CRACKS IN THE FOUNDATION OF FEDERAL ASSISTANCE TO HOUSING

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Federal legislation affects all types of rental and purchased housing—standard multi-family and single-family rentals and traditional single-family homes, cooperatives, and condominiums. Federal initiatives designed to stimulate the higher-income housing market generally include programs without direct subsidy, such as tax benefits from ownership and the encouragement of secondary mortgage markets. Federal involvement has been significant in housing programs to assist middle-income groups: tax benefits for homeowners, Federal Housing Administration (FHA) insurance programs, middle-income rental programs, and to a certain extent tax-exempt financing vehicles. The federal government also has been committed consistently to assisting lower-income persons through traditional public housing programs, the Section 235 and 236 programs, rental assistance, rent supplement and most recently the Section 8 housing assistance payments program. As the federal role in housing changes, the critical issues relate to the level of assistance and the targeting of benefits.

The current state of housing and the legislative impact of the 97th Congress, looked at in tandem, provide less than salutary answers to concerns about the effects that present federal policies will have on housing. For whatever reasons, housing has lost much of its appeal in Washington. Its attractiveness for the Reagan Administration has been as an easy target for budget cutting. The housing lobby discovers again and again it does not have the votes to influence legislative proposals. While budget figures tell the story clearly—the HUD proposed budget for 1984 represents a sixty percent cut[1] in budget authority from Fiscal Year 1983—most telling, perhaps, is not the paucity of housing legisla-

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1. U.S. DEP'T OF HOUS. AND URB. DEV., FY 1984 BUDGET SUMMARY, at ST-9, Exhibit II (1983).

tion but that the legislation that does impact on housing concerns is not "housing legislation" at all.

Housing policy today, such as it is, is being shaped by those who make financial policy. A close look at the legislative record of the last two years clearly demonstrates a major change in the historical role the federal government has taken in housing. The concentration on reduction of the federal budget has been paralleled by an articulated policy of accelerating the withdrawal of the federal presence from housing.[2]

THE CHANGING STATE OF HOUSING

Despite some recent gains due to descending interest rates, in the current economy housing remains a beleaguered industry. Even the President, the industry's most reluctant partisan, has conceded that "[f]or millions of Americans, the dream of home ownership was shattered by soaring costs, record interest rates and economic mismanagement."[3] Between 1977 and 1980 the average monthly payment for a mortgage loan nearly doubled.[4] Over a period when the prime rate of interest reached twenty-one percent, the conventional commitment rates for long-term home mortgages peaked at almost nineteen percent.[5] In 1982 work was begun on fewer than 1.1 million houses, the lowest number of housing starts since 1946.[6] In August 1982, the median sales price for new single-family homes was $73,900, with average sales prices reaching $88,400.[7] When Congress was considering and the President was rejecting a legislative stimulus for single-family homes, the National Association of Realtors estimated the unsold overhang on the market at 275,000 houses.[8]

America's expectations always have included housing. In the 1970s the dream of home ownership became entangled with another strand of the same vision: financial security. George Sternlieb, director of the Center for Urban Policy Research at Rutgers University, has speculated that we are becoming a "post-shelter" society in which housing related decisions are dominated by investment decisions.[9] In 1978, California homes were increasing in price at 1.5% a month and one out of every sixty Californians had a real estate license. By the summer of 1982, Californians were delinquent on mortgages totalling $1.7 bil-

2. *U.S. Studies Shift in Allocating Housing Funds*, N.Y. Times, Oct. 7, 1982, at A18 (quoting Robert Maffin, Executive Director of the National Association of Housing and Redevelopment Officials) [hereinafter cited as *Housing Funds*].
3. Speech by President Reagan before the 1982 Annual Convention of the U.S. Savings League, 18 WEEKLY COMP. PRES. DOC. 1491 (Nov. 22, 1982).
4. 10 HOUSING & DEV. REP. (BNA) 61 (June 21, 1982).
5. *Mortgage Market Trends-October 1982*, MORTGAGE BANKING, Oct., 1982, at 154.
6. Kleinfield, *Who Gains When Housing Prospers*, N.Y. Times, Apr. 17, 1983, at F1 (midwest ed.).
7. GEN. ACCOUNTING OFFICE, HOUSING AND COMMUNITY DEVELOPMENT (1982).
8. *Supra* note 5.
9. *See* FEDERAL NATIONAL MORTGAGE ASSOCIATION, HOUSING FINANCE IN THE EIGHTIES: ISSUES AND OPTIONS 20 (1981) [hereinafter cited as HOUSING FINANCE].

lion.[10] In December 1982, when national unemployment levels reached a discouraging 10.8%, unemployment in the lumber and construction trades was holding at almost twenty-four percent.[11] Restrictive credit policies (which led to high interest rates), a tight rental market, and tax policies, which frequently favored non-real estate investments, almost devastated the housing industry and severely threatened the stability of those financial institutions dependent on housing and long-term investment.[12]

To understand how this crisis developed requires some understanding of the favored position housing had obtained in the post-war decades. During those years, demography, economics, and the thrust of federal legislation combined to establish a particular priority for housing. The pent-up demand of the war years followed by the post-World War II baby boom was met by federal legislative programs, such as the Interstate Highway Trust Fund,[13] that encouraged the development of suburban America and a boom in housing that peaked with a high of two million starts in 1978.[14]

Over the same period, regulated financial institutions paid modest rates for their money and, therefore, were eager to lend mortgage money at low rates for the long-term. Financing had been prearranged by the builders of new homes, or brokers selling existing houses, and homebuyers simply could go to a mortgage company or to their local bank or savings and loan to borrow the necessary funds. It was the golden age of the long-term, fixed rate mortgage. In addition to cheap money and a modest rate of inflation, an expanding economy provided jobs and prospects of advancement for almost every new householder. The prosperous suburban homeowner, in a rising economy, could take smug satisfaction in the best investment he ever made: a house. There was a tremendous increase in homeowner equity as houses appreciated at an average annual rate of fourteen percent.[15]

Those halcyon post-war years were characterized by federal legislation that made home ownership possible for two-thirds of United States households[16] and that responded to the need for improved housing for low- and moderate-income families. Federal Housing Administration (FHA) and Veterans Administration programs eased purchase for

10. Yates, *California Bust: Boom to Time Bomb in the Golden State*, Washington Post, Aug. 21, 1982, at F1, col. 1.

11. *Id.*

12. PRESIDENT'S COMM'N ON HOUS., FINANCING THE HOUSING NEEDS OF THE 1980S: A PRELIMINARY REPORT ON HOUSING FINANCE 17 (1982) [hereinafter cited as PRELIMINARY REPORT].

13. Highway Revenue Act of 1956, 2 U.S.C. § 209 (1976).

14. U.S. DEP'T OF HOUS. AND URBAN DEV., 1980 NATIONAL HOUSING PRODUCTION REPORT 4 (1980) [hereinafter cited as PRODUCTION REPORT].

15. Salkin & Durning, *What is a House Really Worth?*, MORTGAGE BANKING, Oct., 1982, at 10.

16. CONGRESSIONAL BUDGET OFFICE, FEDERAL HOUSING ASSISTANCE: ALTERNATIVE APPROACHES 13 (1982) [hereinafter cited as ALTERNATIVE APPROACHES].

homebuyers.[17] Federal legislation ensured the availability of low interest rates from savings accounts[18] and the federal tax laws enabled homeowners to deduct mortgage interest and property taxes from their taxable income and to reduce their capital gains.[19] Housing, and particularly home ownership, then, benefited from an easy monetary policy, tax breaks low interest rates, and a series of legislative initiatives that focused directly on housing.

The same years saw a steadily increasing federal involvement in the production and subsidy of housing for low-income families. The public housing program dates back to an early effort of the Public Works Administration in 1933,[20] but is firmly grounded in the United States Housing Act of 1937.[21] The Housing and Urban Development Act of 1968[22] authorized both the Section 236 program,[23] a subsidized interest reduction program to rental and cooperative housing for lower-income families, and Section 235,[24] a similar interest reduction program for homeowners. The Section 8 program[25] has been the most recent federal vehicle to provide housing assistance primarily to lower-income renters. In light of current developments it is important to note that while federal assistance for subsidized housing represents only a modest proportion of housing activity,[26] it is an involvement that is magnified in importance at times when the economy takes a downturn and when circumstances, as in the period under discussion, create a housing recession considerably worse than the general downturn of the economy.

THE CHANGING CREDIT MARKET

As a result of shifts in the economy during the past decade and a half, the housing industry finds itself operating in an exceedingly changed credit market. From 1965 to 1978 the average annual growth of net business investment fell nearly fifty percent, a development many analysts saw as a major reason for declining productivity.[27] From 1969 to 1979 housing prices rose an unprecedented 150%.[28] These de-

17. CONGRESSIONAL BUDGET OFFICE, THE TAX TREATMENT OF HOMEOWNERSHIP: ISSUES AND OPTIONS 71-72 (1981) [hereinafter cited as TAX TREATMENT].
18. PRELIMINARY REPORT, *supra* note 12, at 3-4.
19. TAX TREATMENT, *supra* note 17, at xi.
20. National Industrial Recovery Act, ch. 90, tit. II, 48 Stat 195, 200 (1933).
21. 42 U.S.C. § 1437 (1978) (originally enacted as Act of Sept. 1, 1937, ch. 896, 50 Stat. 888).
22. 42 U.S.C. §§ 1401, 1437 (1978) (originally enacted as Act of Aug. 1, 1968, 82 Stat. 504).
23. 12 U.S.C. § 1715z-1 (1980).
24. 12 U.S.C. § 1715z (1980).
25. 42 U.S.C. § 1437f (1978) (originally enacted as Act of Sept. 1, 1937, ch. 896, 50 Stat. 888). Section 8 of the Housing Act of 1937 was substantially amended and lower-income rental assistance began by the Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633, 662 (1974).
26. Although the net impact of federal assistance on the construction industry is uneven, federally assisted multifamily construction represents an increasing share of that submarket, perhaps two-thirds of all multifamily starts in 1980. *See* ALTERNATIVE APPROACHES, *supra* note 16, at 11-12.
27. TAX TREATMENT, *supra* note 17, at xiii.
28. *Id.* at 36.

velopments took place against the troublesome backdrop of a sagging economy interrupted only by weak periods of recovery, a mounting federal deficit that weighed heavily on credit markets and consumer confidence, a seemingly intractable upward rate of inflation, and a consistent upward climb in the rate of unemployment.

At least two areas of change in the credit markets should be noted: first, the development of a vigorous secondary market that is itself in a period of change and, second, the explosive growth of a virtual supermarket of financial alternatives that may be redefining banking and the role of the traditional thrift institutions. A reliable supply of mortgage credit over the long term is critical for housing. Traditionally mortgage loans were made in "primary" markets by lenders to borrowers.[29] Often such mortgages were held as long-term assets in the portfolio of the originating institution, but in many cases, and with increasing frequency in the last decade, originators have sold their loans on secondary markets, replenishing their available loan funds.[30]

The major development in secondary mortgage markets over the last ten years has been the introduction and the growth of pass-through securities issued against pools of government underwritten and conventional residential mortgage loans;[31] the predominant actor has been the Government National Mortgage Association (GNMA),[32] although the Federal National Mortgage Association (FNMA)[33] recently has begun to issue and guarantee such pass-through instruments. In addition, the Federal Home Loan Mortgage Corporation has initiated a significant program based on participation certificates, conceptually similar to pass-through securities. Such securities also have been issued by private issuers through public offerings or private placements.[34]

The share of residential mortgages involving federal and federally-related credit agencies has more than doubled since the 1950's. In the housing downswing under discussion, however, federal agencies and federal legislation have provided a lesser share of support for mortgages and housing activity than in other recent periods of instability.[35]

There are at least two response levels where the system of housing credit falters. In the first instance, under a deteriorating economic environment, there is a not unexpected sensitivity of demand for mort-

29. PRELIMINARY REPORT, *supra* note 12, at 15.
30. *Id.* at 7. *See also* PRODUCTION REPORT, *supra* note 14, at 73; U.S. DEP'T OF HOUS. AND URBAN DEV., GNMA ANNUAL REPORT 1980 5 (1980) [hereinafter cited as GNMA 1980 REPORT].
31. PRELIMINARY REPORT, *supra* note 12, at 54.
32. PRODUCTION REPORT, *supra* note 14, at 75. The GNMA is a government corporation established to administer mortgage support programs which cannot be managed in the private mortgage market. GNMA 1980 REPORT, *supra* note 30, at 3.
33. PRODUCTION REPORT, *supra* note 14, at 75. The FNMA is a private corporation established to provide secondary support for the private residential mortgage market. GNMA 1980 REPORT, *supra* note 30, at 3.
34. PRELIMINARY REPORT, *supra* note 12.
35. At the same time, changes in federal law and regulation since 1980 have limited the volume of tax-exempt revenue bond financing available to housing. *See* Brownstein & Lore, *TEFRA Revises Tax Liabilities of Multiunit Rentals*, Legal Times, Dec. 6, 1982, at 21.

gage credit relative to interest rate sensitivity in the overall economy. As interest rates rise, mortgage credit demand plummets.[36] Second, "the increasingly wide swings in residential mortgage and housing construction activity also are traceable to structural shortcomings in the housing finance system."[37]

Accelerated inflation and high interest rates affected the climate for secondary market investors at the same time that a growing number of real estate transactions were financed outside "traditional" institutional lending channels—the thrift institutions.[38] The plight of the thrifts has been well documented and publicized. Despite ongoing federal efforts to address those problems, however, their recorded losses continued into the fourth quarter of 1982.[39] Over the same period the budgetary thrust of the administration was to diminish federal support for the secondary credit market, particularly in the matter of funding for the Government National Mortgage Association.[40]

THE LEGISLATIVE RECORD

Federal Appropriations

Budget proposals are perhaps one of the clearest indications of housing's diminished claim on federal resources. One of the Reagan administration's first, and indeed determinative, actions on assuming office was to revise the final budget shaped by the Carter Administration. A responsive Congress acted in 1981 to reduce federal spending for housing by nearly fifty percent.[41]

This budget shift represents not only a fiscal cutback, but a profound policy shift. Section 8 budgets from 1974 through 1980, for example, placed considerable emphasis on new construction and substantial rehabilitation, which translate into new production and additions to the existing stock.[42] For Fiscal Year 1980, fully half the Section 8 units were to be new or substantial rehabilitation.[43] A radical change is evidenced in the Department of Housing and Urban Development's (HUD) recommended legislative program for Fiscal Year 1983. HUD proposed a sharply reduced subsidized housing program that would eliminate three housing rehabilitation programs in favor of a block grant, establish a direct rental subsidy for very low income families, and provide an extremely modest new construction program

36. PRESIDENT'S COMM'N ON HOUS., THE REPORT OF THE PRESIDENT'S COMMISSION ON HOUSING xxi (1982) [hereinafter cited as COMMISSION REPORT].
37. *Id.* at 116.
38. Brownstein & Lore, *supra* note 35.
39. *Troubled Thrifts*, Book Review, THE BROOKINGS BULLETIN, Winter-Spring 1982, at 18.
40. Brownstein & Lore, *supra* note 35, at 166-67. *See also* U.S. DEP'T OF HOUS. AND URBAN DEV., GNMA ANNUAL REPORT 1981, 1 (1982).
41. *See Reagan Condemns Public Housing,* DOLLARS & SENSE, Apr., 1983, at 12.
42. Brownstein & Lore, *supra* note 35, at 12.
43. *See* The Housing and Community Development Amendments of 1981, Pub. L. No. 97-35, 95 Stat. 384 (1981).

for housing for the elderly.[44] No funding has been proposed for new Section 8 construction or substantial rehabilitation. Whatever emphasis the Administration is willing to give to housing today will focus on improvement of the existing housing stock, which may represent another housing irony: the disenfranchisement of the private developer in terms of assisted housing in an Administration committed to the free market.

Since the 1968 Housing Act,[45] the flow of federal subsidy funds, outside of public housing, has been tied to the applications from private developers, often working with local development agencies, to build low and moderate-income assisted housing.[46] The last hurrah in this area could well be the construction of those Section 8 projects remaining "in the pipeline"; current legislation mandated HUD and the Office of Management and Budget (OMB) to release funds to make possible those projects under construction by October 1, 1982.[47] Lower interest rates and the extension of the construction date for projects using Financing Adjustment Factor funds[48] to January 1, 1983 is likely to make possible a number of additional Section 8 units, although the bulk of the projects pushed construction starts forward to meet the earlier deadline.

The direction posited in the earliest Reagan budget proposals has remained constant during the first two years of his Administration, even as housing moved into a deepening depression. The fate of one new housing proposal in the 97th Congress and the status of other housing legislation emphasize the modest priority accorded to housing and the determined withdrawal of the federal involvement.

Single Family Initiative

The only new housing initiative in the 97th Congress was the single family mortgage subsidy bill, originally introduced as S. 2226 by Senator Richard Lugar (R- Ind.).[49] While there is no question that this was a special purpose bill,[50] no one should have overestimated its prospects for enactment, given the critical importance the Reagan Administration placed on reducing the federal budget. Despite the bill's price tag, there were economic arguments that the bill could have had some turnaround effect on housing, construction, and interrelated industries.

S. 2226 would have provided funds to write down interest rates on

44. *See* The Housing and Community Development Amendments of 1980, Pub. L. No. 95-526, 94 Stat. 3044 (1980).
45. 42 U.S.C. §§ 1401, 1437 (1978), *supra* note 23.
46. Nolon, *Reexamining Federal Housing Programs in a Time of Fiscal Austerity: The Trend Toward Block Grants and Housing Allowances,* 14 URB. LAW. 249, 255 (1982).
47. 10 HOUSING & DEV. REP. (BNA) 310 (Sept. 13, 1982).
48. Continuing Appropriations Resolution, Pub. L. No. 97-276, 96 Stat. 1186 (1982).
49. S. 2226, 97th Cong., 2d Sess., 128 CONG. REC. S4049 (daily ed. Apr. 27, 1982).
50. When S. 2226 was reported out of the Banking Committee, the Senators stated: "The Committee has not created a permanent housing program, it has created a short-term emergency stimulus program." S. REP. No. 362, 97th Cong., 2d Sess. 2 (1982).

new homes by as much as four percentage points, to a minimum of eleven percent, during the first five years of a mortgage. The bill authorized $3 billion for such assistance: $2.5 billion to subsidize homes built between the date of enactment and November 3, 1983; $400 million for homes purchased out of builder inventory; $100 million to high-cost areas, subsidizing some part of mortgages exceeding the basic mortgage limit for the program. In all instances, it was envisioned that the entire subsidy would be repaid when an owner sold or refinanced the home.[51]

In a series of legislative maneuvers, the single-family housing stimulus program passed both Houses as part of an Urgent Supplemental Appropriations bill, H.R. 5922.[52] However, citing the three billion dollar price tag and his commitment to economic recovery rather than special industry assistance, the President vetoed the bill.[53] Without giving inordinate symbolic weight to the failure of one bill to pass, the veto of the single family subsidy bill, when viewed in tandem with the writing off of Section 8 and other housing programs, and with the current limbo into which assisted housing falls, can be read only as a direct shift in national housing policy.

Assisted Housing

The assisted housing issue was not resolved until the brief lame duck session of the 97th Congress. During the regular session the routine housing agenda remained deadlocked. Neither the housing appropriations nor the authorizing legislation was capable of passage. In a struggle over dollars for assisted housing, the House and the Senate were unable to agree on a compromise and did not adopt Fiscal Year 1983 housing authorization but were finally able to get a Presidential signature on a compromise package on December 21, 1982.[54]

During the regular session, the Fiscal Year 1983 budget resolution assumed a ceiling of $10.4 billion for assisted housing.[55] The Senate appropriations bill originally approved a level of only $3.8 billion. The House had deferred action on the appropriations bill, however, pending passage of an authorization bill. Rather than accepting the lower Senate figure, the House conferees argued successfully for deferring consideration of funding for assisted programs. The 1983 HUD/Independent Agencies Appropriations bill passed without any decision or money for Section 8 assistance.[56] While the post-election session did

51. *Id.*
52. H.R. 5922, 97th Cong., 2d Sess., 128 CONG. REC. S6342 (daily ed. June 9, 1982).
53. 1981-82 CONG. INDEX (CCH) 34,518.
54. 10 HOUSING & DEV. REP. (BNA) 636 (Jan. 3, 1983). The bill contained money for Section 292, Section 8 and Indian housing.
55. S. Con. Res. 92, 97th Cong., 2d Sess. (1982).
56. *See* Department of Housing and Urban Development-Independent Agencies Appropriation Act of 1983, Pub. L. No. 97-272, 96 Stat. 1160 (1982). While programs are funded, no mention is made of Section 8 rental assistance.

determine funding levels for assisted housing, that legislative deadlock is, again, symbolic of housing's lack of priority today.

Tax Legislation

The attractiveness of housing and other real estate as an investment has much to do with the tax incentives accorded to housing. Perhaps the two major legislative achievements of the current administration in the 97th Congress are the two tax bills, the Economic Recovery Tax Act of 1981 (ERTA),[57] and the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).[58] With the enactment of ERTA, the initial reading was that tax incentives for housing, and particularly for low-income housing, had improved.

For instance, ERTA contains several provisions that directly benefit investment in residential real property. Major changes are made under the Act's "Accelerated Cost Recovery System" in which most real estate can be depreciated during a fifteen year period, a substantial benefit compared to depreciation over the previous twenty to forty year norm.[59] ERTA also retains some special treatment regarding recapture of depreciation as ordinary income upon disposition of residential property.[60] Another benefit is that construction period interest and taxes will not have to be capitalized and amortized in conjunction with the construction of low-income rental housing; under prior law, such a requirement would have been imposed after December 31, 1981.[61]

One important indirect tax change is likely to have a negative impact on housing investment: the reduction in maximum tax rates. Since the maximum tax on gross income now will be fifty percent—reduced from seventy percent—investors may have less incentive to invest in housing tax shelters.[62] The reduction in maximum tax also produces a detrimental effect on tax-exempt bonds: the spread between taxable and tax-exempt rates has narrowed to reflect the reduction in benefits to a fifty percent taxpayer who would otherwise have been in a seventy percent bracket, for example. The good news seems to be that tax incentives for housing, and particularly low-income housing, have improved. Less heartening for the long-term, however, is that, comparatively, tax incentives for other kinds of investment have improved even more.[63] For a number of reasons it is possible that money looking for a place to go will go elsewhere.

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57. The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 176 (1981).
58. The Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 590 (1982).
59. I.R.C. § 168(b)(2)(A)(ii) (1982).
60. I.R.C. § 1250 provides that only depreciation in excess of straight-line depreciation will be recaptured as ordinary income on a disposition of residential rental property, while § 1245 requires recapture of all depreciation for other assets. The scope of § 1245 was otherwise greatly expanded by § 204 of ERTA.
61. I.R.C. § 189(b) (1982).
62. ERTA, *supra* note 57, at § 101.
63. Specifically, Title II's other "Business Incentive Provisions," —accelerated cost recovery, investment tax credit, research and experimentation, and small business rules—simplified and

ERTA was billed as a triumph of supply-side economics. In a semantic and philosophical reversal, the second tax bill, TEFRA, took the opposite tack: "tax reform," in the President's words, to raise tax revenues in the face of a $100 billion federal deficit. For housing and real estate investment, the bottom line was a modest loss—but at a time when the industry sector could least afford it.

TEFRA contains a number of provisions of substantial importance to real estate and housing investment.[64] An area of liberalization that has been of particular importance to housing interests over the last two years is that affecting the rules under IRC Section 103 regarding the issuance of obligations that are exempt from the federal income tax.

The Administration, particularly the Department of the Treasury, has held consistently negative positions with regard to extension of tax exemption. Although the concern about the use of tax-exempt financing by states and local governments for single and multifamily housing bonds developed late in the 1970's, the legislative and regulatory pace of this matter has been a particular reminder that delay in itself sometimes is policy.[65] The Treasury's proposed regulations on the use of tax-exempt financing for multifamily housing exemplified the Administration's intent to ignore housing policy in favor of a tax policy that in many respects ignored or reflected an ignorance of housing finance. The legislative and regulatory infighting as this issue moved toward resolution made it quite clear that to the extent housing considerations were weighed in these decisions, they were being evaluated and determined at the Department of the Treasury and the Office of Management and Budget. It is consistent with recent developments pointing up housing's low priority that those measures which impact on housing do so almost peripherally: they are tax measures, budget measures, jobs bills; they are not weighed against the needs of any coherent housing policy.

The TEFRA provisions affecting housing overall have a liberalizing effect. This is particularly apparent in Section 221, which addresses the major problem for housing development in the proposed Treasury regulations for multifamily tax-exempt obligations. Prior to TEFRA, a rental project, if financed with obligations exempt from federal income taxes pursuant to IRC section 103(b)(4)(A) and issued prior to January 1, 1984, had to be maintained solely as a rental project for twenty years or the term of the bond, whichever was greater; furthermore, twenty

made more attractive these other types of investments. *See* ERTA, *supra* note 57, §§ 201-252.

64. For instance, §§ 231 and 232 of TEFRA, *supra* note 58, changed the rules for original issue discount on industrial revenue bonds, and the tax treatment of stripped bonds and detached coupons.

65. COMMISSION REPORT, *supra* note 36, at 169. The issue of the use of revenue from tax-exempt mortgage bonds was addressed by the Mortgage Subsidy Bond Tax Act of 1980. Pub. L. No. 96-499, tit XI, subtit. A, 94 Stat. 2660 (1980). The 18-month hiatus before Treasury issued its multi-family regulations placed considerable chill on the market for such bonds. The new regulations, when they appeared, 47 Fed. Reg. 22,966 (May 26, 1982), went beyond the intent of Congress in their rigidity.

percent of the units had to be available for low to moderate income families for the same period of time. In the context of current interest notes, multifamily housing for low to moderate income families is economically feasible only when flexibility exists to permit, for example, ten-year terms with the option of conversion or some other alternative at that time. A flat twenty-year term might be feasible where projects could expect 100% Section 8 subsidies, but the developments under discussion, of course, parallel the absolute disappearance of new Section 8 funding authority.

Treasury took a relatively inflexible attitude in the regulations it published and any modifications thereto. Various legislative efforts at modification were unsuccessful until the enactment of TEFRA. Now, under TEFRA, the low to moderate income requirement for bonds issued after September 3, 1983, is to be the longer of 1) ten years after the date on which half the units are first occupied; 2) one half the term of the longest maturity obligation (including any refunding); or 3) the period during which the project receives Section 8 assistance. All units in a project, including those other than the low to moderate income set aside, must remain as rentals for the duration of the low-income requirement or the remaining term of the obligation.

Even the liberalization TEFRA represents is tempered to a degree by more burdensome procedural requirements including public approval requirements[66] and the reporting requirements imposed on Industrial Development Bonds generally.[67] The imposition of these and other rules in TEFRA that require regulatory clarification may increase the difficulty of issuing tax-exempt obligations at a time when state and local governments have fewer economic development tools at hand.[68]

Thrifts and Depository Institutions

Late in the second session, the 97th Congress passed and President Reagan signed the Garn-St. Germain Depository Institutions Act.[69] This act culminates at least a decade of legislative and other efforts to address the increasing problems of depository institutions. Although this act may be "the most comprehensive piece of substantive banking law to be enacted for 50 years,"[70] it also has considerable impact on housing. The thrust of the act, in part, is a salvage operation for those institutions most closely involved with housing finance.

For a number of years those financial depository institutions whose portfolios are tied primarily to long-term mortgages at low interest

66. TEFRA, *supra* note 58, at § 215.
67. *Id.*
68. COMMISSION REPORT, *supra* note 36, at 169-70.
69. The Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982).
70. Vartanian & McFarlane, *F.H.L.B.B. Helps Bring About Major Changes in Thrifts*, Legal Times, Nov. 1, 1982, at 16.

rates have been in serious difficulty.[71] The present plight of thrift institutions shows how severely regulated firms are especially vulnerable in periods of economic stress.[72] As Senator Garn noted in one of many hearings, thrifts succeeded so well in making reasonably priced mortgages that they had no earnings for a year and a half.[73] Savings and Loan Associations (S&L's) suffered a particularly severe disintermediation into the new money market funds; both commercial banks and thrifts have seen these funds grow to over $200 billion largely from their depositors.[74] The new Money Market Account authorized under Garn-St. Germain are savings instruments designed to allow thrifts to compete effectively with the money market funds. They have attracted twenty-one billion dollars in net new savings to thrifts, but to date thrifts are not putting much of this new money into housing.[75]

Since the late 1970's various legislative proposals have targeted on assistance to the thrift industry. During the same period depository institutions have chafed at the heavy web of regulation that has limited their options while outside their plate glass windows a whole new financial supermarket opened up. The new entrants into the financial services markets are unfettered by the regulations governing commercial banks and thrifts. Major changes in demand for means of delivery of financial services bypassed banks and savings and loans while those institutions remained hampered by statutes and regulations enacted in the 1900's and 1930's to meet problems that no longer are paramount. The classic example, of course, is the Glass-Steagall Act of 1933,[76] passed to prevent banks from engaging in the underwriting of most securities.[77]

In contrast, these new entrants, such as Shearson American Express, are now offering travel agency services, cash management accounts, real estate and insurance services, securities and money market funds, credit cards, loans, and check writing. Sears, Roebuck & Co. has acquired Coldwell Banker & Co., the largest real estate brokerage firm in the country, and Dean Witter Reynolds, the fifth largest securities company. Similar positions are held by Merrill Lynch and the Prudential Insurance Company. The problems that inflation, volatile interest

71. COMMISSION REPORT, *supra* note 36, at 123.
72. *Id.*
73. *Capital Assistance Act and Deposit Insurance Flexibility Act: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs on S. 2531 and S. 2532*, 97th Cong., 2d Sess. 1 (1982) (opening statement of Senator Jake Garn, R-Utah, Chairman).
74. There was quite a dramatic reversal once interest rate ceilings were lifted on consumer accounts. After the passage of Garn-St. Germain Act, the depository institutions could begin paying interest rates of their choice as of December 14, 1982. In the first month of deregulation, about $111 billion moved into this new type of account. The thrifts appear the primary beneficiaries of the shift in the flow of money among competing financial institutions. *See* Hill, *Shift in Savings Flows May Help Individuals, Small-Firm Borrowers*, Wall St. J., Jan. 21, 1983, at 1.
75. *See New Money Market Accounts Don't Help Housing Much*, BUILDER, April 1983, at 28.
76. Banking Act of 1933, 12 U.S.C. chs. 3 and 6 (1976) (orginally enacted as Act of June 16, 1933, ch. 89, 48 Stat. 162).
77. *Id.* 48 Stat. at 165.

rates, and excessive regulation have imposed on the depository institutions have been exacerbated by this intense and increasing competition.

A number of provisions in the Garn-St. Germain Depository Institutions Act are particularly relevant to housing and the availability of mortgage credit.

(1) Titles I and II provide the federal depository institutions' insurance agencies with increased flexibility to aid troubled and financially distressed institutions. They expand the forms of financial assistance the Federal Deposit Insurance Corporation (F.D.I.C.) and the Federal Savings and Loan Insurance Corporation (F.S.L.I.C.) could provide to troubled institutions and extend the circumstances under which such assistance can be granted. Title I also sets out procedures for the agencies to follow to facilitate the acquisition or merger of failed or failing institutions.

(2) Title II establishes an income capital assistance program whereby institutions in trouble may issue capital instruments to be purchased by the insuring agencies with promissory notes. This Net Worth Certificate concept is addressed specifically to those depository institutions that have suffered earnings and capital losses primarily as a result of their mortgage lending activities, and having net worth equal to or less than three percent of their assets. Institutions receiving assistance under this Title are not precluded from receiving assistance under Title I.

(3) Title III significantly expands the investment powers of S&L's to include the right to make commercial loans up to two percent of assets (ten percent in 1984) and to make loans secured by nonresidential real estate up to forty percent of assets.

(4) The Act authorizes a new, high interest rate account. Basically, all types of customers will qualify; there will be no rate ceiling or differential on these accounts; they will be federally insured and offered by thrifts and by commercial banks. In December 1982, the Depository Institutions Deregulatory Committee met and determined that as of December 14, 1982, the depository institutions themselves could set the interest rates they would pay on consumer accounts.

(5) Within Garn-St. Germain, the Alternative Mortgage Transactions Parity Act insures that there will be parity between all lenders, regardless of state law provisions. Previously only federally chartered institutions could engage in alternative mortgage transactions; now nonfederally chartered lenders—any qualified housing creditors—will be able to make, purchase, and enforce Adjustable Rate Mortgages (ARM's) secured by interests in residential real property.

(6) State law is preempted to ensure that assisted state chartered S&L's can continue to operate and pay dividends and that state franchise taxes are suspended during the period of assistance.

The Depository Institutions Act does not go as far as many had hoped it would. Although the act enlarges the lending powers available to savings and loans, it does not provide banks and thrifts full access to the securities business.[78] The act strengthens the banks by

78. That issue remains unresolved; Senator Garn held oversight hearings on Glass-Steagall is-

allowing them to offer higher rates, to attract deposits back from money market funds, and increases the potential for competition between S&L's and small commercial banks. The act also provides federal aid to troubled S&L's and banks, and broadens the powers of federal insurance agencies.[79]

Due on Sale Clauses

Among the more important provisions of the Depository Institutions Act is that which preempts all state restrictions on the enforcement of due on sale clauses. Due on sale clauses were conceived to protect the security of the mortgage lender.[80] The concept originally permitted the lender to declare the mortgage payable at any sale or transfer if the new purchaser lacked financial capacity to assume the original loan. As interest rates increased mortgagees began to use the due on sale clause to renegotiate the mortgage at a higher rate.

Over the last decade over twenty states considered litigation involving the enforceability of due on sale clauses.[81] The issue was brought to a head in August of 1980 by a decision of the Federal National Mortgage Association to begin enforcing the "due on sale" provision in its conventional mortgages. The decision was to affect those mortgages originating after October 1, 1980, and owned by FNMA.[82] After a series of court cases, the United States Supreme Court held that federal savings and loan associations may enforce due on sale clauses in mortgage contracts despite state law to the contrary.[83] The court said that the Federal Home Loan Bank Board, in regulations allowing savings and loan institutions to include due on sale clauses in home loan contracts,[84] exercised authority provided by the Congress to ensure the financial stability of local mutual thrift institutions. The court concluded that the Board's intent to preempt state law was "unambiguous." That certainty, in effect, has been underlined by Garn-St. Germain.[85]

Garn-St. Germain provided an immediate and meaningful safe harbor for the thrift industry, though it is not, nor does it purport to be, a housing bill. Indeed, in eradicating the differential in interest paid by banks and by thrifts, Congress has removed or obliterated the preferen-

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sues April 6, 1983, with additional hearings to come. The House apparently is quite willing for the Senate to take the initiative in this area; no House hearings are scheduled, and most members of the House Banking Committee have not yet taken a position on the expansion of Glass-Steagall.

79. *See* The Deposit Insurance Flexibility Act, Title I of Garn-St. Germain, *supra* note 69.
80. *See* Fidler, *FNMA Program: Negotiating the Variables*, MORTGAGE BANKING, Mar., 1983, at 62.
81. *See* Brownstein & Schomer, *Enforceability is Key Issue in "Due on Sale" Litigation*, Legal Times, Sept. 22, 1982, at 12..
82. 8 HOUSING & DEV. REP. (BNA) 230 (Aug. 8, 1980).
83. Fidelity Federal Savings and Loan v. de la Cuesta, 102 S. Ct. 3014 (1982).
84. 12 C.F.R. § 556.9(f)(1) (1982).
85. *See* "Preemption of Due on Sale Prohibitions," part C of The Thrift Institutions Restructuring Act, title III of Garn-St. Germain, *supra* note 69, 96 Stat. at 1505.

tial treatment housing has received over the years. While federal preemption of due on sale restrictions is important to the holders of long-term low rate mortgages, the enforcement of due on sale effects a serious constraint on the ability to sell existing homes.

FUTURE DIRECTIONS

At least two questions occur in the context of the federal government's direct responsibility for all housing. First, are there legislative remedies available; that is, are there housing issues that could benefit from legislative initiatives that would not have major budgetary impact? Second, what impact will this shift in housing's priority have on the shape of housing in the future?

One highly touted legislative remedy is to free current restrictions on the use of pension funds for housing investment. The Housing Commission Report recommended an almost absolute relaxation of those restrictions that have precluded major pension fund investment in housing and real estate. The primary barrier has been the Employee Retirement Income Security Act (ERISA).[86] While ERISA does not set out specifically the investments a plan may or may not make, it does define prohibited transactions and set out investment standards that pension fund managers must meet. The intent of the Act and its language have been constrained further by the regulations of the Department of Labor under the Act. While a process of relaxation is taking place, it is too soon to determine the impact on housing and real estate investment; pension funds are never likely to provide an all-purpose panacea for housing.

Other legislative alternatives include: a moderate-income multifamily production program, condominium conversion policies, rent control, urban enterprise zone legislation, and further easing of restrictions on pension plan investment in housing and real estate. There may be changes in the community block grant program; states and local governments may assume a stronger housing role under some version of New Federalism.

For housing, the first quarter of 1983 brought welcome recovery. Sales and starts were up as interest rates receded. The unquenchable optimism of realtors, developers, and builders was heard again; there was a certain euphoria in the claims of those who saw housing once again "leading the recovery." A cautionary note may be in order. The present burst of activity—an estimated 1.7 million starts—is not that big a burst. To the degree it represents the pent up demand of purchases delayed over the last two years, it is unclear how strong housing activity will be. With conventional mortgages at 13-13½% at this writing, the band of prospective purchasers remains a narrow one. Interest rates may stiffen. Tax policies remain uncertain. The adminis-

86. 29 U.S.C. §§ 1011-1381 (1976).

tration and the economy still face a two hundred plus billion dollar deficit. And consumer confidence has not rebounded as strongly as the Administration had hoped; the 1980's may indeed be "the era of the scared American [holding] the increasing belief that the future is not going to be as good as the past."[87] This country may not be able "to provide housing at the scale and variety of configurations which we have grown to accept as our right."[88] We may see an increasing dependence on existing housing stock, with new construction responding with variations of the affordable house whose advent the industry has so often announced. There may need to be a shift in consumer expectations; perhaps home ownership is not the optimum for all families.

CONCLUSION

The political and legislative record of the last two years demonstrates a clear movement away from direct federal responsibility for all housing. Most major bills of the 97th Congress that affected housing were not, primarily, housing bills. The debate on housing issues in the foreseeable future will be dominated by the enormous budget deficit projections.

It is unclear at this point whether the President's New Federalism will succeed in shifting assistance programs, including housing, back to the states, either in the form of block grants or some other vehicle.[89] The prospects for new initiatives, such as urban enterprise zones or the Trust for Investment in Mortgages, is equally uncertain. The record of the past session, however, provides little optimism that a coherent housing policy will be forthcoming.

A chronology of housing legislation since the turn of the century demonstrates a federal concern for two persistent issues: the needs of the poor and the problems of the cities.[90] The legislative record of the 97th Congress marks an abrupt about face in federal policies. Housing and its financing institutions must struggle through a period of transition without the legislative buttress that has structured housing policy for so long. The legislative directions from Washington represent an inadequate response to current needs. They suggest as well that housing and the cities must address their problems in a changed and restricted environment as they adjust to a reduced federal presence.

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87. HOUSING FINANCE, *supra* note 9, at 32.
88. *Id.*
89. *Housing Funds, supra* note 2.
90. *See* PRESIDENT'S HOUSING COMMISSION REPORTS, S. DOC. NO. 644, 60th Cong., 2d Sess. 19 (1909). There is quite a contemporary ring to its recommendations: government loans to build habitable dwellings; condemnation and purchase of slum properties by the government; and the improvement or replacement of these properties so that inexpensive and healthful housing would be available to the poor through rentals or purchases at reduced interest rates.