The original documents are located in Box 51, folder "1975/09/30 - Economic Policy Board" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

ECONOMIC POLICY BOARD MEETING
8:30 a.m.
Tuesday, September 30, 1975

Roosevelt Room

THE WHITE HOUSE

WASHINGTON

September 27, 1975

MEMORANDUM FOR JAMES M. CANNON

FROM: ROGER B. PORTER RBP

The attached paper from Secretary Hills will be discussed at the Tuesday, September 30 Economic Policy Board Executive Committee meeting at 8:30 a.m. We certainly hope you will be able to attend.

Attachment

THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D. C.. 20410

September 26, 1975

MEMORANDUM FOR: L. William Seidman, Executive Director
Economic Policy Board

FROM: Carla A. Hills CAH

SUBJECT: Reactivation of the Suspended Homeownership Subsidy Program

On April 15, 1975, the Comptroller General filed suit to compel the obligation of $291.7 million of impounded budget authority to carry out Section 235, as amended, of the National Housing Act.

HUD recommends release of the impounded funds and reactivation of an administratively modified Section 235 Homeownership Assistance Program.

EXECUTIVE SUMMARY

The housing industry's recovery is fragile and slow. The projected level of total housing starts for 1975 is 1.2 million, or 59% of the number in 1973 and fewer than in 1974, which was considered a dismal year for the industry. Unemployment in the residential construction industry is running about 20%.

Partial causes of the lagging recovery in the housing industry are high interest rates and recent rises in housing costs, which have priced an increasingly large segment of American families out of the market. In 1965, 44% of American families could afford the median-priced new single-family home; today that proportion is only 31%.

In January 1973, the Nixon Administration suspended the Section 235 program and impounded $253.5 million of unutilized Section 235 contract authority.

The Section 235 homeownership program provides families at 80% of median income or less with an opportunity to purchase homes by reducing the interest rate on their mortgages down to 1%, and requiring the homeowner to contribute 20% of his adjusted gross income to amortization. As family income increases, the subsidy decreases and finally ceases.

The GAO has filed suit seeking the release of impounded Section 235 funds, and it is the belief of HUD's General Counsel, trial counsel in the Civil Division of the Department of Justice and the Solicitor General that the GAO is likely to prevail.

HUD believes that it can remedy administratively many of the identified defects in the Section 235 program. Accordingly, it recommends reimplementation of Section 235 but instead of subsidizing the mortgage interest rate down to 1%, it proposes to limit the interest subsidy to 5%, to require a 3% down payment, and to implement greater geographic dispersal of units.

The immediate budgetary effect of this proposal would be the obligation of $291.7 million in contract authority unutilized as of July 31, 1975. Outlays would occur primarily in 1977 and 1978. The total run-out cost should not exceed $1.8 billion over 15 years.

The funds impounded will subsidize 348,000 units, largely incremental in nature. This level of construction will provide 213,000 construction jobs. A net GNP increase of $12.8 billion is projected, providing increased revenues of almost $2.6 billion.

The advantages and disadvantages of reactivation of the Section 235 program are as follows:

Pros

- Permits the GAO impoundment suit to be settled, avoiding the embarrassment of losing that suit.
- Avoids a court ordered reimplementation of Section 235 at a later time, when (hopefully) the housing sector is less in need of a stimulant to new construction.
- Avoids a court ordered reimplementation of Section 235 which might preclude us from implementing proposed administrative revisions to improve the program.
- Impacts positively on starts in a period of depressed housing production and during the six months immediately preceding the election.
- Responds to the homebuilding industry's demands for a quick stimulus to the single-family sector.
- Increases the opportunity for homeownership for many of those moderate income families priced out of the market by recent rapid rises in housing costs.

- Costs approximately 40% less per unit than the per unit cost of the earlier 1% mortgage 235 program.

- Costs significantly less than assistance for a similar family under the Section 8 rental assistance program or a GNMA 5% tandem mortgage.

- Adds a moderate income homeownership opportunity program to HUD's tools to aid the housing sector.

- Enables the Administration to take credit for the administrative changes which transform the program into a workable homeownership subsidy for moderate income homeowners.

- Defuses a thirty-four month dispute with Congress.

- Decreases Congressional desire for a new interest subsidy program.

Cons

- Requires outlays of $39.6 million in 1977, and $109.8 million in 1978.

- Involves run-out costs of $1.8 billion.

- Requires additional staff in 1976 of 362, in 1977 of 725, and in 1978 of 725.

- Involves potential legislative pressure for a permanent continuation of the program, if revisions prove successful.

- Involves potential legislative pressure to extend the program to rehabilitated or existing housing, as a result of realtors' interest.

- May subject the Administration to criticism for having suspended the program only to reimplement it two years later, but changes in program would counter this potential criticism.

Recommendation

HUD recommends that an administratively altered Section 235 homeownership program be activated immediately and that the impounded funds be obligated.

Single-Family Housing Outlook

I. BACKGROUND

A. Housing Industry Conditions

The recovery in the housing sector is fragile and slow:

(AT A SEASONALLY ADJUSTED ANNUALIZED RATE)	JUNE	JULY	AUG	PERCENT CHANGE FROM YEAR AGO
Total Starts*	1,088	1,238	1,260	-5.8
Single-family Starts	879	927	977	-0.8
New single-family houses sold	565	521		+2.4
Total units under construction	1,076	1,092		-27.2
Single-family units under construction	541	558		-9.4

. Housing production has been discouraged by high interest rates, escalating housing prices, and a lack of consumer confidence.

The rapid savings inflows of the last spring and early summer have slowed, tending to confirm the fears of many lending institutions that interest rates will rise during the coming months.

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*Although the multi-family sector is even more badly depressed than single-family construction, this paper addresses itself only to the latter.

Construction lending has dropped, totalling 25% less in June 1975 than in June of last year. Single-family construction lending dropped 15%.

Between 1971 and 1974, the median price of a new home jumped more than one-third, and between 1973 and 1974, it increased 10.5%. A decade ago, 44% of American families had sufficient income to purchase the median price new home, as compared with 31% today.* A gross income of over $18,400 is required to support a mortgage of $23,000, whereas the median income for a family of four is now only $12,836. This growing gap between housing and real incomes precludes home-ownership for an increasing segment of American families.

B. Housing Industry Outlook

It appears that in the next twelve months interest rates may well rise and that housing costs will not drop sufficiently to increase the opportunities for homeownership for middle America.

We are projecting 1,200,000 total starts and 850,000 single-family starts for calendar year 1975. For 1976, we are projecting 1,400,000 total starts and 1,000,000 single-family starts. The below chart compares these projections to housing production levels for recent years.

	1972	1973	1974	(projected) 1975	(projected) 1976
Total Starts	2,379	2,058	1,353	1,200	1,400
Single-family Starts	1,311	1,133	889	850	1,000

(in thousands)

*A Legislative Reference Service report estimates that only 15% of American families can afford the median priced new single-family home today.

II. THE SECTION 235 PROGRAM

A. History

The Section 235 Lower-Income Homeownership Program was suspended in January, 1973. The United States Court of Appeals for the District of Columbia Circuit sustained the suspension and the impoundment of unexpended program funds in Commonwealth v. Lynn, 501 F.2d 848 (CADC 1974).

B. Background of the GAO Lawsuit

On July 12, 1974, the provisions of Title X of the Budget Impoundment and Control Act became effective. On October 4, 1974, the President sent a message to Congress which contained a deferral of obligational authority for the Section 235 program in the amount of $264,117,000. The message indicated that the President had been informed by the Attorney General that the Budget Control Act was not applicable to impoundments pre-dating the effective date of the Act and that the 235 deferral was being reported for informational purposes only.

On November 6, 1974, the Comptroller General submitted a message to Congress purporting to reclassify the Section 235 deferral as a rescission on the grounds that since the statutory authority to obligate 235 funds expired on August 22, 1975, the purported deferral was a "de facto" rescission.

Under the Act, if applicable, Congress can disapprove a rescission by inaction, but one House must pass a deferral resolution in order to disapprove a deferral of funds. In view of the doubt regarding the Comptroller General's authority to reclassify a deferral as a rescission, on March 13, 1975, the Senate passed a resolution disapproving the 235 deferral (S. Res. 61). Under Title X, the President has 45 days to begin expending funds after he becomes legally obligated to do so, and if he fails to abide by the Act's requirements, the Comptroller General may bring suit 25 days thereafter.

The Comptroller General has brought such a suit (Staats v. Ford, Civ. No. 75-0551, D.C.D.C., filed April 15, 1975) claiming that the Section 235 impoundment is subject to the provisions of the Budget Control Act, which require the immediate obligation of the impounded funds.

District Judge, June Green, on August 20, 1975, entered an interlocutory order that the impounded Section 235 funds be obligated, albeit not expended, so that the program funds would not terminate on August 22, 1975, when the statutory authority terminated. HUD complied. That order is now on appeal.

HUD's General Counsel, trial counsel in the Civil Division of the Department of Justice and the Solicitor General believe that the GAO is likely to prevail in this litigation.

C. Description of the 235 Program

The Section 235, Lower-Income Homeownership Program, by which direct cash payments are provided to a lender on behalf of a lower-income family to enable it to purchase a home, was substantially amended in the Housing and Community Development Act of 1974. It now provides that:

-- the payments can reduce amortization costs to as low as 1%;

-- the homeowner must pay a minimum of 20% of adjusted income toward regular monthly payments;

-- the homeowner must pay a minimum of 3% of the purchase price as a down payment;*

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*These provisions represent amendments to the 235 program contained in Section 211 of the Housing and Community Development Act of 1974.

-- the mortgage ceilings are $21,600 ($25,200 in high cost areas) or $25,200 ($28,800 in high cost areas) for a family with 5 or more persons;* and

-- to be eligible a family's adjusted income must not exceed 80% of median income for the area.*

D. Strengths of the Section 235 Program

HUD's evaluation of the 235 program in Housing in the Seventies identified several strengths.

(1) The program did provide lower but particularly moderate income families with the stabilizing influence of an opportunity for homeownership. (We have no homeownership program today.)

(2) The program was useful for minority families and marginally increased the geographic dispersion of inner-city inhabitants to suburban areas, thereby contributing to the racial heterogeneity of some communities.

(3) Construction costs for 235 units were no higher than for similar conventional houses, partially because a Section 235 house is not actually designated as such until an eligible buyer is certified. Thus, the builder tended to build competitively.

(4) Section 235 has a relatively low first-year cost and a long run-out period.

(5) Fifty thousand families of the 450,000 beneficiaries of the program worked themselves out of subsidy and became self-sufficient homeowners.

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*These provisions represent amendments to the 235 program contained in Section 211 of the Housing and Community Development Act of 1974.

E. Criticisms of the Section 235 Program

The Section 235 program was suspended in January, 1973 for programmatic and budgetary reasons. The programmatic reasons are identified in Housing in the Seventies, pages 104-110.

(1) There was perceived horizontal inequity in that only one out of fifty income-eligible families obtained those home-ownership benefits. However, this type of inequity is inherent in every subsidy program where the number of beneficiaries almost always exceeds available funding.

(2) There was a perceived vertical inequity problem in that beneficiaries with higher incomes received greater subsidies because they tended to purchase more expensive homes and the subsidy is a percentage of mortgage interest.

(3) There was a perceived geographical inequity as a result of low statutory mortgage limits and differences in regional construction costs which resulted in an over-concentration of subsidized units in low costs areas such as the South.

(4) Concern was expressed that the program had a substitution effect in that subsidized starts reduced the availability of mortgage funds and building resources for non-subsidized starts.

(5) Concern was expressed that the minimum down payment of $200 did not create sufficient incentive in the purchasers to care for their property. (Section 211 of the Housing and Community Development Act of 1974 increased the minimum down payment to 3% of purchase price which corrects this concern.)

(6) Finally, there has been a significant problem with defaults on 235 mortgages, particularly with respect to existing housing and large subdivisions. Currently, defaults coupled with our losses on acquired mortgages are running at a rate that makes the program actuarily unsound.

F. Proposed Administrative Revisions of 235

There are several ways in which the perceived deficiencies in the 235 program could be ameliorated.

(1) A screening process to select homeowners likely to work themselves out of subsidy range would significantly help to avoid defaults and minimize ultimate run-out costs. A recently reported experiment in the San Francisco area has proved extremely successful in avoiding delinquencies.

(2) A minimum down payment of 3% of the purchase price up to $25,000 and 5% of excess, with the purchaser to pay full closing costs, would give most homeowners a $2,000 or more cash investment in their homes and focus the program more on moderate-income families, which was the group which succeeded under the prior 235 program.

(3) Specifying 5% as the lowest interest rate to which the mortgage would be subsidized instead of the old 1% floor would:

(a) Limit participation to a higher income group which succeeded under the previous program, while leaving almost 6 million families within the eligible income range.

(b) Decrease the interest differential between 235 and other FHA home purchasers and thereby decrease the preceived inequity of the subsidy.

(c) Narrow the subsidy so that the funding would be available for more units. Assuming an average mortgage of $23,000 at a 9-1/2% market rate, the available $291.7 million would support 203,000 units at 1% but 348,000 units at 5%. The effect of a subsidy to 5% is demonstrated in the below table showing the gross income required to support a $23,000 mortgage at 9-1/2% and 5%, respectively.

Rate	Monthly Payment	Gross Income
5	134.25	$12,300
9-1/2	200.95	$18,411

Since the median income for an American family in 1974 was $12,836 a 5% subsidy brings a modest home within the reach of the average American family.

(4) Restricting 235 funds to new construction would maximize the immediate impact on housing starts.

(5) Restricting 235 funding to the lesser of 20 homes or 30% of the total units in a subdivision would avoid the large 235 financed subdivisions which gave rise to the most severe problems in the old 235 program. This restriction might also encourage non-subsidized housing starts by, in effect, assuring a developer of a relatively quick sale of 30% of his stock when he built a subdivision.

(6) Utilization of 235 would require compliance with Section 213 of the 1974 Housing and Community Development Act, which requires the allocation of 235 assistance to be on a geographical formula basis and in conformance with housing assistance plans. Thus, geographical inequities of the old 235 program could be mitigated and local governments could be given some control to assure more rational location of 235 construction.

G. Effects of Reimplementation

(1) Timing. If regulations were published simultaneously for effect and comment, Section 235, with the suggested changes, could be implemented in 30 to 45 days. Processing of larger scale developments would take 90 to 120 days. Hence, the program would be having its greatest effect on starts in the early spring of 1976.

(2) Housing Starts. At the recommended 5% interest rate, the available $291.7 million would cover 348,000 units. It is unlikely there would be significant substitution for unsubsidized starts, because the program would reach families now squeezed out of the market.

(3) Jobs and GNP. The construction of 348,000 units would provide 213,000 jobs and $12.8 billion in increased GNP. The GNP translates into $2.6 billion in increased revenues.

(4) Total Costs. Releasing the impounded Section 235 funding would involve $264 million of contract authority this year. In terms of actual outlays, because all funded units will be new, it is likely that there would be only minimal outlays

in FY 1976 -- followed by outlays of $39.6 million in FY 1977 and $109.8 million in FY 1978.

Based on previous experience with Section 235, we calculated the total potential run-out cost of the program over 15 years to be approximately $1.8 billion, although the theoretical maximum run-out cost over 30 years would be $8.7 billion, assuming no increases in recipient's incomes. The higher interest rate and prepurchase screening envisioned should insure that more of the recipients will work themselves out of the subsidy than under the program as previously implemented, further reducing the run-out cost.

The additional staff years required are 362 in 1976, 725 in 1977, and 725 in 1978.

(5) Cost Comparisons. Section 235 provides housing to moderate income families at about half the annual subsidy cost of the currently operable Section 8 Lower-Income Rental Assistance Program.

The annual Federal subsidy for a family of four with a gross income of $8,800 in a unit costing $25,000 is $1,619 under Section 8, $1,339 under the old Section 235 program, and $953 in the revised Section 235 program.

Because a Section 235 subsidy terminates when the recipient family's income increases to a given level, a Section 235 5% homeownership program is less expensive, on a per unit basis, than a GNMA tandem program involving 5% mortgages. For example, a 5% tandem plan for 60,000 units would cost approximately $395 million as compared to $178 million for the same number of units subsidized to 5% under Section 235.

OPTION

Whether or not to activate the Section 235 Lower-Income Homeownership Program with the administrative changes discussed above.

Pros

- Permits the GAO impoundment suit to be settled, avoiding the embarrassment of losing that suit.
- Avoids a court ordered reimplementation of Section 235 at a later time, when (hopefully) the housing sector is less in need of a stimulant to new construction.
- Avoids a court ordered reimplementation of Section 235 which might preclude us from implementing proposed administrative revisions to improve the program.
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- Enables the Administration to take credit for the administrative changes which transform the program into a workable homeownership subsidy for moderate income homeowners.
- Defuses a thirty-four month dispute with Congress.
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- Requires outlays of $39.6 million in 1977, and $109.8 million in 1978.
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- Involves potential legislative pressure to extend the program to rehabilitated or existing housing, as a result of realtors' interest.
- May subject the Administration to criticism for having suspended the program only to reimplement it two years later, but changes in program would counter this potential criticism.

RECOMMENDATION

HUD recommends that Section 235 be reactivated as modified immediately and the impounded funds obligated.

[9/30/75]

1) How soon court decision ?

2) If can make Adm. improvements before court acts, why cannot do after court acts ?

3) Figures on -2 comparable ?

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