HomeK Accounts: A Down Payment on Homeownership and Retirement

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Many potential homebuyers may face more—not fewer—obstacles in their path to homeownership.

Two years after the meltdown in the nation's housing market, housing remains weak. Home prices fell to a new low in the first quarter of this year—confirming a feared "double-dip" in the market. Prices are now down nearly 33 percent from their high five years ago.[1]

With housing and its related industries—construction, home retail, etc.—constituting almost 19 percent of the nation's economy over the last 40 years,[2] restoring the housing market will be essential to a sustained economic recovery. And key to this will be ensuring a robust market for first-time home sales.

Yet, even with home prices as low as they currently are, many potential homebuyers may face more—not fewer—obstacles in their path to homeownership. In the aftermath of the crisis, credit is tighter, as are down payment requirements. At the same time, the stresses of the economy have meant that potential homebuyers are in worse shape financially than they once were.

The creation of a new, tax-preferred mechanism for down payment savings—a "HomeK"—could help first-time homebuyers navigate these new hurdles while also promoting more savings. And if structured as a carve-out from existing retirement planning mechanisms, not as a new type of account, the HomeK would have the added benefit of promoting retirement savings and will not contribute to further tax code complexity.

How the HomeK Would Work

Under this proposal, an individual would have the option to segregate up to 50 percent of employee contributions into an existing retirement account (401(k), IRA, SEP) into a housing-specific "sub-account." Employer matching contributions would not be eligible for this set-aside, and the lifetime limit per individual would be $50,000 in pre-tax contributions.

The eligible use for the money in a person's HomeK set-aside would be for a down payment on a first home, provided that the loan does not exceed the applicable loan limits for a government-sponsored Federal Housing Authority (FHA) loan in that area. Buyers who qualify would be allowed a one-time disbursement of the money in their HomeK set-asides for this purpose. This disbursement would either be tax-free or at a steeply reduced rate, depending on their income:

Adjustable Gross Income	Applicable marginal tax rate
$0 to $75,000 (individual) $0 to $150,000 (couple)	5%
$75,000 to $125,000 (individual) $150,000 to $250,000 (couple)	15%
$125,000 or more (individual) $250,000 or more (couple)	No benefit

In addition, to discourage abuse of the mechanism, including "cash-outs" on a newly purchased home or investment-focused activity, buyers would be required to buy the home as a primary residence and would not be allowed to increase the original loan amount for two years in order to receive the full tax benefit of the HomeK set-aside. Moreover, there would be a one-year "vesting period" from the date of the first set-aside before a buyer could withdraw money under this mechanism.

Individuals would also be allowed to terminate the HomeK set-aside at any time, which simply means that the balances in the HomeK would revert to their original status as retirement savings without penalty.

SUMMARY

- Up to 50 percent set-aside from individual contributions to existing retirement accounts
- One-time disbursement for a down payment on a first-time home loan that does not exceed local FHA loan limits
- Tax-free disbursement for lower-income buyers and steeply reduce tax rates for (middle class) buyers
- One-year vesting period, principal residency requirement and two-year moratorium on loan increases to prevent abuses

Benefits of the HomeK

The HomeK proposal would provide a variety of benefits both to individual homebuyers and to the housing market as a whole:

- **Would eliminate or drastically reduce current penalties for withdrawals from retirement savings.**

Many Americans already draw down their retirement savings to pay for a home, but under current law, they do so under heavy penalty. Any permanent withdrawals from retirement accounts are subject to taxation as ordinary income, plus an additional 10 percent early withdrawal penalty. For example, if someone makes a $30,000 withdrawal from a 401(k) account that is subject to the 28 percent marginal rate, the total payable in taxes including the 10 percent penalty would be $11,400. These taxes would effectively reduce someone's available down payment to just $18,600. The other currently available option, loans from a retirement account, must be repaid with interest. There are also additional complications if an employee leaves an employer before the loan is repaid.

The HomeK would not need to be repaid. In addition, the savings cap would be higher than other traditional IRAs and with pre-tax dollars, unlike a Roth IRA.

The HomeK creates a near-term goal for young workers while using a long-term savings mechanism.

- **Would boost first-time housing demand.**

First-time homebuyers are both a key piece of the housing market in and of themselves as well as a catalyst for upstream demand. First-time homebuyers constitute 40 percent of home sales in a "typical" year—in the last two years, they accounted for 3.4 million of the 8.4 million homes sold.[3]

First-time homebuyers are a central source of the "churn" in the housing market that generates continuing demand. Sellers to first-time homebuyers are usually "trading up" to more expensive homes or building new ones. These sales in turn generate a cascading effect on the home building industry, home décor retail stores, furniture makers and so on. When potential new buyers sit on the sidelines, existing homeowners are stuck, unable to move out and up. According to the Washington Research Council, the multiplier effect of 12,000 additional first-time buyers would generate enough construction, resale and renovation activity to create as many as 8,500 desperately needed jobs. Potential wages and benefits from these jobs would total as much as $340 million, and the total increase in gross domestic product (GDP) on the *state* level would potentially be as high as $1.35 billion.[4]

- **Would encourage greater participation in retirement savings.**

As critical as it is for workers to start saving young, too many young people don't save for retirement. In 2009, only 13 percent of workers between ages 20 and 30 who have access to a 401(k) plan participate.[5]

But while retirement may be far from the minds of these young workers, homeownership is not. In 2009, the average age of a first-time homebuyer was 34.[6] The HomeK creates a near-term goal for young workers while using a long-term savings mechanism. Thus, young workers could be effectively "lured" into saving for retirement. And because employer matches would not be eligible for segregation into a HomeK set-aside, and because the HomeK set-aside would apply to a maximum of 50 percent of employee contributions, these workers would be contributing to their retirement savings as well.

Even though some may argue that this proposal encourages Americans to put their savings into a relatively low-return investment--a home--the benefits of early savings outweighs the costs of potential foregone returns from a higher-yield investment (such as stocks).

- **Would encourage "responsible" homeownership.**

Without doubt, risky behavior—including the extension of home loans to buyers with no down payment, no proof of income and other flaws—helped contribute to the housing market's collapse. As late as 2009, as many as one-fifth of first-time homebuyers made no down payment on their loans.[7] In this era, too many people were looking to homes as investments, not as assets, that could be quickly flipped or bought and sold like stocks.

Nevertheless, a home continues to be, as it should, the principal store of wealth and financial security for most middle-class Americans. HomeK would restore and promote this view by ensuring that first-time homebuyers put "skin in the game" by putting their own savings at stake. In addition, the money in a HomeK set-aside that is used for down payment would not be "spent" but instead transformed into equity that will serve as the foundation for even greater accumulation of wealth.

Why HomeK Now

The need for a new mechanism like the HomeK is urgent.

First, homeownership rates are declining and threaten to drop even more. While the peak rate of 69.4 percent in 2004 might be considered "too high," there's now a real danger of over-correction. In the hardest-hit Western states, the homeownership rate is as low as 61 percent[8], which is lower than the historic national average of 66.5 percent.[9]

Arresting this drop and restoring the homeownership rate to its historical stability is essential to the continued well-being of America's middle class. Homes are and will continue to be the largest asset that most Americans own. Homes are not just a place to live in; they are the engine of opportunity for many families. Home equity offers retirement security, collateral for starting a business, the ability to pay for a child's college education and more. Less homeownership means less opportunity for the middle class.

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Second, breaking into the ranks of homeownership promises to be increasingly difficult. Although some new restraint in credit standards is certainly warranted in the wake of the financial crisis, the danger now is overcorrection. Some economists say that overly tight credit standards are depressing home sales by as much as 15 to 20 percent.[10]

Conclusion

The HomeK is a simple, easy-to-administer and cost-effective proposal that would provide multiple benefits to middle-class families while helping to shore up the country's still-flagging housing industry.

Creating HomeK would help ensure that for tomorrow's homebuyers, the dream of homeownership doesn't stay just a dream, but a reality.

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About the Progressive Policy Institute

The Progressive Policy Institute (PPI) is an independent research institution that seeks to define and promote a new progressive politics in the 21st century. Through research and policy analysis, PPI challenges the status quo and advocates for radical policy solutions.

Appendix—Questions and Answers

Isn't this going to add more complexity to the tax code?

No. The HomeK is a set-aside *inside* an existing retirement account mechanism—the 401(k). It is not a separate account.

If the goal of HomeK is to encourage retirement savings, why encourage people to invest in a home versus keeping their money in stocks, which have a higher historical rate of return?

The problem is that too many young people are not opening retirement accounts and saving at all. HomeK gives younger savers a short-term goal that would create an incentive to open a 401(k) account early. The potentially lower rate of investment return from buying a home would be more than offset by the increased participation in retirement accounts by younger workers, the accumulation of equity by these individuals and the social and community benefits of homeownership.

Will this cost the federal government a lot of money?

It may cause some revenue losses to the government if more people are opening retirement accounts and then withdrawing the money earlier at a lower rate (versus paying a higher rate of taxes at a later date). However, the HomeK has several features that make it more likely to be a relatively cheap way for the government to stimulate demand: (1) it's a set-aside in an existing mechanism, not a separate account; (2) withdrawals are not wholly tax-free but at a discounted rate; (3) participation is voluntary; and (4) there is no federal match for the money put into the set-aside account.

Endnotes

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