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Student Op-Ed

A DIFFERENT VIEW OF HOUSING POLICY IN AMERICA

By Antonio Lulli

As American As Apple Pie

White picket fences. Apple pie. The American Dream. These images are synonymous with middle-class life in America and closely associated with homeownership. This has become a truism in the national parlance, but what if decades-long housing policy is detrimental and a significant policy error?

Homeownership is no doubt a worthy goal and there are many good reasons for individuals or families to pursue it; a sense of permanence, financial stability, wealth creation, and civic engagement come to mind. The issue is not with homeownership itself but rather with federal bias in favor of owner-occupation as an end to itself and the significant resources it devotes to that purpose, combined with layers of state and local policies which unduly favor homeowners and restrict growth.

Federal Policy

As explained above, housing policy in the United States is heavily tilted in favor of homeownership over renting in a variety of ways.

One example is federal tax policy, such as the mortgage interest deduction, which allows holders of real estate to deduct annual mortgage interest payments from their taxable income. Another is the capital gains exclusion, which similarly excludes a significant portion of any capital gain tax from the sale of a home. Both subsidies provide a major financial incentive to own housing rather than renting it. Only a handful of advanced nations have similar provisions.

Washington also provides more inconspicuous carrots through the government-sponsored enterprises (GSEs) Fannie Mae, Freddie Mac and Ginnie Mae, created during the New Deal to explicitly incentivize ownership by making mortgage credit more affordable and widely available. They continue to operate today with a similar model and enjoy implicit (Fannie, Freddie) or explicit (Ginnie) government guarantees which allow them to provide prospective homebuyers with a material subsidy in the form of the now-ubiquitous and artificially low-interest 30-year agency mortgage.

Additionally, America provides a shadow subsidy to suburban homeownership through the enormously expensive federal highway program. In fact, the country became majority-homeowning only after WWII and the construction of the Interstate highway system.

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This led to suburban sprawl, which is an economically inefficient use of space that makes public transit unworkable, creates gridlock, encourages pollution and carbon emissions, discourages growth and has historically been a source of exclusionary housing policies and attitudes.

Altogether, this amounts to what The Economist calls "the West's biggest economic-policy mistake" and blames it for "undermining growth, fairness and public faith and capitalism". Interference with free markets often has unintended consequences, which in this case are explored below.

NIMBYism

We often hear in the news about the severe housing shortage the US is experiencing. Some estimates put the deficit at around 3.8 million homes nationally. And it stands to get worse, with per capita housing production in the developed world being half of what it was in the 1960s. Demand is as high as ever, so why the gap? Some will point to issues such as material or labor costs, but these have been shown to have a limited effect on housing production.

Another key obstacle, and arguably the primary one, is the web of restrictions on development in cities around the country such as overly restrictive zoning laws, environmental impact rules or bureaucratic inefficiency. Some of these are more justifiable than others but they actually combine to slow housing development to a crawl.

Even in this bifurcated political environment, community opposition to apartment construction is one of the few remaining unifying sentiments found across the country. Though their reasoning often differs, contrasting groups such as Democrats and Republicans or the wealthy and the downtrodden, share an instinctive distrust of rental housing development.

In the case of many, their opposition stems from their status as homeowners, particularly of the older and wealthier variety, who will do everything in their power—which is considerable—to prevent development around them. Political influence and direct lawsuits under a variety of creative pretexts such as traffic congestion, view preservation or environmental damage are regularly used to that end.

Opponents of apartment development often pay lip service to affordable housing and equity but are most concerned with their property values, in which a majority of their personal wealth is usually tied up, and also want to keep the "character" of their communities intact. Homeowners are incentivized to do this because house prices go up faster when supply is constrained.This frequently happens in the most desirable neighborhoods, which are typically in central locations near job centers that can provide the most upwards mobility. The phenomena explained above are collectively known as the Not In My Back Yard movement, better known as NIMBYism, which is at best misguided and at worst something much more sinister.

In practice, NIMBYISM creates an artificial market distortion and a significant restriction on supply when demand continues to skyrocket. Naturally, as supply decreases, so does affordability. Thus, entrenched homeownership is essentially anti-growth and directly detrimental to the health of our economy. *The Economist* estimates that if just three big cities—New York, San Francisco and San Jose—relaxed planning rules, US GDP could be 4% higher.

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This issue is not only a political or societal one, but also an environmental one. The Real Estate Roundtable, an industry advocacy group, identifies "local land-use rules and community opposition" and "duplicative federal government reviews" as major obstacles to multifamily housing development across the country, especially of the dense, transit-oriented variety which is most crucial for reducing the carbon footprint of our built environment.

Additionally, the obstacles to development result in significant added risk to developers, as well as difficulty in attracting capital and consequently significant lost revenue for the real estate industry.

Some forward-thinking authorities have recognized the severity of the housing crisis and are making genuine efforts to counter it. California's SB9 and New York City's "City of Yes" initiative both seek to boost housing production by streamlining approval processes, by relaxing zoning restrictions and by reducing the power of NIMBYs. While these efforts are made with good intentions, we still have not seen results that indicate we are improving the situation that is the housing affordability crisis.

Homes are going on the market with declining frequency, while the ones that do sell at exorbitant amounts that price all but the wealthiest out of many markets. Baby Boomers in 1990 with a median age of 35 owned 33% of real estate, while a similar Millennial cohort owns only 4% today. All this leads to a toxic political and social situation that puts housing out of reach for many, breeds homelessness and creates stark wealth gaps along generational and class lines. It should be no surprise that America's youth is beginning to lose faith in capitalism.

Financial Risk

The other main downside of tilted housing policy has to do with housing as a financial asset. Homeowners bear significant risk from over-exposure to the housing market, which, like any other investment, is risky, especially considering the majority of household wealth is tied up in this single asset. In past crises where home prices have declined, many borrowers saw themselves facing foreclosure and had their wealth wiped out. Additionally, homeownership can have higher costs than renting, especially at less favorable interest rates like the ones we have now.

Housing is the largest asset class globally, collectively worth around $163 trillion or around 45% of all assets. The Great Financial Crisis (GFC) of 2007-2009 is an illustration of how misguided policy can contribute to systemic financial risk. Before 2008, the federal government sought to encourage owner occupation, especially among less qualified borrowers and adopted a variety of approaches to achieve this, such as pressuring the GSEs to meet congressional affordable housing goals. This loosened credit standards and led to the proliferation of non-conforming/ subprime loans, which accounted for nearly 48% of all loans originated in 2006. This unsustainable situation created a housing market that became detached from the underlying fundamentals and spectacularly crashed , causing widespread economic harm and extreme hardship for many.

Wall Street malfeasance, a lack of regulation and poor risk management undoubtedly played a significant role in the crash, but hindsight shows that artificially low interest rates and easy credit standards, both of which stemmed from misguided housing policy goals, also played a part.

A Better Path

Housing markets need not be this way. Cities such as Tokyo offer a glimpse to a better path. Authorities there don't have a homeownership fixation and so housing supply there has been plentiful. There is no property shortage and homelessness has diminished by 80% in the past 20 years. Likewise in Germany, where renters make up around 50% of the population and NIMBY resistance is muted, house prices are no higher than they were in 1980, in real terms.

Few would argue that owner-occupation needs to be discouraged, but it also shouldn't be an end goal of public policy. Instead, authorities in America would do well to encourage stability and financial success for both renters and homeowners alike. This would be a great start and could ease the pressure from other issues contributing to the housing shortage such as NIMBYISM.