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HUFF POST BUSINESS

Want to Help Homeowners? Replace the Mansion Subsidy and Require Banks to Act Responsibly

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I don't think for a second that the *New York Times* is in bed with the real estate industry. It has done some excellent reporting on the causes of the mortgage crisis and Wall Street's risky and misguided practices that got us in this mess. But yesterday, in a front page story, the *Times* reported as fact one of the real estate industry's favorite lies. In an article examining Americans' attitudes about homeownership in Thursday's *Times*, reporters David Streitfeld and Megan Thee-Brenan wrote that "almost no one favors discontinuing the mortgage tax deduction, a prized middle-class benefit that has been featured on some budget-cutting proposals."

The first half of that sentence is true, but the second half is false.

According to the *New York Times*/CBS News poll summarized in the article, 63% of Americans think it is "very" important for the federal government to continue the mortgage tax break for homeowners and another 30% believe it is "somewhat" important. That's a pretty overwhelming consensus, one that few politicians are likely to challenge, even when they are looking for ways to cut the federal deficit.

But is the mortgage interest deduction really a "prized middle class benefit," as Streitfeld and Thee-Brenan claim? That's what the real estate industry wants us to believe. The National Association of Home Builders, the National Association of Realtors, and other housing industry lobby groups have been pushing this line for decades, arguing that Americans' romance with homeownership is made possible by this tax break. Recently, David Crowe, senior VP for the homebuilders lobby, wrote that the mortgage tax break "is a critical policy helping aspiring homeowners attain that dream."

They've done a good job of repeating this line so often that it has become conventional wisdom. The only problem is: it isn't true.

The homebuilders, Realtors, and bankers happen to be among the largest campaign contributors to members of Congress and candidates for president, so when they speak, politicians listen. For example, in 2005, when some members President George W. Bush's commission on tax reform suggested scaling down the mortgage tax break for wealthy homeowners, the real estate lobby did a full court press to take that revenue-raiser off the table. The idea was quickly abandoned.

But that's no excuse for the *New York Times* reporting as fact something that is in much dispute by economists and other experts on housing policy.

Of the hundreds of tax breaks (what economists call "tax expenditures") for corporations and individuals in the nation's tax code, the largest are the subsidies for homeowners. The two major homeowner tax breaks cost the federal government about $98 billion in 2009 -- $76.6 billion for the mortgage interest deduction and $21.3 billion for the property tax deduction -- according to a report by the Congressional Joint Committee on Taxation.

That would be okay if most of it helped middle- and working-class people. But it doesn't. Those with the highest incomes and the most expensive homes (including second homes) get the largest tax break. That's why some call it the "mansion subsidy."

Most Americans think that federal housing assistance is a poor people's program. In fact, less than one-quarter of all low-income Americans (those who have Section 8 rental vouchers or who live in government-assisted developments, such as public housing) receive federal housing subsidies.

In contrast, almost two-thirds of affluent Americans -- many living in mansions -- get housing aid from Washington. Whether they admit it or not, the wealthy live in subsidized housing.

More than two-thirds (69.2 percent) of the $76.6 billion in mortgage interest deductions went to the 13.5 percent of taxpayers with incomes over $100,000. Almost one-third (29.7 percent) of these subsidies went to the wealthiest three percent of taxpayers with incomes over $200,000 -- some living in mansions.

Wealthy households are most likely to own homes and to itemize deductions. About half of all homeowners do not claim deductions at all. Tenants, of course, don't even qualify.

Three-quarters (73 percent) of households with incomes above $200,000 get the mortgage tax break, averaging $6,650. (For the super-rich, the tax break is much bigger). In contrast, only 1.3 percent of households with incomes between $10,000 and $20,000 get any subsidy, averaging $283. And only 23 percent of households with incomes between $40,000 and $50,000 get a mortgage deduction; among those who do, their annual taxes are reduced by only $797 -- $66 a month. That is not enough to make the difference between renting and owning their home.

If anything, these tax deductions help push up housing prices artificially, especially at the upper end, because homebuyers include the value of the tax subsidy in their purchase decision. This leads wealthy homeowners to buy bigger houses than they would without the tax breaks.

As a result, a wealthy corporate executive is more likely to receive a homeowner tax break -- and to get a much bigger one -- than a garment worker, a construction worker, a nurse, or a schoolteacher. The current system subsidizes the rich to buy huge homes without helping most working families buy even a small bungalow.

The real estate industry -- homebuilders, realtors and mortgage bankers -- has lobbied hard to preserve homeowner tax breaks, arguing that they are the linchpin of the American Dream. This is nonsense. Contrary to the *Times*' off-handed comment, this tax break is not a "prized middle class benefit." Only a handful of middle class families get the prize -- and the prize itself is quite small. Only 29 percent of the 65 million households with incomes between $30,000 and $100,000 receive any homeowner subsidy.

Not surprisingly, the *Times* poll discovered the "nearly nine in 10 Americans say homeownership is an important part of the American dream." According to the *Times*, "Owning a house remains central to Americans' sense of well-being, even as many doubt their home is a good investment after a punishing recession."

Nearly one-quarter of homeowners say their home is underwater -- it is worth less than what they owe on their mortgage -- but that hasn't dampened their enthusiasm for desire to own a home.

No one wants to eliminate existing homeowner subsidies for middle-class families. But the current system -- which subsidizes the rich to purchase huge homes without helping most working families become homeowners -- is in desperate need of reform. What to do?

Some economists suggest that we do away with the mortgage interest deduction entirely. That may be too drastic. But why not lower the ceiling on the amount of principal eligible for the mortgage-interest deduction from the current $1 million to $500,000? Rather than do this all at once, it could be phased in over five years by reducing the ceiling by $100,000 a year. This would affect less than one percent of all homeowners and raise several billion dollars a year in revenues.

Others have suggested limiting the deduction to 15 percent or 25 percent of a taxpayer's mortgage interest. The richest homeowners can now deduct 35 percent.

But if the goal is to promote homeownership, eliminating or reducing mortgage tax breaks for wealthy homeowners isn't the answer. The *Times* poll found that most Americans think that the federal government should do more to help existing homeowners avoid foreclosure and help current renters buy homes. But Washington can't do it alone. The *Times* discovered that a growing number of Americans blame the banking industry for the nation's devastating housing crisis. Wall Street got huge government bail-outs but banks continue to stiff-arm families victimized by risky lending practices.

So it is time for Washington *and* Wall Street to change the way they do business when it comes to helping Americans buy and protect their homes. Here's how:

First, the federal government should create a refundable progressive homeowner tax credit, available to all families each year, including those moderate-income households that do not itemize their deductions. Tying the credit progressively to income would limit subsidies for the wealthy, but preserve them for the middle class. It would also add a large number of families who currently do not benefit. It would be similar to the popular Earned Income Tax Credit for low-wage earners, but would reach a much broader income range. The credit could be adjusted for varying housing costs in different parts of the country to avoid penalizing home buyers and homeowners in high-cost areas.

Second, Washington should require all buyers to have homeownership counseling before they purchase a home. There's overwhelming evidence that families who attended counseling seminars were much less likely to get ripped off by scam artists and banks peddling high-risk predatory mortgages that later led to foreclosures. Washington should require all banks to contribute to a fund to pay for homeownership counseling provided by HUD-certified independent community-based nonprofit groups, like the network of Neighborhood Housing Services.

Third, Congress should require all banks to develop an effective program for negotiating permanent, sustainable loan modifications -- including reducing the mortgage principal -- before they initiate foreclosure proceedings. Congress should also insist that if banks refuse to comply within 60 days, bankruptcy judges should be allowed to reduce an owner's loan amount or interest rate in the same way they now decide how much money most other creditors receive. (Since 1978, bankruptcy laws have prohibited judges from changing the terms of mortgages primary residences.). This approach (called a "cram down") cuts through legal red tape and give consumers more bargaining power with banks and other mortgage lenders. This is an idea that Elizabeth Warren has supported. That's one reason why the banking industry lobby is not only trying to weaken the new Consumer Financial Protection Bureau but also trying to stop President Obama from appointing Warren as its director, as the *Nation* recently reported.

As a nation, we have the resources to assist the millions of moderate income families who are shut out of homeownership or, through no fault of their own, trapped in homes whose values have plummeted. Let's stop subsidizing the rich to live in mansions and help working families achieve -- and hold on to -- the American Dream.

Peter Dreier is Professor of Politics and chair of the Urban & Environmental Policy Department at Occidental College. His next book, *The 100 Greatest Americans of the 20th Century: A Social Justice Hall of Fame*, will be published by Nation Books next year.

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