affordable homes while others require homebuilders to sell or rent 15 to 25 percent of their homes to low-income families at below-market prices. Both of those policies make housing less affordable by discouraging new construction and increasing the cost of new market-rate homes (which, in turn, increases the price of existing homes for sale).

Growth-management policies hit low-income families the hardest. In particular, blacks—whose per capita incomes remain at about 60 percent of white per capita incomes—have been forced to move to lower-quality housing or even out of urban areas that practice growth management. Between 2000 and 2010, the population of the San Francisco–Oakland urban area grew by more than 285,000 people, but the black population declined by nearly 49,000. Boulder, Honolulu, Los Angeles, and San Diego also saw their black populations shrink; in Denver and Portland, Oregon, black homeownership rates declined as increasing numbers of blacks were forced to move from single-family to multifamily housing.

HUD is supposed to monitor fair housing practices and has issued regulations against land-use policies that effectively discriminate against low-income minorities by making housing less affordable. But instead of challenging growth-management practices, the Obama administration has focused on reducing segregation through a program known as "affirmatively furthering fair housing." Under this program, any municipality that receives federal low-income housing funds must compare its mix of races and ethnicities with that of the region in which it is located and take steps to reduce segregation if it doesn't have enough minorities.

Unfortunately, affirmatively furthering fair housing attacks the wrong problem. Census data reveal that segregation is declining everywhere. But in affordable regions, it is declining because more minorities are moving into historically white neighborhoods and new neighborhoods are fairly well integrated; in *un*affordable regions it is declining because whites are moving into more affordable housing in historically minority neighborhoods, pushing the minorities into inferior housing and sometimes completely out of the region. Affirmatively furthering fair housing threatens to penalize the former while rewarding the latter.

Urban Renewal

HUD's fourth major program, community redevelopment, was originally created to help restore slums and other "blighted" neighborhoods, meaning neighborhoods whose condition was so bad that private investors would not spend any money to improve them. While some question whether such neighborhoods ever truly existed, it is clear today that so few true slums exist that many cities are declaring thriving neighborhoods and even greenfields to be blighted so they can use federal, state, and local funds to redevelop those neighborhoods. Such redevelopments are driven more by crony capitalism and social engineering programs than by the need or desire to remove blight.

For example, many cities use urban redevelopment funds to subsidize the construction of high-density housing. Supposedly, millennials prefer high-density housing over single-family homes. If so, there would be no need for subsidies. In fact, high-density housing is a part of the same growth-management programs that restrict the amount of land available for urban growth. The mantra of growth-management supporters is "grow up, not out," and they believe higher densities will reduce driving, saving energy and cutting greenhouse gas emissions.

Thus, the push for high-density housing overrides the desires of Americans, the vast majority of whom would prefer to live in single-family homes if they could afford them. Moreover, the environmental benefits of high-density housing are negligible if they exist at all; there are far better ways to save energy and reduce emissions that don't make housing unaffordable or require Americans to change their lifestyles. While there is nothing wrong with developers building high-density housing if a market for such housing truly exists, there is no need for the federal government to use taxpayer dollars to support such social engineering.

In addition to federal funds, most urban redevelopment is funded using tax-increment financing, which uses property (and sometimes sales) taxes that would otherwise go to schools, fire departments, and other agencies to subsidize developers. City officials often claim this is "free money" because the taxed developments would not have taken place without the subsidies; but studies show that cities that use tax-increment financing grow no faster and may even grow slower than cities that don't. That means urban redevelopment through tax-increment financing is a zero-sum and possibly a negative-sum game, as the developments would have taken place without the financing, though possibly in a different form

and location. Tax-increment financing was first used in California, but that state abolished such programs in 2011; other states should do the same.

Suggested Readings

O'Toole, Randal. *American Nightmare: How Government Undermines the Dream of Homeownership*. Washington: Cato Institute, 2012.

———. "Crony Capitalism and Social Engineering: The Case against Tax-Increment Financing." Cato Institute Policy Analysis no. 676, May 18, 2011.

———. "The Myth of the Compact City: Why Compact Development Is Not the Way to Reduce Carbon Dioxide Emissions." Cato Institute Policy Analysis no. 653, November 18, 2009.

———. "The New Feudalism: Why States Must Repeal Growth-Management Laws." Cato Institute Policy Analysis no. 802, October 18, 2016.

Wallison, Peter J., Alex J. Pollock, and Edward J. Pinto. *Taking the Government Out of Housing Finance: Principles for Reforming the Housing Finance Market*. Washington: American Enterprise Institute, 2011.

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