

# Background

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## The President's Worrisome Narrative to Discourage Homeownership

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**Abstract:** *There is no question that there is much wrong with America's housing finance and homeownership market. There is much evidence to indicate that many of the costly efforts by the federal government to promote housing and homeownership were at best ineffective and at worst contributed to a serious recession. While the focus of reform should be on the flawed mechanisms and the policies and institutions that contributed to the problem, there are those—notably many smart growth advocates and some in the Obama Administration—who see this as a reason to abandon the government's endorsement of homeownership as a goal worthy of promoting and achieving.*

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On July 21, the Obama Administration announced that it would turn its attention to the housing finance market now that Congress has completed work on financial reform legislation.<sup>1</sup> In making that announcement, the Administration noted that it believed federal policies to date had placed too much emphasis on homeownership and that it intended to rebalance those policies that influence the choice in tenancy (rent, buy, live with Mom) and place more emphasis on the availability of affordable rental units.

While this will strike some as a significant withdrawal from the long-standing, bipartisan postwar commitment to encourage homeownership, there is ample evidence that many of the federal policies adopted in the belief that they would foster home-

### Talking Points

- Another 2.7 million homeowners will likely lose their homes as the market continues to correct itself.
- One cannot help but get the unsettling feeling that the President's "Great American Community Transformation Narrative" has been inspired by Professor Richard Florida, a controversial figure in the urban revitalization debate.
- Why would a President who claims to be looking out for the little guy want to make it more difficult for the little guy to accumulate wealth?
- There is every reason to believe that the real justification for discouraging homeownership is to reshape American communities toward the nostalgic vision of the crowded communities common in the early decades of the previous century.
- Moderate-income households would be forced to adjust to the President's new, transformational urban social policy while higher-income families would be able to buy their way out of it.

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ownership were in fact costly and ineffective and that they contributed to occasional bouts of severe financial instability—the current recession being an example of the latter.

Having said that, and in consideration of the many other statements that the Administration has made regarding its desire to substantially alter the way in which Americans live and travel—by, among other things, discouraging suburban living and automobile use in favor of bicycles and walking<sup>2</sup>—there is every reason to believe that this soon-to-be-proposed effort to stabilize the housing market will be (1) little more than a policy vanguard for another “transformational” act of social engineering and (2) a vehicle for a backdoor tax increase to help resolve the unwieldy deficit problem that the Administration has been unable to solve.

### Where Obama Has It Right

Unlike other nations, the U.S. provides substantial subsidies to homeowners, most notably the mortgage interest expense deduction and the exemption from capital gains taxes. It also operates a mortgage insurance program—the Federal Housing Administration (FHA)—and has created a series of massive government-sponsored enterprises (GSEs) to facilitate access to credit. According to the U.S. Office of Management and Budget, in 2010 the mortgage expense deduction will reduce households’ federal income taxes by \$92.2 billion, while the capital gains exemption will reduce income taxes by \$23.7 billion.<sup>3</sup>

***Despite vast subsidies and the counterproductive mortgage market interference, homeownership rates in the U.S. are similar to those in other comparably situated countries that do not offer the lavish subsidies available here.***

Yet despite these vast subsidies and the counterproductive mortgage market interference, homeownership rates in the U.S. are similar to those in other comparably situated countries that do not offer the lavish subsidies available here. In 2006 (the most recent year for which data are available for the countries being compared), the homeownership rate in Australia, Canada, Ireland, Spain, and the United Kingdom matched or exceeded that in the United States. Whereas the U.S. had a homeownership rate of 68.8 percent that year, it was 68.4 percent in Canada, 69.8 percent in Australia, and 70 percent in England.<sup>4</sup>

Importantly, none of these nations possess GSEs (i.e., entities like Fannie Mae and Freddie Mac<sup>5</sup>) dedicated to expanding residential mortgage credit; only Canada offered a government mortgage insurance scheme; and mortgage interest expenses were *non-deductible* for income tax purposes in Canada, the U.K., and Australia—and capped at 9,015 euros for those in the 15 percent tax bracket in Spain. Most developed countries do exempt owner-occupied housing sales from capital gains taxes.<sup>6</sup>

1. Zachary A. Goldfarb, “Next Up for Reform: Housing Finance,” *The Washington Post*, July 21, 2010, p. A14.
2. See Ronald D. Utt, “No Tax Increase for Federal Transportation Programs?” Heritage Foundation *WebMemo* No. 2870, April 19, 2010, at <http://www.heritage.org/Research/Reports/2010/04/No-Tax-Increase-for-Federal-Transportation-Programs>.
3. Office of Management and Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2011*, Table 16-2, p. 215.
4. See Statistics Canada, “Changing Patterns in Canadian Homeownership and Shelter Costs, 2006 Census,” 2006, at <http://www12.statcan.gc.ca/english/census06/analysis/shelter/pdf/97-554-XIE2006001.pdf> (August 6, 2010); Parliament of Australia, Parliamentary Library, “Home Ownership in Australia—Data and Trends,” February 11, 2009, at <http://www.aph.gov.au/library/pubs/rp/2008-09/09rp21.pdf> (August 6, 2010); Department for Communities and Local Government (U.K.), *Housing in England 2005/06*, October 2007, at <http://www.communities.gov.uk/documents/housing/pdf/HousinginEngland0506.pdf> (August 6, 2010).
5. Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC).
6. See Michael Lea, “Alternative Forms of Mortgage Finance: What Can We Learn from Other Countries,” a paper presented at Moving Forward: The Future of Consumer Credit and Mortgage Finance, A National Symposium, Joint Center for Housing Studies of Harvard University, February 18–19, 2010.

On top of these long-standing subsidies, federal support of homeownership escalated in the 1990s when President Bill Clinton required the GSEs to meet specific affordable housing goals by purchasing a specified percentage of mortgages in low-income and minority communities. The Bush Administration continued this policy and raised the percentage (to 56 percent). At the same time, it sought and received legislation to “liberalize” the FHA’s underwriting standards to allow heretofore unqualified borrowers to become eligible for the federal program.

As a consequence of these altered underwriting standards—which largely reflected a similar collapse of standards in the private market—as well as the race and income goals required of the GSEs and easy access to mortgage credit by households that would otherwise not be qualified, home buying reached record levels.

### Implications for the Next Few Years

As is painfully obvious, many of these unqualified borrowers were unable to service their mortgage debt and soon defaulted on their loans. In turn, lenders foreclosed on the properties or agreed to “short sales,” while many other owners simply walked away from their houses. For much of the residential real estate market and the U.S. economy, the consequences of this process has been catastrophic and is likely to continue for the next two to three years as the mortgage market slowly and painfully converges to the more or less sustainable model that held from the early 1950s until the mid-1990s.

Thanks to postwar prosperity, stability in the financial system, and the adoption of the fixed-rate, level-payment, fully amortized mortgage, the homeownership rate soared from 43 percent in 1940 to 63 percent by 1962 and stayed within the 63 percent–65 percent range until 1998. What accounted for this three-decade ceiling in the home-

ownership rate were (1) tough underwriting standards that required full income, asset, and debt documentation to confirm the borrower’s ability to repay the loan and (2) a hefty down payment—generally 10 percent to 20 percent of the purchase price—to limit lender losses in the event that the borrower failed to meet debt requirements.

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For a variety of reasons,<sup>7</sup> the private mortgage market began to reduce its underwriting standards in the mid-1990s, and this allowed previously unqualified households to become homeowners, thereby increasing the homeownership rate from 64.7 percent in 1995 to a record 69.2 percent in the second quarter of 2004. This translates into an increase of nearly 5 million additional new homeowner households. As a 2008 Heritage report on the subprime mortgage problem predicted,<sup>8</sup> and as recently echoed in a *Barron’s* article urging investors to focus on apartment rental companies,<sup>9</sup> the homeownership rate will decline from its subprime peak of 69 percent in 2004 to a sustainable 64 percent–65 percent as many of these new homeowners continue to lose their homes to foreclosure, short sales, and deed in lieu of foreclosure and as the reversion to the tighter underwriting standards of the past allows fewer new homeowners to qualify.

The homeownership rate has since fallen to 66.9 percent—about halfway to the predicted 65 percent sustainable rate—implying that about 2.6 million households have now become renters or have doubled up with others and that another 2.7 million homeowners will likely lose their homes over the next few years as the market continues to correct

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7. See Ronald D. Utt, “The Subprime Mortgage Market Collapse: A Primer on the Causes and Possible Solutions,” Heritage Foundation *Background* No. 2121, April 22, 2008, at <http://www.heritage.org/Research/Reports/2008/04/The-Subprime-Mortgage-Market-Collapse-A-Primer-on-the-Causes-and-Possible-Solutions>.

8. *Ibid.*

9. Gene Epstein, “Renter Nation,” *Barron’s*, July 26, 2010, p. 19.

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### **An Emerging Federal Smart Growth Agenda**

The President will likely note such arguments in any attempt to reduce the tax benefits of homeownership, and these reductions will also offer him a part of the solution to the federal fiscal mess that now confronts him. Indeed, Exhibit A in Obama's move to raise taxes on some homeowners is a provision in the health care bill that will effectively increase the capital gains tax on certain home sales.

At present, capital gains that do not exceed \$500,000 on the sale of a primary residence are exempt from the capital gains tax. Any gains in excess of \$500,000 are subject to the tax. Obamacare applies an additional 3.8 percent tax on capital gains from the sale of a primary resident, so if someone has a capital gain of more than \$500,000 on the sale of their home, he or she will pay a higher tax starting in 2013. Having crossed this line by undoing some of the tax benefits of homeownership, it is an easy matter to revisit this territory in the future in pursuit of both a smart growth agenda and federal budget policies.

While there is evidence to indicate that the many federal subsidies for homeownership have not been particularly effective, any additional revenues arising from their modification should be used to lower tax

rates and simplify the tax code, not to increase the tax burden. The nation is still in a severe recession, and a tax increase oriented toward an act of pointless social engineering would only make matters worse.

As noted, there is every reason to believe that the real justification for discouraging homeownership is to reshape American communities toward the nostalgic vision of the crowded communities common in the early decades of the previous century. Secretary of Transportation Ray LaHood has defined the President's "livability" agenda as "being able to take your kids to school, go to work, see a doctor, drop by the grocery or post office, go out to dinner and a movie, and play with your kids in a park, all without having to get in your car."<sup>10</sup>

As these policy yearnings take shape, one cannot help but get the unsettling feeling that the President's "Great American Community Transformation Narrative"—and its discouragement of homeownership—has been inspired by the writings of University of Toronto Professor Richard Florida. Born in New Jersey, Dr. Florida has become a controversial figure in the urban revitalization debate.

His early claim to fame was the notion that the economic and cultural future belonged to "cool cities" with a thriving "creative class." As his views became briefly fashionable a half-decade ago, a number of elected officials and journalists embraced his theories. Governor Jennifer M. Granholm (D-MI) promised in 2005 to create in Michigan (unemploy-

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ment rate 13.2 percent) a "cool cities" program.<sup>11</sup> Not to be outdone in this cosmic process, the then-mayor of Detroit (unemployment rate 14.3 percent) and now convicted felon Kwame Kilpatrick was dubbed the "hip-hop mayor" for his cool cities approach to redeveloping Detroit.

10. Amy Phillips, "Transportation Officials Stress Importance of Administration's Livability Initiatives," Bureau of National Affairs *Daily Report for Executives*, September 29, 2009.

11. See Governor Jennifer Granholm, "Our Determination, Our Destination: A 21st Century Economy," at [http://www.michigan.gov/gov/0,1607,7-168-29544\\_29546\\_29555-84911--,00.html#cool](http://www.michigan.gov/gov/0,1607,7-168-29544_29546_29555-84911--,00.html#cool) (August 6, 2010).

Dr. Florida's evolving and unique views on the urban environment have come under intense criticism from some in the media<sup>12</sup> and in the academic community,<sup>13</sup> a phenomenon he blames on neoconservatives.<sup>14</sup> Nonetheless, his views fit comfortably with Barack Obama's anti-car, anti-suburb views.

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**Homeownership still remains the most important mechanism for wealth accumulation for moderate-income households, and at a time of disappearing pension plans and a diminished savings rate, such accumulated wealth becomes increasingly important.**

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In the March 2009 issue of *The Atlantic*,<sup>15</sup> Dr. Florida gave full vent to his prejudices, and his views thus expressed seem remarkably similar to the hints that President Obama has been dropping of late about his sometime-soon-to-be-revealed transformational community development/transportation narrative. As Dr. Florida sees it:

The housing bubble was the ultimate expression, and perhaps the last gasp, of an economic system some 80 years in the making and well past its "sell-by" date.... It encouraged low-density sprawl, which is ill-fitted to a creative, postindustrial economy...and a workforce too often stuck in place, anchored by houses that cannot be profitably sold, at a time when flexibility and mobility are of great importance.<sup>16</sup>

His key proposal—now embraced by Obama—is to create more renters and fewer homeowners: "The solution begins with the removal of homeown-

ership from its long-privileged place at the center of the U.S. economy.... Government policies should encourage renting, not buying." To facilitate the implementation of the more-renters policy, Florida embraces the smart growth/New Urbanist creed of the 1990s:

We need to begin making smarter use of both our urban spaces and the suburban rings that surround them—packing in more people.... That means liberal zoning and building codes within cities to allow more residential development, more mixed-use development in suburbs and cities alike, the in-filling of suburban cores near rail links, new investment in rail, and congestion pricing for our roads.<sup>17</sup>

As discerning readers will note, these are precisely the policies being proposed by Secretary of Transportation LaHood and by Congressman Jim Oberstar (D-MN), chairman of the House Committee on Transportation and Infrastructure.

### Where Obama Has It Wrong

While there is no question that the mortgage finance excesses of the past dozen years have had a catastrophic effect on the economy and on the lives of many families, the lesson the President should draw from this experience is that irresponsible lending, cheating and lying on mortgage applications, financial illiteracy, borrower innumeracy, and investor carelessness will cause serious problems.

Homeownership still remains the most important mechanism for wealth accumulation for moderate-income households, and at a time of disappearing pension plans and a diminished savings rate, such accumulated wealth becomes increas-

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12. Murray Whyte, "Why Richard Florida's Honeymoon Is Over," *The Toronto Star*, June 27, 2009, at <http://www.thestar.com/printArticle/656837> (August 6, 2010).

13. Joel Kotkin and Fred Seigel, "Too Much Froth: The Latte Quotient Is Bad Strategy for Building Middle-Class Cities," *Blueprint*, January 8, 2004, at [http://www.dlc.org/ndol\\_ci.cfm?kaid=141&subid=301&contentid=252300](http://www.dlc.org/ndol_ci.cfm?kaid=141&subid=301&contentid=252300) (August 6, 2010).

14. Richard Florida, "Neo-Conservatives and Cities," *Creative Class Blog*, December 16, 2006, at [http://www.creativeclass.com/creative\\_class/2006/12/16/neo-conservatives-and-cities/](http://www.creativeclass.com/creative_class/2006/12/16/neo-conservatives-and-cities/) (August 6, 2010).

15. Richard Florida, "How the Crash Will Reshape America," *The Atlantic*, March 2009, pp. 44–56, at <http://www.theatlantic.com/magazine/archive/2009/03/how-the-crash-will-reshape-america/7293> (August 6, 2010).

16. *Ibid.*, p. 55.

17. *Ibid.*, p. 56.

ingly important as a source of well-being, both in and out of retirement. In 2007, the median value of financial and non-financial assets held by homeowners reporting both types of assets was \$344,000, compared to \$13,600 for similarly reporting renters. For homeowners, their primary residence amounted to \$200,000 of their non-financial assets.<sup>18</sup>

The question, then, is: Why would a President who claims to be looking out for the little guy against the craven interests of the rich and the corporations want to make it more difficult for the little guy to accumulate wealth? Well, perhaps he does not; maybe this outcome is an unintended consequence of the President's attempt to pursue both fiscal and fashionable goals. Specifically, he may very well be pursuing an anti-homeownership policy to justify new tax increases on families to cover his spending plans and pander to his left-wing supporters and radical environmentalists who want him to discourage suburbanization and force new households back into dense urban areas and troubled central cities.

Either way, it will be the moderate-income households who will be forced to adjust while higher-income families have the financial resources to buy their way out of the President's new, transformational urban social policy.

### **Restoring Sense and Sensibility to America's Housing Markets**

There is no question that there is much wrong with America's housing finance and homeownership market, and the catastrophic collapse of the market beginning in 2007 contributed to a global recession that is still underway. There is much blame to go around, and there is also much evidence to indicate that many of the costly efforts by the federal government to promote housing and homeownership were at best ineffective and at worst contributed to a serious recession. While the focus of reform should be on the flawed mechanisms and the policies and institutions that contrib-

uted to the problem, there are those—notably many smart growth advocates and some in the Obama Administration—who see this as a reason to abandon the government's endorsement of homeownership as a goal worthy of promoting and achieving.

As federal data reveal, homeownership among non-Hispanic whites exceeds 75 percent, while the homeownership rate among African-Americans and Hispanics is below 50 percent. As the Obama Administration pushes for less emphasis on home-

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ownership, it will be these moderate- and lower-income families on the margins of the economy who will suffer. Indeed, they will become the cannon fodder for Richard Florida's reconstruction of America's cities to cultivate the already upwardly mobile "creative class" and Ray LaHood's nostalgic embrace of a bygone era when all but the very rich had to walk everywhere.

Some in Toronto, Canada—where Dr. Florida now lives and works—have caught on to his elitist agenda and are expressing their concern. At a public forum in Toronto in June 2009 to discuss the implications of Dr. Florida's proposals for the city, a participant named Uzma Shakir told the audience: "Richard Florida's exotic city, his creative city, depends on ghost people working behind the scenes. Immigrants, people of colour. You want to know what his version of creative is? He's the relocation agent for the global bourgeoisie. And the rest of us don't matter."<sup>19</sup>

Until the 1950s, the homeownership rate in America was below 50 percent, and the majority of Americans were renters, boarders, or farm hands living above the stable for room and board and a small cash stipend. Postwar prosperity ended these

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18. Federal Reserve Board, "2007 Survey of Consumer Finances," May 7, 2009, at <http://www.federalreserve.gov/pubs/oss/oss/2007/scf2007home.html> (August 6, 2010).

19. Whyte, "Why Richard Florida's Honeymoon Is Over."

primitive social arrangements; within 15 years, nearly two-thirds of American households became homeowners. Similar trends occurred in many other countries somewhat later, and all view this as a success.

Why President Barack Obama wants to reverse a trend that most of the world and most Americans view as progress and success is something he needs to explain as he pushes his new austerity

housing agenda on a reluctant nation. No doubt many thousands of domestic versions of Toronto's Uzma Shakir will be there to remind us all about how unfair and elitist the President's smart growth agenda really is.

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