AEI Housing Center

State of the Union – Biden's Housing Proposals Would be Harmful, Not Helpful

By Ed Pinto, *Senior Fellow and Co-Director, AEI Housing Center*

President Biden in his State of the Union pitched a raft of proposals with the stated purpose of lowering costs for homebuyers and increasing the supply of rental units. As has been the case with dozens of housing acts passed by Congress over the last 75 years, hold onto your wallet when the federal government says it wants to help you. Over the years, the government has done a great job at juicing demand but has failed miserably at increasing supply. This is especially true when housing supply is as tight (a seller's market) as it is today, particularly for starter homes. As economics 101 dictates, when demand exceeds supply, the result is inevitably higher prices. The President's State of the Union proposals are no different. They would create programs that promote house price and rent inflation or fund programs that have a troubling history of scandal and failure.

Mortgage Relief Credit. President Biden also called for a new $10,000 tax credit over two years to middle-class first-time homebuyers. This has the effect of reducing the mortgage rate by more than 1.5 percentage points for two years on the median priced home. About 3.5 million middle-class families are expected to benefit.

Problem: This proposal would increase demand for starter homes, which are already in short supply, thereby driving up prices. In addition, many of the 3.5 million beneficiaries would have been able to buy a home without the credit. However, since money is fungible, these families will have additional purchasing power to bid up the price of homes.

Starter Home Credit. The President also calls for a "new one-year tax credit of up to $10,000 to middle-class families who sell their starter home, defined as homes below the area median home price in the county." This credit would purport "to unlock inventory of affordable starter homes, while helping nearly 3 million middle-class families move up the housing ladder and empty nesters right size. Many homeowners have lower rates on their mortgages than current rates."

Problem: Not mentioned by the President is that this "lock-in" effect was the result of the Federal Reserve's excessive and lengthy interest rate suppression by way of its zero-interest rate and quantitative easing policies, which drove mortgage rates down to a record low of 2.65% in early 2021. When the Fed belatedly raised rates in 2022 to counter the strongest bout of inflation in over 40 years, mortgage rates more than doubled to over 7%. This proposal will likely be ineffective for two reasons. First, will this credit entice 3 million locked-in homeowners

to sell? Seems unlikely. The median priced home is valued at about $350,000. Lock-in effect loans on these homes have a rate about 3.5 ppts. below the current rate and an average balance of say $200,000. Thus, the interest savings over two years would be $14,000. In addition, the now move-up buyer would need to find a replacement home in a tight market and, unless a cash buyer, would need to finance it with a 7% loan. Second, it is likely that an insubstantial number of the credit's beneficiaries would have sold without the credit, further reducing its impact and wasting precious government resources.

Down Payment Assistance for First-Generation Homeowners. The President's proposal would "provide up to $25,000 in down payment assistance to first-generation homebuyers whose families haven't benefited from the generational wealth building associated with homeownership." An estimated 400,000 families would use the credit to purchase their first home.

Problem: This suffers from the same infirmities as the Mortgage Relief Credit.This proposal would increase demand for starter homes, thereby driving up prices. In addition, many of the 400,000 beneficiaries would have been able to buy a home without the credit. However, since money is fungible, these families will have additional purchasing power to use to bid up the price of homes that are in short supply.

Tax Credits to Build More Housing with the Low-Income Housing Tax Credit (LIHTC). "President Biden is calling for an expansion of the LIHTC to build or preserve 1.2 million more affordable rental units. Renters living in these properties save hundreds of dollars each month on their rent compared with renters with similar incomes who rent in the unsubsidized market."

Problem: In reality this program, because it crowds out private sector development, has historically created far fewer housing units than advertised. On top of that, these units are costly and often poorly targeted. The system's beneficiaries are the various intermediaries that can navigate the program's complexity—not low-income families. It also suffers from substantial corruption.

Neighborhood Homes Tax Credit. This credit would incentivize the building or renovation "of affordable homes for homeownership, which would lead to the construction or preservation of over 400,000 starter homes in communities throughout the country."

Problem: Here again the federal government has a long history of failure. Notwithstanding numerous efforts, it has never successfully scaled up a subsidized building or renovation program.

Alternative. There is a growing consensus that the solution to making housing more affordable lies in adding more housing supply, not in easy credit and market distorting subsidies.

The solution is for states and localities to free the market from unduly restrictive zoning and land use restrictions that constrain supply and drive up home prices. If more states implement light-touch density, which moderately increases density and makes such development by-right, they will unleash a swarm of naturally affordable small-scale development.