

# The Mortgage Interest Deduction: An Example of an Upside Down Federal Government Housing Subsidy

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*Federal housing subsidies overwhelmingly benefit homeowners over renters and wealthier Americans over poorer Americans through the US tax code. A better balance in both areas is needed to encourage equitable economic growth. The mortgage interest deduction is the primary driver of this imbalance and is by far the federal government's largest investment in housing. Further, no evidence exists that the mortgage interest deduction encourages renters to become owners. Rather, its documented effect has been to encourage those who would purchase homes to buy bigger homes. Modest reforms to the mortgage interest deduction are necessary because of its size and inequitable nature. Any and all savings achieved through reforms must be used to balance housing subsidies by providing more resources for low- and moderate-income renters and owners.*

## Introduction

The mortgage interest deduction disproportionately benefits those in the upper-income brackets. It is by far the biggest expenditure the federal government makes on homes of any kind, and there is no evidence to support the claim that the deduction significantly encourages homeownership. Some would question whether the federal government should be subsidizing homeownership at all, particularly at the level spent on the mortgage interest deduction. But, if the political forces behind homeownership

subsidy are too strong for elimination of the deduction, what options exist for improvement? Following a discussion of the mortgage interest deduction and its economic and social impacts, this paper concludes that (1) homes are a social imperative, (2) housing and homeownership play a significant role in the US economy and will remain a focus of lawmakers, (3) current federal housing subsidies disproportionately benefit owners and wealthier Americans, (4) mortgage interest deduction benefits and consequences are unevenly distributed, (5) race plays a unique role in homeownership, and (6) immediate reform of the mortgage interest deduction is desirable and possible.

## Home: A Social Imperative

Having a safe, affordable, and stable home is a social imperative. A stable home is a platform for life. In short, a home sets us up for success. The concept of a “home”—if viewed as a place of safety—is one of humanity’s most basic needs (Maslow 1943). It is a human need, right after food and water. According to the National Neighborworks Association (2013), a stable home produces better health outcomes; homes play a role in education and higher achievement in children; homes produce safer neighborhoods; and a stable home correlates with economic participation. This should not be surprising—a home is a base for society, whether rented or owned.

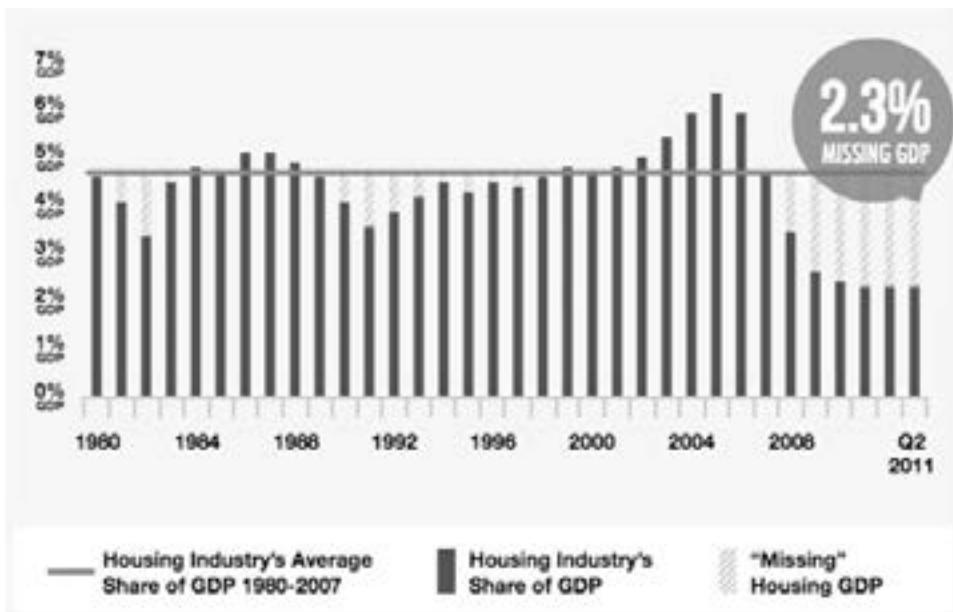
Assuring basic human needs are met is an obvious role for government, particularly in industrialized countries where adequate resources exist. Government ensures food, water, and safety through food assistance for struggling families, enforcement of clean water regulations, and through its police and military. The largest way the federal government ensures housing is through the mortgage interest deduction. But as this paper explores, a mortgage-based tax incentive does not conceptualize home as a platform for life. Rather, it encourages housing as an investment through ownership, a fundamentally different purpose.

Few would argue the two conceptualizations of “home” are mutually exclusive. Homes can be both an investment and a platform for life, depending on one’s perspective. An individual raising a family may consider the safety of the neighborhood in which the home sits, the home’s proximity to good schools or jobs, or the amount of comfortable living space. That same person may consider the home an investment that will provide for

them in retirement. A contractor sees the home as a product from which to earn an income. A real estate agent sees a potential sales commission. A single home presents opportunities in many ways for different types of people. But where does the federal government draw the line when setting priorities and designing subsidies? As will be described below, government has an interest in doing both, ensuring individuals have a safe, stable home, while encouraging home investment for those who choose to own.

A homeownership subsidy for low and moderate-income individuals who wish to make the leap from renter to owner makes sense as part of an approach to balancing the social imperative with investment encouragement. The mortgage interest deduction is the closest policy through which the federal government has attempted to strike this balance. As this paper outlines, however, federal housing subsidies are out of balance and skewed to favor the wealthy. The mortgage interest deduction is a significant contributor to that imbalance.

**Figure 1.** The Housing Industry as a Percentage of Gross Domestic Product



Source: Bipartisan Policy Center 2013

## The Homeownership Industry

According to a report by the Bipartisan Policy Center’s Housing Commission (2013), homeownership is linked with multiple positive externalities, including stable communities, increased civic engagement, higher voter turnout, enhanced home maintenance, lower crime rates, and positive behavioral and educational achievement in children. Furthermore, housing generally is a significant part of the overall economy, accounting for between 2 and 6 percent of gross domestic product. As Figure 1 from the Bipartisan Policy Center report illustrates, the housing industry’s role as a driver of the US economy has wavered over time; during the most recent economic recession beginning in 2007, housing’s economic impact decreased significantly.

Homeownership has been a historically popular means to attain wealth. According to the U.S. Census Bureau (2012), homeownership rates

have stayed relatively constant between 64 and 69 percent of all households over the last several decades. Given the social and economic importance of housing, it is reasonable to assume that the federal government will play some role in ensuring housing and homeownership’s place in the economy and society. However, as the subsequent section demonstrates, housing subsidies have been misdirected and focused heavily on wealthier homeowners, leaving vulnerable and less affluent individuals behind.

## Overview of Federal Housing Subsidies

In the US, two households are owned for every household rented, and similarly, federal housing subsidies favor owners over renters by a ratio of 2 to 1. If tax expenditures and direct appropriations are aggregated, owners receive approximately \$120 billion annually, and renters approximately \$60 billion. Table 1

**Table 1.** Federal Tax Expenditures and Appropriations for Owners and Renters (Fiscal Year 2012 dollars in billions)

Owner		Renter	
Tax Expenditure		Tax Expenditure	
Deduction for mortgage interest on owner-occupied residences	68.5	Low-Income Housing Tax Credit	6.0
Deductions for property taxes on real property	24.5	Preferred rate on capital gains	5.2
Exclusion of capital gains on sales of principal residences	22.3	Depreciation of rental housing in excess of alternative depreciation system	4.7
Other tax expenditures (owner)	2.4	Other tax expenditures (renter)	4.2
<b>Total</b>	<b>111.7</b>	<b>Total</b>	<b>20.1</b>
Appropriations		Appropriations	
Other appropriations (owner)	2.5	Tenant-based rental assistance	18.9
<b>Total</b>	<b>2.5</b>	Project-based rental assistance	9.3
		Other appropriations (renter)	7.4
		Public housing	5.8
		<b>Total</b>	<b>41.5</b>

Source: Bipartisan Policy Center 2013

demonstrates the disparity between housing subsidies for owners and renters at the line item level.

Renter subsidies are focused on direct rental assistance for low-income households. Homeowner subsidies are implemented almost exclusively through the tax code. Of the total \$180 billion spent annually on housing, \$140 billion is spent through tax expenditures, most noticeably through the mortgage interest deduction (Bipartisan Policy Center 2013).

Those benefiting from current federal housing policies are owners with a large enough tax liability from which to deduct or invest, or both. Middle- and high-income homeowners are provided additional annual subsidy from the federal government, leaving low- and moderate-income renters at a considerable disadvantage. Figure 2 illustrates how acute the subsidy advantage is for upper income individuals (Carasso *et al.* 2005). Again, the primary driver is the mortgage interest deduction.

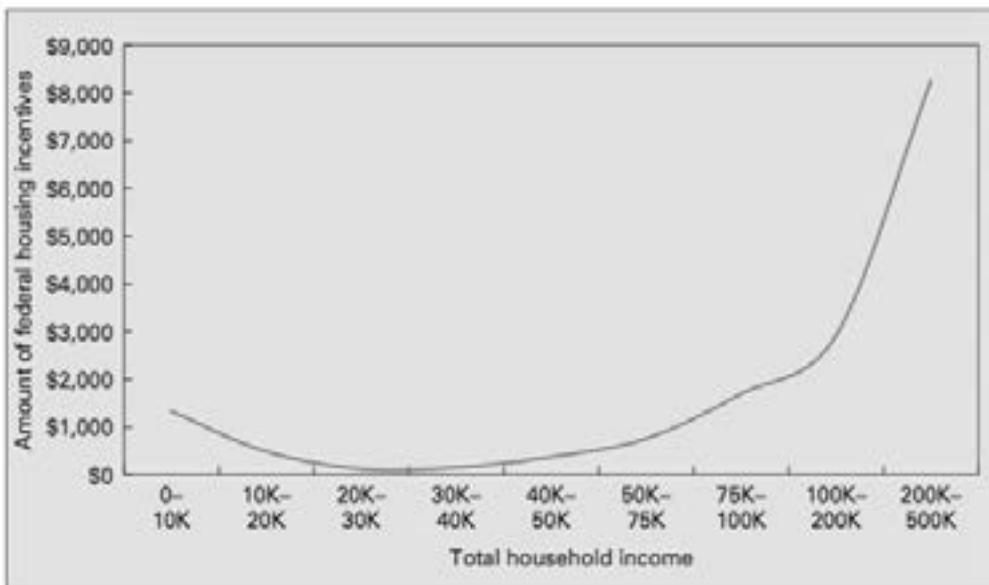
### The Mortgage Interest Deduction

The mortgage interest deduction was enacted in 1913 as part of the negotiations for the 16th Amendment, which established the right to collect a federal income tax. After 1913, almost all loan interest was deductible. Any loan interest paid within a tax year could be deducted from an individual's taxable income. There was nothing special about the mortgage interest deduction. It was deductible just as any other loan: agricultural loans, business loans, car loans, or credit card interest.

Prior to World War II, the mortgage interest deduction was also a very modest expense to the federal government. Most homes were bought with cash. After World War II, however, a new financial tool was invented to allow the non-wealthy access to homeownership: the 30-year fixed rate mortgage.

The mortgage interest deduction expense to the federal government rose as more households gained access to homeownership through mortgage loans. Though precise estimates of the

**Figure 2.** U-Shaped Curve: Average Annual Federal Housing Benefits by Total Household Income (2004)



Source: Carasso *et al.* 2005

costs associated with tax expenditures are difficult to locate and calculate, the Joint Committee on Taxation estimates the mortgage interest deduction cost the federal government \$60 billion in 2000, projecting that this cost will rise to \$113 billion by 2015 (Pew 2013). The only substantial reform to the mortgage interest deduction came in 1986 through taxpayer reform legislation. The legislation removed the deductibility of most forms of interest payments. The mortgage interest deduction remained due primarily to heavy lobbying on the part of the housing industry (National Low Income Housing Coalition 2013).

However, the mortgage interest deduction was not left untouched, and a deductibility cap was placed on the first \$1 million dollars of a mortgage. That cap remains, but the deduction was never intended as a tool to encourage homeownership. It is simply a vestige from an era when all loan interest could be deducted from an individual's annual taxable income.

### *Who Benefits?*

The Bipartisan Policy Center compared the mortgage interest deduction to other federal housing subsidies for both owners and renters. The deduction's price tag tops both the next two housing subsidies, which are both targeted to homeowners, by a magnitude of three. Overall, the \$68.1 billion expense accounted for 37 percent of all federal government housing-related expenditures in 2012.

Given the substantial price tag for the deduction, some have taken on a deeper analysis of the distribution of benefits. The distribution is far from equal, with the primary benefit going to wealthier households (Glaeser and Shapiro 2002). A driving factor benefiting wealthier households is the nature of deductions in general. To realize direct benefit, one must itemize his or her tax return. In 2012, only 30 percent of all

tax filers itemized and only 51 percent of homeowners did so (Joint Committee on Taxation 2012; National Low Income Housing Coalition 2013). Of those who itemize, almost half (48 percent) have incomes over \$100,000 (Joint Committee on Taxation 2012).

In 2012, households making over \$200,000 comprised just 7 percent of mortgage interest paying households, yet 14 percent of all households that claim a deduction. Households making over \$100,000 comprise less than 30 percent of those paying mortgage interest, yet 55 percent of those claiming a mortgage deduction. The overall distribution of the tax benefit favors those making over \$100,000; of the \$68.1 billion spent on the mortgage interest deduction in 2012, 77 percent (\$52 billion) went to households with annual incomes over \$100,000, while those households make up less than 30 percent of all mortgage interest payers (2012).

### **The Mortgage Interest Deduction and the Broader Economy**

Major studies on the effects of tax treatment on homeownership will typically focus on the mortgage interest deduction, the property tax deduction, and an instituted tax on imputed rents. This paper provides a review of literature and focus almost exclusively on outcomes related to the mortgage interest deduction.

In general, tax incentives attempt to indirectly influence economic choices and behavior, and in the case of the mortgage deduction, of consumers. Tax incentives are complex subsidies. The mortgage deduction does not just impact consumer behavior. It also impacts sellers, builders, lenders, and asset managers, among others. Economic analyses of housing tax subsidies generally accept and use four indicators to assess the policy's usefulness: mortgage prices (interest rates), homeownership rates, aggregate welfare, and wealth distribution (as measured by the Gini coefficient). This research will

consider these indicators to judge the consequences and impacts of the mortgage interest deduction.

### *Mortgage Prices*

The economist Andrew Hanson has argued that the mortgage interest deduction inflates mortgage interest rates for consumers. “[F]or every \$1,000 borrowed without the [mortgage interest deduction], the interest rate on the entire loan decreases by between 3.3 and 4.4 percent,” suggesting that the mortgage interest deduction inflates the cost of purchasing a home. Further, Hanson estimates that between 9 to 17 percent of the subsidy is captured by lenders as a result of those higher interest rates (2011).

This is in sharp contrast to claims made by the National Association of Realtors (2013), which states “home owner tax incentives [...] make home ownership more affordable for more families.” This claim should not come as a surprise. The mortgage interest deduction acts as a demand-side subsidy, putting more home-purchasing power in the hands of consumers. Nonetheless, estimates of the income elasticity of housing indicate that as one’s income goes up, so does housing consumption, with estimates of this elasticity around 0.8 (Polinsky and Ellwood 1979). This brings into question whether or not a demand-side subsidy is necessary to support the homeownership market.

### *Homeownership Rates*

As discussed previously, the mortgage interest deduction inflates the cost of purchasing a home by putting more purchasing power in the hands of consumers. Policy makers are presented with a tradeoff. The policy increases prices for consumers but also increases their purchasing power. Measuring the homeownership rate is one way to quantify that tradeoff. Economists Sang-Wook Cho and Johanna Francis (2011) predicted a small decrease of 0.07 percent in the homeownership rate if the deduction is removed.

This paper argues that a 0.07 percent effect on the homeownership rate is not meaningful and, therefore, not worth the increased cost to consumers for a home purchase. At the very least, policymakers should be aware that the mortgage interest deduction is not a tool that has a significant impact on homeownership rates.

### *Aggregate Welfare*

Aggregate welfare can be measured by observing changes in the average utility of a policy intervention. In other words, what effect does the mortgage interest deduction have on the average utility of homeowners and buyers? Under the scenario set by Cho and Francis, they predicted that a removal of the mortgage interest deduction would cause an increase in average utility resulting from a reallocation of assets away from housing and toward other financial assets. While the removal of the mortgage interest deduction resulted in a very small positive change in average utility (0.14 to 0.16 percent), the overall effect was quite negligible, “suggesting that the mortgage interest deduction has little impact on reallocation between housing and financial assets and that those individuals who delay homeownership only increase their non-housing consumption” (2011, 54).

### *Wealth Distribution*

The very small effect on national homeownership rates as a result of removing the mortgage interest deduction could also indicate whom the deduction benefits. If, in fact, the deduction had a significant impact on renters’ abilities to become homeowners (and thereby create more homeowners), removing the deduction should have a notable impact on national homeownership rates. However, as discussed previously, this effect has not been demonstrated. A closer examination of how the deduction effects wealth distribution across income levels is warranted.

Prior research has demonstrated

two areas of impact related to wealth distribution and equality. First, questions of wealth distribution equality can be approached with a Gini coefficient measurement. The Gini coefficient measures statistical dispersion, in this case, changes in the dispersion of wealth once the mortgage interest deduction is removed. The deduction's existence or elimination does little, if anything, to reduce income inequality as measured by the Gini coefficient (Cho and Francis 2011). The coefficient stayed fixed to baseline projections in both the short and long term. This was not the case for other housing tax incentives (2011).

Second, the marginal cost of housing (i.e., the cost of purchasing a larger home) increases by an average of 5 percent assuming consumers do not change their debt-to-value ratios. In other words, the deduction currently makes purchasing larger homes cheaper (Poterba *et al.* 2008). Cho and Francis discovered very similar impacts on the marginal cost of housing. Both studies concurred that the rise in marginal cost was primarily driven by an incentive shift among wealthier households to divert money from financial assets into housing assets. Glaeser and Shapiro (2002) came to similar conclusions.

### **Mortgage Interest Deduction and Income Stratification**

Douglas Massey (2007) explicitly states that stratification or income inequality does not just happen as a force of nature, "It is produced by specific arrangements in human societies that allow exploitation and opportunity hoarding to occur along categorical lines." He attributes stratification in recent decades to modifications in labor laws, stagnant wage standards, reduced spending on unemployment and food supplements, cutbacks in public employment, and time limits on welfare receipts, resulting in more consumer-borrowing in spite of tougher bankruptcy laws and real increases in

interest rates.

Additionally, Massey contends that those on the upper end of society have benefited from the elimination of progressivity in the tax code, scaled back tax rates in the top brackets, reductions on capital gains, and redirection of tax enforcement away from the wealthy and toward the low and middle class. "By 2005, levels of inequality with respect to income and wealth had returned to values not seen since [...] the 1920s" (Massey 2007).

The mortgage interest deduction is another example of governmental policies contributing to the wealth gap that Massey describes. Within the realm of homeownership, the consequences could be quite dire. Christopher Leinberger (2008) argues that trends in US homeownership are leading to a new and undesirable destiny for suburbs. Cities are trending more attractive and expensive in price per square foot, but can offer cultural and lifestyle stimulation in ways few suburbs can. Over time, he says, "[t]he fate of many homes on the metropolitan fringes will be resale, at rock-bottom prices, to lower-income families—and eventual conversion to apartments." He contends this could be the fate of suburbs that have been overbuilt and offer fewer lifestyle advantages. Leinberger calls the suburbs the new frontier for American slums, concentrating poverty and all that comes with it.

In the context of Leinberger's article, it is fair to ask if the mortgage interest deduction is subsidizing America's "next slum." A fair amount of evidence exists suggesting the mortgage interest deduction may be doing so. Research has demonstrated the mortgage interest deduction has contributed to homebuyers choosing larger, more expensive homes in the suburbs, where land use, lot size, and zoning favor such development. The most notable and demonstrable outcome of the mortgage interest deduction is not increased homeownership or more affordable homes. Rather, the policy is

**Table 2.** Homeownership Rates by Race and Ethnicity: 1994 to 2012

Year	US	Non-Hispanic White	Black	Hispanic	All Other Races
1994	64.2	70.2	42.6	47.6	42.2
1999	66.9	73.3	46.8	54.3	45.5
2004	69.2	76.2	49.1	58.9	48.9
2007	67.8	74.9	47.7	58.6	48.5
2008	67.5	74.8	46.8	58.3	48.6
2009	67.2	74.5	46.0	58.4	48.4
2010	65.5	74.2	44.9	57.7	46.8
2011	66.0	73.7	45.1	56.5	46.6
2012	65.4	73.6	44.5	55.2	45.0

Source: U.S. Census Bureau 2012

contributing to over-building and urban sprawl, having encouraged large suburban homes often built ostentatiously.

At the heart of the policy is the framing of housing as an investment, as opposed to a social imperative. As stated previously, the government has an interest in housing in both conceptualizations. But, the imbalance is skewed far too much in favor of investors and the wealthy, resulting in American society not living up to its responsibilities to fulfill the social imperative.

### Homeownership and Race

From fair housing to urban renewal to the recent subprime meltdown, the interaction of race and housing has a long history in America. Minority homeownership has played a significant role in telling that history. As seen in the following table, the homeownership rate in America has stayed relatively steady between 64 to 69 percent over the past 20 years (U.S. Census Bureau 2012). However, this average masks significant differences between the homeownership rates of whites versus blacks and Hispanics.

As Table 2 demonstrates, approximately three out of four white households have owned their home over the past 20

years. Blacks and Hispanics have been unable to break the 50 percent mark over that same period. Consequently, blacks and Hispanics have not had the same homeownership asset opportunities and the accompanying ability to build wealth. They also have been unable to realize the same positive externalities of homeownership that have been outlined.

Information on minority homeowner utilization of the mortgage interest deduction is not widely available, but some generalizations can be inferred from what is known about the deduction's disproportionate utilization among the upper class. Following the collapse of the housing market in 2006, black and Hispanic median incomes and accumulated wealth (assets minus debts) declined by a greater percentage than did those for whites (Taylor *et al.* 2011). As such, these groups may be among the types of households less likely to be in a financial position to itemize their taxes, and therefore, benefit from the deduction.

Minority homeowners, particularly blacks and Hispanics, continue to face an uphill battle. These groups saw ownership rates rise steadily over a ten-year period from the mid-90s to the mid-2000s. Unfortunately, their utilization of subprime and other less desirable mortgage

products disproportionately accompanied that rise (Federal Reserve 2013).

The financial downfall in the housing market resulting from the market collapse in the latter half of the decade had relatively small effects on homeownership rates, but home assets were struck hard, particularly among minority owners. Driven by a precipitous loss in home values, median Hispanic household wealth fell by 66 percent between 2005 and 2009 and black wealth by 53 percent, compared to just 16 percent for white households (Taylor *et al.* 2011).

The role the mortgage interest deduction played in the distribution of the housing collapse is unclear. What is clear is that the mortgage interest deduction has contributed to suburbanization, over-sized homes, urban sprawl, and the flight of the middle-class from the urban core. And as middle-class families discovered over the last decade, suburbs are far from immune to concentrated poverty, or extreme poverty neighborhoods where 40 percent of its residents live below the poverty line. Concentrated poverty grew twice as fast in suburbs as cities from 2005 to 2009. The number of residents in extreme poverty tracts increased by 41 percent in suburbs, compared to 17 percent in cities (Kneebone and Berube 2011).

The wealth gap between white and black households now stands at nearly 20:1 (Taylor *et al.* 2011). Financial regulation failed black and Hispanic homeowners. They paid a steep price, having been disproportionately provided undesirable and risky loan products (Federal Reserve 2013).

The long-term consequences could be significant for middle-class minority neighborhoods already struggling. Pronounced costs exist for primarily black neighborhood enclaves (Cashin 2004). Even before the collapse, middle-class minority neighborhoods were associated with lower home values, fewer neighborhood amenities, low

quality public services, relatively high property taxes, more crime, and poor schools (2004). For some, these costs are worth it, as residents realize cultural and personal value from racially concentrated neighborhoods.

These same homeowners bore the brunt of the housing collapse, threatening to erase marginal gains in minority homeownership and assets made since the mid-90s. Recovering the lost gains will be difficult. However, a good start may be a federal homeownership subsidy truly targeted at low- and moderate-income homebuyers.

### **Option to Encourage Homeownership**

Whether or not the federal government should subsidize homeownership is a fair question; conservatives and liberals alike have argued for Congress to end the practice. Politically, the practice is popular. The National Association of Realtors, the National Association of Home Builders, and the Mortgage Bankers Association are among the politically powerful voices that will commit millions of dollars and countless hours to preserve the deduction for their industry. However, the fragility of the housing market, real or perceived, makes lawmakers timid to dramatically alter present policy at this time.

Modest and just reforms to the mortgage interest deduction are the most likely policy changes that can be realistically hoped for in the short-term. At the heart of reforms to federal housing subsidies should be a tax incentive aimed at encouraging homeownership among low- and moderate-income homeowners. Such an incentive should also provide better overall balance to federal housing subsidy to fulfill our social imperative, freeing more resources for low-income, minority, impoverished, elderly, and disabled renters.

This type of policy was proposed in the U.S. House of Representatives in

early 2013, when Representative Keith Ellison (D-MN), introduced *The Common Sense Housing Investment Act*. It is a concept partially developed by the National Low Income Housing Coalition and is currently being pushed by the United for Homes Campaign, a national coalition of homeless, housing, and community development advocates and practitioners (Crum 2013).

The Act has two primary parts. The first would modify the mortgage interest deduction by turning it into a 15 percent non-refundable tax credit. It would lower the credit eligible cap to the first \$500,000 of a mortgage (down from \$1 million), and could be applied to second homes and to lines of equity credit up to \$100,000. This is estimated to save the federal government approximately \$196 billion over ten years (Eng *et al.* 2013).

The Act's second half would use savings from the proposed changes to the mortgage deduction to fund a handful of rental assistance and housing production programs for low- and extremely low-income renters, bringing the renter and owner subsidies more in balance. Specifically, it directs approximately \$196 billion over ten years to the National Housing Trust Fund (\$109 billion), Low Income Housing Tax Credit (\$14 billion), Section 8 rental assistance (\$54 billion), and Public Housing Capital Fund (\$18 billion).

The Act produces a homeownership subsidy more targeted to low- and moderate-income buyers. It then results in better balance between conceptualizations of home as investments and as social imperatives. The proposed mortgage tax credit would expand the number of homeowners eligible to benefit; taxpayers are eligible for tax credits regardless of whether they itemize their federal tax return.

In total, the number of households receiving tax-based homeownership assistance would grow from approximately 39 million to 55 million, adding 16 million households. Of the household

growth, 99 percent would have annual incomes under \$100,000 (National Low Income Housing Coalition 2013).

### **Political Discussion and Timing**

The Act is creatively designed to bring a variety of housing and community development advocates to the table (Crum 2013). Those looking to help low-income homeowners will like the mortgage tax credit. Nonprofit developers will take advantage of funds for the National Housing Trust Fund and the Low Income Housing Tax Credit. Poverty and homeless advocates want the National Housing Trust Fund, rental assistance, and capital improvements to public housing.

But, housing advocates advocating for housing is predictable and does not necessarily garner the attention needed for broad-based realignment of housing subsidies. Coalition building among other progressive interest groups (e.g., labor or environmental groups) and expanding the political tent will likely be necessary (2013). Opposition is being led by some political heavyweights: the National Realtors Association and the National Association of Home Builders. But bring in labor, environmental, transportation, or other groups, and housing and community advocates have the type of broad coalition required for transformational change (Dreier 2011).

Tax reform is on the table in Congress. Broad reform is seen as an avenue of compromise for Democrats and Republicans to overcome the budget battles of recent years (Montgomery 2013). Given the mortgage interest deduction's substantial price tag and bipartisan support for the deduction's modification (Bipartisan Policy Center 2013), it is hard to imagine a scenario in which broad tax reform leaves this particular deduction untouched.

### **Conclusion**

Federal housing subsidies are unbalanced in favor of homeowners and the wealthy. The mortgage interest deduction

is a major culprit. It is expensive and does not encourage homeownership. Rather, it encourages purchases of larger homes among those who would have purchased regardless of the deduction. Historically, the mortgage interest deduction has played at least an indirect role in white families leaving cities for the suburbs, urban sprawl, and poverty concentration.

The economic impacts and consequences of the mortgage interest deduction show the inadequacies of the policy as a tool to encourage homeownership. In fact, the policy was never designed as a tool to do so. It is simply a vestige from another time. The deduction inflates mortgage prices, does not significantly increase the homeownership rate, fails to reduce wealth inequality through asset purchase, and provides a very minimal average increase in utility for homebuyers given the deduction's substantial cost to the federal government.

These findings are consistent with prior research. Glaeser and Shapiro (2002) concluded, "The home mortgage interest deduction is a particularly poor instrument for encouraging homeownership since it is targeted at the wealthy." Cho and Francis (2011) similarly found, "The mortgage interest deduction does little, if anything, to encourage homeownership." Further, the most noteworthy impact the mortgage interest deduction has is to encourage those who would purchase anyway to buy bigger, more expensive homes.

It should be noted, however, that

increases in mortgage prices do benefit lenders (Hanson 2011). And, to the extent that increased mortgage prices lead to higher home values, the deduction does benefit current homeowners. The deduction also decreases the marginal cost of a home purchase, allowing families to buy larger homes with the same resources.

However, even under the best circumstances, the quantifiable benefits of the mortgage interest deduction may not be worth the cost to the federal government. Yet, the housing market is perceived to be fragile and sensitive and dramatic reform or complete elimination of the deduction is not likely. Nonetheless, a modest and reasonable reform is both appropriate and politically possible. An ideal reform to the mortgage interest deduction, using the tax code, would create a tax credit incentive for low- and moderate-income households to purchase, as well as a reduction in the eligible mortgage cap. Reform would re-balance housing subsidies for renters and owners, as well as middle-, lower-income, and impoverished Americans.

The federal government's overall housing spending is currently shaped as a tool to enhance homes as investments. But, homes are not just moneymakers: they provide safety, shelter, and a place to live. Reforming the mortgage interest deduction now to both encourage homeownership *and* provide a platform for life is politically possible, fair, just, and economically sound.

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