

Faculty Publications


2017

In Search of Smarter Homeowner Subsidies

Matthew Rossman

Case Western University School of Law, matthew.rossman@case.edu

Follow this and additional works at: https://scholarlycommons.law.case.edu/faculty_publications

 Part of the [Housing Law Commons](#), and the [Taxation-Federal Commons](#)

Repository Citation

Rossman, Matthew, "In Search of Smarter Homeowner Subsidies" (2017). *Faculty Publications*. 2011.
https://scholarlycommons.law.case.edu/faculty_publications/2011

This Article is brought to you for free and open access by Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Faculty Publications by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.

In Search of Smarter Homeowner Subsidies

Matthew J. Rossman*

I. INTRODUCTION	204
II. TAX CODE'S PRINCIPAL HOMEOWNER SUBSIDIES	208
<i>A. Mortgage Interest Deduction</i>	209
<i>B. Property Tax Deduction</i>	211
<i>C. Exclusion of Capital Gain on Home Sales</i>	212
III. RELATIONSHIP OF SUBSIDIES TO ENCOURAGING AND EXPANDING ACCESS TO HOMEOWNERSHIP	213
IV. RELATIONSHIP OF SUBSIDIES TO NEGATIVE HOUSING EXTERNALITIES AND RELATED POLICIES	217
<i>A. Ameliorating Blight, Deterioration, and Public Health Threats in Disinvested Communities</i>	218
1. <i>Background</i>	218
2. <i>Relationship to Homeowner Subsidies</i>	223
<i>B. Decreasing Economic and Racial Segregation</i>	226
1. <i>Background</i>	226
2. <i>Relationship to Homeowner Subsidies</i>	231
<i>C. Lessening Environmental Degradation Resulting from Housing Choices, While Reducing Vulnerability of Those Who Reside in Environmental Hotspots</i>	232
1. <i>Background</i>	232
2. <i>Relationship to Homeowner Subsidies</i>	237
V. UNDERSTANDING THE DISCONNECT (HOW AND WHY CURRENT HOMEOWNER SUBSIDIES ARE NOT SMART)	238
<i>A. What are "Smart" Subsidies?</i>	238
<i>B. Why the Current Homeowner Subsidies Are Not Smart</i>	241
1. <i>Idealization of Homeownership</i>	241
2. <i>Administrative Simplicity</i>	242
3. <i>Political Entrenchment</i>	244
VI. IN SEARCH OF SMARTER HOMEOWNER SUBSIDIES	246
<i>A. An Assessment of Current Proposals</i>	246
<i>B. Examining Comparable Subsidies</i>	250

* Professor of Law, Case Western Reserve University School of Law. I would like to acknowledge the helpful feedback I received from participants at the 2017 Developing Ideas Conference at the University of Kentucky College of Law and the 2017 Clinical Law Review Writers' Workshop at New York University School of Law. I also thank Professors Jonathan Entin, Jessie Hill, Erik Jensen and David Reiss for their comments, as well as Megan Rossman (J.D. Candidate, 2018 at Loyola University Chicago School of Law) for her outstanding research assistance. Finally, I am grateful for funding provided by the Social Justice Institute of Case Western Reserve University that supported research related to this article. The content of this article is my sole responsibility and does not necessarily represent the views of the Social Justice Institute or Case Western Reserve University.

C. <i>Conceptual Models for Smarter Subsidies</i>	254
1. <i>Subsidy Eligible/Ineligible Zones</i>	254
2. <i>À La Carte Subsidies</i>	257
3. <i>Community and Project Level Subsidies</i>	259
D. <i>Data and Innovation as Gateways to Smarter Subsidies</i>	262
E. <i>A Path Forward</i>	264
VII. CONCLUSION.....	267
VIII. POSTSCRIPT – TAX CUTS AND JOBS ACT OF 2017	268

I. INTRODUCTION

The opportunity to own one’s home has long been considered part and parcel of the American Dream. Homeownership, so it is contended, provides a pathway to upward mobility, fosters good citizenship, and is a reliable form of long-term savings.¹ Even in the wake of the recent foreclosure crisis, a complex phenomenon in which homes plunged millions of American households into financial distress, the nation has by and large kept the faith in homeownership.²

For the last century, the federal government has unabashedly promoted homeownership. It supports credit markets to help make home mortgages affordable, offers counseling and financial assistance to prospective low income homebuyers, and, most pertinent to this article, provides a collection of income tax breaks directly to homeowners. These tax breaks (which this article will refer to as “homeowner subsidies”) are no small matter. In 2017 alone, it is estimated that the three principal homeowner subsidies—the mortgage interest deduction, the property tax deduction and the exclusion of home sale capital gains—will total \$135 billion in forgone tax revenue.³ This amounts to the country’s second largest tax expenditure,

¹ See, e.g., *Social Benefits of Homeownership and Stable Housing*, NATIONAL ASS’N OF REALTORS (April 2012), https://www.nar.realtor/sites/default/files/migration_files/social-benefits-of-stable-housing-2012-04.pdf.

² Eric S. Belsky, *The Dream Lives On: The Future of Homeownership in America 2* (Joint Ctr. for Hous. Stud. of Harvard Univ., Working Paper No. 13-1, 2013), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-1_belsky_0.pdf.

³ H.R. COMM. ON WAYS AND MEANS, S. COMM. ON FINANCE, AND STAFF OF THE J. COMM. ON TAXATION, 115TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2016-2020, at 33 (Comm. Print 2017) [hereinafter 2017 TAX EXPENDITURE BUDGET]. It is worth pointing out that Congressional estimates of forgone revenue associated with homeowner subsidies, while useful in understanding their costs, are not equal to the gain to the federal budget that would result if Congress eliminated the subsidies. Taxpayer behavior would change to some extent upon elimination of the subsidies. See, e.g., JOINT ECON. COMM., 106TH CONG., TAX EXPENDITURES: A REVIEW AND ANALYSIS 1, 8 (Comm. Print 1999). For example, a homeowner might move less frequently if she faced the prospect of capital gains tax on each sale.

and nearly triple what Congress budgeted for the U.S. Department of Housing and Urban Development and all of its programs in 2017.⁴ The subsidies are premised on the rationale that homeownership is a good investment for homeowners and also creates spillover benefits for those who live around them (what are known as “positive externalities”⁵) because homeowners take better care of their properties and are more invested and involved in their communities.⁶ Therefore, it is a choice that ought to be encouraged.

A great deal of criticism has already been directed at the homeowner subsidies for failing to do what they are ostensibly meant to accomplish. A veritable phalanx of economists, policy analysts, and academics have dissected and assailed the subsidies, contending that they neither increase the country’s overall homeownership rate nor cause those who are on the fence about or face financial barriers to purchasing a home to do so.⁷ Instead, the primary effect of the subsidies appears to be to encourage those higher income households that would already buy homes to buy larger and more expensive ones.⁸ Perversely, they may even drive up home prices in those supply-limited housing markets where home affordability is most problematic.⁹ These outcomes are due to some serious design defects in the subsidies and have led to a groundswell of calls for their reform so that they are better engineered to address the home affordability concerns of prospective low and middle income homebuyers.¹⁰

As this article will contend, the homeowner subsidies are problematic in another way that has attracted much less attention. While homeowner decisions can benefit those other than the homeowner, so too can they impose costs on others (“negative externalities”¹¹). For example, a steady exodus of prospective home buyers from less affluent communities to more affluent and exclusive ones can decimate income tax bases and property values in the less affluent communities, making the marginalized populations left behind financially and otherwise much worse off. Home

⁴ See U.S. Dept. of Hous. & Urban Dev., *HUD’s Proposed 2017 Budget* (2017), <https://www.hud.gov/sites/documents/PROPOSEDFY17FACTSHEET.PDF>.

⁵ A positive externality occurs when one party’s actions make another party better off, but the first party is not compensated for causing this benefit. See, e.g., JONATHAN GRUBER, *PUBLIC FINANCE AND PUBLIC POLICY* 128 (4th ed. 2013).

⁶ See, e.g., Edward L. Glaeser & Jesse M. Shapiro, *The Benefits of the Home Mortgage Interest Deduction* 22-24 (Nat’l Bureau of Econ. Research, Working Paper No. 9284, 2002.).

⁷ See *infra* Part III.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ A negative externality occurs when one party’s actions make another party worse off, but the first party does not bear the cost of doing so. See, e.g., GRUBER, *supra* note 5, at 124.

purchases in newly built developments on greenspace far away from urban job centers can heighten damage to the environment, harming both present and future generations, through increased carbon emissions, decreased biodiversity, and watershed destruction.

Just as a housing decision might have positive and negative consequences for others (“housing externalities”), so are federal policies related to housing concerned with more than simply its availability. To varying degrees and at considerable expense, federal policies act to contain or offset negative housing externalities, especially those that impose significant or concentrated costs on others.¹² These policies are wide-ranging and evolving, and include: (i) ameliorating blight, deterioration and public health threats in disinvested communities, (ii) decreasing economic and racial housing segregation, and (iii) lessening environmental degradation that results from housing choices, while reducing the vulnerability of those who reside in environmental hotspots.¹³

The problem is that the homeowner subsidies are profoundly disconnected from these other policies and the negative housing externalities they seek to contain. The homeowner subsidies are facially neutral with respect to the location and type of home one lives in, rewarding homeownership decisions at large (assuming that a homeowner is affluent enough to benefit from them).¹⁴ So, the subsidies do not aid in ameliorating these negative housing externalities, each of which bears some relationship to homeowner decisions about home location and type. Furthermore, as this article will explain, the subsidies actually encourage to some degree homeowner decisions that exacerbate these externalities.¹⁵ In other words, the government pays for housing consumption that, at best, does little to support and, at worst, actually undermines several of its other key housing related policies.

Why the disconnect? Homeowner decisions are complex. So is the nation's housing market, which actually consists of thousands of much smaller local markets and submarkets that vary, sometimes dramatically, in their strengths and weaknesses. The homeowner subsidies, on the other hand, are simplistic and monolithic. This article offers three explanations for this design: an idealization of homeownership, administrative simplicity, and political intransigence.¹⁶ The end result is that the homeowner subsidies have come to operate like entitlements, reserved primarily for higher income homeowners, rather than strategic investments

¹² See *infra* Part IV.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ See *infra* Part V.

capable of advancing multiple housing objectives. Meanwhile, lacking a demand-side supplement capable of meaningfully influencing homeowner behavior, federal policies meant to address negative housing externalities reflect a half-hearted, crisis management mentality rather than proactively seeking to contain them.

In addition to shining a light on this disconnect, this article explores whether “smarter” homeowner subsidies might be devised to lessen it.¹⁷ Assuming that Congress chooses to continue financially inducing American households to own homes, it seems sensible to ask whether Congress can leverage these inducements to simultaneously encourage choices that impose fewer costs on others. As a starting point, this article offers a definition of smarter subsidies as those that are more precisely targeted, externality sensitive, and capable of adaptation across multiple housing submarkets. It then looks for lessons from the body of public finance research that has emerged on the experiences of state and local government in targeting demand-side tax subsidies to contain similar types of negative externalities.¹⁸ Although success has been mixed and criticism plentiful, this article draws from the research that when these types of subsidies are tailored, limited, variable, and complementary, they can be successful and impactful.

Based on these qualities, this article identifies and scrutinizes three different conceptual legal models for smarter federal homeowner subsidies.¹⁹ These models are: (i) creating a national map of subsidy eligible and ineligible zones based on the relationship between homeowner behavior in those zones and the reduction of negative housing externalities; (ii) offering a collection of a la carte subsidies, each rewarding a specific type of homeowner decision; and (iii) allocating subsidies on a community-by-community or project-by-project basis to support community housing plans and public sector programs that address prescribed negative housing externalities. It is important to emphasize that none of these models need work to the exclusion of improving the performance of homeowner subsidies in making homeownership more affordable. Again, the very question this article grapples with is whether it is possible to engineer the subsidies to simultaneously accomplish multiple housing policy objectives.

Each of these models has advantages, but presents challenges, not least of which follows from trying to accomplish multiple objectives across thousands of different U.S. housing markets.²⁰ At the same time, the article calls attention to the recent revolution in the quality, quantity, and

¹⁷ See *infra* Part VI.

¹⁸ See *infra* Part VI.B.

¹⁹ See *infra* Part VI.C.

²⁰ See *infra* Part VI.D.

accessibility of housing market and property specific real estate data, which is fueling a significant uptick in the sophistication of land use planning at the community level. Those advances may be the best reason to think that smarter federal homeowner subsidies are attainable.

This article closes by suggesting a path forward.²¹ Congress should approve a HUD-administered pilot program for targeted homeowner subsidies using the third model, and through it foster community level innovation to identify models that are replicable throughout the country. Considering the significant political and practical challenges to undertaking immediate and wholesale reform of the current homeowner subsidies, a more gradual, less expensive, and pilot-based strategy should also make adoption by Congress more likely. For several practical reasons, and a potential constitutional one, a program like this probably belongs outside of the federal tax code.

This article proceeds as follows. Part II provides a short overview of the three principal homeowner subsidies. Part III summarizes criticism of the subsidies as to the principal rationale for their existence—encouraging and expanding access to homeownership. Part IV examines the subsidies through a different lens by identifying the negative housing externalities that other federal housing-related policies seek to combat and the complete disconnect between the subsidies and containing or offsetting these externalities. Part V introduces the concept of smarter subsidies and explains why the current subsidies miss the mark. Part VI explores in depth how smarter homeowner subsidies might be devised. It examines what research has revealed about the effectiveness of selectively available, demand-side subsidies at the state and local levels, how this might be reflected in the design of federal homeowner subsidies, and the recent advances in real estate data and analytics that may make this feasible. Part VII closes with this article's proposal for a path forward.

II. TAX CODE'S PRINCIPAL HOMEOWNER SUBSIDIES

This article focuses on the three principal tax breaks that the federal income tax code provides directly to homeowners—the mortgage interest deduction, the property tax deduction, and the exclusion from taxable income of capital gain on home sales. The tax code contains other subsidies for homeowners, but none are nearly as expensive nor as broadly utilized as these three.²² For ease of reference, this article uses the term “homeowner subsidies” to mean just these three subsidies.

²¹ See *infra* Part VI.E.

²² See Benjamin H. Harris, C. Eugene Steuerle & Amanda Eng, *New Perspectives on*

It is also worth noting that the U.S. income tax system provides homeowners a fourth substantial tax break by not taxing the imputed net rental income that results from them living in their own homes. Because the notion of taxing imputed home rental income is viewed as administratively very difficult, politically perilous, and inconsistent with how the tax code treats other imputed rental income, this article does not include it.²³

As background, below are basic overviews of the three principal subsidies.

A. *Mortgage Interest Deduction*

Generally speaking, Section 163(h)(2)(D) of the Internal Revenue Code (the “Code”) allows homeowners to deduct the interest they pay on their home mortgages from taxable income.²⁴ The mortgage interest deduction (the “MID”) is an exception to the general rule that taxpayers may not deduct interest on personal debt (i.e. debt not attributable to a trade or business, or investment activity).²⁵ It is the largest of the homeowner subsidies. Congress estimates that the MID alone will cost the federal government \$63.6 billion in forgone tax revenue in 2017.²⁶

As with most deductions, the MID is subject to numerous statutory clarifications. Most of these are included in the definition of “qualified residence interest,” which provides the actual parameters on what is deductible.²⁷ Qualified residence interest includes interest on debt up to \$1,000,000 that is secured by a qualified residence and that is used to acquire, construct, or substantially improve the residence (“acquisition indebtedness”).²⁸ It also includes interest on up to \$100,000 in “home equity indebtedness,” which is debt secured by a qualified residence and

Homeownership Tax Incentives, TAX NOTES, Dec. 23, 2013, at 1315, 1317, <http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/1001710-New-Perspectives-on-Homeownership-Tax-Incentives.pdf> (identifying the cost of the three principal homeowner tax incentives in 2013 as \$121.3 billion as compared to \$7.8 billion for the cost of the Code’s eight other housing related tax expenditures). Examples of other tax code homeowner subsidies include the deduction for premiums for qualified mortgage insurance and the exclusion of income attributable to the discharge of principal residence acquisition indebtedness.

²³ See, e.g., Steve R. Johnson, *Imputed Rental Income: Reality Trumps Theory*, in *CONTROVERSIES IN TAX LAW: A MATTER OF PERSPECTIVE* 65 (Anthony C. Infanti ed., 2015).

²⁴ 26 U.S.C. § 163(h)(2)(D) (2017).

²⁵ *Id.* § 163(h).

²⁶ 2017 TAX EXPENDITURE BUDGET, *supra* note 3, at 32.

²⁷ 26 U.S.C. § 163(h)(3) (2017).

²⁸ *Id.* § 163(h)(3)(B)(ii). The limitation if the taxpayer is a married individual filing a separate return is \$500,000.

used for any other purpose.²⁹ “Qualified residence” means the taxpayer’s principal residence, as well as up to one additional home the taxpayer uses as a residence (e.g. a vacation or weekend home).³⁰

An important feature of the MID is that it is an itemized deduction.³¹ This imposes some very significant limitations on who can claim it. First, in order to take any deduction, a person must have taxable income from which to subtract the deduction.³² Many U.S. households fall below the income thresholds for paying any federal income tax and, thus, cannot utilize the MID.³³ Second, because the Code automatically provides all taxpayers with a standard deduction that can be taken in lieu of itemized deductions, an itemized deduction is only worthwhile to those taxpayers whose total itemized deductions exceed their standard deduction.³⁴ For that reason, only about 30% of taxpayers itemize, most of whom are in the top income brackets.³⁵

At the very high end of the income spectrum, the total amount of itemized deductions a taxpayer can claim is gradually reduced pursuant to what is commonly known as the Pease limitation.³⁶ The likelihood of the Pease limitation making the mortgage interest deduction entirely worthless, however, is virtually non-existent for all but the very richest of itemizers who would seek to claim it.³⁷

²⁹ *Id.* § 163(h)(3)(C). Additional limitations apply to the definition of home equity indebtedness. It cannot exceed the difference between the fair market value of the home minus the acquisition indebtedness on the home. *Id.* § 163(h)(3)(C)(i). In the case of a separate return filed by a married individual, the limitation on home equity indebtedness for which interest is deductible is \$50,000. *Id.* § 163(h)(3)(C)(ii).

³⁰ *Id.* § 163(h)(4)(A).

³¹ *See id.* § 63(d).

³² *See id.* § 63(a).

³³ Approximately 43% of the population, many of whom are lower income, did not owe any federal income taxes for 2013. Robertson Williams, *Who Doesn't Pay Federal Taxes?*, TAX POL'Y CTR. (Aug. 29, 2013), <http://www.taxpolicycenter.org/resources/video-who-doesnt-pay-federal-taxes>.

³⁴ *See* 26 U.S.C. § 63(c) (2017).

³⁵ SEAN LOWRY, CONG. RESEARCH SERV., R43012, ITEMIZED TAX DEDUCTIONS FOR INDIVIDUALS: DATA ANALYSIS 2 (2014), <https://fas.org/sgp/crs/misc/R43012.pdf>.

³⁶ 26 U.S.C. § 68 (2017).

³⁷ For fiscal year 2016, the Pease limitation only applied to taxpayers with an adjusted gross income (AGI) of more than \$311,300 if married filing jointly or \$259,400 if single (the “baseline”). INTERNAL REVENUE SERV., TAX GUIDE 2016, FOR INDIVIDUALS 205 (2016). Most taxpayers affected by the Pease limitation see their itemized deductions reduced by 3% of the difference between the taxpayer’s adjusted gross income and this baseline. *See* 26 U.S.C.S. § 68(a)(1) (2017).

B. *Property Tax Deduction*

The Code also allows homeowners to deduct property taxes assessed on their homes from taxable income. The real property tax deduction is part of a broader deduction that the Code allows for most taxes a taxpayer must pay to state and local governments, which this article will refer to by its commonly known acronym “SALT” (deduction for State and Local Taxes).³⁸ Congress estimates that the real property tax deduction component of SALT will cost the federal government \$33.3 billion in forgone tax revenue in 2017.³⁹

Carved out of SALT are taxes assessed against a particular property for a benefit understood to increase that property’s value, like the installation of a sidewalk or an irrigation system on that property.⁴⁰ But, so long as the real property tax is levied for the general public welfare, the taxpayer may deduct it.⁴¹

As with the mortgage interest deduction, SALT is an itemized deduction, and thus only claimed by those who have federal taxable income and also have enough qualifying expenses to make itemizing deductions worthwhile.⁴² SALT may also be reduced for high income taxpayers by the Pease limitation, though as with the MID, this is only even potentially an issue for very high income households.⁴³

SALT is potentially reducible in another way, which for the most part does not apply to the MID.⁴⁴ SALT is added back into taxable income when a taxpayer is subject to the Code’s alternative minimum tax (“AMT”).⁴⁵ The AMT is a parallel income tax system that applies an alternative tax rate to a broader base of income of a wealthier taxpayer whose taxable income under the normal rules has been so reduced by exemptions and deductions that her effective tax rate has reached an unacceptable level.⁴⁶ About 5% of

³⁸ 26 U.S.C. § 164(a) (2017) (identifying “state and local, and foreign, real property taxes” as includable within the deduction).

³⁹ 2017 TAX EXPENDITURE BUDGET, *supra* note 3, at 32.

⁴⁰ 26 U.S.C. § 164(c)(1) (2017); 26 C.F.R. § 1.164-4(a) (2017).

⁴¹ *See* 26 C.F.R. 1.164-3(b) (2017).

⁴² *See* 26 U.S.C. § 63(d) (2017).

⁴³ *See* Williams, *supra* note 33.

⁴⁴ The alternative minimum tax does not apply to amounts deducted as acquisition indebtedness, which is the more substantial component of the MID. *See* 26 U.S.C. § 56(e) (2017). Interest on home equity indebtedness is, however, added back in to taxable income when calculating the AMT.

⁴⁵ *Id.* § 55.

⁴⁶ NORTON FRANCIS ET AL., TAX POL’Y CTR. BRIEFING BOOK (Peter Passell et al. eds., 2016), <http://www.taxpolicycenter.org/briefing-book/how-does-deduction-state-and-local-taxes-work>. (ebook).

taxpayers are subject to the AMT,⁴⁷ and it is good bet that many of them see the value of their SALT deduction reduced.⁴⁸ Nevertheless, this is far less than the total percentage of taxpayers claiming SALT, which is virtually all itemizers.⁴⁹

C. Exclusion of Capital Gain on Home Sales

Section 121 of the Code also allows homeowners to exclude from federal income tax up to \$250,000 (or \$500,000 if married and filing jointly) of the gain they realize when selling their principal residences.⁵⁰ Forgoing tax on this income will cost the federal government an estimated \$32.1 billion in 2017.⁵¹

Certain qualifications apply, of course. A taxpayer can use this exclusion no more than once every two years.⁵² Also, generally speaking, the taxpayer must have owned and used the home in question as her principal residence for at least two of the five years prior to sale; there are, however, several statutory permutations of this requirement to address circumstances like subsequent marriages, spouses residing in separate homes, time spent in uniformed services, etc.⁵³

As an exclusion from income rather than a deduction, Section 121 applies more broadly than a deduction. Most home sellers benefit from it. This is because the gain, subject to the monetary limits identified above, is not calculated as part of taxable income in the first place, and therefore is not subject to the limitations imposed on itemized deductions. For the same reason, it is not subject to offset by the Pease limitation or the AMT.

⁴⁷ T17-0149—*Characteristics of Alternative Minimum Tax (AMT) Payers, 2016 – 2018 and 2027*, TAX POL'Y CTR. (Apr. 28, 2017), <http://www.taxpolicycenter.org/model-estimates/baseline-alternative-minimum-tax-amt-tables-april-2017/t17-0149-characteristics>.

⁴⁸ FRANCIS, ET AL., *supra* note 46.

⁴⁹ See CONG. BUDGET OFFICE, THE DEDUCTIBILITY OF STATE AND LOCAL TAXES 2 (2008).

⁵⁰ 26 U.S.C. § 121 (2017).

⁵¹ 2017 TAX EXPENDITURE BUDGET, *supra* note 3, at 32. It is worth a reminder here that the tax revenue gained from eliminating Section 121, in particular, would fall short of the tax revenue currently forgone. It is reasonable to expect that fewer home sales would occur without the home sale capital gain exclusion. *See id.*

⁵² 26 U.S.C. § 121(b)(3) (2017).

⁵³ *Id.* § 121.

III. RELATIONSHIP OF SUBSIDIES TO ENCOURAGING AND EXPANDING ACCESS TO HOMEOWNERSHIP

Judging by their origins, the homeowner subsidies are a motley crew. The mortgage interest deduction originates from a provision in the nation's original income tax code that at one time made interest on all personal debt deductible.⁵⁴ The property tax deduction is part of the broader deduction for most state and local taxes, which is available to homeowners and non-homeowners alike and is arguably separately justified as shielding taxpayers from the apparent inequity of paying income tax on dollars they must pay in taxes.⁵⁵ Even the exclusion of home sale capital gains did not originate from a global effort to promote homeownership. Rather, it came about piecemeal, through gradual accretion to the notion that gains realized on the sale of one's home can bring about large, untimely, and administratively challenging tax burdens, and that trying to relieve this tax only in certain circumstances causes distortions in the behavior of other homeowners and creates inequities.⁵⁶

Origins notwithstanding, all three subsidies are now commonly justified as encouraging homeownership. The mortgage interest deduction survived the 1986 overhaul of the Code, when Congress repealed the rest of the personal debt interest deduction, because proponents spun it as essential to preserving the American Dream of homeownership.⁵⁷ SALT has been the object of multiple unsuccessful repeal efforts, and in each case Congress has considered carving out the property tax deduction component, in recognition of its link to homeownership.⁵⁸ And the periodic expansions of the home sale capital gains exclusion clearly would not have been possible without the understanding that homeownership, as a form of saving and investment, was something Congress sought to promote. Year after year,

⁵⁴ This deduction may have resulted from Congress wishing to save taxpayers from what was then perceived as the difficult task of distinguishing between personal and profit-seeking debt. *See generally* Dennis J. Ventry, Jr., *The Accidental Deduction: A History and Critique of the Tax Subsidy for Mortgage Interest*, 73 LAW & CONTEMP. PROBS. 233 (2010).

⁵⁵ MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 410 (Foundation, 7th ed. 2013).

⁵⁶ *See generally* Lily Kahng, *Path Dependence in Tax Subsidies for Home Sales*, 65 ALA. L. REV. 187 (2013).

⁵⁷ *See* Ventry, Jr., *supra* note 54.

⁵⁸ Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, 2116. *See also*, Aaron Lorenzo & Rachel Bade, *First GOP Tax Reform Feud Erupts Over State, Local Tax Break*, POLITICO (Sept. 28, 2017), <http://www.politico.com/story/2017/09/28/gop-tax-reform-feud-state-local-tax-break-243285>.

Congress reports all three subsidies as housing expenditures, making no secret of what it believes they are meant to do.⁵⁹

There is some irony then in the significant doubt cast on the link between the homeowner subsidies and encouraging or expanding access to homeownership. The MID, perhaps because it is the largest of the subsidies, has received the greatest scrutiny. Most strikingly, several policy experts have proclaimed that the MID has had no discernible effect on the homeownership rate.⁶⁰ Viewed over a half century, the American homeownership rate has remained relatively constant, even though the value of the MID has fluctuated significantly at times, indicating that an increased level of MID subsidy doesn't cause a greater percentage of Americans to become homeowners.⁶¹

This is not to say that the MID has no impact on home-buying decisions. In fact, numerous studies have shown that the MID does increase the amount Americans spend on housing.⁶² But its primary impact is on high-income households who increase their housing consumption by buying larger and more expensive homes than they might have otherwise.⁶³ These are households that would likely already buy homes and thus don't need subsidies to encourage them to do so.⁶⁴ Low and middle income households, which are those likely to be on the fence between renting and buying a home, are by comparison largely unaffected by the MID.⁶⁵

⁵⁹ See 2017 TAX EXPENDITURE BUDGET, *supra* note 3.

⁶⁰ See, e.g., Glaeser & Shapiro, *supra* note 6, at 3; Christian A. L. Hilber & Tracy M. Turner, *The Mortgage Interest Deduction and Its Impact on Homeownership Decisions*, 96 REV. ECON. & STAT. 618 (2013); Jonathan Gruber, Amalie Jensen & Henrik Kleven, *Do People Respond to the Mortgage Interest Deduction? Quasi-Experimental Evidence from Denmark* (Nat'l Bureau of Econ. Research, Working Paper 23600, 2017).

⁶¹ Glaeser & Shapiro, *supra* note 6.

⁶² See Andrew Hanson, *Size of Home, Homeownership and Mortgage Interest Deduction*, 21 J. HOUS. ECON. 195 (2012); Jeremy Horpedahl & Harrison Searles, *The Home Mortgage Interest Deduction*, MERCATUS CTR.: MERCATUS ON POL'Y SERIES (Jan. 8, 2013), <https://www.mercatus.org/publication/home-mortgage-interest-deduction>; Dean Stansel & Anthony Randazzo, *Unmasking the Mortgage Interest Deduction: Who Benefits and by How Much? 2013 Update*, REASON FOUND. (Dec. 18, 2013), <http://reason.org/news/show/mortgage-interest-deduction-benefit>.

⁶³ Hanson, *supra* note 62; Horpedahl & Searles, *supra* note 62; Jeremy Horpedahl & Harrison Searles, *The Home Mortgage Interest Deduction*, MERCATUS CTR.: MERCATUS ON POL'Y SERIES (Jan. 8, 2013), <https://www.mercatus.org/publication/home-mortgage-interest-deduction>; Andrew Hanson, *Size of Home, Homeownership and Mortgage Interest Deduction*, 21 J. OF HOUS. ECON. 195 (2012).

⁶⁴ Hanson, *supra* note 62; Horpedahl & Searles, *supra* note 62. See also, ERIC TODER, ET AL., REFORMING THE MORTGAGE INTEREST DEDUCTION (2010), <http://www.urban.org/sites/default/files/publication/28666/412099-reforming-the-mortgage-interest-deduction.pdf>.

⁶⁵ *Id.*

The explanation for why the MID produces these results is no great mystery and has received considerable attention. The MID is a classic example of an upside-down subsidy. As discussed in Part II, the only homeowners who can take advantage of the MID are those who have taxable liability to offset and have sufficient qualifying expenses (mortgage interest, income taxes, charitable contributions, etc.) to make itemizing deductions worthwhile, as opposed to taking the standard deduction.⁶⁶ These requirements alone make nearly all of the lower two income quintiles of American households ineligible for the MID and leaves only roughly 30% of taxpayers, primarily those in the upper two income quintiles, as potential claimants.⁶⁷

Furthermore, even among claimants, tax-code deductions are significantly more valuable to higher-income taxpayers than they are to middle and lower income taxpayers. This is partly due to the fact that a taxpayer's income is not taxed at a uniform rate, but rather at a series of escalating marginal rates that increase as a taxpayer's income increases.⁶⁸ The value of a deduction depends on the rate at which the deducted income would have been taxed. To illustrate, a married couple (filing jointly) with \$280,000 in taxable income and \$10,000 in deductible mortgage interest reduces their taxable income to \$270,000, which is income taxed at 33%.⁶⁹ Accordingly, they receive a tax reduction of \$3,300. An otherwise identical couple with \$70,000 in taxable income also deducts \$10,000, but gets a tax reduction of only \$1,500 because this income is in the 15% tax bracket.⁷⁰ Add to this that higher income households own more expensive homes and so usually have larger mortgages and more mortgage interest to deduct, and it is little wonder that the lion's share of the benefits from the MID go to high income households.⁷¹

Although it has received less isolated scrutiny than the MID, the property tax component of SALT has similar consequences.⁷² This is because SALT

⁶⁶ Williams, *supra* note 33. See INTERNAL REVENUE SERV., TAX GUIDE 2016 FOR INDIVIDUALS 205 (2016).

⁶⁷ See Harris, Steuerle & Eng, *supra* note 22, at 1318-19. See also Eric J. Toder, Benjamin H. Harris & Katherine Lim, *Distributional Effects of Tax Expenditures*, TAX POL'Y CTR. 9 (July 21, 2009), <http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/411922-Distributional-Effects-of-Tax-Expenditures.PDF>.

⁶⁸ See GRAETZ & SCHENK, *supra* note 55, at 23-24.

⁶⁹ See *2016 Federal Tax Rates, Personal Exemptions, and Standard Deductions*, US TAX CTR. (last visited July 24, 2017), <https://www.irs.com/articles/2016-federal-tax-rates-personal-exemptions-and-standard-deductions>.

⁷⁰ See *id.*

⁷¹ Toder, Harris & Lim, *supra* note 67.

⁷² *Id.* See also, Harris, Steuerle & Eng, *supra* note 22, at 1319.

is nearly identical in design to the MID and likewise an upside-down subsidy. Unsurprisingly, its benefits also inure disproportionately to those who have higher income and it is much less valuable to homeowners who have less income.⁷³

The exclusion of home sale capital gains is a different animal than the deductions. But the benefits of this subsidy also flow primarily to higher income individuals. First, households in the 15% tax bracket and below pay no capital gains tax and, thus, receive no benefit from this subsidy.⁷⁴ For those not automatically exempt from this tax, marginal tax brackets play less of a role than with MID and SALT, since most taxpayers pay tax on capital gains at a rate of 15%.⁷⁵ However, those with very high incomes would pay capital gains tax at a 20% rate and so the break is larger at the high end of the income scale.⁷⁶ Furthermore, wealthier taxpayers tend to own more expensive homes, which, all other factors equal, generate larger gain.⁷⁷ Finally, wealthier homeowners tend to live in more exclusive and wealthier neighborhoods, where home values appreciate at greater rates and so, again, receive larger amounts of tax-free gain upon re-sale.⁷⁸

Not only are the homeowner subsidies by design primarily beneficial to upper income households, they actually tend to inflate home prices, particularly in areas where housing supply is limited, and thus, paradoxically, often reduce home affordability. Several economists have studied whether the MID, in particular, reduces the cost of homeownership for prospective home buyers or is anticipated by the housing market and simply absorbed (“capitalized”) into higher home prices.⁷⁹ The answer

⁷³ Harris, Steuerle & Eng, *supra* note 22, at 1319, 1328 (referencing the Urban-Brookings Tax Policy Center Microsimulation Model at Table 1). *See* Toder, Harris, & Lim, *supra* note 67.

⁷⁴ *See* 26 U.S.C. § 1(h) (2014) (referring to the tax imposed on capital gains). *See also* Topic Number: 409 - Capital Gains and Losses, IRS: TAX TOPICS, <https://www.irs.gov/taxtopics/tc409.html> (last updated Sept. 21, 2017).

⁷⁵ *Id.* Topic Number: 409 - Capital Gains and Losses, IRS: TAX TOPICS, <https://www.irs.gov/taxtopics/tc409.html> (last updated Sept. 21, 2017).

⁷⁶ *Id.* Generally speaking, for 2016 returns, the 20% rate applies to single taxpayers with taxable income \$415,050 or greater, and married taxpayers filing jointly with taxable income \$466,950 or greater. *Id.*

⁷⁷ *See* Harris, Steuerle, & Eng, *supra* note 22, at 1319.

⁷⁸ *See, e.g.,* David Albouy & Mike Zabek, *Housing Inequality*, (Nat'l Bureau of Econ. Research, Working Paper No. 21916, 2016). *See also* Jim Tankersley & Ted Mellnik, *Exclusive Neighborhoods, Exclusive Recovery*, WASH. POST (May 4, 2016), <https://www.washingtonpost.com/graphics/business/wonk/housing/charlotte/>.

⁷⁹ *See* Hilber & Turner, *supra* note 60. *See also* DENNIS R. Capozza, Richard K. Green, & Patrick H. Hendershott, *Taxes, Mortgage Borrowing and Residential Land Prices in ECONOMIC EFFECTS OF FUNDAMENTAL TAX REFORM 171-98* (Henry J. Aaron & William G. Gale eds., 1996); Joseph Gyourko & Richard Voith, *The Tax Treatment of Housing and its*

appears to be that it depends. Where the supply of housing is limited, due to a combination of regulations that hamper construction and geographic factors, and housing demand is high, home prices fully capitalize the subsidy.⁸⁰ So the subsidy does not act to lower homeownership costs and instead increases the bar for lower income, down payment constrained households entering the market in those places where they most need a subsidy.⁸¹

In markets with lax land use regulations, fewer geographic barriers, and/or lower demand, the MID is not fully capitalized and does reduce homeownership costs.⁸² But, as explained above, even in these areas the MID inures primarily to the benefit of high income households who would likely already purchase a home and, therefore, does not really improve homeownership attainment.⁸³

In sum, as it relates to increasing homeownership opportunities, the track record of the homeowner subsidies is abysmal. It is more accurate to say that the subsidies reward the homeownership investments of certain homeowners, most of whom need no incentive to become homeowners, than to say that the subsidies encourage or expand access to homeownership.

IV. RELATIONSHIP OF SUBSIDIES TO NEGATIVE HOUSING EXTERNALITIES AND RELATED POLICIES

The homeowner subsidies are problematic in another way that has drawn significantly less attention. Decisions as to where and in what type of home a household lives have consequences not only for that household, but the surrounding community and society at large. The benefits to and costs on others that result from homeowner decisions can be thought of as a category of “housing externalities.” To some degree and at considerable expense, the federal government intervenes through policies it adopts to contain or offset negative housing externalities, especially those that impose significant or concentrated costs on others.

As this Part will demonstrate, the homeowner subsidies, at best, provide very little support to these other housing related policies. At worst, they actually exacerbate the negative externalities that the policies try to contain and, in this sense, undermine these policies. Moreover, in the absence of a

Effects on Bounded and Unbounded Communities (Fed. Res. Bank of Phila., Working Paper No. 98-23, 1998).

⁸⁰ See Hilber & Turner, *supra* note 60.

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

demand-side supplement capable of meaningfully encouraging homeowner behavior that reduces negative housing externalities, the policies themselves are not very effective. This Part identifies several categories of negative housing externalities, the conditions that give rise to them, the federal policies that seek to contain them and their relationship (or, in actuality, the lack thereof) with the current homeowner subsidies.

A. *Ameliorating Blight, Deterioration, and Public Health Threats in Disinvested Communities*

1. *Background*

Communities throughout the country grapple with the collateral damage that results from chronic disinvestment.⁸⁴ Community disinvestment is a process by which residents, businesses, and other financially mobile economic actors extricate themselves from a community they perceive as deteriorating and too risky in which to invest capital, leading to further decline and, in some cases, large-scale abandonment.⁸⁵

Illustrative of this phenomenon is the now familiar story of Midwestern and Northeastern “legacy” cities.⁸⁶ These are places where industry and manufacturing once flourished and supported thriving residential communities.⁸⁷ Persistent adverse economic forces subsequently turned the tide in these cities, causing the loss of many large employers and good paying jobs, lowering the overall standard of living, and stemming population growth.⁸⁸ As their economic fortunes turned for the worse, other forms of capital also fled. Highways, readily available mortgages, and a quest for greener, roomier, and more homogenous communities catalyzed the flight of more affluent residents, often times to newly-created suburbs just beyond the boundaries of legacy cities.⁸⁹ As more financially mobile residents left and new ones have looked elsewhere, stores have shuttered, community institutions like hospitals and schools have closed or consolidated, and banks have stopped lending.⁹⁰ Compounded over time, these decisions can dramatically shrink a legacy city’s income base and

⁸⁴ See, e.g., Arthur J. Naperstek & Dennis Dooley, *Countering Urban Disinvestment Through Community-Building Initiatives*, 42 SOC. WORK 506 (1997).

⁸⁵ See, e.g., *id.*

⁸⁶ See ALAN MALLACH & LAVEA BRACHMAN, *REGENERATING AMERICA’S LEGACY CITIES* (2013).

⁸⁷ See *id.*

⁸⁸ *Id.* at 2.

⁸⁹ *Id.*

⁹⁰ *Id.* at 4-5.

decrease its property values, meaning local government receives less tax revenue and struggles to provide basic services. At the same time, sustaining an economically needier community and aging infrastructure increases the demands on government.

Left unchecked, disinvestment can cause a full-fledged, downward community spiral, spurring the remaining mobile capital to leave, overwhelming local resources and accelerating physical deterioration. Those residents who cannot afford to leave are left behind. More recently, older suburbs closest to the urban cores of legacy cities are encountering the next wave of disinvestment as developers and economically mobile homebuyers push out one ring farther to brand new suburbs and exurbs, or selectively re-populate more trendy sections of urban cores.⁹¹

This pattern of historically short periods of community settlement, expansion and abandonment in legacy cities is only one narrative (albeit a common one) of community disinvestment in the United States. A bird's eye view of the country reveals the wide-spread prevalence of disinvesting and disinvested communities, often within close proximity of communities that are prospering.⁹² By one measurement, 22.1% of U.S. census tracts have significantly depressed property values and predominantly low income populations, which are hallmarks of community disinvestment.⁹³ So-called "middle neighborhoods" constitute another large category of communities that are less distressed at this point, but sit on the precipice of disinvestment due to their increasingly poorer and older populations, and aging housing stock.⁹⁴

The physical condition of housing stock is a particularly visible and jarring manifestation of the consequences and costs of community disinvestment. Disinvested communities must manage increasing stockpiles

⁹¹ ELIZABETH KNEEBONE & ALAN BERUBE, *CONFRONTING SUBURBAN POVERTY IN AMERICA* 5-9 (2014).

⁹² See, e.g., *Heat Maps*, TRULIA, https://www.trulia.com/home_prices/ (last visited July 28, 2017); see also Albouy & Zabeck, *supra* note 78; Martin Burch et al., *Housing Prices Still Falling for Working-Class Families*, WALL ST. J. (June 23, 2015), <http://perma.cc/NM6R-B6KC>; Albouy & Zabeck, *supra* note 78; *The 2016 Distressed Communities Index*, ECON. INNOVATION GROUP, <http://eig.org/wp-content/uploads/2016/02/2016-Distressed-Communities-Index-Report.pdf> (last visited Nov. 11, 2017).

⁹³ Neighborhood Homes Investment Act Coalition, *Neighborhood Homes Tax Credit Presentation*, Ohio Presentation (July 20-21, 2017), https://www.dropbox.com/s/048w8v0mygpihmt/NHTC_Ohio_presentation_FINAL.pdf?dl=0.

⁹⁴ See generally Ira Goldstein et al., *Demographics and Characteristics of Middle Neighborhoods in Select Legacy Cities*, in *ON THE EDGE: AMERICA'S MIDDLE NEIGHBORHOODS* ch. 3 (Paul Brophy ed., 2016) (indicating that between 37 and 51% of residents in sample legacy cities, like Baltimore, Detroit, Milwaukee and Philadelphia, live in middle neighborhoods).

of outdated, orphaned, devalued, and deteriorating homes. Direct costs associated with these properties include increased code enforcement, boarding, property maintenance (grass and trash), fire and police runs, and, ultimately, when they have reached an advanced stage of decay, demolitions.⁹⁵ Meanwhile, local government loses property tax revenue necessary to cover the direct costs as these properties deteriorate and lose value, the owners stop paying the taxes altogether, and/or the structures on them are demolished.⁹⁶ Then, there is the negative spillover effect that vacant and deteriorating homes have on the values of surrounding homes, which not only further reduces property tax revenue for the city, but also depletes the wealth of neighbors, sometimes dramatically.⁹⁷

At work is severe market failure. Disinvestment decisions drive down property values to the point that they can no longer support private investment. Remaining homeowners hesitate to make improvements to their homes out of a concern they will not recoup these investments.⁹⁸ Developers, lenders, and prospective home buyers view rehabbing viable homes or demolishing and replacing those that are blighted as cost prohibitive or too risky, and so new capital also dries up.⁹⁹

The costs of supporting flailing housing markets typically prove too much for local actors to bear alone, and the federal government steps in. In 1965, Congress created a cabinet level agency, the U.S. Department of

⁹⁵ CMTY. RESEARCH PARTNERS & REBUILD OHIO, \$60 MILLION AND COUNTING: THE COST OF VACANT AND ABANDONED PROPERTIES TO EIGHT OHIO CITIES v (2008), <https://www.issueab.org/resources/3351/3351.pdf?download=true>.

⁹⁶ *Id.* (studying eight Ohio cities, prior to the national foreclosure crisis that drastically increased property vacancy and deterioration in those cities, and “conservatively” estimating the annual costs of vacant and abandoned properties to those cities at \$64 million—nearly \$15 million in city service costs and over \$49 million from lost tax revenues from demolitions and tax delinquencies).

⁹⁷ DAN IMMERGLUCK, CMTY. PROGRESS, THE COST OF VACANT AND BLIGHTED PROPERTIES IN ATLANTA: A CONSERVATIVE ANALYSIS OF SERVICE AND SPILLOVER COSTS 23 (2015) (estimating “conservatively” the costs of vacant and blighted properties in Atlanta to city government at between \$2.6 million and \$5.7 million annually along with a one-time cost to single family property values of \$153 million).

⁹⁸ See generally Susie Chung, *The Geography of Home Improvement Activity: A Metropolitan-Level Analysis of Remodeling Expenditures During the 2000s*, JNT. CTR. FOR HOUS. STUD. (2011), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w11-6_chung.pdf.

⁹⁹ One example of this is known as the “appraisal gap.” Due to a home appraisal that comes in at a price that is lower than what was agreed upon by a seller and buyer, a mortgage lender is unwilling to lend a sufficient amount to allow the transaction to move forward. See, e.g., Brena Swanson, *Homeowner Expectations and Appraisal Values Divided as Gap Widens*, HOUSINGWIRE (Mar. 8, 2016), <https://www.housingwire.com/articles/36481-homeowner-expectations-and-appraisal-values-divided-as-gap-widens>.

Housing and Urban Development (HUD), largely as a response to disinvestment in U.S. cities and a heightening concern for those left to live in them.¹⁰⁰ While HUD has overseen an alphabet soup of different programs over a half century, its longest standing and primary program for addressing disinvestment is the Community Development Block Grant (CDBG) program.¹⁰¹ Through CDBG, HUD annually transfers billions of federal dollars to cities, urban counties, and states, much of which goes to trying to stabilize and revitalize their disinvested housing markets.¹⁰² Eligible expenses include strategic property acquisition, housing construction and rehabilitation, housing code enforcement, and community planning.¹⁰³

Ultimately, however, the amount of assistance HUD provides is small compared to the scope of the problem.¹⁰⁴ Furthermore, CDBG rules effectively restrict funding to areas with high poverty and, thus, already highly distressed housing markets; in so doing, these rules exclude communities that are starting to deteriorate, but where intervention could enable a turnaround.¹⁰⁵ This is emblematic of the crisis-management mentality the federal government takes to disinvestment. This mentality was further exemplified by the Congressional response to communities hit hardest during the country's recent foreclosure crisis, a disinvestment event of mammoth proportions. Congress approved over \$7 billion in Neighborhood Stabilization Program funds, administered through CDBG, over a five year period to try and stop the most severe bleeding in housing markets afflicted by concentrated numbers of foreclosures and vacancies.¹⁰⁶ But it refused to extend the program beyond this point, even though few of

¹⁰⁰ Jill Khadduri, *The Founding and Evolution of HUD: 50 Years, 1965–2015* IN HUD AT 50: CREATING PATHWAYS TO OPPORTUNITY 7-8, 16 (2015).

¹⁰¹ *Id.* at 20-21. The CDBG program was established by the Housing and Community Development Act of 1974 (P.L. 93-383) and codified, as amended, at 42 U.S.C. 5305.

¹⁰² See generally George Galster et al., Measuring the Impact of Community Development Block Grant Spending on Urban Neighborhoods, *Housing Policy Debate* 15:4, 903-34 (Mar. 2004), <https://pdfs.semanticscholar.org/0224/860d0b954e996986b18c728bf459dd1fd308.pdf>.

¹⁰³ *Chapter 2: Activity Selection and Implementation*, in BASICALLY CDBG FOR ENTITLEMENTS, HUD EXCHANGE (May 2014), <https://www.hudexchange.info/resources/documents/Basically-CDBG-Chapter-2-Activity.pdf>.

¹⁰⁴ Goldstein et al., *supra* note 94, at 24.

¹⁰⁵ PAUL C. BROPHY ET AL., RETOOLING HUD FOR A CATALYTIC FEDERAL GOVERNMENT, A REPORT TO SECRETARY SHAUN DONOVAN 112 (Penn Inst. for Urb. Res., 2009).

¹⁰⁶ Paul A. Joice, *Neighborhood Stabilization Program*, 13 *CITYSCAPE: A J. OF POL'Y DEV. AND RES.* 135, 135 (2011).

the communities funded had begun to show signs of a meaningful turnaround.¹⁰⁷

To this point, this section has focused on the housing market dysfunction that follows from community disinvestment, while ignoring the associated human costs. These are in fact quite staggering. Older communities with large numbers of distressed and vacant residential properties have remarkably higher incidences of public health issues, like lead paint poisoning among children,¹⁰⁸ asthma,¹⁰⁹ chronic health conditions,¹¹⁰ and other environmental hazards.¹¹¹ They also correlate strongly with higher incidences of violent crime.¹¹² Local governments rely on a stable residential tax base to fund critical infrastructure like school systems, water line maintenance, sewage and storm water systems, road repair, and public transit. When tax revenue shrinks, all of these suffer.¹¹³

The federal government routinely directs billions of dollars annually to communities struggling to meet these types of costs through a wide array of programs.¹¹⁴ Again, it is also the ultimate backstop when a crisis that traces

¹⁰⁷ See e.g., Gail R. Chaddock, *House looks to cut \$62 billion for distressed homeowners, properties*, CHRISTIAN SCI. MONITOR, Mar. 11, 2011, <https://www.csmonitor.com/USA/Politics/2011/0311/House-looks-to-cut-62-billion-for-distressed-homeowners-properties>. Later efforts to extend and expand the Neighborhood Stabilization Program, via the Project Rebuild Act of 2013, stalled in Congress.

¹⁰⁸ See e.g., *Exploring the Relationship Between Vacant and Distressed Properties and Community Health and Safety*, CTR. ON URB. POVERTY & CMTY. DEV. (June 7, 2017), http://povertycenter.case.edu/wp-content/uploads/2017/06/vacant_distressed_props_comm_health_safety.pdf [hereinafter *Distressed Properties Study*]; *A Hidden Problem: Lead-Poisoned Children in the U.S.*, CAL. ENVTL. HEALTH TRACKING PROGRAM (Apr. 2017), <http://www.cehtp.org/page/lead/lead-report>.

¹⁰⁹ See Jonathan J. Sheffield, *Resident Health and HUD's Choice Neighborhoods Initiative*, 23 J. AFFORDABLE HOUS. & CMTY. DEV. L. 117, 119 (2014).

¹¹⁰ See Susan J. Popkin, *A Glass Half-Empty? New Evidence from the HOPE VI Panel Study*, 20 HOUS. POL'Y DEBATE 43 (2010).

¹¹¹ See Emily A. Benfer & Allyson E. Gold, *There's No Place Like Home: Reshaping Community Interventions and Policies to Eliminate Environmental Hazards and Improve Population Health for Low-Income and Minority Communities*, 11 HARV. L. & POL'Y REV. S1, S1 (2017).

¹¹² See *Distressed Properties Study*, *supra* note 108; see also Erica Raleigh & George Galster, *Neighborhood Disinvestment, Abandonment, and Crime Dynamics*, 37 J. URB. AFF. 397 (2015).

¹¹³ See e.g., Jonathan Masters, *Why the Fiscal Health of States and Cities Matters*, COUNS. ON FOREIGN REL.: RENEWING AM. (Oct. 2, 2012), <https://www.cfr.org/background/why-fiscal-health-states-and-cities-matters>.

¹¹⁴ Some examples include HUD's Lead-Based Paint Hazard Control Program, the Department of Transportation's Transportation Investment Generating Economic Recovery grant program, and the Department of Education's Title I and Title IV funding for low income school systems.

back to disinvestment arises. As simply one example, cost-cutting to meet municipal general fund shortfalls, recently resulted in contamination of the water supply of Flint, Michigan, long viewed as a poster child for urban disinvestment. With the city teetering on the brink of bankruptcy, Congress stepped in with \$120 million to help replace lead water supply lines in all of Flint's homes and to make an initial down payment on the long-term health issues expected from the widespread lead poisoning of the city's residents that occurred.¹¹⁵

This is to say nothing of the considerable dollars Congress has spent or forgone in attempts to revitalize disinvested communities through economic development. These initiatives have varied from decade to decade and included Empowerment Zones, Enterprise and Renewal Communities, and New Market Tax Credits.¹¹⁶ For the most part, they have sought to leverage federal grants and tax breaks to attract private capital to invest in businesses in distressed neighborhoods in order to put local residents to work and spark community reinvestment.¹¹⁷

2. *Relationship to Homeowner Subsidies*

As some of the federal interventions described above suggest, what disinvestment has wrought, the reinvestment of private dollars could help remedy. An influx of new homeowners would reduce stockpiles of vacant structures, invest capital in rehabilitated or new homes, increase tax revenue, and, by extension, offset negative housing externalities associated with disinvestment.¹¹⁸ This has proven to be the case in communities throughout the country where disinvestment wrecked less damage and some combination of market dynamics and forward looking policies created the right mix of circumstances for reinvestment to occur.¹¹⁹ It is also the

¹¹⁵ Todd Spangler, *Congress Approves at Least \$120M for Flint Water Fix*, USA TODAY (Dec. 10, 2016, 8:04 AM), <http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/12/10/congress-flint-water-funding/95243816/>.

¹¹⁶ See Linda Schakel, *Empowerment Zones and Enterprise and Renewal Communities*, in BUILDING HEALTHY COMMUNITIES: A GUIDE TO COMMUNITY ECONOMIC DEVELOPMENT FOR ADVOCATES, LAWYERS AND POLICY MAKERS 117 (Roger A. Clay & Susan Jones eds., 2009); Herbert F. Stevens, *New Markets Tax Credits*, in BUILDING HEALTHY COMMUNITIES: A GUIDE TO COMMUNITY ECONOMIC DEVELOPMENT FOR ADVOCATES, LAWYERS AND POLICY MAKERS 161 (Roger A. Clay & Susan Jones eds., 2009).

¹¹⁷ *Id.*

¹¹⁸ MAUREEN KENNEDY & PAUL LEONARD, DEALING WITH NEIGHBORHOOD CHANGE: A PRIMER ON GENTRIFICATION AND POLICY CHOICES 14 (2001), <https://www.brookings.edu/wp-content/uploads/2016/06/gentrification.pdf>.

¹¹⁹ *Id.*

philosophy Congress has adhered to in creating federal tax breaks for businesses to locate in disinvested communities.

And yet the homeowner subsidies are, at least on their face, entirely neutral in this regard. They reward an investment in homeownership equally no matter where it occurs, whether it is in a thriving residential market or one that is highly disinvested. The result is that although the federal government absorbs significant costs in containing damage to and ostensibly laying the foundation for housing market recoveries in disinvested communities, its primary mechanisms for encouraging households to invest in homes do nothing to encourage prospective homebuyers to purchase there.

Furthermore, although facially neutral, the reality is that the subsidies to a large extent support homeowners who live in affluent, non-disinvested communities. Numerous studies have demonstrated that the geographic distribution of the subsidies is strongly tilted towards areas where housing prices, income levels, and homeownership rates are high¹²⁰—the hallmarks of a healthy housing market. This is unsurprising considering the design of the subsidies. Home sale gains are more likely to occur (and in greater amounts) in robust housing markets, and, therefore, the savings yielded by excluding them from capital gains tax will also be greater.¹²¹ Also, home prices are higher in stronger housing markets. Those with the most expensive homes not only are likely to have larger mortgages and higher property taxes, but also sit in higher marginal tax brackets and, therefore, receive a greater tax benefit for each dollar of mortgage interest and property tax they deduct.

Conversely, homeowners in disinvested communities will, generally speaking, have lower mortgage interest and property tax costs (due to the lower values of their homes), sit in lower marginal tax brackets, and yield smaller gains upon selling their homes, and, thus, yield less benefit from the homeowner subsidies. An exception to this rule exists for those who own more expensive homes in disinvested communities that have higher local property tax rates due to greater municipal costs. In this way, the property tax deduction may alleviate a barrier to homeownership in disinvested communities. But this subsidy is not designed to achieve this end and so its

¹²⁰ See, e.g., Fiscal Federal Initiative, *The Geographic Distribution of the Mortgage Interest Deduction*, THE PEW CHARITABLE TRUSTS (Apr. 30, 2013), <http://www.pewtrusts.org/en/research-and-analysis/reports/2013/04/30/the-geographic-distribution-of-the-mortgage-interest-deduction>; Joseph Gyourko & Todd Sinai, *The (Un)Changing Geographical Distribution of Housing Tax Benefits: 1980-2000*, 9 (Nat'l Bureau of Econ. Res., Working Paper No. 10322, 2004).

¹²¹ Thomas Bier et al., *A Preliminary Assessment of the New Home Seller Capital Gains Law*, 11 HOUS. POL'Y DEBATE 645, 645-73 (2000).

impact on housing markets in disinvested communities is largely incidental and much less than it could be. The reality is that homes are typically worth less in disinvested communities and fewer residents are affluent enough to itemize their deductions, making the property tax deduction relatively much less valuable for homeowners in these communities than in more affluent communities.

The bottom line is that the homeowner subsidies do relatively little to encourage homeowners to invest in disinvested communities. While this again is unsurprising based on how deductions and exclusions operate, it seems difficult to justify a system in which the vast majority of the homeowner subsidies incentivize home purchases in housing markets that function well and in which the private market already rewards homeowners for their purchases, while doing little for struggling markets that present large disincentives to purchase and impose significant costs on the public sector. This is especially true given that, as Part III demonstrated, the subsidies do not even help lower-income households access thriving markets and, in fact, probably operate to exclude them.

To go one step further, the homeowner subsidies probably counteract the federal government's policy of containing the damage in disinvested communities by incentivizing higher income taxpayers to leave or stay away. This is because the principal impact of the subsidies is to cause these types of taxpayers to over-invest in housing by buying larger, more expensive homes and in higher income areas than they might otherwise so that they can maximize their tax benefits under the subsidies.¹²² Especially when coupled with exclusionary land use restrictions (like large minimum lot size requirements) imposed in many high-end developments, the subsidies contribute to a form of income-level sorting, attracting more affluent prospective homeowners to higher income areas. This squeezes out low income entrants and contributes to capital flight and home price losses in declining housing markets.¹²³

¹²² See RICHARD VOITH, DOES THE FEDERAL TAX TREATMENT OF HOUSING AFFECT THE PATTERN OF METROPOLITAN DEVELOPMENT?, FED. RES. BANK PHILA. 3 (Mar./Apr. 1999), https://pdfs.semanticscholar.org/9d66/8c1917d0c389593dbf4f37bf4834800b3bb8.pdf?_ga=2.228286557.1385482424.1510778488-1033708948.1510778488; Joseph Gyourko & Richard Voith, *The Price Elasticity of Demand for Residential Land* (Feb. 9, 2000), <http://realestate.wharton.upenn.edu/wp-content/uploads/2017/03/329.pdf>. Interestingly, this outcome conflicts with one of the objectives of the 1997 tax code amendments to the treatment of the home sale capital gain exclusion, which was to eliminate the incentive that the previous rules included to “buy up” to avoid the capital gain tax. See, e.g., Amelia M. Biehl & William H. Hoyt, *The Taxpayer Relief Act of 1997 and Homeownership: Is Smaller Now Better?*, 52 ECON. INQUIRY 646 (2014).

¹²³ Gyourko & Voith, *supra* note 122; VOITH, *supra* note 122.

B. *Decreasing Economic and Racial Segregation*

1. *Background*

Housing in the United States is highly segregated by wealth and race. Economic segregation, in particular, is increasing dramatically. The percentage of poor households living in high poverty neighborhoods has grown from 43% to 54% in just the last 15 years; meanwhile, the percentage of high income households living in high income neighborhoods has also escalated (from 40% to 49% in the last 25 years).¹²⁴ These statistics are consistent with recent studies revealing that high income households are choosing with greater frequency to pay more to live in exclusive communities, and with the decrease in the size of the middle class.¹²⁵ This increasing stratification is facilitated by land use restrictions imposed by local ordinances and property developers and market-driven forces that drive up the cost of housing in affluent communities to the point where it effectively bars low income residents.

Racial segregation in housing is actually declining gradually, but remains quite high. A Brookings Institution study based on 2010-2014 census data showed that all fifty-two of the nation's largest metropolitan areas are significantly segregated by race.¹²⁶ This is especially true as it relates to black-white segregation. According to one common measurement of housing segregation, more than half of all blacks would have to move from their current communities to white communities for those communities to match the national ratio of white to black residents.¹²⁷ Racial segregation is the legacy of a legal system that for much of the country's history permitted discrimination in housing practices and a culture that has long stigmatized differences in race.¹²⁸ Race-based neighborhood stereotyping continues to

¹²⁴ See JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *THE STATE OF THE NATION'S HOUSING 2017* 17 (2017); see also, Richard Fry & Paul Taylor, *The Rise of Residential Segregation by Income*, PEW RES. CENT.: SOC. & DEMOGRAPHIC TRENDS (Aug. 1, 2012), <http://www.pewsocialtrends.org/2012/08/01/the-rise-of-residential-segregation-by-income/>.

¹²⁵ Fry & Taylor, *supra* note 124. See also JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *supra* note 124, at 35; Albouy & Zabek, *supra* note 78.

¹²⁶ William H. Frey, *Census Shows Modest Decline in Black-White Segregation*, BROOKINGS INST.: THE AVE. (Dec. 8, 2015), <https://www.brookings.edu/blog/the-avenue/2015/12/08/census-shows-modest-declines-in-black-white-segregation/>.

¹²⁷ *Id.* This is called the racial dissimilarity index. See, e.g., John Iceland et al., U.S. Census Bureau, *Racial and Ethnic Residential Segregation in the United States: 1980-2000*, App. B (Aug. 2002), available at http://www.census.gov/hhes/www/housing/housing_patterns/pdf/censr-3.pdf.

¹²⁸ See generally RICHARD ROTHSTEIN, *THE COLOR OF LAW: A FORGOTTEN HISTORY OF HOW OUR GOVERNMENT SEGREGATED AMERICA* (2017).

be a common practice and an explanation for why many white homebuyers choose to avoid or leave neighborhoods with large or growing African-American populations.¹²⁹

Because poverty rates are much higher among African Americans and Hispanics than among whites, it is difficult to separate a discussion of economic and race segregation.¹³⁰ Low income neighborhoods in the United States have disproportionately high minority populations.¹³¹ In fact, not only poor African-Americans but all African-Americans are much more likely to live in high poverty neighborhoods than their white counterparts.¹³² Perhaps most troubling, 66% of young African-Americans live in poor neighborhoods (10 times as many as young whites).¹³³

Housing segregation imposes severe costs on those who live in high poverty communities.¹³⁴ To a large extent, these communities overlap with the disinvested communities discussed in Part IV.A and, thus, face many of the same problems. These include smaller tax bases and less private investment, resulting in poorer quality housing, institutions, infrastructure, and services for their residents.¹³⁵ High poverty communities also fare much worse in terms of safety, environmental quality, and health.¹³⁶ Part IV.A details these negative housing externalities and federal attempts to mitigate them.

Particularly germane to residential segregation and worth separate mention here is the opportunity gap, or a lack of access to pathways out of poverty, for those isolated in high poverty communities. These pathways include well-performing schools, positive role models, access to job

¹²⁹ See Ingrid Gould Ellen, *Continuing Isolation: Segregation in America Today*, in SEGREGATION: THE RISING COSTS FOR AMERICA 270 (James H. Carr & Nandinee K. Kutty eds., 2008); Maria Krysan et al., *Does Race Matter in Neighborhood Preferences? Results from a Video Experiment*, 115 AM. J. SOC. 527, 527-59 (2009).

¹³⁰ U.S. CENSUS BUREAU, P60-256(RV), INCOME AND POVERTY IN THE UNITED STATES: 2015 (2016), <https://www.census.gov/content/dam/Census/library/publications/2016/demo/p60-256.pdf>.

¹³¹ Kathleen McCormick, *Planning for Social Equity*, LAND LINES, Winter 2017, at 26.

¹³² PATRICK SHARKEY, STUCK IN PLACE: URBAN NEIGHBORHOODS AND THE END OF PROGRESS TOWARDS RACIAL EQUITY (2013).

¹³³ *Id.*

¹³⁴ JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *supra* note 124, at 35.

¹³⁵ Laura M. Tach, *Diversity, Inequality and Microsegregation: Dynamics of Inclusion and Exclusion in a Racially and Economically Diverse Community*, 16 CITYSCAPE 13, 14 (2014).

¹³⁶ See, e.g., Catherine Cubbin et al., *Where We Live Matters for Our Health: Neighborhoods and Health*, COMM. ON HEALTH (Sept. 2008), <http://www.commissiononhealth.org/PDF/888f4a18-eb90-45be-a2f8-159e84a55a4c/Issue%20Brief%203%20Sept%2008%20-%20Neighborhoods%20and%20Health.pdf>.

opportunities, and examples of success.¹³⁷ Instead of these pathways, residents of communities with concentrated poverty must contend daily with unsafe streets, substandard housing conditions, and dysfunctional behavior.¹³⁸ Of foremost concern is the individual personal harm that follows. However, it is also important to recognize the resulting societal costs that compound over time. These include an increased reliance on entitlement programs, and high incarceration rates among residents in these communities, which imposes costs on all taxpayers.¹³⁹ On a macro level, high levels of residential isolation inhibit local labor markets, stunting a metropolitan area's economic growth and harming both marginalized and non-marginalized residents.¹⁴⁰ Spread across multiple metropolitan areas, it impairs the country's ability to compete in a global economy, running counter to national interests.¹⁴¹

As mentioned previously, explaining the costs of racial segregation, separate from economic segregation, is more challenging. And yet solid evidence exists. For instance, it has long been established that home prices and appreciation in predominantly African-American communities lag considerably behind homes in predominantly white communities with comparable resident income levels.¹⁴² This disparity rises with increasing levels of segregation.¹⁴³ Lower home appreciation impairs wealth accumulation among African Americans, and the significance of this is magnified because the home is more likely to be the primary financial asset of an African American household.¹⁴⁴ The ripple effect of lower property values also manifests in less local tax revenue which negatively impacts school funding, educational achievement, and the delivery of public services in these communities, which in turn contributes to negative racial stereotypes and social polarization. A recent analysis of metropolitan

¹³⁷ SHARKEY, *supra* note 132.

¹³⁸ See, e.g., James H. Carr & Nandinee K. Kutty, *The New Imperative for Equality, in* SEGREGATION: THE RISING COSTS FOR AMERICA 2 (James H. Carr & Nandinee K. Kutty eds., 2008).

¹³⁹ *Id.*

¹⁴⁰ Huiping Li, Harrison Campbell & Steven Fernandez, *Residential Segregation, Spatial Mismatch and Economic Growth across US Metropolitan Areas*, 50 URB. STUD. 2642 (2013).

¹⁴¹ Carr & Kutty, *supra* note 138.

¹⁴² See, e.g., Gregory D. Squires, *Demobilization of the Individualistic Bias: Housing Market Discrimination as a Contributor to Labor Market and Economic Inequality*, 609 ANNALS AM. ACAD. POL. & SOC. SCI. 200 (2007). See also David Rusk, *The "Segregation Tax": The Cost of Racial Segregation to Black Homeowners*, BROOKINGS INSTITUTION (Oct. 2001), <https://www.brookings.edu/wp-content/uploads/2016/06/rusk.pdf>.

¹⁴³ See Squires, *supra* note 142. See also Rusk, *supra* note 142.

¹⁴⁴ REBECCA TIBBETT ET AL., BEYOND BROKE: WHY CLOSING THE RACIAL WEALTH GAP IS A PRIORITY FOR NATIONAL ECONOMIC SECURITY 4 (Ctr. for Global Policy Sols., 2014).

regions across the country demonstrated that a high level of racial segregation causes a much lower per capita income for African Americans and projected the cost to the Chicago region alone at an estimated \$4.4 billion in annual regional income and more than \$8 billion in annual gross domestic product.¹⁴⁵

All of this said, federal policy on housing segregation has a complicated history. Racial discrimination was at one point the law of the land. Through at least the mid-twentieth century, federal agencies adhered to explicitly segregationist practices that have left an enduring mark on contemporary housing patterns.¹⁴⁶ These included, perhaps most notoriously, the Federal Housing Administration's mortgage underwriting standards, which prevented African American homeowners from getting mortgages to live in white communities, and vice versa, and the Public Works Administration's construction of racially designated public housing projects in neighborhoods with matching racial compositions.¹⁴⁷ These expressly discriminatory policies are fortunately now a relic of the past. Yet, federal agencies to this day face criticism that they do not do enough to address less overt forms of socioeconomic and racial discrimination in housing programs they design.¹⁴⁸

The passage of the Fair Housing Act by Congress in 1968¹⁴⁹ was a monumental turning point, at least as it relates to express racial discrimination. The Act prohibited discrimination in any housing transaction based on race¹⁵⁰ and charged the Secretary of the U.S. Department of Housing and Urban Development (HUD) with enforcing the Act.¹⁵¹ Of course, prohibiting discrimination and decreasing segregation are two different matters. The Act also obligated the HUD Secretary (in addition to all federal executive agencies and programs related to housing and urban development) to implement programs not just to prevent

¹⁴⁵ See GREGORY ACS, ROLF PENDALL, MARK TREKSON & AMY KHARE, *THE COST OF SEGREGATION: NATIONAL TRENDS AND THE CASE OF CHICAGO, 1990-2010* ix (2017).

¹⁴⁶ See generally ROTHSTEIN, *supra* note 128.

¹⁴⁷ *Id.* (discussing also a range of other agency and judicial practices that promoted housing discrimination against certain racial, religious and ethnic groups).

¹⁴⁸ For example, federal law allows private landlords to refuse to accept tenants who would pay rent with Section 8 housing vouchers, notwithstanding fairly clear evidence that this is a thinly veiled form of discrimination against the poor and largely minority population of voucher holders. See Evan F. Anderson, *Vouching for Landlords: Withdrawing from the Section 8 Housing Choice Voucher Program and Resulting Disparate Impact Claims*,—Graoch Associates #33, L.P. v. Louisville/Jefferson County Metro Human relations Commission, 508 F.3d 366 (6th Cir. 2007), 78 U. CIN. L. REV. 371 (2009).

¹⁴⁹ See Fair Housing Act, 42 U.S.C. § 3604 (2017).

¹⁵⁰ *Id.*

¹⁵¹ 42 U.S.C. § 3608.

discrimination against protected classes, but also to “affirmatively [] further” fair housing.¹⁵² This mandate has proven more elusive. Its meaning, as well as how vigorously HUD has pursued it, has varied in the years since the Act’s enactment, based in part on who has occupied the White House and Congress at the time and the level of opposition mounted by private interests regulated by it.¹⁵³

Nevertheless, HUD has by and large embraced the mantle of fostering more economically and racially inclusive communities as a fundamental part of its mission, especially in recent decades. This goal consistently appears as a critical plank in HUD’s mission statements and strategic plans.¹⁵⁴ Moreover, HUD and Congress have adopted some significant programs aimed squarely at encouraging residential integration. Perhaps the longest standing pro-integrationist program is the Section 8 rental housing voucher program which, at least in theory, enables low income voucher recipients to move outside their current neighborhoods to find housing.¹⁵⁵ In 1992, Congress authorized the HOPE VI program, a multi-billion dollar, two decade long initiative intended to deconcentrate poverty in public housing projects by demolishing and replacing many of them with mixed income developments.¹⁵⁶ Perhaps the most dramatic strides towards decreasing residential segregation were made during the Obama administration. During this time, HUD enlivened the long-standing obligation that all recipients of HUD funding (which includes many state and municipal governments) regularly assess the state of fair housing within their jurisdictions and report to HUD on their efforts and plans to further it as a condition of continued funding.¹⁵⁷ The Obama administration also introduced a new approach to rental formulas for the Section 8 program

¹⁵² See 42 U.S.C. § 3601 (formally stating, in the Act’s preamble, that it is the policy of the United States to provide for fair housing); 42 U.S.C. § 3608 (charging agencies with the duty to affirmatively further the Fair Housing Act’s purposes).

¹⁵³ See Khadduri, *supra* note 100.

¹⁵⁴ See, e.g., Mission, U.S. DEP’T OF HOUS. & URB. DEV., <https://portal.hud.gov/hudportal/HUD?src=/about/mission>; *FY 2014-2018 HUD Strategic Plan Executive Summary*, U.S. DEP’T OF HOUS. & URB. DEV., https://portal.hud.gov/hudportal/HUD?src=/program_offices/spm/strategicplan2014_2018 (last visited July 30, 2017).

¹⁵⁵ Ingrid Gould Ellen and Jessica Yager, *Race, Poverty and Federal Rental Housing Policy in HUD at 50: Creating Pathways to Opportunity* 113-16 (2015).

¹⁵⁶ SUSAN J. POPKIN ET AL., URBAN INST., *A DECADE OF HOPE VI: RESEARCH FINDINGS AND POLICY CHALLENGES* 14 (2004).

¹⁵⁷ DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, *AFFIRMATIVELY FURTHERING FAIR HOUSING* (2015), https://www.huduser.gov/portal/sites/default/files/pdf/AFFH_Final_Rule.pdf.

aimed at increasing options for voucher holders in more affluent neighborhoods.¹⁵⁸

2. *Relationship to Homeowner Subsidies*

Homeowner subsidies would seem to be a potentially powerful mechanism for alleviating housing segregation. To the extent that traditional biases or development financing concerns stand in the way of affluent and racially homogenous communities accommodating mixed income housing, the carrot of homeowner subsidies could serve as meaningful leverage for these communities to decide to become more inclusive. Subsidies might also serve as tempting incentives to draw more affluent homeowners to less affluent communities, or to attract homeowners to a racially homogenous community that would improve its diversity. Poorer and racially marginalized communities would, in turn, presumably stand to benefit from increased tax bases, improved public services, and an overall reduction of the other negative housing externalities that follow from concentrated economic and racial isolation.

As designed, however, the current homeowner subsidies do very little to support residential integration. Not only are they facially neutral as to where a homeowner purchases, but also as to a prospective homeowner's race, ethnicity, and, at least in theory, income level. Thus, the subsidies do not explicitly reward or penalize a homeownership decision that promotes integration or enhances segregation.

Once again, however, the subsidies are also not actually all that neutral in terms of their impact. Because by design they inure primarily to the benefit of high income homeowners, who are typically found in affluent communities with high home prices, they by and large supplement spending on homeownership in communities that are inaccessible to lower income households (and by extension to the strong majority of minority households as well). Conversely, they are not of much value to those lower income (and oftentimes minority) households who wish to move from opportunity poor to opportunity rich communities.¹⁵⁹

¹⁵⁸ See Press Release, Brian Sullivan, HUD Announces New Approach to Expand Choice and Opportunity for Section 8 Voucher Holders in Certain Hous. Markets, U.S. Dept. of Hous. & Urban Dev. (Nov. 15, 2016), https://www.hud.gov/press/press_releases_media_advisories/2016/HUDNo_16-173 (announcing Small Area Fair Market Rent approach). The Trump Administration has since suspended this approach for the next two years.

¹⁵⁹ See, e.g., Fiscal Federal Initiative, *supra* note 120; Gyourko & Sinai, *supra* note 120, at 9.

Stacked on top of this reality is the recognition that the subsidies encourage the type of income sorting discussed in Part IV.A, by which affluent homebuyers seek to live in higher yield, higher cost communities to maximize their tax benefits from the subsidies.¹⁶⁰ Accordingly, the subsidies probably serve to increase economic segregation. The one exception, as described in Part IV.A.2, is the property tax deduction, which helps alleviate a barrier to living in communities that have higher taxes due to the greater public expenses that follow from serving lower income populations in poorer cities. However, any positive benefit that follows from this deduction is largely incidental and not a reflection of its design.¹⁶¹

The homeowner subsidies probably heighten racial segregation for the same reasons they heighten economic segregation and another more race specific reason as well. As noted earlier, homes in majority African American neighborhoods do not appreciate as much as homes in predominantly white neighborhoods.¹⁶² White prospective home buyers recognize this and factor it into their choice of neighborhood.¹⁶³ From this, it is not difficult to extrapolate that many white prospective homeowners view predominantly African American neighborhoods or neighborhoods with growing black populations as bad places to maximize their homeowner subsidies and avoid them.

C. *Lessening Environmental Degradation Resulting from Housing Choices, While Reducing Vulnerability of Those Who Reside in Environmental Hotspots*

1. *Background*

A homeowner's decisions as to where to live and in what type of home affect his or her relationship to the natural environment in a wide and complex variety of ways. One example is a home's carbon footprint. Homes are a major source of carbon dioxide (and other greenhouse gas) emissions, and greenhouse gas emissions are the principal cause of global warming.¹⁶⁴ A home built with energy efficient materials that is smaller,

¹⁶⁰ Gyourko & Voith, *supra* note 122, at 25; VOITH, *supra* note 122, at 9.

¹⁶¹ See Part IV.A.2.

¹⁶² TIBBETT ET AL., *supra* note 144. See also Dorothy Brown, How Home Ownership Keeps Blacks Poorer Than Whites, FORBES (Dec. 10, 2012).

¹⁶³ See Squires, *supra* note 142; Ellen, *supra* note 129.

¹⁶⁴ Residential heating, cooling, and electrical consumption alone accounted for 17% of all greenhouse gas emissions, the principal cause of global warming, in the U.S. Transportation accounts for 27% of total emissions, and "household travel" accounts for over 80% of miles traveled on the country's roadways. ALEX F. SCHWARTZ, HOUSING POLICY

uses renewable energy, and requires less driving to get to and from a job center has a smaller carbon footprint. This type of home harms the environment less, all other things being equal, than one that does not use these materials, is larger, burns fossil fuels, and is further away. Some other examples of environmental conditions impacted by housing choices include wetlands protection, habitat and wildlife preservation, fresh and groundwater supply, and storm and sewer water management.¹⁶⁵

Not only does housing impact the environment, the environment impacts housing. Homes built along coasts and in floodplains are more susceptible to damage by severe weather events and rising tides.¹⁶⁶ Likewise, homes near fault lines, mountains, and forests are more susceptible to damage from earthquakes, landslides, and forest fires, respectively.

Furthermore, housing can impact the environment in ways that in turn increase the vulnerability of that housing. Houston's recent encounter with Hurricane Harvey is a telling example. Long recognized as the epitome of booming development catalyzed by a lack of land use regulation, housing developers in Houston have constructed one low-density, concrete laden subdivision after another on top of former prairie.¹⁶⁷ At the same time, Houston sits close to the Gulf of Mexico exposing it to severe storms, which appear to be occurring with greater frequency in vulnerable regions due to climate change and rising sea levels.¹⁶⁸ By replacing 65 square miles of freshwater wetlands with impervious surfaces on which water can accumulate, Houston's housing development patterns have made it much more vulnerable to massive flooding.¹⁶⁹ This has occurred three times in just the last three years, most recently and tragically with Hurricane

IN THE UNITED STATES 3 (3rd ed. 2015) (citing to U.S. ENVIRONMENTAL PROTECTION AGENCY, INVENTORY OF U.S. GREENHOUSE GAS EMISSIONS, AND SINKS: 1990-2011 (2013)).

¹⁶⁵ JunJie Wu, *Land Use Changes: Economic, Social, and Environmental Impacts*, CHOICES (2008), <http://www.choicesmagazine.org/magazine/article.php?article=49>.

¹⁶⁶ See *Life's a Beach*, FREDDIE Mac (Apr. 26, 2016), http://www.freddiemac.com/research/insight/20160426_lifes_a_beach.html.

¹⁶⁷ See, e.g., Douglas Belkin & Shibani Mahtani, *In Harvey's Wake, Houston Rethinks Real Estate Development*, WALL STREET J. (Sept. 11, 2017), <https://www.wsj.com/articles/in-harveys-wake-houston-rethinks-real-estate-development-1505145759> ("Federal officials and scientists have long urged Houston, one of the nation's fastest-growing cities, to preserve more of its prairie and regulate development to mitigate the flooding that has plagued residents for decades. They haven't had the ear of the area's politicians who, by and large, have championed development to push economic growth.")

¹⁶⁸ See, e.g., Manny Fernandez & Richard Fasset, *A Storm Forces Houston, the Limitless City, to Consider Its Limits*, N.Y. TIMES (Aug. 30, 2017), <https://www.nytimes.com/2017/08/30/us/houston-flooding-growth-regulation.html>; see also, Andreas F. Prein, et al., *The future intensification of hourly precipitation extremes*, NATURE CLIMATE CHANGE 7, 48–52 (2017).

¹⁶⁹ *Id.*

Harvey, which caused flooding that led to a loss of lives, inundated entire neighborhoods and damaged an estimated 200,000 homes.¹⁷⁰

The negative externalities flowing from human behavior that degrades the environment, including housing choices, are wide-ranging and potentially severe. For example, if greenhouse gas emissions do not slow, global warming is expected to raise temperatures worldwide between 2 and 11.5 degrees Fahrenheit during the 21st century.¹⁷¹ Such an increase is projected to raise sea levels, fully or partially submerge certain coastal cities, kill off 30% of the world species, increase human disease, decrease agricultural productivity, and lead to a dramatic increase in severe weather events and a significant impairment of the world population's overall quality of life.¹⁷² Accurately pegging the costs imposed by global warming is a difficult task because it is forward-looking and involves many secondary impacts. Attempts to do so have estimated the price tag to the United States as reaching into the trillions of dollars annually if patterns do not change.¹⁷³ Although the economic, health, and social costs may potentially be enormous, many will not manifest for decades. This is part of why federal efforts to significantly scale back U.S. greenhouse gas emissions have not succeeded.¹⁷⁴

Federal policies related to housing and the environment reflect this inability to gain serious traction. A good example is the federal response to suburban sprawl. Sprawl is commonly understood to mean low density, minimally controlled, single use residential development that outpaces population growth, occurs on urban fringes and is accessible almost exclusively by automobile.¹⁷⁵ Evidence has mounted in recent years of the

¹⁷⁰ Tulsi Kamath, *Latest Numbers Show Extent of Harvey Damage in Houston and Texas*, HOUS. CHRONICLE (Sept. 6, 2017), <http://www.chron.com/news/houston-weather/hurricaneharvey/article/Latest-numbers-show-extent-of-Harvey-damage-in-12175543.php>.

¹⁷¹ INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, CLIMATE CHANGE 2007: IMPACTS, ADAPTATIONS AND VULNERABILITY 33 (Martin Parry et al. eds., 2007).

¹⁷² *Id.* at 9, 41.

¹⁷³ See, e.g., Matthias Ruth et al., *The US Economic Impacts of Climate Change and the Costs of Inaction*, THE CTR. FOR INTEGRATIVE ENVTL. RES. (Oct. 2007), <http://cier.umd.edu/documents/US%20Economic%20Impacts%20of%20Climate%20Change%20and%20the%20Costs%20of%20Inaction.pdf>; Frank Ackerman & Elizabeth A. Stanton, *The Cost of Climate Change: What We'll Pay if Global Warming Continues Unchecked*, NAT. RESOURCES DEF. COUNCIL (May 2008), <https://www.nrdc.org/sites/default/files/cost.pdf>.

¹⁷⁴ Vested business interests, skepticism as to government driven solutions to solve environmental problems, global competitiveness, and doubt among a segment of politicians and the U.S. population as to the existence of the problems are other reasons.

¹⁷⁵ See, e.g., Lee R. Epstein, *Where Yards Are Wide: Have Land Use Planning and Law Gone Astray?*, 21 WM. & MARY ENVTL. L. & POL'Y REV. 345, 347 (1997).

many negative environmental externalities resulting from uncontrolled sprawl, including the loss of wetlands, increased storm water run-off, increased carbon consumption, and the destruction of wildlife habitats.¹⁷⁶ On the one hand, the federal government recognizes sprawl as a significant problem.¹⁷⁷ Congress has empowered the U.S. Environmental Protection Agency (EPA) to regulate certain aspects of land development particularly critical to managing sprawl such as local storm water management and wetlands protection.¹⁷⁸ The EPA, through its Office of Sustainable Communities, encourages local and state planners, through funding and educational resources, to implement “Smart Growth” techniques that minimize negative environmental impacts in constructing new residential communities and re-designing existing ones.¹⁷⁹ Other federal agencies, like HUD, the Department of Transportation, and FEMA, have recently forged partnerships with the EPA to coordinate their housing and infrastructure funding to provide more leverage for the construction of environmentally sustainable communities.¹⁸⁰

On the other hand, the federal government leaves individual development decisions in the hands of state and local governments,¹⁸¹ many of which pay no mind to and lack a significant incentive to adopt Smart Growth principles. The degree of attention that environmental sustainability receives has varied based on who leads the relevant federal departments and agencies, which has led to a lack of consistency in policy implementation. Furthermore, many have suggested that long-standing, pro-growth policies of the federal government, like the construction and expansion of federal highways, have been instrumental in encouraging suburban sprawl (a

¹⁷⁶ See Todd Litman, *Analysis of Public Policies that Unintentionally Encourage and Subsidize Urban Sprawl* 20-21 (Mar. 2015) (unnumbered working paper) (on file with The New Climate Economy).

¹⁷⁷ See, e.g., Al Gore, Vice President of the U.S., Livability Announcement by the Vice President at the Am. Inst. Of Architects (Jan. 11, 1999).

¹⁷⁸ See *Wetlands Protection and Restoration*, EPA: WETLANDS, <https://www.epa.gov/wetlands> (last updated Aug. 18, 2017).

¹⁷⁹ See *What are Some Environmental Benefits of Smart Growth Strategies?*, EPA: ABOUT SMART GROWTH, <https://www.epa.gov/smartgrowth/about-smart-growth#environmental> (last updated Aug. 15, 2017) [hereinafter SMART GROWTH].

¹⁸⁰ See, e.g., *About Us*, PARTNERSHIP FOR SUSTAINABLY COMMUNITY (last updated Mar. 2, 2015), <https://www.sustainablecommunities.gov/mission/about-us>; Memorandum of Agreement Between the Dep’t of Homeland Security/Fed. Emergency Mgmt. Agency (DHS/FEMA) & the U.S. Envil. Protection Agency (Aug. 2016), <https://www.epa.gov/sites/production/files/2016-08/documents/moa-between-fema-and-epa-signed-8-9-16.pdf> [hereinafter EPA-FEMA MOU].

¹⁸¹ SMART GROWTH, *supra* note 179.

contention that a comprehensive Government Accountability Office study on the topic has contested).¹⁸²

Meanwhile, federal policy has been clearer and more consistent in mitigating the financial risks of those who choose to reside in environmental hot spots. Damages homeowners in these places incur due to severe weather events become negative housing externalities because of the federal government's long standing policy of providing taxpayer-funded disaster relief. For example, Congress and the executive branch have typically rushed to the aid of coastal areas hit hardest by hurricanes and super storms. This assistance has gone well beyond emergency assistance and included helping these higher risk communities rebuild homes and homeowners recover financial losses due to home damage.¹⁸³ The federal price tag for storm recovery packages since Hurricane Katrina in 2004 was \$200 billion prior to Hurricane Harvey.¹⁸⁴ Estimates of projected damage from Hurricane Harvey alone are in the range of \$180 billion, much of which the federal government will cover.¹⁸⁵

Part of these federal aid packages cover deficits in the National Flood Insurance Program (NFIP), which insures homeowners in high flood risk areas due to the shortage of private insurance options. NFIP homeowner insurance premiums historically run far short of homeowner flood claims, resulting in a deficit of between \$16 billion and \$25 billion for years 2002 through 2013, which taxpayers ultimately have had to pay.¹⁸⁶ More recently, Congress has simply started buying out homeowners in high-risk coastal communities (termed "climate change refugees"), recognizing that it may be cheaper in the long-run to demolish the homes rather than having to continually bail them out. Congress has already allocated \$1 billion in dollars to HUD for home purchase and resettlement programs, and Houston is expected to add to the demand.¹⁸⁷

¹⁸² U.S. GOV'T ACCOUNTABILITY OFF., GOA/RCED-99-87, COMMUNITY DEVELOPMENT: EXTENT OF FEDERAL INFLUENCE ON "URBAN SPRAWL" IS UNCLEAR 2 (1999).

¹⁸³ FRANCIS X. MCCARTHY, CONG. RESEARCH SERV., RL33053, FEDERAL STAFFORD ACT DISASTER ASSISTANCE: PRESIDENTIAL DECLARATIONS, ELIGIBLE ACTIVITIES, AND FUNDING 1 (2011).

¹⁸⁴ Umair Ifran, *The Stunning Price Tags for Hurricanes Harvey and Irma, Explained*, VOX: EXPLAINERS (Sept. 18, 2017), <https://www.vox.com/explainers/2017/9/18/16314440/disasters-are-getting-more-expensive-harvey-irma-insurance-climate>.

¹⁸⁵ *Id.*

¹⁸⁶ FREDDIE MAC, *supra* note 166.

¹⁸⁷ See, e.g., Coral Davenport & Campbell Robertson, *Resettling the First American 'Climate Refugees'*, N.Y. TIMES (May 6, 2016), <https://www.nytimes.com/2016/05/03/us/resettling-the-first-american-climate-refugees.html>; see also ROBERT FREUDENBERG ET AL., BUY-IN FOR BUYOUTS: THREE FLOOD PRONE

2. Relationship to Homeowner Subsidies

As just discussed, certain homeowner choices do greater harm to the environment than others, although a significant portion of these negative housing externalities will be borne by future generations. Also, certain choices place homeowners in more environmentally vulnerable locations, and a portion of these costs are incurred more immediately by all taxpayers as a result of federal disaster relief policies. The homeowner subsidies could serve as one way to discourage those decisions that impose more of these negative housing externalities and encourage those that impose less.

Yet, once again, the homeowner subsidies provide virtually no help. Neutral as they are to location and form, they neither encourage nor discourage a prospective homeowner's decisions to, for example, live in a community that is near or far from an urban center, public transportation, or an environmentally sensitive or vulnerable area, even though these decisions vary significantly in the price tag they impose on others. Federal policy focuses much more on responding to severe damage that follows from environmental and natural catastrophes, than on proactively influencing housing decisions that reduce environmental harm or susceptibility in the first place.

Some would go a step further and argue that the subsidies have encouraged certain negative externality producing choices like suburban sprawl.¹⁸⁸ Across almost all metropolitan areas, the benefits of tax subsidies are claimed with greater frequency by those living in suburban and exurban areas, where lot sizes and home are bigger.¹⁸⁹ Homeowners in these areas utilize the subsidies not as an incentive to purchase a home, but rather as an incentive to purchase a bigger home on a larger lot.¹⁹⁰ Accordingly, these studies contend that a primary effect of the subsidies has been the construction of larger, "McMansion" style homes that are an average of 250 to 1000 square feet larger than necessary.¹⁹¹

At the same time, it should be noted that federal tax policy has recently made some inroads in encouraging greater energy efficiency in homes, although they are often marketed primarily as ways to cut consumer energy

COMMUNITIES OPT FOR MANAGED RETREAT 26 (Lincoln Inst., 2016).

¹⁸⁸ See, e.g., Andrew Hanson, Ike Brannon & Zackary Hawley, *Rethinking Tax Benefits for Home Owners*, 19 NAT'L AFF. 40 (2014).

¹⁸⁹ *Id.* at 45. Interestingly, this outcome conflicts with one of the objectives of the 1997 tax code amendments in the treatment of the home sale capital gain exclusion, which was to eliminate the incentive the previous rules provided to "buy up" to avoid the capital gain tax. See, e.g., Biehl & Hoyt, *supra* note 122.

¹⁹⁰ *Id.* at 47-48.

¹⁹¹ *Id.* at 48-49.

bills rather than as reducing negative housing externalities. Congress has passed an array of tax incentives for home-builders, home appliance makers, and consumers aimed at spurring the supply of and demand for energy efficient homes and home products.¹⁹² For homeowners, these have taken the form of federal income tax credits for the purchase of energy efficient appliances, certain home improvements that increase energy efficiency, and the installation of renewable energy systems.¹⁹³ Sustained commitment to the homeowner subsidies has been relatively weak, however. The homeowner energy tax credits have been small and subject to low overall caps, raising concerns that they did not act as much of an incentive.¹⁹⁴ Most of the credits recently expired, and there appears to be little political will in Congress to renew them.

V. UNDERSTANDING THE DISCONNECT (HOW AND WHY CURRENT HOMEOWNER SUBSIDIES ARE NOT SMART)

As Part IV demonstrated, a striking disconnect exists between the homeowner subsidies and other key federal housing-related policies as well as the negative housing externalities they seek to contain. Why? The current subsidies are not smart. This Part explains what “smart” means for purposes of this analysis, as well as how and why the subsidies fail to meet the mark.

A. *What are “Smart” Subsidies?*

When it comes to evaluating policies, rather than people, “smart” has a variety of possible meanings, several of which are relevant here. One use of the word is in connection with a system change that deploys resources more strategically to improve performance and reduce inefficiencies associated with its use. For example, “smart” energy grids deploy energy based on two-way communications with consumers in order to reduce waste, lower costs, and make power outages less likely.¹⁹⁵

The current homeowner subsidies are inefficient in that they reward homeowner decisions at large, and without regard to the negative

¹⁹² See Steven Nadel, Energy Efficiency Tax Incentives in the Context of Tax Reform (July 2012) (unnumbered working paper) (on file with the Am. Council for an Energy-Efficient Econ.).

¹⁹³ 26 U.S.C. §§ 25C-25D (2017).

¹⁹⁴ MARGOT L. CRANDALL-HOLLIK & MOLLY F. SHERLOCK, CONG. RESEARCH SERV., R42089, RESIDENTIAL ENERGY TAX CREDITS: OVERVIEW AND ANALYSIS 4-7 (2016), <https://fas.org/sgp/crs/misc/R42089.pdf>.

¹⁹⁵ See, e.g., *What is the Smart Grid?*, SMARTGRID.GOV, https://www.smartgrid.gov/the_smart_grid/smart_home.html (last visited Nov. 12, 2017).

externalities homeowner decisions impose. As a result, at best, the federal government gets very little bang in containing these externalities for the very significant buck it spends promoting homeownership.¹⁹⁶ At worst, it must pay to clean up damage resulting from homeowner choices it subsidizes.¹⁹⁷

“Smart” subsidies would reduce these inefficiencies by targeting financial incentives at homeowner decisions that also offset or reduce negative housing externalities. For example, as explained in Part IV.C, homeowner decisions to build new homes in higher risk coastal and floodplain areas can increase federal taxpayer burdens due to the government’s policy of providing disaster relief and increase flooding risk for those who already live in the area. A smarter homeowner subsidy in these areas might be limited to those who purchase homes that are built to maximize storm water absorption and/or minimize the likelihood of flooding damage.¹⁹⁸

A separate, though not unrelated, use of “smart” is in connection with policies that advance “sustainable development.” Development decisions that are sustainable take into account their impact on others, including future generations.¹⁹⁹ The replacement of combined sewer and storm water systems that discharge into fresh water sources during large rainfalls with those that can instead temporarily store this water underground is an example of sustainable development. “Smart” is frequently used synonymously with “sustainable” when referring to places that implement sustainability practices (e.g. “Smart Cities”), especially when those places use advances in information and communication technology to do so.²⁰⁰

When used in this way, “smart” has a normative component. Sustainable development has specific environmental, economic, and social goals. These include protecting the planet from environmental degradation, conserving natural resources, striving for economic growth that does not heighten socioeconomic segmentation, and creating places to live that are inclusive, safe, and resilient.²⁰¹ The federal housing policies that are the subject of

¹⁹⁶ See *supra* Part IV.

¹⁹⁷ *Id.*

¹⁹⁸ An example is elevating a home above street level using a foundation or posts. FED. EMERGENCY MGMT. AGENCY, HOMEOWNER’S GUIDE TO RETROFITTING 5-1 (3rd ed. 2014), <https://www.fema.gov/pdf/rebuild/mat/sec5.pdf>.

¹⁹⁹ The most cited to definition of sustainable development is in the 1987 World Commission on Environment and Development (“Brundtland Report”). Gro Harlem Brundtland, Rep. of the World Comm’n on Env’t & Dev.: Our Common Future, U.N. Doc. A/42/427, annex (1987).

²⁰⁰ See, e.g., Vito Albino et al., *Smart Cities: Definitions, Dimensions, Performance, and Initiatives*, 22 J. URB. TECH. 3 (2015).

²⁰¹ *Sustainable Development Goals*, UNITED NATIONS,

Part IV fit comfortably within these goals. So, as with the first meaning of the word discussed above, “smart” in this instance means policies that minimize the negative externalities associated with development. The current homeowner subsidies are not smart because they are completely insensitive to them.

Another definition of “smart” has emerged in the technology field. Smart devices are those that are capable of sensing a particular user’s needs or a change in environment and modifying their performance accordingly.²⁰² Smart data refers to data that can be analyzed and converted to actionable insights to address a particular problem.²⁰³ The key concepts are individualized, adaptable, and actionable.

These concepts are meaningful to crafting effective housing strategies. This is because housing markets are highly localized. The United States consists not of one nor even of fifty housing markets, but rather thousands of highly localized markets that vary significantly in strengths and challenges. For example, high density cities with robust economies have thriving real estate markets by most measures, but grapple with inadequate supply and affordability issues, particularly for low and middle income homeowners.²⁰⁴ Post-industrial Rust Belt cities have more anemic housing markets with vast inventories of antiquated or deteriorating vacant homes that deplete surrounding home values and pose public health issues.²⁰⁵ Certain coastal areas face rising tides, and need to re-think how, where, and whether housing exists.²⁰⁶ New growth Southwestern cities face high demand, but limited natural resources to support this demand.²⁰⁷ Within each of these local housing markets exist even smaller submarkets that reflect different amenities, job access, and housing stock, among other factors. Smart homeowner subsidies would be perceptive and adaptable

<http://www.un.org/sustainabledevelopment/sustainable-development-goals/> (last visited Nov. 12, 2017).

²⁰² See, e.g., *What is Smart Technology*, IGI GLOBAL, <https://www.igi-global.com/dictionary/smart-technology/38186> (last visited Nov. 12, 2017).

²⁰³ Alissa Lorentz, *Big Data, Fast Data, Smart Data*, WIRED, <https://www.wired.com/insights/2013/04/big-data-fast-data-smart-data/> (last visited Nov. 15, 2017).

²⁰⁴ See EDWARD L. GLAESER & JOSEPH GYOURKO, *RETHINKING FEDERAL HOUSING POLICY*, 142-68 (2008).

²⁰⁵ See, e.g., Frank Ford, *Is the Cuyahoga County Foreclosure Crisis Over?*, W. RESERVE LAND CONSERVANCY (Mar. 18, 2016), <https://www.wrlandconservancy.org/articles/2016/03/18/is-the-cuyahoga-county-foreclosure-crisis-over>.

²⁰⁶ See generally *supra* Part IV.C.1.

²⁰⁷ N. Light Prods. & Lincoln Inst. of Land Policy, *Making Sense of Place—Phoenix, The Urban Desert*, YOUTUBE (Mar. 15, 2013), <https://www.youtube.com/watch?v=y0qOD019dbQ>.

enough to address different problems in different places. By this standard too, the current homeowner subsidies are clearly not smart. They are simplistic and monolithic with no intended sensitivity to the challenges faced by different housing markets and submarkets.

So a definition of smarter homeowner subsidies is emerging. They would be more carefully targeted, aiming to increase the social benefits (or reduce the social costs) that follow from homeowner decisions and capable of adaptation among and within different housing markets.

B. Why the Current Homeowner Subsidies Are Not Smart

Before considering whether and how smarter federal homeowner subsidies are feasible, it is helpful to understand why the current subsidies are designed as they are. This article offers three explanations.

1. Idealization of Homeownership

One explanation is a historic cultural attitude in which the homeowner subsidies are rooted that views all homeownership as “good” (in economist-speak, resulting only in positive internalities and externalities). The federal government has long idealized homeownership as possessing multiple virtues that have since gained popular acceptance. Perhaps foremost is the view first popularized in the 1920s and 1930s that homeownership promotes good citizenship and stable communities, appealing qualities during the social unrest and political radicalism that followed from mass urbanization in the early 20th century.²⁰⁸ In the ensuing decades, the government saw the expansion of homeownership as the means to address a host of social, economic, and political problems, including post-World War II population expansion, slum removal, and racial unrest.²⁰⁹ Towards the end of the century, in the context of rising home prices and a shift away from New Deal and welfare state policies, politicians cast homeownership as an ideal vehicle for household savings and the accumulation of wealth.²¹⁰

From the perspective of the federal government, then, homeownership has typically been something to promote rather than regulate. This approach finds support in the U.S. Constitution’s deference to state and local governments on matters of land use and sacrosanct view of private property rights.²¹¹ Congress has occasionally intervened to legislate on certain land

²⁰⁸ See BRIAN MCCABE, NO PLACE LIKE HOME: WEALTH, COMMUNITY, AND THE POLITICS OF HOMEOWNERSHIP 21-44 (2016).

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ See, e.g., John R. Nolon, *Historical Overview of the American Land Use System: A*

use matters, like environmental protection and housing discrimination, when it has determined that relying on more localized levels of governmental to independently regulate will fail to consistently or adequately address significant harm to others.²¹² It has also used its tax and spend authority to offer financial incentives to prompt state and local governments to take action that reflects federal concerns.²¹³ But as it relates to individual homeowners, federal policy has focused more on creating opportunities to own homes than on trying to meaningfully influence where or in what types of homes homeowners live. The design of the homeowner subsidies reflects this mindset.

2. *Administrative Simplicity*

Like many federal tax code adjustments to taxable income, the homeowner subsidies are tax incentives trapped in the bodies of exclusions and deductions from taxable income. Exclusions and deductions are different devices for accomplishing the same task—i.e. removing otherwise taxable dollars from tax.²¹⁴ The difference between them is primarily a matter of timing. An exclusion keeps otherwise taxable dollars from entering a taxpayer's pool of gross income in the first place, while a deduction subtracts them from a taxpayer's gross income in the process of tabulating her taxable income.

Exclusions and deductions are straightforward, effective, and easy to justify mechanisms for removing dollars from a household's tax base that Congress believes do not really constitute income (a "normative" adjustment).²¹⁵ They are also easy to administer as the taxpayer simply claims them on her return. The tax savings on exclusions and deductions

Diagnostic Approach to Evaluating Governmental Land Use Control, 23 PACE ENVTL. L. REV. 821 (2006).

²¹² *Id.*

²¹³ *Id.*

²¹⁴ GRAETZ & SCHENK, *supra* note 55, at 211.

²¹⁵ The most widely acknowledged definition of income, often considered "normative" in the sense of establishing the conceptual understanding of what ought to be taxable, is the Haig-Simons definition. GRAETZ & SCHENK, *supra* note 55, at 84. This definition is paraphrased as a person's change in wealth plus her consumption during a particular tax period. ROBERT M. HAIG, *The Concept of Income—Economic and Legal Aspects*, in THE FEDERAL INCOME TAX 1, 7 (Robert M. Haig ed., 1921); HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1st ed. 1938). Increases or reductions in a taxpayer's tax base in order to get closer to this definition of income are considered normative adjustments. As an example, the Code allows households to deduct certain unreimbursed job expenses on the belief that dollars a taxpayer must spend in order to make taxable income are not really income. 26 C.F.R. § 1.67-1T(a)(1)(i) (2010).

are greater for higher income taxpayers because, as explained earlier, the amount excluded or deducted would be taxed at a higher marginal rate.²¹⁶ But this should not be a concern from a policy perspective, because the amounts removed do not fall within a normative definition of income and so are not properly taxable in the first place.

More controversially, Congress has also employed exclusions and deductions to accomplish social policy. For example, the tax code provides a deduction for college tuition and fees up to \$4,000 per year to encourage taxpayers (and their dependents) to go to college.²¹⁷ It is when influencing social policy that exclusions and deductions are susceptible to becoming upside down subsidies because they are more valuable to high income taxpayers than low income ones.²¹⁸ In fact, many have questioned why Congress, when its intent is to encourage certain social behavior, does not use a more flexible, less regressive mechanism like grants.²¹⁹ To address this problem, many exclusions and deductions come packaged with income caps, and other income-sensitive limitations.²²⁰ If not carefully crafted, exclusions and deductions meant to encourage social behavior can be regressive, overbroad, and blunt instruments.

This is the case with the homeowner subsidies. The income and benefit limitations on homeowner subsidies do not meaningfully alter their regressive qualities.²²¹ It is the reason that the subsidies don't even do a good job of accomplishing their ostensible purpose of making homeownership more accessible. Some commentators have identified normative reasons or other justifications for each of the homeowner subsidies that could account for their packaging as deductions and exclusions.²²² The more plausible read is that they took the form of what

²¹⁶ See *supra* notes 68-71 and accompanying text.

²¹⁷ 26 U.S.C. § 222 (2015).

²¹⁸ Stanley Surrey, former secretary of the Department of Treasury, is viewed as the principal architect of the "tax expenditure budget" and often credited with calling attention to "upside down subsidies" contained in the tax code. See, e.g., Stanley S. Surrey, *The Tax Expenditure Concept and the Budget Reform Act of 1974*, 17 B.C.L. REV. 679 (1976).

²¹⁹ *Id.*

²²⁰ For example, among other limitations, the tuition and fees deduction cannot be claimed by a household whose adjusted gross income is greater than \$160,000 (if married, filing a joint return) or \$80,000 (if single, head of household or qualifying widow), and more than \$2,000 or \$4,000 (depending on a household's income) in total per year cannot be deducted. 26 U.S.C. § 222 (2015).

²²¹ See generally *supra* Parts II and III.

²²² See Boris Bittker, *Income Tax Deductions, Credits and Subsidies for Personal Expenditures*, 16 J.L. & ECON. 193, 200-01 (1973) (providing a non-normative defense of SALT). See MARVIN A. CHIRELSTEIN & LAWRENCE ZELENAK, *FEDERAL INCOME TAXATION*, 218-23 (13th ed. 2015) (showing how a normative argument might be made on behalf of the MID).

were, at the times they originated, the simplest and most conventional mechanisms for creating tax preferences, without much regard for their regressivity or effectiveness in actually promoting homeownership.²²³

3. *Political Entrenchment*

The final explanation is political. Once entrenched, tax expenditures are very difficult to modify, even in the face of substantial criticism. Taxpayers and industry groups come to expect the financial benefits associated with a particular tax break and, if those impacted are broad and powerful enough, any proposed significant cutback invites peril for those political actors who support it.

This has certainly been the case for the homeowner subsidies, often described as one of the “third rails” of American politics.²²⁴ The subsidies benefit a powerful coalition of political interests. Those who receive the lion’s share of the benefits are upper middle income households, who vote in high proportions and, even more significantly, make up the donor base of both major political parties.²²⁵ Because housing prices are significantly higher in large coastal cities, homeowners in these areas also benefit disproportionately from the homeowner subsidies.²²⁶ Interestingly, many of the more liberal politicians, who would otherwise push hardest against subsidies distributed so heavily in favor of the wealthy, represent these coastal cities and, in pursuit of their constituents’ interests, defend the subsidies.²²⁷ And then there is the highly vested and vociferous participation of two of the nation’s largest and most broadly influential special interest groups—the National Association of Realtors and the National Association of Homebuilders.²²⁸ At the first sign of any potential

²²³ See John R. Brooks, *Doing Too Much: The Standard Deduction and the Conflict Between Progressivity and Simplification*, 2 COLUM. J. TAX. L. 203, 214 (2011) (observing that the form some income tax deductions have taken reflect the era in which Congress adopted them more so than normative or other rationales). See Ventry, Jr., *supra* note 54 (tracing the history of the mortgage interest deduction and ascribing its survival to political forces and vested interests rather than to its effectiveness in promoting homeownership).

²²⁴ See, e.g., BRUCE KATZ, CUT TO INVEST: REFORM THE MORTGAGE INTEREST DEDUCTION TO INVEST IN INNOVATION AND ADVANCED INDUSTRIES 5 (2012), <https://www.brookings.edu/research/cut-to-invest-reform-the-mortgage-interest-deduction-to-invest-in-innovation-and-advanced-industries/>.

²²⁵ See, e.g., Matthew Desmond, *How Homeownership Became the Engine of American Inequality*, N.Y. TIMES MAG. (May 9, 2017), <https://www.nytimes.com/2017/05/09/magazine/how-homeownership-became-the-engine-of-american-inequality.html>.

²²⁶ See generally Part IV.A.2.

²²⁷ Desmond, *supra* note 225.

²²⁸ *Id.*

roll back of the homeowner subsidies, these groups spring to action and let their dissatisfaction be known in ways that have caused even the staunchest of tax loophole closers to tread carefully.²²⁹

At first glance, political theorists would refer to the challenge of rolling back the homeowner subsidies as a case of reform that has concentrated costs and highly diffuse benefits, which is among the most difficult to enact.²³⁰ That is to say that, in this instance, the losses resulting from eliminating all or part of the subsidies are concentrated among a distinct group who are highly motivated to vocalize opposition (and politically powerful).²³¹ Meanwhile, the resulting benefits would be spread out among the population at large, potentially simply through increasing the government's tax revenue. This means the potential beneficiaries have had little motivation to support reform.²³²

Some additional factors have added to the intractability of the status quo. The first is that even though the lion's share of the benefits go to upper middle and high income taxpayers, many households receive at least a small bump from the homeowner subsidies and, thus, see themselves as vested in their survival. For example, most homeowners can claim the capital gains exclusion on home sales, even if lower-income households see a much smaller benefit.²³³ The second is that some economists and virtually all industry group experts have predicted a housing market Armageddon if the homeowner subsidies are removed.²³⁴ This is predicated on the assumption that the subsidies have been capitalized into higher home prices, which will fall if the subsidies disappear, decreasing the value of the principal asset of many homeowners.²³⁵ Although the extent to which home prices would fall (and exactly for whom they would fall) is unclear, the mere notion that it could happen has had a stifling effect on reform.²³⁶

²²⁹ *Id.*; Ventry, Jr., *supra* note 54.

²³⁰ Susannah C. Tahk, *Making Impossible Tax Reform Possible*, 81 *FORDHAM L. REV.* 2683, 2686 (2013).

²³¹ *Id.*

²³² *Id.*

²³³ *Supra* notes 74-78 and accompanying text.

²³⁴ *See, e.g.*, Dennis R. Capozza et al., *Taxes, Mortgage Borrowing and Residential Land Prices*, in *ECONOMIC EFFECTS OF FUNDAMENTAL TAX REFORM 171-98* (Henry J. Aaron & William G. Gale eds., 1996).

²³⁵ MARGERY AUSTIN TURNER, URBAN INST., ERIC TODER, ROLF PENDALL, & CLAUDIA SHARYGIN, *HOW WOULD REFORMING THE MORTGAGE INTEREST DEDUCTION AFFECT THE HOUSING MARKET?* (2013), <http://www.urban.org/sites/default/files/publication/23431/412776-How-Would-Reforming-the-Mortgage-Interest-Deduction-Affect-the-Housing-Market-.PDF>.

²³⁶ *Id.*

The result is that the homeowner subsidies have come to function like entitlements, reserved primarily for upper two income quintiles of American households, rather than strategic investments, adaptable to different housing markets and capable of containing negative housing externalities. This is not to say that there is no hope for smarter homeowner subsidies. But the tasks of designing and implementing them are challenging ones.

VI. IN SEARCH OF SMARTER HOMEOWNER SUBSIDIES

While they have proven very difficult to roll back, calls for reform of one or more of the homeowner subsidies are virtually unceasing. A long line of policy analysts, economists, tax experts, and legislators from places that experience less benefit from the subsidies have turned the mortgage interest deduction, in particular, into a popular punching bag.²³⁷ Three consecutive Presidential administrations have started down the path towards reform, although none to date have succeeded.²³⁸

A. *An Assessment of Current Proposals*

Variations abound, but the proposals for reform by and large fall into two principal camps. The first camp seeks to eliminate or reduce the homeowner subsidies without replacing them.²³⁹ At the root of this approach are contentions that the subsidies either do not work or are not defensible, and should not be used.²⁴⁰ Common to this line of criticism are claims that homeowner subsidies unfairly preference homeowners over renters, inflate home prices, and require all taxpayers to foot the bill for the housing preference of one segment of the population.²⁴¹ A more equitable approach would be to use the money spent on the subsidies to lower

²³⁷ See *supra* Parts III; *infra* Part VI.A.

²³⁸ See, e.g., CONNIE MACK III ET AL., THE PRESIDENT'S ADVISORY PANEL ON FED. TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM (2005), <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Fix-Tax-System-2005.pdf>; U.S. DEP'T OF THE TREAS., GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2013 REVENUE PROPOSALS (2012), <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf>; *Tax Reform That Will Make America Great Again*, TRUMP, <https://assets.donaldjtrump.com/trump-tax-reform.pdf> (last visited Aug. 7, 2017) [hereinafter Trump Tax Plan].

²³⁹ See, e.g., Horpedahl & Searles, *supra* note 62, Stansel & Randazzo, *supra* note 62.

²⁴⁰ *Id.*

²⁴¹ *Id.*

everyone's taxes and let them make up their own mind as to whether to rent or own.²⁴²

Recent Republican tax reform proposals emanate from this camp, although they are mindful of the political risks of proposing a complete elimination of long-standing tax breaks.²⁴³ They propose significantly increasing the standard deduction, which would reduce the number of taxpayers who would find the MID and SALT valuable (without making them worse off financially) while lowering marginal tax rates, which would reduce the value of these deductions to those who would still claim them.²⁴⁴ Some proposals also call for imposing or lowering caps on one or more of the subsidies to limit to what extent homeowners, especially higher income ones, can claim them.²⁴⁵ The tax revenue gained from these caps would be used to pay for lower overall tax rates.

The second camp wants to improve the performance of the homeowner subsidies and in particular the MID, in making homeownership more affordable for those who are financially constrained. The central contention in this camp is that the subsidies would work better if they were built better. Most of these proposals call for converting the mortgage interest deduction to a tax credit designed to ensure low and middle income homebuyers can take advantage of it.²⁴⁶

A tax credit is a dollar for dollar reduction in how much a taxpayer owes, as opposed to an exclusion or deduction, which reduces the amount of income on which the taxpayer must pay tax.²⁴⁷ So a tax credit is potentially of equal value to all taxpayers, no matter their tax bracket, if they have tax liability to offset. Some tax credits go further and are "refundable," which means the IRS will pay the full amount of the credit to the person claiming it even if the credit exceeds the claimant's tax liability (or the claimant has

²⁴² *Id.*

²⁴³ TAX REFORM TASK FORCE, A BETTER WAY: OUR VISION FOR A CONFIDENT AMERICA (2016), https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf; Trump Tax Plan, *supra* note 238; TAX CUTS AND JOBS ACT (draft) (2017), https://waysandmeansforms.house.gov/uploadedfiles/bill_text.pdf.

²⁴⁴ TAX REFORM TASK FORCE, *supra* note 243; Trump Tax Plan, *supra* note 238.

²⁴⁵ *Id.*

²⁴⁶ *See, e.g.*, WILL FISCHER & CHYE-CHING HUANG, CTR. ON BUDGET & POLICY PRIORITIES, MORTGAGE INTEREST DEDUCTION IS RIPE FOR REFORM: CONVERSION TO TAX CREDIT COULD RAISE REVENUE AND MAKE SUBSIDY MORE EFFECTIVE AND FAIRER 3 fig. 1 (2013), <https://www.cbpp.org/sites/default/files/atoms/files/4-4-13hous.pdf> (comparing five such proposals); ALAN D. VIARD, PROPOSAL 8: REPLACING THE HOME MORTGAGE INTEREST DEDUCTION (2013), https://www.brookings.edu/wp-content/uploads/2016/06/THP_15WaysFedBudget_Prop8.pdf.

²⁴⁷ *See, e.g.*, GRAETZ & SCHENK, *supra* note 55, at 234.

no tax liability at all).²⁴⁸ These features make the tax credit approach popular among reformers who seek to use the tax code to encourage homeownership without creating an upside-down subsidy. Capping the amount of a mortgage that qualifies for the credit goes even further in equalizing the benefit. For example, a 2005 tax reform panel established by President George W. Bush recommended converting the mortgage interest deduction to a flat tax credit equal to 15% of the mortgage interest a homeowner pays each year, but limiting the maximum amount of the mortgage eligible for the credit to 125% of a community's median local home price.²⁴⁹

This article agrees with both camps that the homeowner subsidies ought to be reformed. The evidence is overwhelming that the current subsidies primarily encourage those who are relatively affluent and would already buy homes to buy larger and more expensive ones. This is neither the purported objective of the subsidies nor responsive to a separate market failure.

This article agrees with the second camp but disagrees with the first camp as to the defensibility of the concept of homeowner subsidies. Ensuring that a sufficient supply of affordable housing exists to shelter citizens is a legitimate interest of government. Housing affordability is a persistent and growing challenge for low and middle income households throughout the country, especially in this era of growing income disparity. Moreover, although the subject of debate, many have cited to the positive internalities and externalities associated with homeownership.²⁵⁰ So if the government is to be in the field of subsidizing housing at all, then making homeownership more attainable and affordable, as an alternative to renting, is defensible. The proposals from the second camp are undeniably more efficient and equitable ways of accomplishing that objective than the current homeowner subsidies and very likely more so than proposals from the first camp.²⁵¹

However, the proposals from these two camps are not, on their face, smarter subsidies in the way Part V describes. One could speculate that either an elimination or roll back of the current homeowner subsidies or a conversion to an affordability oriented tax credit might incidentally reduce

²⁴⁸ See, e.g., 26 U.S.C. § 32 (2012) (Earned Income Tax Credit).

²⁴⁹ MACK III ET AL., *supra* note 238. See also, FISCHER & HUANG, *supra* note 246 (noting that other proposals for conversion to tax credit each include an upper limit on amount of mortgage eligible for credit).

²⁵⁰ See, e.g., Glaeser & Shapiro, *supra* note 6, at 3.

²⁵¹ One caveat, however, is that policymakers would need to consider whether broadly available tax credits would simply be capitalized into higher home prices in supply-constrained housing markets.

some of the negative housing externalities discussed in Part IV. For example, higher income households would either receive no or less mortgage based tax relief under any of those proposals and, thus, have less incentive to seek out larger and more expensive homes on low density lots or in exclusive neighborhoods. Also, lower and middle income and minority households might see lower housing prices (if one or more of the current homeowner subsidies are eliminated) or increased buying power (if affordability-oriented tax credits are adopted) and so presumably would have greater ability to move into and integrate neighborhoods of opportunity. On the other hand, one could also speculate as to how certain negative housing externalities might be exacerbated. The push of additional households into more affluent suburban and exurban areas could exacerbate sprawl and accelerate disinvestment and further isolation of marginalized communities. Furthermore, the proposals from the two main camps are not adaptable to address the varying range of strengths and challenges faced by different housing markets.

The bottom line is that none of the proposals from these two camps are specifically engineered to be “smarter” as this article envisions. In that sense, they represent missed opportunities to turn homeowner subsidies into tools for meaningfully reducing negative housing externalities. The aim of the rest of this article is to consider whether and how smarter homeowner subsidies might be engineered.

A critical starting point is to recognize that different homeowner choices as to home location and form result in different amounts and types of housing externalities. Accordingly, rather than rewarding homeowner decisions at large and in roughly equivalent ways, smarter homeowner subsidies should be equipped to reward certain decisions, but not others, or to do so in varying amounts according to the housing externalities they generate.

A smaller contingent of reformers has offered ideas on allocating homeowner subsidies more strategically and selectively. As part of a package of reforms aimed at improving affordability in inelastic, supply-constrained housing markets, Edward Glaeser and Joseph Gyourko have called for capping the mortgage interest deduction for homeowners in those markets and rebating the resulting tax revenue to local government in exchange for its efforts to increase housing supply.²⁵² The goal would be to reduce overall home prices and allow more households to access these opportunity-rich markets.²⁵³ In the midst of cleanup efforts from the foreclosure crisis, Alan Mallach called for eliminating or scaling back the

²⁵² GLAESER & GYOURKO, *supra* note 204, at 142-68.

²⁵³ *Id.*

MID and investing the tax revenue gained into a package of investor and homeowner tax credits to encourage private reinvestment in “tipping point” neighborhoods.²⁵⁴ Roberta Mann proposed replacing the MID with tax credits that incentivize the purchase of modest sized homes and those located near public transit as a strategy for reducing urban sprawl.²⁵⁵ Meanwhile, Dorothy Brown, among others, has suggested limiting mortgage interest and property tax subsidies to those living in racially diverse neighborhoods.²⁵⁶

Each of these proposals is thoughtfully formulated for the housing market problem it seeks to address. In that sense, each calls for a smarter form of homeowner subsidy. That said, each drills down on only one type of problem or negative housing externality and some focus on a challenge unique to certain types of housing submarkets. The purpose of this article is to think more systemically and with the aim of identifying a viable approach for designing homeowner subsidies capable of addressing a collection of different housing externalities across many different types of markets and submarkets.

B. *Examining Comparable Subsidies*

Fortunately, the slate is not completely blank. State and local governments are increasingly using demand-side tax subsidies to influence business and homeowner location and form decisions when they believe doing so will generate sufficient public benefit within their boundaries to outweigh the forgone taxes. In fact, the driving force for doing so has often been to combat negative externalities, like those following from chronic economic or housing disinvestment. The body of public finance research that has emerged on the efficacy of these subsidies is worth examining.

A good starting point is the track record on demand-side tax subsidies meant to attract and retain businesses and encourage job creation. Although aimed at businesses rather than homeowners, the record is deeper and more established as many states and localities have engaged in this practice for

²⁵⁴ These are neighborhoods, which HUD would select, that would have experienced a large number of foreclosures but still have significant assets and market building potential. ALAN MALLACH, CUT TO INVEST: CREATE NEW BOND AND TAX CREDIT PROGRAMS TO RESTORE MARKET VITALITY TO AMERICA'S DISTRESSED CITIES AND NEIGHBORHOODS (2012), <https://www.brookings.edu/wp-content/uploads/2016/06/06-land-use-bonds-taxes.pdf>.

²⁵⁵ Roberta F. Mann, *The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deduction*, 32 ARIZ. ST. L.J. 1347 (2000).

²⁵⁶ Dorothy A. Brown, *Shades of the American Dream*, 87 WASH. U. L. REV. 329, 371-74 (2009). See also, Rothstein, *supra* note 130 (proposing the withholding of the mortgage interest deduction from racially homogenous communities with exclusionary zoning laws).

several decades.²⁵⁷ In fact, the practice has become so pervasive that most businesses seeking to relocate (or simply considering whether to stay put) have come to expect generous state and local tax abatement to be a part of the package and often insinuate that they are prepared to go to the highest bidder. This has led to an unhealthy level of competition and a race to the bottom among states and cities, in which subsidies are so broadly available, overly generous and free of conditions that they become unhinged from accomplishing discernible, and justifiable public benefits.²⁵⁸

In this failure lies an important lesson about the value of carefully limiting and targeting demand-side tax subsidies. Among those economists and policy analysts who support business attraction and retention subsidies, the prevailing opinion is that subsidies for which the resulting benefits justify the costs are those that are carefully targeted and monitored.²⁵⁹ This includes being: geographically limited (to those places under great fiscal stress or where a market failure truly acts as a barrier to entry); right-sized in terms of amount, scope, and class of eligible recipients to tie closely to the problem the subsidy seeks to overcome; periodically evaluated to make sure the subsidy works; and retractable if the business isn't holding up its end of the bargain.²⁶⁰ Even many of those skeptical about such subsidies acknowledge that carefully constructed subsidies approved after a thorough and open cost-benefit discussion may sometimes be justified.²⁶¹

Although the subject of less study, even more substantively relevant is the experience of local governments that have used property tax abatement to induce prospective homebuyers to buy new homes or substantially rehabilitate existing homes within their boundaries. Numerous cities have adopted policies like this in response to steep population declines.²⁶² Their stated objective is typically to combat the negative externalities that result from chronic disinvestment in their communities, like the decimation of the local tax base and the human, social, and economic costs associated with deteriorating neighborhoods.²⁶³

²⁵⁷ Esteban G. Dalehite, John L. Mikesell & C. Kurt Zorn, *Variation in Property Tax Abatement Programs Among States*, 19 *ECON. DEV. Q.* 157 (2005).

²⁵⁸ *Id.*

²⁵⁹ *Id.* See also, Gary Sand, Laura A. Resse & Heather L. Khan, *Implementing Tax Abatements in Michigan: A Study of Best Practices*, 20 *ECON. DEV. Q.* 44 (2006).

²⁶⁰ Dalehite, Mikesell & Zorn, *supra* note 257; Sand, Resse & Khan, *supra* note 259.

²⁶¹ See, e.g., William H. Bowen & Chang-Shik Song, *Reasons for Misgivings About Local Economic Development Initiatives*, in *THE ROAD THROUGH THE RUST BELT: FROM PREEMINENCE TO DECLINE IN PROSPERITY* 245 (William H. Bowen ed., 2014).

²⁶² Mark S. Rosentraub, Brian Mikelbank & Charlie Post, *Residential Property Tax Abatements and Rebuilding in Cleveland, Ohio*, 42 *ST. & LOC. GOV'T REV.* 104 (2010).

²⁶³ *Id.*

Here are some of the lessons learned concerning taxes, subsidies and homeowner decisions. First, tax rates and overall tax burdens associated with purchasing in different jurisdictions within a region are influential in homebuyer decisions as to where to locate, especially where supply is elastic (i.e. comparable alternatives exist in nearby communities).²⁶⁴ Likewise, subsidies in the form of tax breaks are capable of influencing prospective homebuyer decisions.²⁶⁵ However, they are not the exclusive, nor even necessarily the driving factor, as to where a homebuyer chooses to purchase.²⁶⁶ Furthermore, although subsidies can influence behavior, the challenge is in achieving the desired results.²⁶⁷ For example, residential property tax abatement in Cleveland, Ohio has been successful in attracting new high income residents to the city, improving neighboring property values and even in creating net fiscal gain for the city's tax base.²⁶⁸ It has not, however, reversed overall population decline nor improved certain important neighborhood outcome measurements.²⁶⁹

Success appears to be a result of several factors. These include carefully tailoring the subsidies to attract the types of development and homeowners that the locality has determined are important to meet its objectives.²⁷⁰ They also include vigilance in monitoring the impact of the subsidy to ensure it is at the correct price point and has the right other features to actually influence consumer decisions, and the adaptability to adjust the policy as needed based on this data.²⁷¹ Subsidies seem to be most viable when they are not designed in isolation but, rather, cognizant of other factors that affect homebuyer decision-making in that particular community (e.g., public school quality, proximity to metropolitan area, demographic trends) and ideally as part of a more comprehensive, community strategic

²⁶⁴ Erik B. Johnson & Randall Walsh, *The Effect of Property Taxes on Location Decisions: Evidence from the Market for Second Homes*, (Nat'l Bureau of Econ. Research, Working Paper No. 14793, 2009).

²⁶⁵ Rosentraub, Mikelbank & Post, *supra* note 262.

²⁶⁶ CENT. COLL. & PELLA AREA CMTY. & ECON. ALLIANCE, EXAMINING FACTORS THAT SHAPE THE RATE OF HOMEOWNERSHIP OF PELLA AND SIMILARLY SIZED MUNICIPALITIES (2017), <http://kniakrls.com/wp-content/uploads/2017/05/Phase-3-Final-Report.pdf>.

²⁶⁷ Rosentraub, Mikelbank & Post, *supra* note 262; Doreen Swetkis, Residential Property Tax Abatement: Testing a Model of Neighborhood Impact (Dec. 2009) (unpublished Ph.D. dissertation, Cleveland State University), <http://engagedscholarship.csuohio.edu/cgi/viewcontent.cgi?article=1285&context=etdarchive>.

²⁶⁸ *Id.*

²⁶⁹ *Id.*

²⁷⁰ CENT. COLL. & PELLA AREA CMTY. & ECON. ALLIANCE, *supra* note 266.

²⁷¹ Rosentraub, Mikelbank & Post, *supra* note 262, at 106 (referencing to Portland, Des Moines and Tacoma as cities that altered their residential abatement policies to better match homebuyer behavior).

development plan.²⁷² Finally, policymakers should take the long view in expecting results, as it may take several years to see the type of improvement that justifies the short-term costs of the subsidies.²⁷³

Collectively, these studies suggest the mix of qualities smarter homeowner subsidies should possess. These types of subsidies work best when they are tailored, limited, variable, and complementary. **Tailored** means crafted to encourage behavior that squarely addresses the identified problem. If the problem is deteriorating or antiquated housing stock and a market for housing exists, then appropriately tailored subsidies should fund home rehabilitation or new construction. If the problem is residential segregation, then tailored subsidies could include incentivizes for excluded homeowners to purchase in exclusive communities or non-excluded homebuyers to purchase in excluded communities.

Limited means not too broadly available. Instead, a subsidy should be restricted to those individual homeowner decisions demonstrated to achieve the subsidy's objective. If the objective of a subsidy is to offset chronic community disinvestment, then it should not be available to a homebuyer seeking to purchase in a healthy housing market.

Subsidies should be **variable** in the sense that they allow for variations across housing markets and submarkets. As discussed earlier, different markets face different problems and possess different strengths, and often contain multiple submarkets. Furthermore, homeowners or prospective home buyers within one market or submarket may not respond in the same way as those within others.

In a similar vein, the subsidies should be **complementary**, in that they should support, not counteract, other federal, state, and local efforts to address negative housing externalities. Ideally, subsidies should be designed so that they coordinate with appropriate community planning and the investment of other private, public, and philanthropic resources.

As a final note, it bears mention that state and local government tax abatement, as a means to attract development, is frequently criticized for being inequitable. This is because relieving the tax burden of one party typically means that other taxpayers within the jurisdiction must make up for this forgone revenue or that the jurisdiction simply goes without the revenue, meaning schools and other local services suffer. Equity objections may be less intense with federal subsidies, because the tax burdens at issue

²⁷² CENT. COLL. & PELLA AREA CMTY. & ECON. ALLIANCE, *supra* note 270; *see also* CLAIRE DEWIND, JENNIFER DICKEY, ELLEN O'NEILL, & MOLLY W. METZGER, TAX ABATEMENT IN SAINT LOUIS: REFORMS COULD FOSTER EQUITABLE DEVELOPMENT (2016), <https://csd.wustl.edu/Publications/Documents/PB16-21.pdf> (Central for Social Development Policy Brief 16-21).

²⁷³ Rosentraub, Mikelbank & Post, *supra* note 262.

are spread out across the entire country rather than across a city. Furthermore, the current homeowner subsidies are, in fact, highly inequitable and regressive, and so smarter subsidies may very well serve as an improvement.²⁷⁴ Nonetheless, a desirable quality of virtually any subsidy is that it “pencil out”—i.e., demonstrate a net gain and return on investment for the community. A study of the previously mentioned Cleveland property tax abatement showed that over time it generated a dollar and a half of property tax for every dollar abated, and this finding aided significantly in its renewal.²⁷⁵

C. Conceptual Models for Smarter Subsidies

Part VI.B looked to state and local examples of smarter subsidies. This is because there are far fewer examples of federal-level, demand-side homeowner subsidies that aim to accomplish objectives other than rewarding homeownership at large or making it more affordable. Perhaps this is because it is challenging to conceive of a subsidy (or collection of subsidies) that works across thousands of different housing markets that experience and are responding to a range of different housing externalities in a variety of different ways. There is an inherent tension between the highly tailored qualities of the ideal subsidy and designing an approach that could work across the board. Nevertheless, three models present theoretically plausible approaches and are worth discussion here.

I. Subsidy Eligible/Ineligible Zones

The first model is to adopt a single homeowner subsidy aimed at reducing homeownership costs, but to make it only claimable by those whose homeownership decision also reduces other negative housing externalities. An example would be offering the subsidy to homeowners who live in communities that are disinvested or disinvesting. Or, to those who purchase median-sized homes in the built environment or within new development boundaries designed to reduce suburban sprawl. Or, to those who purchase homes in racially integrated neighborhoods. The latter two solutions are similar to those posed by Professors Mann and Brown, respectively.²⁷⁶ In any of these scenarios, the end result would probably be a complicated national map of subsidy-eligible and ineligible zones.

²⁷⁴ See *infra* Part III.

²⁷⁵ Thomas Bier et al., *Cleveland's Residential Tax Abatement Study: Its Impact, Effects and Value* (Feb. 2007); Swetkis, *supra* note 267, at 3.

²⁷⁶ See *supra* notes 255-256, and accompanying text.

A model like this would have the potential to reduce whatever negative housing externality or externalities at which the subsidy was aimed on a grand scale. Take the example of a subsidy aimed at encouraging homeownership in disinvested communities. Homeowners in these communities would receive a considerable discount on their housing costs, while homeowners in communities with normally functioning housing markets would not. Using a hypothetical \$4,000 annual subsidy,²⁷⁷ a homeowner in a qualifying community would receive a \$40,000 discount on housing costs over a ten-year period (the average homeowner tenure). This level of subsidy would presumably drive some segment of homeowners to purchase homes in disinvested communities and others to stay put. Demand for homes in qualifying communities would probably increase, as would private investment, home prices, and the tax base. Over time, increased tax revenue should help to improve public services while decreasing crime, public health risks, and infrastructure concerns.

There are, however, several challenges with a solution along these barriers. One challenge relates to the degree of tailoring that may be required to ensure that the subsidy accomplishes its objective. For example, what amount of subsidy would be necessary to impact homeowner decisions? Would that amount need to vary by community based on regional home prices? What constitutes a “disinvested community”? At what point is it no longer considered disinvested, such that subsidies can be eliminated? If a community reached that point, would a separate subsidy need to remain in place for lower income households to keep homes affordable as prices rise?

Moreover, how would policymakers account for other, more community-specific variations? For example, a disinvested community near a high growth area might turn around quickly, at which point gentrification becomes a concern. On the other hand, in a Rust Belt city with too much housing stock, the city might prefer to limit the subsidy to “tipping point” neighborhoods (those with greater turnaround potential) and redeploy

²⁷⁷ Merely for illustration’s sake, I arrived at a \$4,000 annual credit by dividing the amount of tax revenue currently forgone due to the mortgage interest deduction (\$63.6 billion) among the percentage (22.1%) of current U.S. homeowners (75 million) who would live in disinvested communities if current U.S. homeowners were distributed evenly across U.S. census tracts. The quotient equals \$3,837, which I rounded up to \$4,000. *See supra* notes 26 and 93 for the forgone tax revenue due to the MID and the percentage of census tracts that are within disinvested communities, respectively. The number of U.S. homeowners came from a 2016 Pew Research Center analysis of U.S. Census Bureau data. *See* Anthony Cilluffo et al., *More U.S. households are renting than at any point in 50 years*, FACT TANK (Jul. 19. 2017), <http://www.pewresearch.org/fact-tank/2017/07/19/more-u-s-households-are-renting-than-at-any-point-in-50-years/>.

largely abandoned neighborhoods to park space or wetland recovery. In dealing with thousands of communities, it is easy to imagine that many different types of development scenarios could emerge and that some level of variability in how a subsidy is deployed would be important. Analogous sets of questions would undoubtedly arise for subsidies targeted at other negative housing externalities.

Allowing for subsidies that are highly tailored to work in particular communities also raises the possibility of an unaddressed constitutional issue. The Uniformity Clause of the United States Constitution requires that federal tax code provisions apply uniformly throughout the United States.²⁷⁸ Theoretically, this clause prohibits Congress from enacting tax provisions that distinguish taxpayers in one geographic area over those in another.²⁷⁹ The very limited case law has applied the provision quite narrowly, allowing tax laws to stand provided they discuss the distinction in nongeographic terms or where it is at least possible that they could do so.²⁸⁰ In other words, the Uniformity Clause does not prohibit Congress from making a tax distinction based on “geographically isolated problems”²⁸¹ (such as, presumably, community disinvestment, residential segregation, or environmental harm), as long as this distinction is motivated by the condition and not “actual geographic discrimination.”²⁸² While this interpretation appears to provide a good deal of leeway for Congress to craft tax subsidies tailored to address negative housing externalities that occur in particular housing markets, it also indicates some theoretic outer limits on allowing specific housing market refinements to these subsidies.²⁸³ To address this concern, Congress could provide the subsidies outside of the tax code (for example, as HUD-administered grants).

Another challenge is that the disinvested community subsidy addresses only one type of negative housing externality. Would it aid, hamper, or be inconsequential as it relates to other externalities? It is reasonable to speculate that some overlap exists. For example, incentivizing moves to racially integrated neighborhoods would probably reduce socioeconomic segregation, given that poverty rates are significantly higher among certain

²⁷⁸ See U.S. CONST. art. I, § 8, cl. 1. “The Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be *uniform* throughout the United States.” *Id.* (emphasis added).

²⁷⁹ Ellen P. Aprill & Richard Schmalbeck, *Post-Disaster Tax Legislation: A Series of Unfortunate Events*, 56 DUKE L.J. 51, 78-84 (2006).

²⁸⁰ See, e.g., *United States v. Ptasynski*, 462 U.S. 74 (1983).

²⁸¹ *Id.* at 84.

²⁸² *Id.* at 85.

²⁸³ *But see* Aprill & Schmalbeck, *supra* note 279 at 84 (explaining practical limitations on establishing standing to bring this type of a claim).

racial groups.²⁸⁴ These incentives might also aid in the reduction of suburban sprawl, because minority households are disproportionately located in older, urban areas that white households may move into in order to obtain the subsidy. On the other hand, this type of subsidy may also have the opposite effect. More economically mobile minority households may move from older urban areas into newer, suburban, and exurban communities, increasing demand for this type of housing and further isolating those left behind. Policymakers would then be left either to determine which negative externalities matter most and prioritize accordingly, or to try and craft a map of subsidy eligible and ineligible areas that is responsive to each of the externalities or most socially beneficially in the aggregate. Then, there is the question of how to treat individual homes that cause fewer negative housing externalities (say a home fully powered by solar energy), but sit in non-qualifying communities (e.g., one with a thriving local housing market). Marshalling information to pinpoint areas and homes that represent socially optimal homeowner decisions would be daunting.

Yet another concern is the potential impact on homeowners living in areas or in homes that would no longer qualify for homeowner subsidies. As demand would increase for qualifying communities and homes, it inevitably would decrease for non-qualifying communities and homes. This would reduce home prices and homeowner equity in the latter, although the extent is unknown and depends to some degree on how fully capitalized the current homeowner subsidies are into a particular community's home prices. Nonetheless, some homeowners could see a significant drop in the value of their homes, which could call into serious question the fairness and political viability of this type of approach.

2. *À La Carte Subsidies*

A second model would involve Congress authorizing a broader range of separate subsidies, each targeted at a type of homeowner decision that serves to reduce a type of negative housing externality. Think of this as the *à la carte* approach. One subsidy, like a tax credit that offsets a percentage of a homeowner's mortgage interest expenses, could be widely available in order to promote affordability. On top of that, Congress could stack additional subsidies to encourage specific homeowner behavior, such as making qualifying home repairs in a community with older housing stock, purchasing a LEED certified home, and purchasing a home in an integrated neighborhood.

²⁸⁴ See *supra* note 130 and accompanying text.

Congress has actually used this model in the recent past. Between 2005 and 2016, it provided a collection of federal income tax credits to homeowners who purchased energy efficient appliances, made specified home improvements that increase energy efficiency, and installed renewable energy systems for their homes.²⁸⁵ A principal underlying rationale was to encourage homeowner purchases that reduce the negative environmental externalities resulting from residential energy consumption.²⁸⁶ Between 2008 and 2010, Congress also made available a tax credit of up to \$8,000 for first-time homebuyers (later expanded to include many other homebuyers) to help stabilize the national housing market as home prices tumbled during the foreclosure crisis.²⁸⁷

The à la carte approach also has the potential to impact the behavior of a substantial number of homeowners and, therefore, reduce negative housing externalities on a large scale. The credits would offset the perceived or actual costs of certain socially beneficial homeowner behavior—like repairing an older home when the homeowner would otherwise be unlikely to fully recoup the costs. This helps not only the homeowner who receives the subsidy, but also has potential spillover effects on neighboring homeowners whose homes might increase in value as a result and who then would be more likely to make similar repairs.

One challenge with the presumably smaller,²⁸⁸ à la carte subsidies is designing them so that they actually prompt the desired behavior and have the desired impact. Both the homeowner energy credits and first-time homebuyer credit faced questions as to whether they served as effective incentives.²⁸⁹ The individual energy credits were relatively small and also subject to low overall caps raising concerns that they did not act as much of an incentive and instead were mostly claimed as a windfall by those who already planned to make the subsidized investments.²⁹⁰ The homebuyer tax

²⁸⁵ See 26 U.S.C. §§ 25C, 25D (2017).

²⁸⁶ See CRANDALL-HOLLOCK & SHERLOCK, *supra* note 194, at 4-7.

²⁸⁷ The Federal first-time homebuyer credit was first introduced as part of the Housing and Economic Recovery Act of 2008. It was modified and extended via the American Recovery and Reinvestment Act. The credit was expanded and extended a third time under the Worker, Homeownership and Business Assistance Act of 2009. See 26 U.S.C. § 36.

²⁸⁸ I am assuming the overall pool of tax expenditures is not increasing, and thus a la carte subsidies would probably be smaller because that pool would have to be split up across several subsidies, rather than delivered as one larger subsidy.

²⁸⁹ See, e.g., CRANDALL-HOLLOCK & SHERLOCK, *supra* note 194, at 8-9; see also Karen Dynan, Ted Gayer & Natasha Plotkin, *The Recent Homebuyer Tax Credit: Evaluation and Lessons for the Future*, BROOKINGS INST. (June 28, 2013), <https://www.brookings.edu/research/the-recent-homebuyer-tax-credit-evaluation-and-lessons-for-the-future/>.

²⁹⁰ CRANDALL-HOLLOCK & SHERLOCK, *supra* note 194.

credit was larger, caused home purchases to rise over a two year period, and probably helped keep the national housing market from total freefall.²⁹¹ But whether it increased the overall homeownership rate or even had a sufficient long-term stabilizing impact on housing prices are largely in question. Because the credit had an expiration date, many analysts wondered if it simply caused those who already planned to purchase a home to do so earlier.²⁹²

Moreover, the à la carte approach is potentially a scatter shot strategy. Unless carefully coordinated, a subsidy might support a homeowner decision that reduces one negative externality while simultaneously increasing others. For example, a homeowner might claim a renewable energy tax credit for putting solar panels on a new McMansion built on a floodplain.

Finally, as with the first approach, policymakers would face the challenge of crafting subsidies at the national level to work in thousands of different housing submarkets. A home rehabilitation tax credit that incentivizes the repair of a historic home in a tipping point neighborhood with rebound potential may make perfect sense. On the other hand, the use of that subsidy to repair an antiquated home in a mostly abandoned neighborhood where new construction or re-purposing is a better strategy may make much less sense.

3. *Community and Project Level Subsidies*

A third model represents the other side of the coin, in that it is more bottom up than top down. Congress could authorize homeowner subsidies to be allocated on a community-by-community or project-by-project basis and in coordination with other community or public sector efforts to address negative housing externalities in a comprehensive way.

This type of subsidy could be deployed in a couple of different scenarios. One scenario would be in support of housing development proposed as part of locally driven, community planning that meets federally prescribed standards. For example, in Cleveland, Ohio, a coalition of community organizations, city and county agencies, and local technical assistance providers have prepared a comprehensive land use plan in response to a recognition that regional population decline and changing land-use patterns means the city has more developed property than it can sustain in the

²⁹¹ See Dynan, Gayer & Plotkin, *supra* note 289; see also Tricia Snyder & Elizabeth Ekmekjian, *What are the Impacts of the Home Buyer's Tax Credit on Housing and the Economy?*, RES. BUS. & ECON. J. (last visited Nov. 3, 2017), <http://www.aabri.com/manuscripts/131478.pdf>.

²⁹² Dynan, Gayer & Plotkin, *supra* note 289, at 9.

foreseeable future.²⁹³ The plan, called “Re-imagining a More Sustainable Cleveland,” has been adopted by the Cleveland City Planning Commission and it proposes strategic redeployment of land in ways that stabilize and begin to revitalize neighborhoods with development potential, while devoting other land to green infrastructure (e.g. parks and storm water management), agriculture and energy generation.²⁹⁴

If a plan like this meets prescribed standards for community participation, sustainability, and the reduction of negative externalities, the federal government could approve homeowner subsidies for use in those neighborhoods that the plan targeted as having the potential for residential revitalization. In this way, the subsidies would be more selectively available in circumstances where informed local actors could demonstrate that spurring homeownership or a particular type of homeowner behavior would be highly beneficial. The subsidies would serve as one arrow in a quiver of strategies that a community might use to engage in strategic development. When used in this scenario, the homeowner subsidy should almost certainly take the form of grants rather than tax code subsidies to avoid the potential Uniformity Clause concerns identified in the discussion of the first model.²⁹⁵

Another scenario could be in support of other government-funded housing development programs aimed at reducing one or more negative externalities. For example, over the past few decades, two major federal programs—HOPE VI and now the Choice Neighborhoods Initiative—have sought to replace distressed public and assisted housing projects with better quality mixed-income housing in order to reduce residential segregation and break up concentrations of poverty.²⁹⁶ Very recently, a coalition of community development advocates launched a campaign for a new form of financing called the Neighborhood Housing Tax Credit, aimed at incentivizing developers and lenders to finance the construction and rehabilitation of housing that would attract moderate and middle income households to disinvested neighborhoods.²⁹⁷ These are both examples of

²⁹³ Neighborhood Progress, Inc. & Cleveland City Planning Comm'n, RE-IMAGINING A MORE SUSTAINABLE CLEVELAND, CLEVELAND PLANNING COMM'N (adopted Dec. 19, 2008), <http://www.reconnectingamerica.org/assets/Uploads/20090303ReImaginingMoreSustainableCleveland.pdf>.

²⁹⁴ *Id.*

²⁹⁵ See *supra* notes 278-283, and accompanying text.

²⁹⁶ See Taryn Gress, Seungjung Cho & Mark Joseph, *HOPE VI Data Compilation and Analysis*, OFFICE OF POL'Y DEV. & RESEARCH 7 (Sept. 2016), <https://www.huduser.gov/portal/sites/default/files/pdf/HOPE-VI-Data-Compilation-and-Analysis.pdf>.

²⁹⁷ See *What is the Neighborhood Homes Investment Act?*, NEIGHBORHOOD HOMES INVESTMENT ACT, <https://neighborhoodhomesinvestmentact.org/about/> (last visited Aug 8,

supply side initiatives aimed at reducing negative housing externalities. Offering homeowner subsidies directly to potential homebuyers in developments like these would provide a corresponding demand side incentive that could significantly increase the likelihood of success of these programs.

This third approach is also the flipside of the other two in terms of its advantages and challenges. It serves as a much better vehicle for incorporating the unique aspects of each particular community's housing market and submarkets into the allocation of subsidies. It coordinates with community planning and the investment of other public resources, and thus is likely to be highly complementary to local efforts to impact housing conditions. Because targeting of the subsidies originates at the local level where knowledge of the housing market is greatest identifying development that addresses all or most of the negative housing externalities also seems more achievable. The involvement of local policymakers might make monitoring the impact of the subsidies over time and adapting them as necessary much easier.

Of course, there are challenges as well. This model would not catalyze substantial changes in homeowner behavior in one fell swoop as the other models potentially would. Changes would come about more gradually and sporadically. Deciding on and overseeing the allocation of subsidies on a project-by-project basis would also be more administratively burdensome and necessarily require significantly more federal time, attention and expense.

This approach also assumes, especially in the scenario in which the subsidies would complement community planning, capacity at the local level across the country to generate comprehensive and useful plans that meet federal standards and take into account multiple forms of housing externalities. Federal funds and involvement to help interested, but capacity lacking, communities achieve this would probably be necessary. This is to say nothing of the increased susceptibility of locally driven processes to political and private interest influence and corruption. Coordinating this type of a program across such a large and diverse landscape could be a tall task.

On the other hand, the federal government does have experience in overseeing similarly structured programs. Of particular relevance is the Community Development Block Grant program, which involves the allocation of federal investments in community development to local governments for implementation in response to planning priorities

identified at the local level.²⁹⁸ Using the infrastructure of an existing program, like CDBG, to allocate homeowner subsidies, rather than starting from scratch, could help overcome some of the administrative concerns.

D. *Data and Innovation as Gateways to Smarter Subsidies*

As noted throughout this article, a significant challenge to making homeowner subsidies smarter under any model is understanding the housing externalities at play within thousands of different housing markets and submarkets, and engineering the subsidies to be precise and sensitive enough to address these externalities. In this respect, the world is changing rapidly and in ways that portend success.

The real estate industry, like many others, is in the midst of a data revolution. Online sources are compiling and making readily accessible property specific data on everything ranging from owner, parcel and building information, mortgages and liens, code violations, past sales history, crime and fire history, and more.²⁹⁹ Simultaneously, a data analytics industry has emerged. Firms in this industry have developed sophisticated algorithms and valuation models, which, coordinated with geographic mapping technology, can process spools of available data and translate it into digestible, real time, accurate market assessments of local housing conditions.³⁰⁰

Predictably, much of the data analytics industry serves banks, insurance companies and mortgage servicers.³⁰¹ However, a separate and growing segment of the industry, consisting of both nonprofit and for-profit entities, focuses on community planning and revitalization.³⁰² Community leaders and local governments are working with these service providers to incorporate property and neighborhood specific data into more sophisticated, forward looking, and sustainable development plans.

²⁹⁸ See *supra* notes 101-103 and accompanying text.

²⁹⁹ See, e.g., NEO CANDO: PROPERTY DATA, <http://neocando.case.edu/cando/housingReport/interface.jsp> <http://neocando.case.edu/> (last visited Aug. 8, 2017).

³⁰⁰ See *infra* text accompanying notes 301-309.

³⁰¹ See, e.g., CORELOGIC: DATA, <http://www.corelogic.com/about-us/data.aspx> (last visited Aug. 8, 2017).

³⁰² See, e.g., DYNAMO METRICS, <http://www.dynamometrics.com/> (last visited Aug. 8, 2017); LOVELAND TECHNOLOGIES, <https://makeloveland.com/company> (last visited Aug. 8, 2017); THE CENTER CTR. FOR COMMUNITY PROGRESS, <http://www.communityprogress.net/the-help-you-need-pages-7.php> (last visited Aug. 8, 2017).

There are many examples of this type of planning. Cities like Detroit,³⁰³ Cincinnati,³⁰⁴ Kansas City,³⁰⁵ and Memphis,³⁰⁶ each confronted by large stockpiles of vacant and distressed properties, are creating data infused mapping interfaces covering every property within their boundaries. This visual mapping technology allows community leaders and agencies to more efficiently determine what code enforcement, demolition and rehabilitation strategies for which properties make the best (i.e. smartest) use of their resources. In Cleveland, a community development funding intermediary recently hired a “spatial econometrics” firm to use hedonic pricing models to determine which types of homes, if rehabilitated, would yield the highest increases in surrounding property values.³⁰⁷ This is another data-based mechanism for prioritizing the spending of a city’s limited public and philanthropic revitalization funds, in this case specifically to maximize positive externalities on neighbors and the local tax base.

Smaller cities are getting into the game as well. Danville, Virginia, a former mill town, is just one example of a city with a size, location and economic base that suggests continued population stagnancy and perhaps even further contraction. Rather than simply letting development happen as it will and spread out further, Danville’s planning department worked with an urban development consulting firm to create a multi-tiered housing plan within the city’s current footprint. The plan delineates separate areas for targeted demolition, rehabilitation and growth based on what future homeowners are likely to seek and population projections.³⁰⁸ Meanwhile, the Center for Neighborhood Progress, a national nonprofit, has begun offering publications and technical assistance aimed at helping communities

³⁰³ John Gallagher, *Start-Up Firm Mines Data to Aid Detroit Blight Fight*, DETROIT FREE PRESS (Jan. 16, 2016, 10:55 PM), <http://www.freep.com/story/money/business/michigan/2016/01/16/blight-detroit-econometrics/78645606/>.

³⁰⁴ Janis Bowdler, Opinion, *Mapping Blight at the Parcel Level in Cleveland, Columbus and Cincinnati*, CLEVELAND.COM (Apr. 9, 2017), http://www.cleveland.com/opinion/index.ssf/2017/04/mapping_blight_in_cleveland_co.html.

³⁰⁵ Ellie Moxley, *To Tackle Blight Kansas City, Kansas, Will Crunch the Numbers*, KCUR (June 14, 2016), <http://kcur.org/post/tackle-blight-kansas-city-kansas-will-crunch-numbers#stream/0>.

³⁰⁶ Madeline Faber, *Memphis Property Hub Using Micro-Level Data to Drive Solutions*, THE DAILY NEWS (Aug. 8, 2016), <https://www.memphisdailynews.com/news/2016/aug/8/memphis-property-hub-using-micro-level-data-to-drive-solutions/>.

³⁰⁷ *Rehab Impacts in Cleveland 2009-2015*, DYNAMO METRICS, <http://www.rehabimpact.com/> (last visited Aug. 8, 2017).

³⁰⁸ Sandy Smith, *How to Shrink a Housing Market So It Can Grow Again*, NEXT CITY (Oct. 24, 2016), <https://nextcity.org/daily/entry/shrink-housing-market-growth>.

large and small develop the capacity to use data to shape planning and revitalization decisions.³⁰⁹

For sake of illustration, the above examples have focused on the use of property data, technology, and analytics to address community disinvestment. But these advances are also taking place with respect to the other negative housing externalities this article addresses. For example, HUD developed data-infused mapping tools for its fund recipients (state and local governments, and housing agencies) to use in measuring residential segregation within their boundaries and developing strategies to address it.³¹⁰ The EPA has developed “smart location” maps, designed to reveal block-by-block characteristics like proximity to jobs, transit options and walkability, to encourage home seekers to make choices that lessen greenhouse gas emissions and improve their health and access to amenities.³¹¹

E. A Path Forward

Demand-side subsidies can influence homeowner behavior. As discussed throughout Part VI, if properly constructed, this can include encouraging homeowner decisions that impose fewer negative housing externalities (and create more positive ones). Rapid, recent advances in housing data, analytics and planning make the prospect of smarter homeowner subsidies increasingly more plausible.

So how to proceed? While each model discussed in Part VI.C has potential advantages, the third would probably be the best starting point. This is due to its flexibility. It is the most adaptable to community-by-community variations, can be integrated as a complement to other federal, state and local programs that subsidize housing, and lends itself most easily to experimentation and adjustment. In these ways, it holds the greatest potential for “smarter” subsidy design in the way this article envisions.

Certain features are important to include if proceeding with the third model. First, community or project-level homeowner subsidies should take the form of homeowner grants or loans allocated through HUD, rather than

³⁰⁹ See ALAN MALLACH, CTR. FOR CMTY. PROGRESS, NEIGHBORHOODS BY NUMBERS: AN INTRODUCTION TO FINDING AND USING SMALL AREA DATA (2017), http://www.communityprogress.net/filebin/Center_for_Community_Progress_Alan_Mallach_Neighborhoods_by_Numbers_FINAL_DIGITAL_MARCH_2017.pdf.

³¹⁰ See, e.g., *Affirmatively Furthering Fair Housing Data and Mapping Tool*, DEP'T OF HOUS. AND & URB. DEV. <https://egis.hud.gov/affht/#> (last visited Aug. 8, 2017).

³¹¹ See, e.g., *Smart Location Mapping*, U.S. ENVTL. PROT. AGENCY EPA: SMART GROWTH, <https://www.epa.gov/smartgrowth/smart-location-mapping> (last visited Aug. 8, 2017).

as tax breaks provided through the Internal Revenue Code. HUD, after all, is a housing agency. It has a great deal of experience allocating federal funding in response to community planning processes that identify localized funding needs. Just a few examples include the CDBG program,³¹² the Neighborhood Stabilization Program,³¹³ and the HOME Investment Partnerships Program.³¹⁴ The Internal Revenue Code, on the other hand, is not a good vehicle for delivering on social policy with as many moving parts as this would entail. Furthermore, there is a risk, discussed at various points in Part VI.C., that highly tailored, community specific subsidies delivered as tax breaks could violate the Uniformity Clause of the U.S. Constitution or at least appear to do so.³¹⁵

Second, local governments should serve as the applicants for and the ultimate distributor of homeowner subsidies within their boundaries. Congress and HUD would set the parameters for the housing objectives and types of homeowner decisions that the subsidies could support, and these would correlate closely with the negative housing externalities discussed throughout this article. But local communities would identify the specific instances in which they would deploy the subsidies.

For example, a city grappling with disinvestment might identify several tipping point neighborhoods where an influx of new homeowners could provide the foundation for stabilization and a turnaround. This city might then propose in its application purchase grants for home buyers and local property tax offset grants for existing homeowners. HUD standards might additionally require that these grants advance (or at least not undermine) residential integration and environmental objectives. In addition, a community planning process should support the application for these types of subsidies. This is similar to the design of already existing HUD programs like CDBG, NSP and HOME.³¹⁶ The basic premise is that HUD provides oversight, but communities are given significant leeway in proposing the best specific uses of the funds.

Third, given that this type of a subsidy model represents a significant departure from the current model, it would be best initiated as a pilot program, limited in scope and subject to review, until its merits are demonstrated and its preliminary kinks are worked out. In addition,

³¹² See *supra* notes 101-103 and accompanying text.

³¹³ Congress authorized three phases of the Neighborhood Stabilization Program (“NSP”). NSP 1 was authorized by the Housing and Economic Recovery Act (2008), NSP 2 by the American Recovery and Revitalization Act (2009), and NSP 3 by the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010).

³¹⁴ The statute codifying HOME is at 42 U.S.C. 12722.

³¹⁵ See *supra* Part VI.C.

³¹⁶ See *supra* notes 312-314 and accompanying text.

Congress should strongly consider making this program competitive in its pilot phase in order to encourage innovation and to identify communities with the capacity to succeed.

Federal agencies have significant recent experience launching new funding programs in this manner. The second round of Neighborhood Stabilization Program funding involved a competitive application process in which local governments and nonprofit applicants had to demonstrate to HUD that their proposed use of the funds would help to stabilize targeted neighborhoods (while achieving a number of other objectives, including environmental ones), resulted from a planning process and that they possessed the capacity to carry it out.³¹⁷ In a similar vein, the American Recovery and Reinvestment Act of 2009 provided \$4.35 billion for a competitive grant fund for state plans that accomplished a broad range of objectives related to improving educational outcomes, and might be used as models for other states.³¹⁸ This approach to funding has become a useful method for spurring innovation and reform within the public sector, as local actors are highly motivated by available funds to get creative in designing plans capable of success. Ultimately, a pilot phase may reveal that it is actually feasible and more efficient to allocate homeowner subsidies using the first or second models, or that some type of hybrid model would work best.

A pilot phase would also allow policymakers to determine the impact of the third model on housing affordability and equity concerns. Smarter homeowner subsidies, as discussed throughout this article, would involve direct, selectively available subsidies to private individuals, the allocation of which is influenced by data analytics, market factors, and local leaders who are also focused on keeping or making their communities competitive. This raises well-merited and significant concerns regarding housing access and equity, especially as it relates to politically marginalized groups. Congress should include standards and safeguards to address these concerns, which HUD should be charged with implementing. Yet, it is reasonable to expect that this will not be a perfect science, and will take time.

A pilot model would make sense for another reason as well. It may match best with the political challenges certain to follow from tackling reform as charged as that involving the homeowner subsidies. As Part V discussed, any effort at changing the current homeowner subsidies will encounter immediate and stern resistance from the powerful interests benefiting from

³¹⁷ Joice, *supra* note 106, at 139.

³¹⁸ U.S. DEP'T OF EDUC., RACE TO THE TOP PROGRAM EXECUTIVE SUMMARY 2 (2009), <https://www2.ed.gov/programs/racetothetop/executive-summary.pdf>.

them. This resistance may include invoking, not without merit, the potential for a drop in home prices that could result from a significant roll back of the subsidies. A more politically feasible scenario for reform would involve an incremental roll back of one or more of the current homeowner subsidies, by lowering the existing caps on the amount of gain that qualifies for the capital gains exclusion or the value of the mortgage or property that qualifies for the MID or property tax deduction. Proceeding in this way would primarily only affect the tax breaks of wealthy homeowners (and only on a portion of their tax breaks), be unlikely to significantly disrupt home prices and yield significant tax revenue for the federal government.³¹⁹ A portion of this revenue could then be devoted to piloting smarter homeowner subsidies.

It bears repeating here that the quest for smarter homeowner subsidies is not a call for abandoning homeowner subsidies that seek to make homeownership more affordable. The calls for more thoughtfully constructed tax credits aimed at low and middle homeowners, in what Part VI.A described as the second camp of proposals, is in a sense a smarter homeowner subsidy as it relates to home affordability. The goal of this article is not to work to the exclusion of this objective, but rather to advocate for subsidy reform that is also smarter as it relates to negative housing externalities. These two goals can and should be complementary.

VII. CONCLUSION

The prospect of smarter homeowner subsidies is tantalizing. When considering the sheer scale of what the federal government currently invests in homeowner subsidies that inure primarily to the benefit of higher income households and are completely insensitive to negative housing externalities, it is difficult not to wonder what a more carefully considered system of allocating subsidies might yield. If done right, a powerful tool could be added to the mix of federal housing strategies.

At the same time, the challenges to successfully implementing smarter subsidies on a nationwide basis are daunting, as this article identifies. In earlier eras, the potential for inequities, inefficiencies and problems in administration would likely have proven too difficult to overcome. Rapidly advancing technology and corresponding increases in planning sophistication at the community level should ultimately provide the opportunity for the federal government to persevere and get a much better

³¹⁹ See FISCHER & HUANG, *supra* note 246, (citing to proposals that would limit the mortgage interest deduction to 28% for all claimants or that would alternatively provide all homeowners with a 15% tax credit, limited to a \$500,000 mortgage, and result in tens of billions of dollars of additional tax revenue).

return on its massive investment in homeownership. Participation and innovation at the community level in designing these subsidies would be important catalysts to success.

VIII. POSTSCRIPT—TAX CUTS AND JOBS ACT OF 2017

In a year that challenged political convention in almost every respect, the unexpected also happened with federal income tax reform. As this article advanced through the final stages of the publication process, Congress introduced, considered and passed a far-reaching package of changes to the federal income tax code called the Tax Cuts and Jobs Act of 2017 (the “Act”).³²⁰ The entire process took less than two months—warp speed by Congressional standards, especially for tax reform.

As it relates to the homeowner subsidies, the Act represented a victory for those this article described in Part VI.A as belonging to the first camp of reformers. The Act approximately doubled the size of the standard deduction, meaning millions of additional taxpayers will no longer itemize deductions.³²¹ This greatly reduces the number of those who will claim two of the three principal homeowner subsidies: the mortgage interest deduction and the deduction for state and local taxes.³²² At the same time, the Act reduced the amounts of mortgage interest and state and local taxes that are deductible, and eliminated the MID for home equity debt (i.e. mortgage financing used for purposes other than to acquire, construct, or substantially improve a home).³²³ A primary goal of the Act’s proponents was to reduce

³²⁰ Tax Cut and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017). It was signed into law on December 22, 2017.

³²¹ *Id.* § 11021. As with many of the individual income tax provisions in the Act, this one is due to expire on December 31, 2025. *Id.* § 11021(a).

³²² See *supra* notes 32-36, and accompanying text. Estimates as to what percentage of taxpayers will itemize deductions with the Act in effect have ranged from between 5% and 10%. See, e.g., *Comparison of Key Provisions in House/Senate Tax Reform Bills*, NAT'L COUNCIL OF NONPROFITS 1, 2 (Dec. 15, 2017), <https://www.councilofnonprofits.org/sites/default/files/documents/comparison-house-senate-tax-bills-nonprofits.pdf>; see also Alexander Casey, *Tax Reform With \$750k Cap on Mortgage Interest Deduction Would Leave 1 in 7 U.S. Homes Eligible*, ZILLOW RESEARCH (Dec. 12, 2017), <https://www.zillow.com/research/mortgage-interest-deduction-750k-17620/> (estimating the percentage of homes for which taking the mortgage interest deduction would be worthwhile drops from 44% to 14% as a result of the Act).

³²³ For mortgage debt incurred after December 15, 2017, Section 11043 limits the amount of mortgage interest that may be deducted to the interest paid on the first \$750,000 of mortgage debt. Tax Cut and Jobs Act § 11043. It also eliminates the interest deduction for new or existing home equity debt. *Id.* Section 11042 limits the itemized deduction for state and local income, sales, and property taxes to \$10,000. *Id.* § 11042. Each of these provisions expires on December 31, 2025. *Id.* §§ 11042(a), 11043(a).

long-standing tax expenditures in order to pay for across the board corporate and individual income tax rate reductions. This made the homeowner subsidies an obvious target, although not all of the attempted reductions of the subsidies succeeded.³²⁴

This is not to say that the homeowner subsidies are no longer relevant. All three of the principal subsidies survived, and the exclusion of capital gains on home sales did so entirely intact. The federal government will continue to invest substantially in the homeowner subsidies,³²⁵ and it is even possible the subsidies will return to their previous form in 2026 after certain provisions of the Act expire. Because a smaller percentage of taxpayers will itemize and a greater percentage of those that do will be in the highest income brackets, an even greater percentage of the homeowner subsidies will go to those who need no encouragement to purchase a home.³²⁶

Most pertinent to this article is the question of whether the Act makes the homeowner subsidies any smarter. The immediate response is “no.” Proponents of the Act approached the homeowner subsidies principally as opportunities for cost savings, rather than as housing policy tools, and sought simply to reduce them as much as politically feasible. Knowing that, it is difficult to assert that the reformed subsidies are any smarter except to the extent that they do less to fuel certain homeowner behavior that exacerbated negative housing externalities. This is not smarter design as this article envisions it.³²⁷

³²⁴ The exclusion of capital gains on home sales survived in its previous form despite efforts to further limit who can qualify for it. *See The Tax Cuts and Jobs Act – What it Means for Homeowners and Real Estate Professionals*, NAT’L ASS’N OF REALTORS 1, 1 (Dec. 20, 2017), available at <http://narfocus.com/billdatabase/clientfiles/172/19/3062.pdf>. Up to \$10,000 of SALT will still be deductible, notwithstanding a proposal to completely eliminate it. *Id.* at 4; *see also* Heather Long, *The Final GOP Tax Bill is Complete*, WASH. POST: WONKBLOG (Dec. 15, 2017), https://www.washingtonpost.com/news/wonk/wp/2017/12/15/the-final-gop-tax-bill-is-complete-heres-what-is-in-it/?utm_term=.d9e4fac05792.

³²⁵ At the very least, Congress will continue to forgo more than \$30 billion per year on the home sale capital gain exclusion. *See supra* note 52. Preliminary estimates suggest that, taken together, the MID and SALT will continue to cost close to \$100 billion per year in forgone tax revenue. *Compare* 2017 TAX EXPENDITURE BUDGET, *supra* note 3, at 32, 40, with STAFF OF THE J. COMM. ON TAXATION, 115TH CONG., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE “TAX CUTS AND JOBS ACT,” FISCAL YEARS 2018–2027, at 2 (Comm. Print 2017).

³²⁶ In addition, the Act eliminated the Pease limitation, which means high income households face one fewer barrier to claiming itemized deductions like the MID and SALT. Tax Cut and Jobs Act § 11046; *supra* notes 36-37 and accompanying text.

³²⁷ In fact, it is possible that the reduction of SALT, without a replacement, could negatively impact disinvested communities with higher local tax rates. *See, e.g.*, Matthew J.

Looking toward the horizon, however, there may be room for hope. Using a larger standard deduction and lower individual tax rates to blunt the loss of the mortgage interest deduction for most claimants was perhaps the only feasible way of loosening the decades long political stranglehold this deduction has had on housing policy. Reducing reliance on what is probably the least smart and certainly the most expensive of all of the current homeowner subsidies may actually help to clear a path for smarter subsidies if the political will to design and approve them can be mustered. Time will tell.