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9/15

THE PRESIDENT HAS SEEN....

THE WHITE HOUSE

WASHINGTON

MEMORANDUM FOR: THE PRESIDENT
FROM: JIM LYNN/JIM CANNON
SUBJECT: Accelerated Homeownership program

ISSUE

On August 27, you stated that one of the prime issues of the campaign that you intended to emphasize is an accelerated homeownership program. The purpose of this memorandum is to brief you on the options available to you. You should know that there is some question about the need for a Government program to promote homeownership. Home purchases are at a record level, and single-family starts are at longrun equilibrium.

DISCUSSION

An individual's decision to buy a house is affected by two financial considerations:

1. Ability to save enough capital to afford a downpayment.
2. Ability to make monthly payments on interest and principal.

Any expansion of homeownership would necessitate lowering one of these two costs. Various Federal programs like FHA mortgage insurance, VA housing benefits, mortgage purchase by GNMA and FNMA, as well as others, currently serve to reduce these costs. They serve either a nondifferentiated group of recipients like FHA programs or a special group like veterans.

An ad-noc task force comprised of HUD, OMB, and the Domestic Council has reviewed the various possibilities of reducing both downpayments and monthly mortgage payments, through such devices as tax incentives, direct subsidies, and Federal underwriting and guarantees. Much consideration was given to limiting benefits to first homebuyers. The task force has determined four options (two affecting monthly mortgage payments and two affecting downpayment) to be worthy of further consideration.

Because of many unknowns, the precise effects of these policy is difficult to predict. In the past, we have undertaken

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some policies that have had dramatically different outcomes than expected.

This paper briefly describes four viable initiative options selected by the ad-noc task force with their advantages and disadvantages. If you decide to go forward with one or more of these proposals, or a variant of them, the next question is our timing. The last section of this paper indicates the advantages and disadvantages of timing options.

PROGRAM OPTIONS

Monthly Mortgage Payments

1. Tax credit (or direct subsidy) to reduce monthly payments of first homebuyers to a 6 percent effective interest rate or to 20 percent of a person's income (whichever is higher). This program would:
 - have a maximum mortgage limit of \$38,000.
 - phase out above the \$18,000 income level.
 - benefit 1.33 million families.
 - increase first home purchases by between 50,000 and 250,000 per year.
 - cost about \$665 million the first year, \$1.3 million the second year, and \$1.9 billion per year for the life of the program thereafter.
 - cost \$6,100 to \$30,000 per incremental purchaser.

2. Graduated payments to reduce initial mortgage payments. Later payments would increase at a graduated rate to match rising incomes. (This program is already a demonstration program in some parts of the country.) The program would:
 - require acceptance by lending institutions and FHA underwriting.
 - benefit 1.5 million families.
 - would require little or no budget outlays.
 - increase first home purchases by between 20,000 and 250,000 per year.

DOWNPAYMENT

3. Federal guarantee of second loan for one-half of the downpayment on any mortgage, up to a maximum guarantee of 7-1/2 percent and \$5,000. The program would:
 - Require acceptance by lending institutions.
 - Benefit 1.5 million families.
 - Result in outlays for default of \$300-500 million.
 - Assist 40,000 to 140,000 home purchasers.
 - Cost \$2,000 to \$12,000 per incremental purchaser.
4. Reduce FHA downpayment requirement from 5-0- (\$25,000 mortgage) to 50 percent (\$50,000 mortgage), and increase FHA mortgage limit to \$60,000. This program would:
 - Assist 275,000 to 1.0 million families.
 - Increase homeownership by 10,000 to 140,000 per year.
 - Have no outlay effect.

The following are the most important advantages and disadvantages of each of the options:

1. Monthly payment subsidy (tax credit or direct).

pros

- . Accelerates homeownership for first homebuyers, usually young moderate-income families with growing incomes.
- . Assures recipients continued capacity to support mortgages until they reach an \$18,000 income level.
- . Phases out the subsidy with normal income growth, with few families as subsidy recipients for more than 3 to 5 years.
- . Aids a lower income level than other alternatives.

Cons

- . Substantial outlays will be required.
 - . Some families may not experience income growth and thus could be recipients of the program for a considerable period of time.
 - . May be criticized as welfare for the well-to-do (\$14,000 to \$18,000 income).
 - . There are many unknowns as to the number of home-buyers benefited (estimated range of 52,000 to 250,000 for the first year) with implied costs ranging from \$6,100 to \$30,000 per incremental purchaser.
 - . Will either warp the tax system or require considerable administration.
 - . Could be viewed as inequitable by recent first home purchasers and by renters who pay full taxes while new home buyers have up to 100% tax reduction.
2. Graduated payment/fixed-rate mortgage.

Pros

- . Accelerates opportunity for homeownership for those with expectations of rising income by providing lower payments in early years of the mortgage.
- . Involves no direct subsidies.
- . FHA is already financing some graduated payment mortgages.

Cons

- . Requires higher (at least 7 percent) downpayment to avoid outstanding balance exceeding house price (negative equity), so cannot be combined with a downpayment option.
- . Increased default risk since, during early years of mortgage, amount owed could exceed original principal amount.
- . Requires agreement with and cooperation from lenders.

- . Some consumers will be wary if uncertain about their future income growth.
- . will probably require FHA insurance, another impediment to lender and consumer acceptance, as well as an additional workload burden and risk to HUD.

3. Federal guarantee of downpayment.

Pros

- . Substantially reduces equity required.
- . Does not depend on FHA.
- . Can be combined with other subsidies.
- . Can be limited to first home purchasers.

Cons

- . Requires higher monthly payment.
- . Requires cooperation/agreement with traditional lenders.
- . Can be criticized as favoring middle-income families.

4. Reduce FHA downpayment and extend mortgage limit.

Pros

- . Substantially reduces equity required for homes over \$40,000.
- . Can be combined with other subsidies.
- . FHA may demonstrate viability of lower downpayment to private mortgage insurers.
- . Lowest cost and lowest risk to the Government compared with other options.

Cons

- . will not reach many families unless FHA processing is substantially improved.

- . Can be criticized for benefiting mainly middle-income families.
- . will partially compete with private mortgage insurers.

OTHER CONSIDERATIONS

Another question to be considered is the timing of the release of your accelerated homeownership program. Congress goes out of session on October 2. It is conceivable that submission of new legislation by your Administration or even a concrete proposal might be seized upon by the Congress to quickly pass a housing bill that would embarrass your Administration. Even if this does not happen, there is sure to be criticism of your proposal, outlining its inconsistency with past Administration opposition to congressional proposals for accelerated homeownership.

Another consideration is that there are several contingent questions regarding the above options that will require some time to develop answers. They include:

1. Acquiring more data from polling on whether monthly payments and/or downpayments are the most significant impediments to homebuying.
2. Determining if FHA underwriting can be improved and made more efficient to make it acceptable to builders.
3. Refining estimates of the number of incremental purchasers for each program.
4. Determining what terms lenders will require for non-FHA mortgages.

These questions should be resolved by the end of September.