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Improving Homeownership Among Poor And Moderate-Income Households

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Strong disincentives to homeownership are created by existing policies, which often cut off public benefits for those who own.

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Asset ownership is vital to households seeking to expand opportunity, solidify family finances, and hedge against economic uncertainty. No asset is more important in achieving these objectives than owner-occupied housing.¹ Indeed, home equity is the primary source of private saving for most middle-income households, exceeding both retirement plans and savings accounts.²

While 69 percent of all households are headed by homeowners—a record high reached in 2004—many are left out. Only half of the households in the lowest fifth of the income scale are homeowners, and the homeownership rates among both blacks and Hispanics are slightly under fifty percent.

Of course, homeownership is not for everyone. Some families have unstable monthly incomes and few liquid assets. When these families face an income loss, they may be unable to meet mortgage payments and could face foreclosure. For such families, renting may be more economically sensible. Renting may also be the best option for families that expect to move frequently.

However, these exceptions do not excuse the strong disincentives to homeownership created by existing policies, which often cut off public benefits for those who own. U.S. housing programs that account for the bulk of housing assistance to low- and moderate-income households, by their design, discourage ownership of housing.

The bulk of housing assistance is delivered through favorable treatment under the

federal individual income tax. This favorable treatment comes in three parts. First, unlike owners of rental housing, homeowners do not include in their taxable income the equivalent of the rent money they save by owning a home. Except for individuals and families who do not have taxable income, all homeowners therefore pay lower taxes as a result. By comparison, saving that takes place in a fully taxable asset, such as a savings account, is not directly sheltered from tax. However, the second part is that homeowners who itemize on their taxes can deduct their mortgage interest payments and property taxes from their taxable income—these tax deductions effectively cancel out the tax homeowners would otherwise owe on fully taxable interest-bearing assets like a savings account. Third and finally, homeowners are usually not taxed on the capital gains from the resale of their homes.³

The wealthiest households receive the greatest benefits from these tax provisions because they have higher homeownership rates, occupy more expensive housing with bigger mortgages, and are more likely to itemize their tax deductions. For these reasons, their income for tax purposes is understated to a greater extent than the income of poorer households. Also, as the wealthy have higher marginal tax rates, these exclusions from income lead to larger tax savings. Low- and moderate-income homeowners receive smaller benefits from these tax provisions because the untaxed return to savings in their homes is smaller, fewer of these households itemize, and

their low or zero marginal tax rates yield modest or no tax savings.

All this means that any real attempt to create an “ownership” society by expanding asset ownership among those with modest means must confront housing policy head-on.

Rates of Homeownership

As we can see in table 1, generally, homeownership is higher for families with children than for other households, and higher for two-parent families than for one-parent families. Recent gains in ownership rates can be attributed to a variety of factors: a decline in mortgage interest rates, the expansion of the subprime market, and mortgage underwriting innovations and related policy develop-

ments—particularly in the Federal Housing Administration (FHA) and at Fannie Mae and Freddie Mac—that tend to keep interest rates lower and to make mortgages more freely available, even to those with little money for a down payment.⁴

If we look more closely at the data, households showed significant improvement in homeownership after 1990, but much of that was a catch-up for losses in the 1980s. For the longer period between 1980 and 2003, those in the bottom fifth of income have seen no gains in homeownership, holding roughly steady at 51 percent. Even among all homeowners, the rate only increased by 0.6 percentage points, although other sources do show some gains after 2003. A Center for Housing Policy

study (2004) cites the relative rise in one-parent families, who clearly have lower incomes than two-parent families, and who comprise a growing share of the bottom income groups, as a probable cause for the small gains in the lowest income group.

Homeownership is cheaper than renting for long-tenured dwellers. Even for some lower-income households, the tax gains from owning can more than offset the cost of selling their homes if they have to move. However, several factors make it more difficult for the poorest households to become homeowners. They have a greater difficulty saving the money necessary for a down payment. They typically must pay higher interest rates due to their higher credit risk. Even a standard mortgage requires monthly payments that, in the early years, often exceed the market rents payable for the same home.

Over the 1989–2001 period, whites have a markedly higher ownership rate (70–75 percent) than blacks or Hispanics (40–50 percent), although the latter two groups have clearly gained ground (figure 1). Blacks and Hispanics have lower ownership rates than other racial groups, even after controlling for their level of income and other economic or social characteristics.⁵

College graduates enjoyed ownership rates rising from 70 percent to about 76 percent over the 1989–2001 period, while slightly over half of high school dropouts owned a home.

Trends in Federal Low-Income Rental Housing Assistance

Federal subsidies for housing fall into four categories:

1. *Outlays that subsidize renters or builders of rental housing;*
2. *Outlays that subsidize owners;*
3. *Tax provisions that subsidize renters or builders of rental housing; and*
4. *Tax provisions that subsidize owners.*

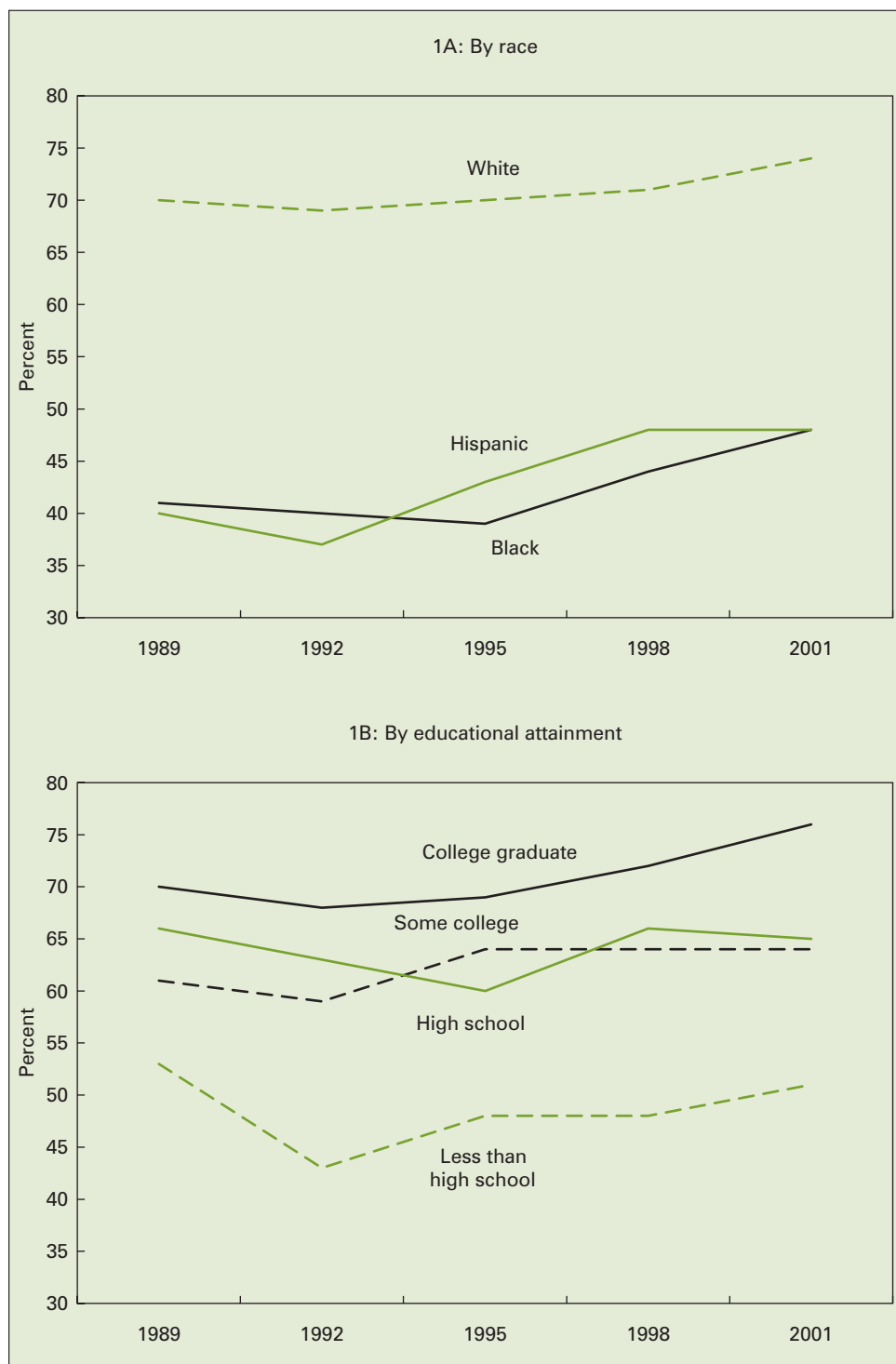
Outlay policy toward renters and builders has undergone a revolution

TABLE 1. Homeownership Rates, 1980–2003

	Percentages				Percentage point change	
	1980	1990	2000	2003	1990–2003	1980–2003
All households						
Overall	67.9	63.9	67.2	68.5	4.6	0.6
1st quintile	51.2	45.8	48.2	51.0	5.2	–0.3
Gap	16.7	18.1	19.0	17.5	–0.6	0.9
All households without children						
Overall	65.2	63.6	66.6	67.4	3.8	2.1
1st quintile	55.9	52.0	53.7	54.9	2.9	–1.0
Gap	9.4	11.6	12.8	12.5	0.9	3.1
All families with children						
Overall	72.1	64.7	68.5	70.8	6.1	–1.3
1st quintile	36.2	27.5	29.6	37.7	10.2	1.5
Gap	35.9	37.1	38.8	33.1	–4.1	–2.9
Married couples with children						
Overall	78.6	73.2	77.1	77.8	4.6	–0.8
1st quintile	45.8	40.9	42.3	49.0	8.2	3.2
Gap	32.8	32.3	34.9	28.8	–3.5	–4.0
Single parents with children						
Overall	43.6	34.5	39.9	42.4	7.9	–1.2
1st quintile	28.6	18.5	21.7	26.7	8.2	–1.9
Gap	15.0	16.0	18.3	15.7	–0.3	0.7

Source: The Urban Institute 2005. Based on data from the March Current Population Survey, various years. When the gap increases, the disparity between Overall and 1st Quintile rises; when the gap decreases, the disparity falls. Note: Different surveys and data sets report slightly different homeownership rates for any given year. Moreover, the Census Bureau uses several different surveys (such as the Current Population Survey, the American Housing Survey, the American Community Survey, the decennial Census, and the Housing Vacancy Survey) to construct various measures of homeownership. For example, in 2000, the decennial Census reports the national homeownership rate as 66.2 percent, the Housing Vacancy Survey reports it as 67.4 percent, and the March Current Population Survey, which we use, reports it as 67.2 percent for that same year; other surveys estimate both higher and lower numbers. To glean more about differences among select surveys, please see <http://www.census.gov/hhes/www/housing/homeownershipfactsheet.html> (accessed May 2005).

FIGURE 1. Homeownership Rates by Race and Educational Attainment, 1989–2001



Source: The Urban Institute 2005. Tabulations based on 1989, 1992, 1995, 1998, 2001 Surveys of Consumer Finances.

in recent decades. Partly in response to dissatisfaction with large public housing projects and the cost of subsidized private construction, the Department of Housing and Urban Development (HUD) has, since the early 1970s, been moving away from

outlays that subsidize new construction or assistance for families living in subsidized projects (Olsen 2003a). This bipartisan shift has turned HUD toward subsidizing renters through more flexible, less location-specific vouchers.

The trend toward vouchers becomes less clear-cut once the Low Income Housing Tax Credit (LIHTC) is factored into the equation. The LIHTC subsidizes developers of low-income housing through substantial credits. Its expansion represents a shifting backward toward subsidizing suppliers of housing and renters who live in tax-subsidized projects. So while HUD outlay programs have shifted to household-based vouchers, the tax subsidies for low-income housing construction work in the opposite direction.

Experience with Homeownership Programs for Low-Income Households

Outlays to support low- and moderate-income homeownership are much smaller than those directed toward rental housing. Historically, the largest programs of this type have been HUD’s Section 235 and the U.S. Department of Agriculture’s Section 502. However, the HOME Investment Partnerships Program enacted in 1990 has provided homeownership assistance to the largest number of additional households over the past decade. In addition, the Housing Assistance Supply Experiment, a component of the 11-year Experimental Housing Allowance Program run by HUD contractors from 1971 to 1982, provided housing assistance as an entitlement to the poorest renters and homeowners in two metropolitan areas.

Section 235. Congress enacted the Section 235 Homeownership Program for Low-Income Households in 1968. This program had two components—one for newly built housing and the other for existing structures. Under the new construction component, HUD allocated the limited subsidies available to selected builders and used various administrative mechanisms to prevent them from charging above-market prices. Under both components, HUD delegated responsibility for informing the public of the existence of the program to members of the real estate indus-

try. However, local FHA Insuring Offices did not advertise the program nor did they seek out potential eligible buyers. Rather, they informed participants in the real estate industry—brokers, builders, and mortgage lenders—of the terms of the program and waited for them to bring in applicants. In large part due to this design flaw, sellers were able to sell homes at above-market rates. Further, the combination of low or zero down payments, housing purchased in areas with low capital appreciation (or actual depreciation), and the inclusion of many families poorly prepared for homeownership led to high foreclosure rates, as some households ended up with negative equity in their homes after owning just a few months or years (Olsen 2003b). As a result, Congress eventually terminated the program. Over its history, Section 235 subsidized roughly half a million households.

Section 502. The Department of Agriculture’s Section 502 Rural Home Ownership Direct Loan Program provides direct loans to rural homeowners seeking to purchase homes or refinance existing mortgages. Over its 50-year history, the 502 Program has loaned over \$51 billion to nearly 2 million households. In 2001, more than half a million loans were outstanding, with 15,000 new direct loans made annually. In contrast to Section 235, this program has experienced few problems.

HOME. The HOME Investment Partnerships Program allocates federal block grants to state and local governments to spend on any type of housing assistance subject to certain limits on the incomes of the households served, the cost to acquire and develop units, and the rents that may be charged for rental units. Over its first decade, this program has provided homeownership assistance to about 270,000 homebuyers. Because HOME is an active program, and because different localities take different approaches to delivering homeownership assistance, it is the best source of information about the performance of different delivery sys-

tems. To date, little has been learned about any effect of the program on its intended beneficiaries, and the cost-effectiveness of alternative approaches has not been studied.

Experimental Housing Allowance Program. The Housing Allowance Supply Experiment operated an entitlement housing allowance program for ten years in the 1970s and 1980s in St. Joseph County, Indiana (which contains South Bend) and Brown County, Wisconsin (which contains Green Bay). The poorest 20 percent of the families in the two counties were eligible to receive assistance. The general structure of the housing allowance program in the Supply Experiment was the same as the Section 8 Voucher Program that HUD operated from 1983 until its merger with the new Housing Choice Voucher Program, except that homeowners were eligible to participate in the Supply Experiment. (Lowry 1983). About 42 percent of recipients were homeowners. Since the homeownership component of the experiment operated without any problems, its design surely contains lessons for the administration of current homeownership programs.

Other Programs. Several programs helped expand ownership by lowering borrowing costs. Mortgages backed by FHA, Fannie Mae, and Freddie Mac include an implicit interest rate subsidy because of federal government involvement. In a new proposal, the FHA would loan households 100 percent of the costs of buying a home. While such an initiative will likely expand homeownership, it may also lead to higher mortgage loan delinquency rates. Pressure by

the government to expand subprime lending has also probably expanded the availability of ownership opportunities. However, subprime lending has a higher-than-average delinquency rate, so it is not clear how much further that type of effort can be pushed. Table 2 shows the differences in delinquency and foreclosure rates between the prime and subprime markets. While 1.12 percent of prime mortgages are seriously delinquent, 7.36 percent, or nearly seven times as many mortgages, are in arrears in the subprime market.⁶

Congress has authorized a homeownership option under the Housing Choice Voucher Program, and HUD issued final regulations in October 2000. However, few housing authorities have adopted the option, and only a few hundred subsidized renters use their subsidy for homeownership. One important reason for the limited adoption of the homeownership option is that the regulations impose substantial administrative burdens on housing authorities without a commensurate increase in administrative budget.⁷

Overall Pattern of Housing Subsidies

Direct outlay programs for low-income renters represent a modest part of the federal budget for housing. By far the largest housing subsidies are tax subsidies for homeowners.

Table 3 summarizes federal housing outlays and tax expenditures over 1996–2010. As of 2005, the direct *outlays* total \$41 billion, most of which HUD spends on programs like Section 8 and public housing. In 2005,

TABLE 2. Loan Delinquency Rates, 2003

Mortgage type	Overdue			Foreclosure Status	Serious Delinquency ^a
	30 days	60 days	90+ days		
Prime	2.26	0.58	0.64	0.48	1.12
Subprime	6.75	2.12	3.98	3.38	7.36

^a Defined as the number of mortgages 90 or more days delinquent plus the number in foreclosure status. Source: Gramlich 2004. Based on data from the Loan Performance Corporation.

TABLE 3. Total Federal Housing Spending by Category and Size, 1996–2010
(In billions of 2005 dollars)

	1996	2000	2005	2010
Outlays				
Discretionary housing assistance ^a	\$31.34	\$31.80	\$37.22	\$33.84
Military family housing	4.50	3.77	3.94	3.98
Veterans housing (mandatory plus discretionary)	0.08	0.38	0.79	0.21
Mandatory housing assistance	0.11	0.01	0.03	0.03
Mortgage credit (mandatory plus discretionary)	-5.59	-3.68	-1.03	-4.58
<i>Total outlays</i>	<i>30.44</i>	<i>32.27</i>	<i>40.96</i>	<i>33.47</i>
Tax Expenditures				
Deductibility of mortgage interest on owner-occupied homes	\$55.87	\$66.57	\$68.87	\$92.79
Capital gains exclusion/deferral on home sales	23.08	20.48	32.84	64.98
Exclusion of net imputed rental income on owner-occupied homes	22.91	27.29	28.60	40.44
Deductibility of state and local property tax on owner-occupied homes	18.69	24.45	16.59	11.56
Credit for low-income housing investments	3.06	3.55	3.85	4.38
Other ^b	10.13	12.61	7.36	1.24
<i>Total Tax Expenditures^c</i>	<i>133.74</i>	<i>154.95</i>	<i>158.11</i>	<i>215.38</i>
Total Federal Housing Spending	\$164.18	\$187.22	\$199.07	\$248.84

^a The lion's share goes to Section 8 and public housing, but also includes homeless assistance, rural housing assistance, and other HUD programs.

^b Totals the following items: exception from passive loss rules for \$25,000 of rental loss; exclusion of interest on owner-occupied mortgage subsidy bonds; deferral of income from post-1987 installment sales; and accelerated depreciation on rental housing (normal tax method).

^c Tax expenditures are not strictly additive due in part to interaction effects among different tax provisions.

Source: The Urban Institute 2005. Based on data from the Budget of the United States FY 2006, Analytical Perspectives, Table 19-1 and unpublished Table 25-13. Converted to 2005 dollars using GDP implicit price deflator.

the largest of tax expenditures taken together—the mortgage interest deduction (\$68.9 billion), the capital gains exclusion on home sales (\$32.8 billion), the exclusion of net imputed rental income on owner-occupied homes (\$28.6 billion), and the property tax deduction (\$16.6 billion)—at about \$147 billion, represent more than three-and-a-half times all direct outlays on low-income housing assistance.⁸ This amounts to roughly \$1,960 in subsidies per owned dwelling in fiscal year 2005.⁹

A U-Shaped Housing Benefit Curve. To gain a comprehensive view of the distribution of housing benefits, we allocated the nation's major housing subsidies (public housing, Section

8 housing vouchers, and mortgage interest and property tax deductions) across income classes. We used data from the March 2002 Current Population Survey and the Urban Institute's Transfer Income Model (TRIM). Figure 2 illustrates the U-shaped nature of overall benefits. At the bottom of the income distribution, the outlay subsidies are almost entirely for renting. Families in the second quarter of the income distribution receive almost no subsidies—their income is too high for rent subsidies and too low to gain much from tax preferences. Middle-to-high-income households receive tax subsidies that are typically much larger: along with more income, they have tax rates as

well as mortgages, property taxes, and capital gains that are higher than among those with lower income.¹⁰

Low-income families actually face negative incentives to buy. Since the rental and public housing subsidies almost never can be converted into ownership, they effectively *discourage* ownership. Figure 3 shows the distribution of housing *ownership* subsidies—treating the subsidies for renting as negative subsidies for owning. The inescapable conclusion is that our patchwork of federal housing subsidy programs pays higher-income households to own their homes while paying some low-income households to rent.

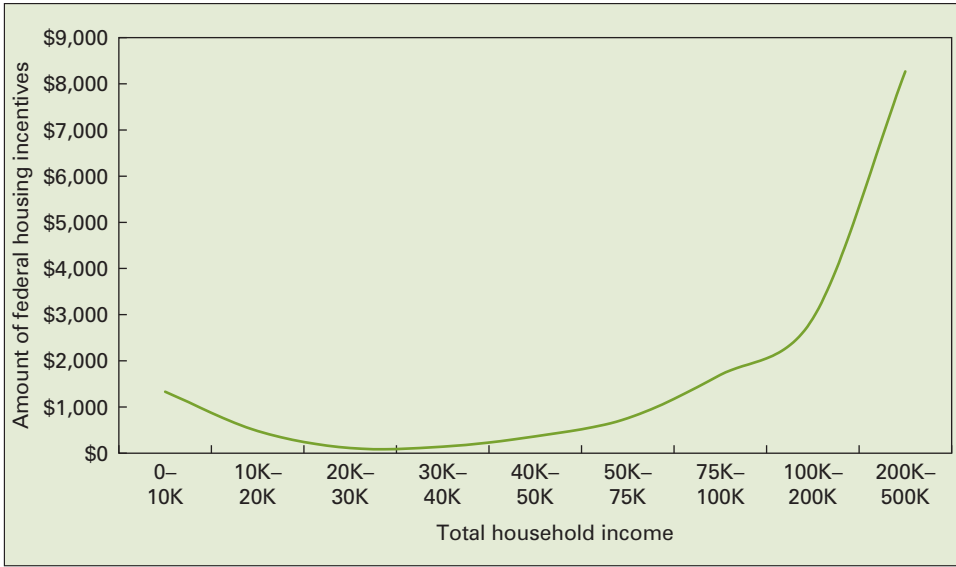
Figures 2 and 3, which rely on survey data, do not take into account several major programs that affect subsidies and are not reflected in the surveys. These are the excess of the untaxed gross rental income over and above interest and property tax costs (which flows to *all* homeowners as a result of owning their own home);¹¹ the Low Income Housing Tax Credit that subsidizes builders who in turn pass some fraction of these subsidies on to renters;¹² and the development of a subprime lending market, which improves affordability for many low-income owners. However, integrating these other programs into the analysis is likely only to make some of the differentials even starker, as its primary effect is to make the subsidies at the higher end of the income scale become even larger.

Future Research and Policies

A roundtable of experts convened at the Urban Institute in August 2004 to examine housing ownership suggested several policy and research ideas. They include the following:

- The United States may have reached a limit on realizing the ownership gains that arise from credit liberalization alone. Perhaps the goal now in this area should be to better insure that current low-income homeowners can retain their homes partly by building up equity.

FIGURE 2. U-Shaped Curve: Average Annual Federal Housing Benefits (Subsidies and Tax Deductions) by Total Household Income

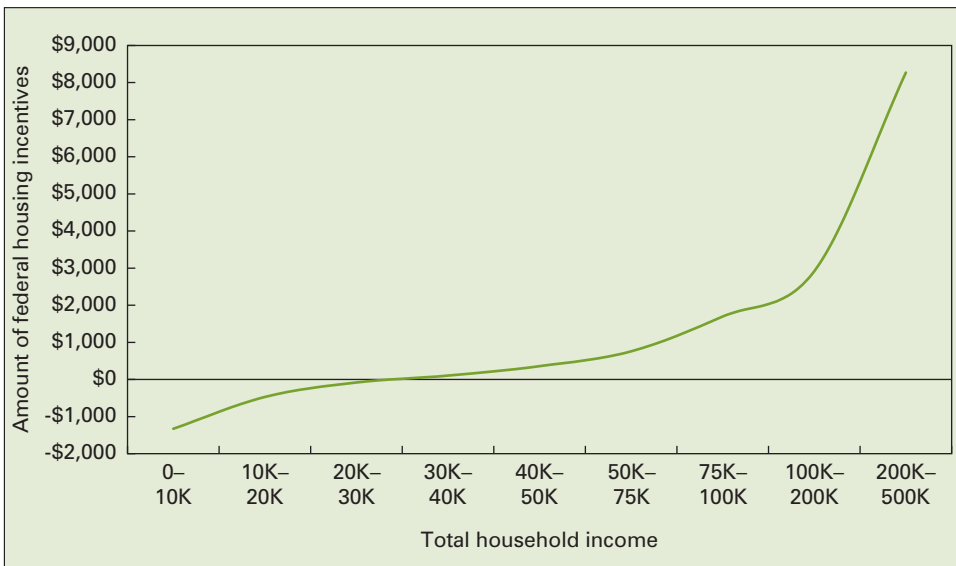


Source: The Urban Institute's Transfer Income Model (TRIM) 2004. The sample is restricted to individuals under 65 years of age.
 Notes: Chart includes households without subsidies. Housing subsidies include federal public or subsidized housing subsidies. Deductions include mortgage and property tax deductions. Not included are the exclusion of net imputed rental income; deductions such as an exception from passive loss rules for \$25,000 of rental loss; or accelerated depreciation on rental housing.

- Better data are needed to improve our understanding of housing programs as a whole. A start would be to produce better data sets by (1) linking the American Housing

Survey to administrative data on assisted households in all government housing programs, (2) selecting larger samples of assisted households, and (3) adding low-

FIGURE 3. S-Shaped Curve: Average Annual Federal Housing Incentives (Subsidies and Tax Deductions) by Total Household Income



Source: The Urban Institute's Transfer Income Model (TRIM) 2004. The sample is restricted to individuals under 65 years of age.
 Notes: Chart includes households without subsidies and counts federal public or subsidized rental subsidies as negative housing incentives. Deductions include mortgage and property tax deductions. Not included are the exclusion of net imputed rental income; deductions such as the exception from passive loss rules for \$25,000 of rental loss; or accelerated depreciation on rental housing.

income observations to the Survey of Consumer Finances.

- Studies of the behavior of renters versus owners requires following households over time to see how they react to a variety of different incentives. At the moment, we do not know how many renters would prefer to own but face serious obstacles to buying a home.
- With the expansion of low-income housing tax credits, new research is needed on how the benefits of tax credits are distributed among developers, nonprofit organizations, and low-income households; the program's cost-effectiveness relative to vouchers; and any increased bias tax credits create against homeownership.
- Current data indicates that continued work is required to identify specific barriers to homeownership by race, ethnicity, culture, or language—including whether concentrating subsidies on renting deters ownership, not just among low-income individuals, but in areas where low-income groups are concentrated.
- Tracking is required to determine the extent to which homeownership rates will decrease in response to increases in interest rates.
- A significant change in incentives (both for households and for officials such as those in housing authorities) is required if housing programs are to allow subsidized households to own, as well as to rent. A similar but not identical change in incentives is required if subsidized households are to be more readily allowed to move to better jobs and schools outside their housing authority area.
- Most importantly, the bottom of the U-shaped curve should be leveled out—perhaps by leveling out the tax subsidies available to individuals throughout the income distribution.

Notes

1. See, for example, Di, Yang, and Liu 2003 and Sinai and Souleles 2003.

2. Based on our own tabulations of wealth using the 2001 Survey Of Consumer Finances; and Di 2003.
3. Assuming the sellers lived in the home (as opposed to renting it out) for two years out of the prior five years. See IRS Publication 523 for details.
4. See, for instance, Duda and Belsky 2001; Gates, Perry, and Zorn 2002. Another driver of the increase in homeownership rates may be the joint decision in 1990 by Fannie Mae and Freddie Mac to drop underwriting guidelines that had required single women applying for mortgages to have cosigners.
5. A finding from using the 2001 Survey of Consumer Finances to regress homeownership (via a logit) on an array of economic, household, and demographic variables. This corresponds with similar findings in Bostic and Surette 2000, who used the 1998 Current Population Survey.
6. Mortgage revenue bonds and community development block grant funds are also used to subsidize homeownership for low- and moderate-income households. However, there have been few, if any, serious studies of the economic effects of either program.
7. For example, housing authorities must provide extensive counseling to recipients.
8. Here, we use the traditional measure of housing subsidy, namely, numbers from the government's tax expenditure budget.
9. We arrive at this figure by dividing \$147 billion by 75 million occupied owner households in 2005—our estimate based on the Census Bureau's 2004 fourth quarter data on the national housing inventory.
10. Collins, Belsky, and Retsinas (1999) make similar observations about the incentive effects of homeownership within the federal income tax and the disparity

between the sums spent on housing through tax expenditures as compared to outlays.

11. A renter pays for the privilege to live somewhere whereas an owner lives "rent free"—economically equivalent to someone else paying him rent on which he is not taxed.
12. See Olsen 2003a.

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Given the chance, many low-income families can acquire assets and become more financially secure. Conservatives and liberals increasingly agree that government's role in this transition requires going beyond traditional antipoverty programs to encourage savings, homeownership, private pensions, and microenterprise. The Urban Institute's *Opportunity and Ownership Project* held five roundtables in 2004 to explore these options. This policy brief series presents some of our findings, analyses, and recommendations. The authors are grateful to the Annie E. Casey Foundation for funding the roundtables and policy briefs and to the roundtable participants for their insightful comments.

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