Insight

Housing: You Reap What You Sow

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Today's news that housing starts dropped 10 percent during May was another blow to the residential sector. Starts were weak across the board – down from as much as 21.3 percent in the South, to only 6.3 percent in the Northeast – and pointed to yet additional softness in the nascent recovery from the Great Recession.

Analysts quickly pointed out that the May data were heavily influenced by the expiration of the temporary tax credit that pumps $8,000 of taxpayer money into the real estate deal for first-time home buyers. Not surprisingly, the immediate conclusion in some congressional circles was to "solve" the problem, and the drumbeat to extend the credit has begun.

No. Please, I beg you, no.

Tax subsidies to housing are far from new. Indeed, from the inception of the U.S. income tax, mortgage interest has been a deductible expense. Technically, this is the correct treatment under an income tax if the taxpayer simultaneously pays tax on the market value of renting the property (i.e., if the homeowner fictionally purchases the house as a landlord – and deducts the cost of debt finance – and rents it to himself – and pays tax on the revenue from the property). But putting the niceties aside, the bottom line is that other interest is no longer deductible; the tax code is subsidizing only housing and only debt-financed housing. On top of that, the first $500,000 of capital gains are excluded from tax and owners can deduct their property taxes.

The tax code does not operate in isolation. The federal government created two giant housing enterprises – Fannie Mae and Freddie Mac – to channel capital into mortgage credit markets, and then set up requirements that it push mortgages out to lower-income buyers. Taxpayers underwrite the Federal Housing Authority, which provides lender guarantees against borrower default – another subsidy to home purchases. The list could go on, but the upshot is that the entire weight of federal policy was to push Americans into owning a home.

One might wonder why. After all, does giving up a rent check for a mortgage payment really transform Americans into better citizens? And it is not without cost. In recent years, policy contributed to the huge housing bubble. The economic fallout of the bubble has been dramatic. Housing values have fallen, houses stand empty, and new housing construction has ground to a figurative halt.

Why? Because too many policies pushed too many Americans to pay too much money for too many houses. Congresses' answer was to double-down on bad policy and try to bribe broke and scarred Americans back into the market with temporary tax credits.

The temporary tax credit was bad policy; extending it would be worse.