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Federal Government Provides More Than $25 in Subsidies for Homeownership to Each $1 for Rentals

By Michael J. Novogradac, CPA

Estimates of foregone federal tax revenue for the five years of 2006-2010 reveal that homeownership subsidies will outstrip rental subsidies by 25 to 1. Only modestly less disconcerting to the rental housing industry is the 21 to 1 disparity if one uses outlay equivalent to measure the loss, rather than the cash based estimate.

As is the case every year, and required by the Congressional Budget Act of 1974, the president released last month his estimates of the foregone federal tax revenue that is attributable to provisions in the tax law that allow a special exclusion, exemption or deduction from gross income, or that provide a special credit, a preferential tax rate or a deferral of liability.

While the annual value of total income tax expenditures for tax deferrals is reported on a cash basis and reflects the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years, they are not an accurate reflection of the true economic cost of these provisions.

The outlay-equivalent measure, on the other hand, allows the cost of a tax expenditure to be compared with a direct federal outlay on a more even footing. Outlay equivalent is the amount of budget outlays that would be required to provide the taxpayer the same after-tax income as would be received through the tax provision.

Some Homeownership vs. Rental Housing Background

While a majority of Americans are homeowners (estimates place homeownership levels at approximately 70 percent), it is increasingly apparent that those who because of their economic status must, or through personal choice prefer to, rent are being squeezed out of the federal budget.

In keeping with his administration's keen focus on homeownership, President George W. Bush in his 2006 budget has for the fourth year in a row proposed a single-family homeownership tax credit for developers of affordable for-sale housing, as well as two mortgage programs that would be administered through the Federal Housing Administration (FHA) and a new program called Payment Incentives, which will allow borrowers with limited or weak credit histories to purchase homes paying higher mortgage insurance premiums that would be reduced gradually after a period of timely payments. The U.S. Department of Housing and Urban Development, on the other hand, saw its budget decreased 12 percent from the amount enacted for its 2005 budget.

This leads to the question: isn't it time to level the playing field somewhat?

Even the long-time advocate of homeownership former HUD Assistant Secretary of Housing William Apgar, concludes in his working paper for Harvard's Joint Center for Housing Studies that "America overstates the benefits of homeownership and fails to appreciate the benefits of rental housing."

He characterizes the American view of homeownership as the "silver bullet" solution to a range of individual and social problems. "Yet there are downsides to excessive focus on promoting homeownership," he says. "Notably...owning a home may prove unhelpful or even financially disastrous." Apgar explains that the denigration of rental housing limits American's housing options. "It … causes us to miss out on opportunities to use low cost rental housing as a pathway to social and economic opportunity," he says.

According to Apgar, public policy should focus on the larger goals of promoting access to decent and affordable housing, along with expanding social and economic opportunity for all, and in doing so recognize that promoting homeownership is just one of many possible means for achieving these end goals.

The government's expenditure estimates

For the five-year period 2006-2010, federal tax expenditures for homeownership subsidies, measured on a cash basis, include $445.5 billion for homeowners' interest deductions, $247.2 billion in capital gains exclusion, $68.1 billion in property tax deductibility and $6.5 billion in interest on exclusion on homeowner bonds, resulting in a total of $767.3 billion in subsidies for homeowners. (An estimate of additional federal tax expenditures of $185.2 billion is also included for the exclusion of net imputed rental income on owner occupied homes. This estimate has been excluded for this analysis.)

Using the outlay equivalent measure, those numbers escalate dramatically. In this scenario, the government is spending the same for homeowner's interest

(continued on page two)

Federal Government

(continued from page one)

deductions and property tax deductibility, $445.5 billion and $68.1 billion, respectively, but the capital gains exclusion soars to $300.1 billion and the interest of exclusion on homeowner bonds jumps to $9.3 billion, for a total of $823.0 billion in homeowner subsidies. (The estimate for the exclusion of net imputed rental income on owner-occupied homes leaps to $246.9 billion.)

By comparison, for the same period, the federal tax expenditures that subsidize rental housing, using the cash basis measure, include $22.1 billion for low-income housing tax credits; $22.1 billion in passive loss exceptions, and $2.2 billion in interest exclusion on rental housing bonds, generating a total of $46.4 billion in rental housing subsidies. However, the allowance of more rapid rental housing depreciation deductions generate additional revenues of $15.4 billion over the five-year period, resulting in a net subsidy for rental housing of only $31 billion.

Using the outlay equivalent measure, the numbers close the gap only a little and are quite discouraging for the rental housing industry. Credits for low-income housing are subsidized at a meager $29.8 billion, passive loss exceptions are funded at $22.2 billion and the interest exclusion on rental housing bonds are backed by $3.2 billion. The allowance of more rapid depreciation deductions would generate an additional $15.4 billion for a total of $39.8 billion and an astonishing 21 to 1 ratio in favor of homeownership.

The Joint Committee on Taxation (JCT) finds a similar bias for homeownership in its 2005-2009 estimates. It shows homeowner subsidies of $638.1 billion and rental subsidies of $51 billion.

Again this year, it is time to call for the narrowing of the gap in the amount of tax dollars given to encourage homeownership and the tax dollars provided for rental housing. It is time that rental housing gets the respect it deserves in the federal budget and the federal tax code.

More on tax expenditures

On page 351 of the Analytical Perspectives

	President's Budget 2006-2010 (Cash-basis tax expenditures, in billions)	President's Budget 2006-2010 (Outlay equivalent, in billions)	Joint Committee On Taxation 2005-2009 (Tax Expenditures,in billions)
Homeownership			
Homeowner Interest Deduction	445.5	445.5	434.2
Gain Exclusion on Home Residences	247.2	300.1	123.0
Property Taxes Deductibility	68.1	68.1	74.1
Interest Exclusion on Homeowner Bonds	6.5	9.3	6.8
Total	767.3	823.0	638.1
Rentals			
Low-Income Housing Tax Credits	22.1	29.8	25.2
Passive Loss Rules	22.1	22.2	Not Included in JCT List
Rental Housing over 27.5 Years	-15.4	-15.4	24.4
Interest Exclusion on Rental Housing Bonds	2.2	3.2	1.4
Total	31	39.8	51.0

(continued on page three)

Federal Government

(continued from page two)

released with the president's proposed budget in February, the Office of Budget and Management assesses which of the top 30 federal tax expenditures (this includes the LIHTC) would still be considered federal tax expenditures under a consumption tax. The top 30 federal tax expenditures are segregated into four categories:

(1) is a tax expenditure,
(2) probably is a tax expenditure,
(3) uncertain as to whether it is a tax expenditure, and
(4) is not a tax expenditure.

Category (1), "is a tax expenditure," means that under a consumption tax the item being subsidized by the tax expenditure would be taxed, so the subsidy would still be needed if public policy was to subsidize it. The fourth category, "is not a tax expenditure," means that under a consumption tax the item being subsidized by the tax expenditure would not be taxed, so the subsidy would not be needed.

The LIHTC is classified in the uncertain category. Obviously, it is good news that it is not in the "not a tax expenditure" category. The industry's goal should be to convey the fact that the LIHTC would (and should) remain a tax expenditure under a consumption tax.

For more on this issue and other matters relating to tax reform, please see next month's edition of the Washington Wire in the *LIHTC Monthly Report* and the *Housing Bond Report*. For a copy of the proposed budget, go to www.whitehouse.gov/omb/budget/fy2006/. For a copy of the Joint Committee on Taxation's estimates on tax expenditures, go to www.house.gov/jct/s-1-05.pdf.