BLEAK HOUSE

Mansions on the hill

How Congress can reform America's "mansion subsidy."

By Peter Dreier and John Atlas

Every year since 1980 the Congressional Budget Office (CBO) has produced a thick tome entitled, "Reducing the Deficit: Spending and Revenue Options." Usually, the book—which, among other stirring proposals, has included calls to trim the Small Business Administration's tree planting program—generates little interest beyond the Beltway.

But this year, one proposal has the nation's housing industry up in arms—and twisting arms on Capitol Hill. In the bracing language of the CBO bureaucrat, it's called "eliminate or limit deductions for mortgage interest." The CBO proposal targets the provision in the U.S. tax code that allows homeowners to deduct interest paid on home mortgages from their taxable income. This tax break—known as the mortgage interest deduction—cost the federal government $51 *billion* last year in lost revenues.

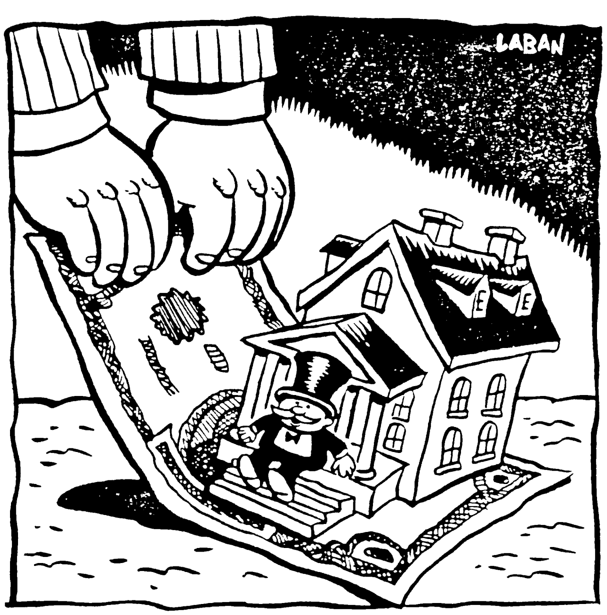
With the GOP in control of Congress and deficit-reduction mania at a peak, proposals to slash the once-sacrosanct mortgage interest deduction are now being hotly debated. At the center of the debate in Congress are two Republican proposals. Senate Finance Committee Chairman Bob Packwood (R-OR) is pressing to limit the deduction to the first $250,000 of a homeowner's mortgage. (The limit is currently $1 million.) House Majority Leader Dick Armey (R-TX) has proposed a 17 percent flat tax on personal income that would eliminate virtually all tax loopholes, including the mortgage interest deduction. Both proposals would reduce the tax breaks that wealthy homeowners now receive, an undeniably worthy goal. But neither measure would help the millions of American families who cannot afford the American dream of homeownership.

Contrary to public perception, the bulk of federal housing assistance goes to the affluent, not the poor. The current budget of the U.S. Department of Housing and Urban Development (HUD), the agency responsible for helping house the poor, is $26 billion—half the size of the mortgage deduction. HUD provides subsidies to only 29 percent of the low-income renters eligible for assistance. In contrast, 71 percent of taxpayers with annual incomes of more than $200,000 get housing assistance through the mortgage interest deduction.

Currently, housing activists are trying to address the skewed structure of housing aid by refocusing the congressional debate over the mortgage interest deduction. On behalf of the National Low-Income Housing Coalition, a public interest advocacy group, Rep. Major Owens (D-NY) has introduced legislation that would reduce the mortgage interest deduction for families with yearly incomes of more than $75,000 and funnel the savings into a trust fund for low-income housing. Given the clout of the housing industry, such a bill would have been a long shot even when the Democrats controlled Congress. And today's Republican majority has shown even less interest.

For years, the industry has claimed that the mortgage interest deduction is the bedrock of middle-class homeownership. But a review of recent figures from Congress' Joint Taxation Committee shows that 44 percent of last year's $51 billion homeowner subsidy went to the richest 5 percent of taxpayers—those with incomes of more than $100,000. Only one-fifth of middle-class taxpayers—the 28 million households with incomes between $30,000 and $50,000—received any mortgage subsidy. Even the chief economist of the National Association of Homebuilders (NAHB), David F. Seiders, has expressed concern that "questions are being raised about the deduction's cost effectiveness as a tool to broaden homeownership." In a recent article in the NAHB magazine *Builder*, he noted that "frankly, it's possible to find countries with homeownership rates comparable to the United States without deductions." Neither Canada nor Australia has a deduction, and their homeownership rates—about two-thirds of all households—is roughly the same as America's.

But there is another approach, one that both housing advocates (fighting drastic cuts in the HUD budget) and the housing industry (fearing attacks on the mortgage interest deduction) could unite behind. Why not scrap the homeowner deduction entirely and institute a homeowner tax credit? This credit would work like the already existing earned income tax credit, which provides a tax refund to low-wage workers, but its benefits would reach into the middle class. The homeowner tax credit would distribute refunds progressively, giving a larger tax break to homeowners with modest incomes and gradually reducing benefits as family income increases. The credit could also be adjusted to reflect regional housing costs, so homeowners in high-priced markets would not be penalized.



Housing advocates often call the current mortgage interest deduction the "mansion subsidy" because it gives the greatest subsidy to taxpayers with the highest incomes and most expensive homes. In contrast, the homeowner tax credit would be available to all homeowning families—including those moderate-income households that do not itemize deductions on their tax returns and so cannot take advantage of the current tax break. And allocating tax credits to homeowners progressively would limit subsidies for the wealthy, while preserving them for the middle class. At the same time, progressive tax credits would add a large number of families who currently do not benefit. Moreover, the tax credit would not add any government bureaucracy.

For the same $51 billion we now spend on the mortgage interest deduction, a progressive homeowner tax would encourage homeownership far more effectively. The wealthy would continue to buy homes with or without a tax subsidy. But, for millions of working- and middle-class Americans, a homeowner tax credit could mean the difference between renting an apartment and owning a home. And by making it possible for more people to purchase homes, the tax credit would catalyze homebuilding, generate jobs and add to local tax bases.

Of course, reforming homeowner tax policies will be a daunting task. For years, the mortgage interest deduction has been sustained by the enormous political muscle of America's builders, bankers and real estate agents. In fact, the housing industry contributes more to Congress than does any other business sector. Now, with the Packwood and Armey plans on the table, the housing industry has redoubled its efforts to preserve the current deduction, insisting that any change in it would wreak havoc with the real estate market and the economy at large. In March, a group of housing industry trade groups issued a 47-page report examining possible changes in the mortgage interest deduction. Citing this report, Mortgage Bankers Association President Joe Pickett told Congress last month that tampering with the deduction would be "harmful to the nation's economy and to efforts to spur homeownership. The indirect efforts of lowering the cap could hamper business activity, slow employment growth, and greatly reduce state and local government revenues."

But, in fact, the housing industry study refutes Pickett's argument. It provides no evidence that Packwood-style legislation would have such disastrous consequences. The report offers two examples of the impact of a $300,000 cap on housing prices. It first looks at its effect on the owner of a $625,000 home with a $500,000 mortgage and estimates that the value of the house would drop by as much as 12.2 percent. Next, it estimates that an owner with a $1.25 million house and a $1 million mortgage would see his home's value decline by as much as 16.6 to 21.3 percent. This homeowner would see the value of his tax break fall from $380,000 to $103,738. It's hard to imagine the general public feeling sorry for a millionaire who finds his mansion subsidy reduced to a mere $103,738. In fact, a recent *Time*-CNN poll found that 68 percent of respondents support Packwood-style reform. There was almost no variation among Democrat, Republican and independent respondents.

Almost everyone supports the idea of homeownership—it's a fundamental part of this nation's promise of prosperity. And no one wants to eliminate housing subsidies for middle-class families. But the current system—which subsidizes the rich to purchase huge homes without helping hard-working families to buy a small bungalow—is in desperate need of reform.

As a nation, we have the resources to assist the millions of poor and working-class families who cannot afford market-rate rents or home prices. It's time to stop subsidizing mansions. A progressive tax credit is the best way to help hard-working families achieve the dream of homeownership. ◀

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