# Development of Federal Homeownership "Policy"

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*Abstract*

Federal programs that have been established with homeownership as an explicit objective have been rare, limited, and often short-lived. Programs that promote or facilitate homeownership were generally created to serve other purposes, such as macroeconomic stimulus. Such programs have often been retained or expanded because of their effects on homeowners and homeownership, however, with their initial purpose forgotten or ignored.

The federal government's active involvement in housing generally dates from the 1930s. With regard to homeownership, federal involvement has included tax provisions, credit market participation and regulation, and (rarely) direct subsidies. Federal programs such as the Federal Housing Administration have had profound impacts on owner-occupied housing and housing finance, but many of the innovations commonly attributed to government programs were in fact present in the past and developed by the private sector.

**Keywords:** Federal; Homeownership; Policy

## Introduction

The federal government has a significant impact on the ability of American households to achieve homeownership and on the incentives for households to choose homeownership over rental housing. The existence of government policies and programs that effectively support homeownership has created the perception that encouragement of homeownership was the basis for creating these government policies. In most cases, however, the principal reason they were adopted was not to facilitate or encourage homeownership. In many cases they were established to stimulate construction activity and the overall economy. At other times, policies were established to improve the physical quality of the housing stock, to bail out existing homeowners or financial institutions, or to meet other objectives, such as to reward veterans for serving the country in wartime.

This article does not address the very interesting questions of whether homeownership is beneficial, either for individual households or for the community, and whether it is an appropriate objective for federal policy. Such questions have been addressed in a limited number of studies in the past, but interest in that subject appears to have increased recently (Boehm and Ihlandfeldt 1986; DiPasquale and Glaeser 1997; Galster 1983; Green and White 1996; Krumm 1986; Marcuse 1972; Mitchell 1985; Oswald 1996, 1997; Rohe and Stewart 1996; Rossi and Weber 1996). There is also only limited attention given in this article to whether policies that facilitate or encourage homeownership do so effectively or efficiently. The focus is on the historical roots of current policies.

Insofar as this article is a reexamination of history and of very public events, the subject material is not new. But much of the history of housing policy and housing finance has become shrouded in myth and misinformation. For example, it is widely but incorrectly believed that long-term, fixed-rate, level payment, fully amortizing mortgages were unknown or rare before the federal government became seriously involved in housing finance in the 1930s. As discussed below, fully amortizing mortgages were common in the 1920s, although the term to maturity was rarely more than 15 years and the loan-to-value ratios were low. Thirty-year mortgages did not come into widespread use until after World War II.

Federal government policy toward housing in general, and homeownership in particular, is exercised through three primary mechanisms: tax benefits, regulation of and participation in the financial system, and direct subsidies to housing producers and consumers. The federal income tax code allows homeowners to deduct mortgage interest expense and real estate taxes and offers favorable treatment on gains from the sale of owner-occupied homes. Moreover, the implicit rental income from owner-occupied dwellings is tax free. There have also been provisions under the federal tax law permitting state and local government agencies to offer below-market-rate financing to home buyers at the expense of the federal treasury. The federal involvement in the housing finance system has been extensive, including the provision of mortgage insurance and guarantees, sponsorship of private secondary mortgage market entities, support of depository institutions that specialize in housing finance, creation of regulations encouraging or requiring financial institutions to provide funds for housing, and in some cases, the provision of direct loans to home buyers. Direct subsidies have been the least active element with regard to homeownership but have included mortgage subsidies.

Prior to the 1930s, there was little federal involvement in housing, except for land grants such as the 1862 Homestead Act, which were largely oriented toward farming and fulfilling the "manifest destiny" of filling up the frontier. There was limited federal support for housing needed in connection with military supply efforts during World War I.

An "Own Your Own Home" campaign was launched by the U.S. Department of Labor in 1918 (Weiss 1989). In the same vein, Herbert Hoover, while Secretary of Commerce in the Harding and Coolidge administrations, served as president of Better Homes of America, Inc. This remarkable public-private partnership offered education and publications promoting housing and homeownership. By 1930 there were 7,279 local Better Homes committees sponsoring home improvement contests and lectures on how good homes build character (Wright 1981). But no financial support for homeownership was forthcoming from the federal government during the 1920s, and housing finance was primarily regulated by the states.

## Tax policy

The deductibility of home mortgage interest and property taxes is often cited as the largest source of federal assistance to housing and as evidence of a bias in favor of homeownership over rental housing. There is no evidence that support of homeownership was considered in the original formulation of the provisions allowing these deductions. The deduction of interest expense was not limited to home mortgage interest, and the deduction of local and state taxes was not limited to property tax in the earliest versions of the income tax—the Revenue Acts of 1864 and 1865 and the Tariff Act of 1913.

It was not until the 1986 Tax Reform Act that a distinction was made between mortgage interest and other consumer interest in the regular personal income tax, although such a distinction was incorporated earlier in the alternative minimum tax. The deduction of mortgage interest and property tax was preserved in the 1986 act, while deductions for nonmortgage consumer interest and various state and local taxes were eliminated. Moreover, tax reform virtually eliminated the existing incentives for investment in rental housing, which had been made more generous by the 1981 Economic Recovery Tax Act.

The preservation of the mortgage interest deduction in 1986 showed that this tax preference, whatever its genesis, had become a matter of policy. The mortgage interest deduction, uniquely among the provisions of the Internal Revenue Code, was taken "off the table" by the Reagan administration during the tax reform debate.

Following a speech to the National Association of Realtors in May 1984, in which he said that everything would be on the table as the

Treasury Department developed proposals for tax reform, President Reagan encountered a barrage of complaints because of the possibility that the mortgage interest deduction might be eliminated. The president, facing reelection, reversed himself the following day (McLure 1986).

Although the homeowner deductions were preserved in the 1986 act, their value was substantially reduced by the reduction in marginal tax rates, which meant that each dollar in deductions represented smaller tax savings. Moreover, the simultaneous elimination of many nonhousing deductions and increase in the standard deduction had the effect of sharply reducing or totally eliminating the reduction in taxable income and tax liability for moderate-income households attributable to homeownership.

Many analysts regard the real tax subsidy to homeownership not as the deductibility of mortgage interest and property tax, but the exclusion of homeowners' implicit rental income from taxable income (Aaron 1972; Follain, Ling, and McGill 1993; Gravelle 1983). Homeowners are their own landlords, and the notion is that they ought to pay tax on the rent they are implicitly receiving from themselves. But the absence of a tax on implicit rental income is consistent with the treatment of other noncash implicit income, such as the value of homegrown food consumed by farmers, the rental value of consumer durables, or unpaid services provided by family members.

Several other provisions affect the calculation of homeowners' taxes in ways that reduce the effective cost of homeownership. Beginning in 1951, homeowners were permitted to "roll over" the gain from the sale of one home if they bought another home of equal or greater value. This provision was enacted largely to alleviate hardship for relocating wartime workers, but it was also recognized as facilitating the purchase of larger homes by growing families (Semer et al. 1976). The 1964 Revenue Act introduced a once-in-a-lifetime exclusion of all or part of the gain on sale for owners ages 55 and over who trade down or become renters.

The Taxpayer Relief Act of 1997 replaced the rollover of capital gains for homeowners who buy another house and the exclusion of up to $125,000 in gains for owners 55 or older with an exclusion of gains up to $500,000 for owners of any age filing joint returns. This provided a greater incentive for becoming a homeowner, but it removed a disincentive for dropping out of homeownership or trading down to a lower-priced home. Although the elimination of taxes on gains from home sales was inherently popular, the change was reportedly motivated by the argument that the rollover provision contributed to the decline of cities as owners traded up to more expensive suburban homes (Bier and Meric 1994; Pierce 1997). The 1997 act also allowed, for the first time, penalty-free withdrawals of funds for down payments from tax-deferred retirement accounts.

In addition to the benefits available to homeowners through reductions of their individual taxes, the federal tax system also provides for state and local government agencies to subsidize homeownership for moderate-income first-time buyers using mortgage revenue bonds (MRBs) and mortgage credit certificates (MCCs). MRBs are tax-exempt securities issued by state or local housing finance agencies to raise mortgage funds for first-time buyers, with the interest rate advantage passed on to mortgage borrowers. The agencies have an option of trading authority to issue MRBs for authority to grant MCCs, which provide credits against individual income tax for eligible home buyers.

The MRB program was not the result of an initiative on the part of Congress to assist home buyers. Instead, it was an innovation by state and local agencies exploiting their tax-exempt borrowing authority. In 1978, tax-exempt bonds were issued to fund below-market-rate mortgages in Chicago, an idea that was quickly copied by many other local government agencies. State housing finance agencies had provided bond-financed mortgages before then, but the entry of municipalities stimulated a surge in such activity (Congressional Budget Office 1979). Alarmed about the loss to the federal treasury from widespread use of this device, Congress enacted, in the Mortgage Subsidy Bond Tax Act of 1980 (P.L. 96–499), restrictions on the issuance and use of MRBs, including limits on the volume of activity in each state, limits on the purchase price of the home, and limits restricting the program to mostly first-time buyers.[1] Further restrictions have since been added, including a limit on borrowers' incomes and a requirement that assisted home buyers repay some of the subsidy when they resell their homes.

The MCC program was established in 1984 as an alternative to MRBs, reflecting concern on the part of some members of Congress that the primary beneficiaries of MRBs were the Wall Street firms underwriting the bonds. So far, MCCs have seen much more limited use than MRBs.

Temporary housing-related tax incentives have been passed by Congress or enacted into law as countercyclical devices in recession periods. In 1975 a temporary tax credit for purchases of new homes was enacted (P.L. 94–12). In 1981 a temporary measure for tax-exempt interest on special thrift institution certificates of deposit ("all-savers certificates") was included in the Economic Recovery

[1] For the MRB program, anyone who has not owned a home in the preceding three years is a "first-time" buyer.

Tax Act (P.L. 97–34). All-savers certificates were intended primarily to support thrift institutions, but the legislation included provisions directing that the funds be used for residential financing and agricultural loans. In 1982 a mortgage interest buydown proposed by Senator Richard Lugar was attached to a supplemental appropriations bill and passed by Congress (H.R. 5922), but it was vetoed by President Reagan. In his 1992 State of the Union message, President Bush proposed a tax credit for first-time buyers of new homes, in response to the 1990–91 recession. The tax credit was included in legislation (H.R. 4210), but the president vetoed the bill because of other provisions.

## Federal involvement in housing finance

Prior to the 1930s, the federal government generally left the provision and management of nonfarm housing and housing finance to the private sector and to state and local governments. Financial institutions providing home mortgages were mostly chartered and regulated by state governments. State laws prohibited mortgage lenders from offering first mortgages with loan-to-value ratios of more than about 50 or 60 percent.

As of 1929, savings and loan associations (then typically known as "building and loans") accounted for 50 percent of all mortgages outstanding on nonfarm homes that were held by financial institutions, while mutual savings banks accounted for another 19 percent (Morton 1956). Most mortgages from savings and loans were fully amortized over periods of 10 to 15 years (Lloyd 1994; Morton 1956; Ratcliff, Rathbun, and Honnold 1957; Lea 1996). Loans financed by insurance companies were typically partially amortized "balloon" loans for 5 to 10 years, and commercial banks, which were prohibited from making long-term mortgages, generally offered only nonamortizing "bullet" loans maturing in less than 5 years. Insurance companies and commercial banks held less than one-third of the institutionally held outstanding loans on one- to four-family nonfarm homes (Lloyd 1994; Morton 1956). Even though a relatively small share of first mortgages from financial institutions were bullet loans, there was widespread exposure to such loans. Many mortgage loans came from private individuals, and those generally did not feature regular amortization. Also, many homeowners with fully amortizing first mortgages had bullet second mortgages. A private mortgage insurance industry operated in the 1920s, but it was wiped out in the early 1930s (Foster and Herzog 1982; Rapkin 1974).

With the financial market and economic collapse that began in 1929, many homeowners were unable to make their mortgage payments or to roll over balloon or bullet loans when they came due. In response to the crisis, President Hoover called for "a system of Home Loan Discount Banks" in order to rescue thrift institutions, stimulate construction and employment, prevent future failures of mortgage lenders, and "create a structure for the promotion of homeownership" (Semer et al. 1976).

The Federal Home Loan Bank Act of 1932 (P.L. 72–304) brought thrift institutions under the federal umbrella for the first time. That measure, together with the Home Owners Loan Act of 1933 (P.L. 73–43) and provisions of the National Housing Act of 1934 (P.L. 73–479) that established the Federal Savings and Loan Insurance Corporation (FSLIC), reinvigorated the thrift industry. The Home Owners Loan Corporation refinanced about 20 percent of mortgaged homes. These actions protected many homeowners from foreclosure and many lenders from failing (Harriss 1951; Lea 1996). Support for expanded homeownership may have played a role in the formulation of these measures, but they were primarily attempts to preserve the financial system.

The Federal Housing Administration (FHA) insurance program, authorized in the 1934 National Housing Act, encouraged home mortgage lending by adding a government guarantee to the security of a lien against the property. Ultimately, FHA mortgage insurance supported expanded homeownership, but the motivation for the FHA program was primarily to stimulate residential construction. Harry Hopkins (1934), testifying on behalf of the Roosevelt administration, argued that a third of the massive unemployment in the nation was identified in some way with the building trades and that the proposed program was an effort to put the unemployed back to work. Miles Colean (1975), one of the pioneers in the FHA, said the proposal "had grown from the President's stated desire to have at least one stimulative agency that did not require spending by the government but would instead rely on private endeavor."

Marriner Eccles (1951), an even more central figure in the development of the FHA, later indicated that the emphasis on stimulation of new construction, rather than on reform of the mortgage market, as justification for the proposal partly reflected a desire to avoid further antagonizing the thrifts and other financial institutions, which bitterly opposed the measure. Eccles, however, also made it clear that the main intent of the program was economic pump priming.

The 1934 act provided for insurance of home improvement loans and of mortgages on rental housing, as well as insurance of mortgages for homeowners. The home improvement loan program became quite active in short order, but it was some time before loans on rental housing were insured, because there was a glut of rental housing at the time, and it was hard to find insurable projects.

Many of the innovations that have often been attributed to the FHA, such as the long-term self-amortizing loan, had already been in fairly widespread use, but the FHA, along with the Home Owners Loan Corporation, caused more lenders to use that type of loan. The FHA home mortgage was initially a 20-year, fully amortizing loan with a maximum loan-to-value ratio of 80 percent. The latter characteristic was the most notable liberalization at that time, requiring changes in state laws limiting loan-to-value ratios. Teams of federal lawyers were sent out to convince state legislatures to allow state-regulated lenders to invest in FHA-insured loans, and the states quickly complied (Colean 1975; Lloyd 1994).

Many of the features of the FHA program were designed to introduce greater prudence rather than more liberal standards to broaden the base of homeownership. FHA required strict appraisals, new standards of construction and design, and escrow of tax and insurance payments. The underwriting standards included a mandate that the neighborhood be "homogeneous" (segregated), with that homogeneity preferably assured through racially restrictive covenants, for which the FHA helpfully supplied forms (Abrams 1965; Woods 1979). The design standards, such as a requirement that bathrooms not be accessed through bedrooms, tended to limit the availability of FHA insurance for existing dwellings, but that was fine with the New Deal administrators, who were more interested in stimulating new construction. Initially, the maximum single-family mortgage eligible for FHA insurance was set at $16,000, far above the median home price of the day.

The focus of the FHA program gradually came to be less risk averse and more oriented toward providing homeownership opportunities for lower-income households. The maximum mortgage term was lengthened and the maximum loan-to-value ratio was increased, especially for loans on lower-priced homes. The first such step was in 1938, when legislation (P.L. 75–424) allowed mortgages on new homes to have 25-year mortgages with loan-to-value ratios of up to 90 percent, provided the mortgage amount did not exceed $5,400. Loans of up to $16,000 were still available with 80 percent loan-to-value ratios and 20-year terms.

Despite steps to make the FHA program accessible to home buyers of more modest means, it continued, at least for the first two decades, to be oriented toward new construction and to account for a relatively small share of loans for lower-priced properties and higher-risk borrowers. According to the Census Bureau's decennial survey of residential finance, FHA-insured loans outstanding in

1950 disproportionately consisted of mortgages on newly constructed homes, serving borrowers with relatively high incomes. In 1960 the homes and owners with FHA-insured loans were generally similar to those with conventional mortgages, but FHA-insured loans were still concentrated among newly built homes. By 1970 the prices of homes with FHA-insured loans, and the incomes of the homeowners with those loans, were below the overall medians (U.S. Bureau of the Census 1952, 1962, 1973).

In the 1960s, FHA support of racially biased lending was officially reversed. President Kennedy (1962) issued an executive order that mandated equal opportunity in FHA and Veterans Administration (VA) lending. Similar equal opportunity requirements were not applied to conventional loans until the 1968 Civil Rights Act (P.L. 90–284). The FHA also became oriented toward lending in older declining areas, as a result of both new legislation and administrative action, including relaxation of the property standards.

The maximum FHA loan amount, which was so generous initially, became increasingly restrictive. In general, the program currently only covers homes priced below the local area median. The combination of positive efforts to serve minorities and central-city areas, restrictions on the maximum loan amount, and competition from conventional lenders and private mortgage insurance companies has resulted in FHA insurance becoming concentrated among existing, low-priced homes and lower-income, higher-risk borrowers.

A number of special FHA programs were developed that offered still more liberal standards and that were recognized as higher risk. Unlike loans under the Section 203(b) program, Congress had to appropriate funds to cover insurance losses for those programs. The higher-risk programs were mainly concerned with rental housing, but some loans to homeowners were included. Loans under the Section 235 program (discussed below) fell into the high-risk category, as well as loans for workers in defense plants (Sections 603 and 903), homes in urban renewal areas (Section 220), and homes for people displaced by government action (Section 221[d][2]).

In addition to the FHA program, federal guarantees of individual mortgage loans are also provided to eligible veterans and active-duty military personnel under the VA loan guarantee program, established by the Servicemen's Readjustment Act of 1944 (P.L. 78–346, also known as the GI Bill of Rights). Unlike the FHA mutual mortgage insurance program, it was not designed to be self-supporting, but instead provides a benefit for serving in the military. It was reportedly created as a lower-cost alternative to a cash bonus for World War II veterans (Booz, Allen, and Hamilton 1991). Congress was partly motivated by regret over allegedly shabby treatment of returning World War I vets. No down payments were required under the VA program, on the theory that soldiers weren't paid enough to accumulate savings (Semer et al. 1976).

The FHA and VA programs provide credit enhancement for individual mortgages. The federal government also assists in the financing of homeownership through sponsorship of secondary mortgage market institutions. The National Housing Act of 1934, in addition to creating the FHA and the FSLIC, provided for the establishment of National Mortgage Associations. These were to be federally chartered private firms that would purchase mortgages. The idea was developed, in large measure, to address regional imbalances in the cost and availability of housing credit. Even after Congress eased the requirements for National Mortgage Associations, none were formed. In 1938 the Roosevelt administration, tired of waiting for private groups to form National Mortgage Associations, created the Federal National Mortgage Association,[2] which was to purchase FHA mortgages (Haar 1960; Jones and Grebler 1961). This new government agency became known informally, and ultimately (in its modern-day, private form) officially, as Fannie Mae.

The creation of Fannie Mae in 1938 is of historical significance because of the precedent it established, and because of the later prominence of Fannie Mae, its offspring the Government National Mortgage Association (GNMA), and its clone Freddie Mac; but Fannie Mae was not a major factor in the mortgage market in the depression or immediate postwar years. Life insurance companies were the principal outlet for secondary market sales of FHA-insured loans in the 1930s, and the Fannie Mae share of FHA and VA mortgage holdings was still modest as of 1950, despite fairly intensive activity in 1949 and 1950.[3]

The Housing Act of 1954, partly reflecting problems identified during the 1953–54 recession, rechartered Fannie Mae, which was still a government agency, and authorized "special assistance" functions "as a means of retarding or stopping a decline in mortgage lending and home building activities which threatens materially the stability of a high level economy." Expansion of these activities was a favorite response to subsequent recessions. During the 1957–58 recession, the 1958 Emergency Housing Act (P.L. 85–364) provided additional funds for Fannie Mae special assistance activities, and in

[2] Initially the agency was named the National Mortgage Association of Washington, but within a few months the name was changed.

[3] This understates the significance of Fannie Mae purchases somewhat because the Fannie Mae operating philosophy at the time was to buy loans in periods of credit shortage and to sell during periods when the supply of housing credit exceeded demand. During World War II, Fannie Mae sold off virtually all of its portfolio.

the aftermath of the 1960–61 recession, the Housing Act of 1961 (P.L. 87–70) pumped more money into special assistance.

In 1966 a spike in interest rates produced a movement of funds out of thrift institutions and a slump in residential construction. There was once again a call for actions to pump financing into housing. Together with concerns about the quality of housing and the supply available to meet an expected surge in demand as the members of the baby boom began to establish households, this helped to bring about the Housing and Urban Development Act of 1968 (P.L. 90–448). Not untypically, by the time the legislation was passed, the credit crunch that had helped to precipitate it was largely over. The 1968 act, among other things, split up Fannie Mae. A secondary market arm, which retained the Fannie Mae name, became a private "government-sponsored" enterprise, authorized to buy FHA and VA loans at their market values.

Under the 1968 legislation, the special assistance functions that Fannie Mae had conducted remained within the government, in an entity to be known as the Government National Mortgage Association. GNMA was also given the authority by the 1968 act to guarantee securities backed by pools of mortgages and issued by private lenders, which proved critical to the future of the secondary mortgage market.

In 1970, in response to yet another housing credit crunch, Congress passed the Emergency Home Finance Act of 1970 (P.L. 91–351). Like the 1968 act, this legislation made several important permanent changes. It authorized Fannie Mae to buy conventional mortgages and created the Federal Home Loan Mortgage Corporation (Freddie Mac) under the control of the Federal Home Loan Bank Board.

The development of the secondary market entities has come to be more of a boon for the single-family mortgage market than for multifamily rental housing and thus has tended to support homeownership. This is largely due to the huge success of mortgage-backed securities based on pools of loans. Single-family home loans were more suitable for grouping in pools than loans on rental housing, which are less uniform in their terms, individually larger, and more divergent in size. More recently, loans on multifamily rental properties have been successfully securitized in substantial volume, but the share of loans securitized is still lower than for single-family mortgages.

At the time of the 1968 legislation, it was expected that GNMA and Fannie Mae would contribute as much to the financing of rental housing as to single-family financing. In the early 1970s, before the secondary market became dominated by mortgage-backed securities, the new government-sponsored secondary market institutions helped to provide the financing that brought rental housing construction to all-time record levels.

The federal government's regulatory authority over financial institutions has also affected the supply of credit for home buyers. Under risk-based capital rules for depository institutions, the capital base needed for home mortgages is lower than for other loans. This distinction was adopted based on the Basle Capital Accord (Basle Committee 1988) and was not necessarily a practice favored by the U.S. negotiators involved in establishing those international standards. Although the Basle standards permitted lower risk weights for rental housing as well as for owner-occupied housing, U.S. regulators did not allow the lower risk ratings to be used for many multifamily mortgages.

The Home Mortgage Disclosure Act was enacted in 1975 (P.L. 94–200). It was followed two years later by the Community Reinvestment Act (P.L. 95–128). These laws were intended to attack redlining and lenders' neglect of local communities by exposing their lending practices to public and regulatory scrutiny. The initial effects were limited, but as subsequent legislation broadened and deepened the reporting requirements, as information processing technology and the expertise of regulators and activists improved, and as regulators were mandated to give community lending practices weight in their decisions, these laws have funneled resources to homeownership. Regulatory requirements imposed on Fannie Mae and Freddie Mac under the 1992 Federal Housing Enterprises Financial Safety and Soundness Act have done likewise. The objectives of the legislation establishing these various requirements were largely to increase the availability of financing in targeted communities, but in practice that tended to mean lending for homeownership.

## Subsidy programs

The U.S. Department of Housing and Urban Development (HUD) Section 235 and Farmers Home Administration (FmHA)[4] Section 502 programs, providing low-rate mortgages to lower-income households to purchase homes, were the most ambitious efforts to date by the federal government to explicitly subsidize homeownership.

[4] FmHA was abolished in 1994. Most of its programs, including Section 502, are now administered by the Rural Housing Service of the U.S. Department of Agriculture.

By the late 1960s, there was growing support for the idea that the government should not only end redlining and racial discrimination in the FHA programs but should help poor people to become homeowners. A limited, experimental program incorporating below-market-rate mortgages, Section 221(h), was enacted in 1966 (P.L. 89–754).

In 1967 Senators Ribicoff, Percy, Clark, and Mondale each offered proposals for subsidized mortgages. Senator Percy's proposal was cosponsored by every Republican in the Senate and by 114 House members, led by William Widnall. In November the Senate Banking and Currency Committee reported a bill (S. 2700) incorporating features from the Ribicoff, Percy, Clark, and Mondale proposals, with the low-income homeownership program designated as Section 235.

HUD Secretary Robert Weaver was not a supporter of the low-income homeownership proposals. Speaking of the Percy-Widnall bill, he said, "It can be a cruel hoax, because in many instances . . . if they lose their jobs, or if they are sick, they will lose their home" (McClaughry 1975).

Part of the interest in proposals to subsidize low-income homeownership was stimulated by the wave of urban riots that began in 1963. The influence of the riots on housing policy was manifest in the Demonstration Cities and Metropolitan Development Act of 1966 (P.L. 89–754), which authorized FHA insurance of loans that fail the test of economic soundness "if . . . the dwelling covered by the mortgage is situated in an area in which rioting or other civil disorders have occurred or are threatened."

The report of President Johnson's National Advisory Commission on Civil Disorders (the Kerner Commission), issued in early 1968, identified housing as a major element contributing to urban problems. Although most of the commission's recommendations with respect to housing involved rental housing, they included the following:

> Third, the rent supplement concept should be extended to provide homeownership opportunities for low-income families. The ambition to own one's own home is shared by virtually all Americans, and we believe it is in the interest of the nation to permit all who share such a goal to realize it. Homeownership . . . would provide many low-income households with a tangible stake in society for the first time. (*Kerner Report* 1988)

The housing legislation in 1968 was influenced to a greater extent by another commission that was appointed in 1967. The President's Committee on Urban Housing (the Kaiser committee) concentrated on the need for increased production, in order to provide housing for the baby boom generation as it began to form households and to replace the remaining large stock of substandard housing. The Kaiser committee's emphasis on production also reflected the sharp drop in housing starts that occurred in 1966, which was only partially reversed in 1967. It set a goal of 26 million new or rehabilitated units over a 10-year period. Although the formal report of this group was not issued until December 1968, it provided input that had significant impact on the development of the legislation that passed in the summer of 1968. The committee did not have a great deal to say about homeownership.

In February 1968, President Johnson sent a message to Congress proposing the Housing and Urban Development Act of 1968, with a goal of constructing 26 million homes and apartments over 10 years, including 6 million to "replace the shamefully substandard units of misery where more than 20 million Americans still live." As part of the plan to meet that goal, he basically endorsed the homeownership plan adopted by the Senate Banking Committee three months earlier.

Describing the homeownership proposal and urging its passage, the president's message said,

> Homeownership is a cherished dream and achievement of most Americans. But it has always been out of reach of the nation's low-income families. Owning a home can increase responsibility and stake out a man's place in his community. The man who owns a home has something to be proud of and good reason to protect and preserve it.
>
> Today I propose a program to extend the benefits of homeownership to the nation's needy families.
>
> Under this program, the broad outline of which has already been set forth in S. 2700, low-income families will be able to buy modest homes financed and built by the private sector. (Johnson 1968, 3957–58)

The president's proposal, and the subsequent legislation, authorized more units, provided a deeper subsidy, and incorporated less stringent income limits than S. 2700, all reflecting the emphasis on increased production. Only a limited share of the subsidized mortgages could be used to finance the purchase of existing structures.

Testifying before Congress in support of President Johnson's proposal, Secretary Weaver said, "To own one's home is to have a sense of place and purpose. Homeownership creates a pride of possession, engenders responsibility and stability. Until now, however, federal help to low- and moderate-income families to achieve homeownership has been very limited. Section 101 of the bill will remedy this gap in our housing programs" (Weaver 1968).

When confronted during questioning at that hearing with his earlier statement about low-income homeownership being a "cruel hoax," Weaver gamely argued that he had only been referring to the provisions of the Percy-Widnall proposal, rather than to the general concept. Despite his newfound belief in homeownership, however, Weaver made it clear that the homeownership proposal was just a means to an end—increased production. He said, "Most significant, I believe, is the fact that this total new effort is aimed primarily at achieving a single, specific, unified goal—the building and rebuilding in 10 years of enough good housing to permit the replacement of substantially all substandard dwellings."

Between January 1969 and January 1973, about 400,000 homes for low- and moderate-income families were financed under Section 235. Home buyers were only required to make nominal down payments, and they only paid 20 percent of their incomes, or 1 percent annual interest, whichever was more.

In the effort to swiftly meet the ambitious production goals, and with little expertise in urban lending of this type, the FHA grossly mismanaged the program. There were several cases in which promoters sold substandard housing at inflated prices to naive low-income households. When the borrower defaulted, as typically happened when the house faced major repairs, HUD would be stuck with the house, while the home sellers and lenders profited at the taxpayers' expense.

Partly because of the scandals under Section 235, as well as a wish to reduce the federal government's role in domestic affairs, President Nixon imposed a freeze on most HUD programs in January 1973 and created a task force, the National Housing Policy Review, to completely reevaluate federal housing policy. The National Housing Policy Review found that the Section 235 program was an efficient form of subsidy, but it criticized the program because its beneficiaries, whose median income was $6,500, were not as needy as the typical household in the rental subsidy programs or public housing.

In 1976 the Section 235 program was reinstated in a modified form with a higher minimum interest rate and larger down payment, and it was strictly limited to new homes. Despite the criticism that the original program did not serve the neediest families, the modified program was targeted to an even higher income group, although income limits were still applied. In its modified form, with limited funds, the Section 235 program was responsible for about

125,000 loans over 10 years. It remained on the books until it was terminated by the Housing and Community Development Act of 1987.

The Section 235 program is generally viewed as a failure, based on the image that was created by the scandals as well as stories that the new owners were ill-equipped for ownership. By 1979 approximately 18 percent of the mortgages insured under the original Section 235 had been foreclosed or assigned (Hayes 1985), compared with rates of about 6 percent for FHA Section 203(b) loans made during the same period. The loans insured and subsidized beginning in 1976 under the modified Section 235 program, however, had default rates lower than those on mortgages insured under the standard Section 203(b) program (Stasulli and Gottlieb 1989).

Even with the relatively high claims rate, more than 80 percent of the households assisted by the original Section 235 program were still in their homes or had sold the homes and paid off their loans by 1979. Of the 60 percent who were still in their homes, the majority had graduated out of the subsidy program because their incomes had risen enough that they were able to make the monthly payments without subsidy (Weicher 1980).

The failures of the original Section 235 program have been blamed on failures of administration (McClaughry 1975). Would more effective administration have made a difference? The experience with the modified Section 235 program after 1976 and with the FmHA Section 502 program suggests that it would.

The FmHA Section 502 program was started in 1949. It called for U.S Department of Agriculture field offices to provide home mortgages directly to farmers when private financing was not available. In 1961 it was expanded to provide mortgages to nonfarmers in rural areas, and farmers now account for only a small share of borrowers under the program. Until 1968 the loans did not include any substantial subsidy, although they did reflect the federal government's borrowing advantage. In 1968, however, a subsidized loan program was created, the rural counterpart to the HUD Section 235 loan program.

Under the interest subsidy program, borrowers generally had to have incomes below 80 percent of local area median family income. There was also a requirement (first imposed in 1983) that 40 percent of the total lending under the program go to families with incomes below 50 percent of local area median. Local area median incomes in rural areas are generally quite low. The house had to be "of modest design" (generally less than 1,200 square feet). No down payment was required, and the term of the loan was usually 33 years. Borrower income was periodically reviewed, and the amount of the subsidy adjusted accordingly. If the home was sold, a share of the profits had to be repaid to FmHA.

From 1969 to 1993 there were over a million FmHA Section 502 loans with interest subsidies. Thus, the Section 502 program ultimately accounted for a larger number of subsidized loans than the more widely publicized Section 235 program, and FmHA loans represented a large share of all mortgage lending in rural areas. In recent years, lending under the Section 502 program has been quite limited due to budget cutbacks.

Although the HUD Section 235 and FmHA Section 502 programs were the most important direct subsidy programs for homeowners, there have been other forms of subsidy for moderate-income buyers, such as the special assistance purchases by Fannie Mae cited above and the GNMA "tandem plan" purchases under the Brooke-Cranston Emergency Home Finance Act of 1974. The tandem program involved purchases of below-market-rate mortgages at par by GNMA, with the mortgages resold for market value, at a loss, usually to Fannie Mae. These were largely economic stimulus programs.

## Recent actions

The Cranston-Gonzalez National Affordable Housing Act (P.L. 101–625), enacted in 1990, was a notable milestone in terms of setting forth homeownership as a policy objective even though it has had little impact on homeownership. The legislation first sets forth a "national housing goal," followed by a statement of the "objective of national housing policy," which is in turn followed by "purposes of the Cranston-Gonzalez National Affordable Housing Act." Most legislation does not include statements of principles, but in those previous pieces of housing legislation that did include goals or principles, such as the Housing Act of 1949 (P.L. 81–171), the 1965 Department of Housing and Urban Development Act (P.L. 89–174), and the Housing and Urban Development Act of 1968 (P.L. 90–448), homeownership was not identified as a goal.[5]

The Cranston-Gonzalez goal is "that every American family be able to afford a decent home in a suitable living environment." This is a

[5] Although the 1968 act did not mention homeownership in its "Declaration of Policy" or "Reaffirmation of Goal," it did call for the president to report on the progress made in "achieving goals of conserving and upgrading older housing and neighborhoods, expanding homeownership and equal housing opportunities, and assuring reasonable shelter costs."

subtly different goal than the one set forth in 1949 and reiterated in subsequent legislation: "a decent home and a suitable living environment." The goal as set forth in the 1949 legislation was focused on housing production and the elimination of substandard housing, with no mention of affordability.

The objective of national housing policy is framed in Cranston-Gonzalez as follows:

> The objective of national housing policy shall be to reaffirm the long-established national commitment to decent, safe, and sanitary housing for every American by strengthening a nationwide partnership of public and private institutions able—
>
> (1) to ensure that every resident of the United States has access to decent shelter or assistance in avoiding homelessness;
>
> (2) to increase the Nation's supply of decent housing that is affordable to low-income and moderate-income families and accessible to job opportunities;
>
> (3) to improve housing opportunities for all residents of the United States, particularly members of disadvantaged minorities on a nondiscriminatory basis;
>
> (4) to make neighborhoods safe and livable;
>
> (5) to expand opportunities for homeownership;
>
> (6) to provide every American community with a reliable, readily available supply of mortgage finance at the lowest possible interest rates; and
>
> (7) to encourage tenant empowerment and reduce generational poverty in federally assisted and public housing by improving the means by which self-sufficiency may be achieved.

Ownership is clearly not a dominant component of the objective, and the objective, as stated, does not declare that ownership should be encouraged, but only that the opportunity for homeownership should be provided for those who are so inclined.

The stated purposes of this legislation are set forth as follows:

> (1) to help families not owning a home to save for a down payment for the purchase of a home;
>
> (2) to retain wherever feasible as housing affordable to low-income families those dwelling units produced for such purpose with federal assistance;

> (3) to extend and strengthen partnerships among all levels of government and the private sector, including for-profit and nonprofit organizations, in the production and operation of housing affordable to low-income and moderate-income families;
>
> (4) to expand and improve federal rental assistance for very low income families; and
>
> (5) to increase the supply of supportive housing, which combines structural features and services needed to enable persons with special needs to live with dignity and independence.

In the list of purposes, the only reference to homeownership is to helping families to save for a down payment. Although the legislation did include several new programs that may be used by local and state governments to facilitate homeownership in various ways, a program for down payment savings using tax-deferred retirement accounts, which was included in earlier drafts of the Senate bill, did not survive in the final legislation, so that purpose was not addressed.

On November 5, 1994, in a speech to the National Association of Realtors, President Clinton announced a goal of increasing the homeownership rate to record levels before the end of the century. He said there would be three components to the effort: (1) cost reductions through regulatory reform, (2) targeting underserved populations, and (3) educating the public about the opportunities for ownership. He called on HUD Secretary Cisneros to create a strategy in cooperation with the private housing industry, state and local governments, and nonprofit organizations.

Under the Clinton administration, HUD has given homeownership a higher priority than in previous administrations, but there has been little tangible support in the form of new or expanded programs. Various "partners" in the homeownership strategy promised to take actions to increase homeownership, but in many cases they were promising to do things they were already doing or planned to do anyway. Indeed, the approach taken by the Clinton administration bears some resemblance to the federal support during the Wilson, Harding, Coolidge, and Hoover administrations, which was largely rhetorical. The many programs that were put in place during the last 60 years continue to operate, however, and the government's explicit and implicit regulatory influence on private financial institutions has a substantial impact on credit flows, especially with regard to the availability of mortgage finance to minorities and other underserved populations.

## Conclusions

Although there is a widespread perception that federal government policy was established to encourage, or at least to facilitate, homeownership, most programs that support ownership have been developed for other purposes. Tax and credit programs that were created for other purposes, however, have often evolved into supports for homeownership.

Many of the policies supporting homeownership were created as economic stimulus measures in response to the depression and subsequent recessions (including the mid-1960s "minirecession" that was largely confined to residential construction). Often, by the time these measures were enacted and put into operation, the cyclical economic problems they were intended to address were past, but the impact on housing remained for the long term.

Explicit federal support for homeownership was quite limited prior to the 1960s, and after a brief spate of enthusiasm for low-income ownership in the late 1960s and early 1970s, support flagged.

The priority of homeownership has recently been revived, as demonstrated by some parts of the National Affordable Housing Act and the policy pronouncements of the Clinton administration. But it may be that explicit adoption of homeownership as a policy objective is not the key to substantial federal support and that homeownership is more effectively encouraged when that encouragement is merely the byproduct of the pursuit of other policy objectives.

Many of the policy considerations that have indirectly served as vehicles for support of homeownership in the past do not provide as much impetus now. Macroeconomic stimulation through government spending has become less fashionable in the era of fiscal restraint, although that could change if the economy falters. There is no call currently for increased supply to meet a deluge of demand. Although there are still some substandard units, that is not the major concern that it was in 1968.

The homeownership rate has increased during the past few years, but the increase was not particularly concentrated among the underserved populations that have received special policy attention (Carliner 1998). The growth in ownership probably has been due more to overall economic growth and lower interest rates than to any specific housing policies.

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