

Economic Downturns and the Housing Market Case Study from the 1970s

Housing is central to the economic crisis facing the nation. The declines in home sales and prices, as well as, the surge in foreclosures are historic in scope and threaten to generate the most severe recession in decades. The nation faced a similar situation in the 1970s, and Congress responded with targeted incentives to bring potential home buyers back into the housing market. The outcome of those policies was dramatic and immediate: home sales increased and the housing market turned around to the benefit of the overall economy. This same approach should be applied today. Policies that aim to improve the current economic environment must address conditions in the housing market.

Economic Environment – Then and Now

In 1975, the U.S. was still in a recession, with negative real Gross Domestic Product (GDP) growth for the second consecutive year after a period of high growth and unemployment jumping up well over 2 percentage points—from 5.6 to 8.5. The residential construction sector of the economy was particularly hard hit. While existing home sales were holding steady at a relatively low rate of less than 2.5 million per year, total housing starts plummeted from over 2 million to less than 1.2 million (see table below):

Year	Housing Starts (thousands)	Real GDP (% change)	Unemployment Rate (percent)	Dow Jones Industrial (Dec avg)	Consumer Confidence Index (at year end)	Existing Homes Sales (thousands)
1972	2,357	5.3	5.6	890	116.1	2,254
1973	2,045	5.8	4.9	850	70.6	2,334
1974	1,338	-0.5	5.6	616	43.2	2,273
1975	1,160	-0.2	8.5	852	93.7	2,480
1976	1,537	5.3	7.7	1004	98.9	3,066
1977	1,987	4.6	7.1	831	109.7	3,646
1978	2,020	5.6	6.1	805	102.2	3,987
2005	2,068	2.9	5.1	10717	103.8	7,076
2006	1,801	2.8	4.6	12463	110.0	6,478
2007	1,355	2.0	4.6	13264	90.6	5,652
2008	817	-0.3	6.5	9336	38	5,180

At the end of 2008, the U.S. economy is entering an overall downturn, with GDP growth turning negative in the third quarter after several years of moderate growth and unemployment increasing by roughly two full percentage points. For home building activity, the parallel with 1975 is striking, as total housing starts plummeted from a peak of over 2 million to well under 1 million (based on seasonally adjusted annual rates through September). This time, however, existing sales have also declined—by approximately 2 million from the peak in 2005, according to the latest seasonally-adjusted annual rates. In summary, the U.S. economy in general and the housing sector in particular were in decline in both periods.

The 1970's Strategy

The strategy used during the housing downturn of the 1970's contained two key components: a temporary tax credit for the purchase of a newly-constructed, unoccupied home and a temporary "buy down" of mortgage rates. The objective of these tools was to reduce the large surplus of new homes and stabilize the housing market by stimulating additional purchases of homes.

Mortgage Rate Buy Down

At the beginning of 1974, to address a slump in housing production, Congress authorized use of the Ginnie Mae "Tandem" program, which existed at the time to stimulate the production of new single family homes. Under this program, Ginnie Mae acquired below-market interest rate mortgages and resold the loans to private sector investors at discounted prices. The difference in the price paid and received by Ginnie Mae (the present value of the difference between the subsidized and market interest rate) was charged to the federal budget.

Congress initially authorized Ginnie Mae to purchase FHA/VA mortgages on 200,000 new homes and subsequently authorized an additional 100,000 units. In the latter part of 1974, Congress also authorized Ginnie Mae Tandem purchases of conventional mortgages for new or existing homes. Each segment of this program authorized a specific dollar amount of mortgage commitments that Ginnie Mae could offer private mortgage originators at a specific mortgage rate and purchase price. The only eligibility restriction was that the mortgages had to be in amounts complying with the FHA single family program limit, which ranged from \$33,000 at the beginning of 1974 to \$42,000 in 1975. The mortgage rates ranged from 7.75 percent to 8.25 percent, while market mortgage rates were generally running between 9 and 10 percent.

Temporary Home Buyer Tax Credit

The *Tax Reduction Act of 1975* (P.L. 94-12, signed by President Ford on March 20, 1975), created a tax credit available for households who purchased a newly constructed home in 1975. The amount of the credit was limited to 5 percent of the purchase price up to \$2,000. The credit was limited to homes under construction before March 26, 1975, occupied between March 12, 1975 and January 1, 1977, and purchased (under contract) before December 31, 1975.

The credit was aimed at reducing the substantial inventory of new, unsold homes, which reached a record high of 422,000 homes in 1973. By the effective date of March 26, 1975, nearly 400,000 homes remained for sale. Condominiums and manufactured housing qualified for the credit, as did homes built by the owner (the credit was based on the portion of construction built between March 26, 1975 and December 31, 1976).

Results

By the end of 1976, 535,000 taxpayers claimed \$716 million in credit, most of it on the 1975 tax returns. The average credit amount was \$1,340; less than the full amount since the average purchase was \$37,000 and the credit was not refundable (the credit was limited to total tax liability less all other credits except the earned income credit). Of the roughly 700,000 homes that could have qualified for the credit, nearly 400,000 single-family homes were started and for sale in March 1975. Another 200,000 homes were under construction and built for the owner. Condos and manufactured housing could account for another 100,000 eligible units. Income tax return data suggest at least three quarters of the eligible homes received the credit. The credit would have to be judged a success as a means of clearing inventory.

The effects on home sales and production over the subsequent years were dramatic. Existing home sales increased by roughly 500,000 per year, reaching almost 4 million in 1978. Housing starts increased by roughly 400,000 per year and were back up to near 2 million by 1977. The impacts on the overall economy were equally dramatic. Real GDP growth rebounded to better than 5 percent the very next year. Unemployment also began to improve in 1976, although it took until 1978 for the rate to fall back into the neighborhood of 6 percent.

Lessons for Today

While not identical, the economic environment of the mid-1970s and today share several similarities, including the serious downturn in the housing market and particularly significant inventory overhang and declining sales. The strategy employed then had dramatic positive results and could have the same benefits in today's tough economic environment. Congress has already taken an important step with the creation of the temporary first-time home buyer tax credit as part of the *Housing and Economic Recovery Act (HERA)* passed in July. Unfortunately, based on feedback from the field, the tax credit is having a minimal impact on the housing market because of the sheer size and scope of the financial crisis, and due to structural characteristics of credit itself.

Congress should build on the foundation created under HERA with a perfected and enhanced temporary homebuyer tax credit, while also creating a complementary mortgage buy down program. This two-pronged approach worked in the 1970s as an incentive for potential home buyers to get into the housing market, and it can work again today.