

# Challenges for Affordable Housing in a New Era of Scarcity

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## Introduction

Nearly a quarter of all U.S. working households, and over 80 percent of the nation's lowest-income working renter households, faced a severe housing cost burden in 2010, spending at least 50 percent of their income on housing costs.<sup>1</sup> Figures like these have jumped dramatically in recent years. Since 2007, the number of renter households experiencing severe housing cost burdens surged by 43.5 percent, or 2.5 million households; the same measure rose just 3.2 percent between 2001 and 2003.<sup>2</sup>

These statistics demonstrate the rapidly growing need for affordable housing in the United States following the Great Recession, yet providers and seekers of affordable homes face multiple challenges in their efforts to develop, finance, or secure quality housing at a reasonable price. Scarcity of funding and policy challenges in both project- and individual-based affordable housing programs require limited resources to be stretched ever thinner to serve as many low- and moderate-income (LMI) community members as possible without compromising quality. These conditions call for innovation at every stage of the development and operations process, and despite a number of success stories, the tremendous gap only grows each year between the supply and demand for affordable homes in the United States. Millions of households lost income during the recession, faced mounting debt that compromised their financial stability, and lost their homes to foreclosure. Many owner households became renter households within the past five years, a significant shift that places even greater pressure on an already expensive and often tight rental market, especially for lower cost rental homes.

Four parallel issues lie at the root of the current affordable housing challenge. First, despite increased affordability among homes available for purchase, mortgage lending standards have tightened and investors are buying properties for cash in large quantities in some markets, effectively shutting out many LMI households from new ownership opportunities. Second, changing demographics and the foreclosure crisis have added to the population of renter households, many of which – along with existing financially burdened low-income renters – cannot afford much of the rental housing that the market currently provides. Third, affordable housing development costs are rising. Despite these cost increases, developers face increasing pressure to contain costs due to significant cuts to housing funds at all levels of government and the impacts of the larger recession, resulting in a sharply decreased pool of resources to work with at exactly the moment that affordable homes are most desperately needed. Fourth, current housing policy and programs have not yet evolved to better address this growing need in the United States for affordable rental and ownership housing opportunities. The majority of housing policy and subsidies in the United States effectively benefit higher-income homeowners, rather than targeting increasingly limited resources toward LMI households with the most challenging and significant housing needs. This article explores these four issues in greater detail and what they mean for the future of affordable housing.

## The Market

Though the overall housing market continues its steady recovery and home prices are reaching affordable levels in many markets across the country, two issues make it difficult for LMI households to enter or rejoin

the market as homeowners. First, since early 2012, market trends in several large metropolitan areas reveal the rapid rise of institutional and individual investors purchasing distressed properties in large quantities for cash, elbowing out potential homebuyers who lack these cash resources. In markets with a large stock of foreclosed properties, including Phoenix, Las Vegas, and Miami, investors seeking to buy properties with cash are now a strong force in the market, with large institutional investors behind more than 20 percent of sales in some markets.<sup>3</sup> Investors purchase these distressed properties in bulk and hold them off the market or convert them into single-family rental homes, a fast-growing segment of the housing market. While not yet a national phenomenon and largely concentrated in certain metro areas, particularly in the South and Southwest, this investor activity drastically changes the landscape of homeownership opportunity in these markets. Because individual LMI households and other traditional homebuyers typically require a loan or LMI homeownership program financing to purchase a home, investors who can make quick and complete cash transactions receive significant preference from sellers, blocking LMI households from these lower-priced homes. Such investor activity also drives up prices on single-family homes in these regions, again frustrating potential LMI buyers who cannot afford higher purchase prices.<sup>4</sup>

Second, even where affordable homes are available, potential LMI buyers may find it nearly impossible to obtain a mortgage loan, with wary lenders sharply tightening their lending standards since the recession. A 2012 Center for Community Capital and Center for Responsible Lending study found that setting a borrower FICO score minimum at 690 would prevent significant portions of the low- and moderate-income and minority population from qualifying for a loan. This study looked at purchase loans originating between 2004 and 2008, and only considered performing loans that were not more than 90 days delinquent or in foreclosure as of February 2011. Even among these loans in good standing, however, 39 percent of low-income and 30 percent of moderate-income borrowers with such performing loans would be excluded if the additional 690 or above credit score limit were imposed, and 42 percent of African American and 32 percent of Latino borrowers with such loans would also be excluded if that credit score restriction were in place.<sup>5</sup>

### **Demographic And Market Shifts**

According to the Joint Center for Housing Studies, the United States lost one million owner households between 2006 and 2011, but added over five million renters between 2001 and 2010, with over two million of these new renter households earning \$15,000 or less per year. At the same time, 470,000 units that would have been

affordable and available to LMI households disappeared from the market, and over 40 percent of the remaining homes affordable to LMI renters were instead occupied by higher-income households in 2010.<sup>6</sup>

In part, these figures reflect the recent trends of former homeowners becoming renters and new households forming, including “echo boom” individuals in their 20s beginning to move out of their parents’ homes following a delay in new younger household formation during the recession.

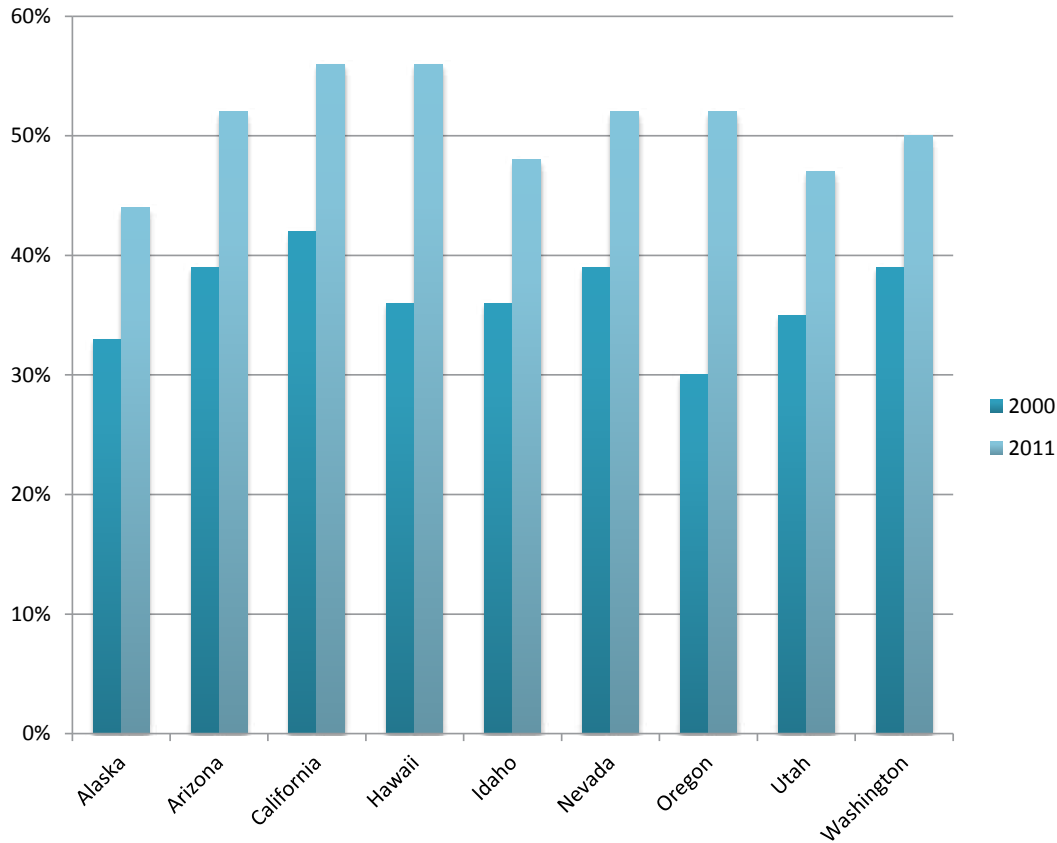
Demographic trends are projected to increase demand pressure on already scarce metropolitan area rental units. Researchers project that of the 11.8 million new households expected to form between 2010 and 2020, roughly 70 percent will be headed by a minority householder; 37 percent single-person households; 42 percent married couples without children; and 12 percent unrelated non-partner individuals living together.<sup>7</sup> Aging seniors are also expected to move out of the homes they own as they grow older and can no longer manage to live comfortably or independently in these single-family properties. All of these groups are traditionally more likely to rent than own their homes, further growing the pool of American renters. Because many of these new or shifting households are predicted to seek rental properties in job-rich metropolitan areas with access to transportation and amenities, even those who wish to rent a single-family home are less likely to choose suburban properties either turned into rentals due to foreclosure or released by seniors moving out.<sup>8</sup>

If current income and rent patterns persist, many renter households also face significant affordability challenges. The U.S. Department of Housing and Urban Development emphasizes that the number of renters with “worst case housing needs” – unassisted, very low-income households paying more than half of their income for housing or living in substandard housing conditions – continues to rise above record levels: there were nearly 8.5 million of these households in 2011, up from 7.1 million in 2009. HUD attributes this increase to “falling incomes among renters, a continuing shortage of housing assistance, and increased scarcity of affordable housing.”<sup>9</sup> With median monthly rent for new units consistently rising each year since 2006, “stepped up efforts to preserve the existing low-cost rental stock will be necessary to help meet rapidly growing demand among low-income households,” as the Joint Center for Housing Studies report stresses. “With rents on most newly constructed units well out of reach, the recent jump in multifamily production will do little to alleviate the shortage.”<sup>10</sup>

### **Development Costs**

Affordable housing developers are struggling to meet the growing need for reasonably priced homes, in part

Figure 1. Percent of Renter Households Paying More than 30% of Income on Housing, 2000 vs. 2011



Sources: Census 2000 Summary File 3, American Community Survey 2011 5-year estimates.

because of mounting development costs, which can be significantly higher than market rate properties in some areas. Practitioners point not only to increases in basic construction costs like labor and materials, but also to lengthy approvals processes for permitting, environmental remediation, design adjustments to appease resistant community members, and other delays that significantly expand the construction timeline and add legal and other costs to projects.<sup>11</sup>

Moreover, recent cost containment forums in Washington, California, and the District of Columbia reveal that the requirements that must be fulfilled in order to receive funding through government programs often create some of the biggest logistical hurdles for developers, and as a result significantly drive up costs. However, these requirements – which may include siting a development near public transit and amenities; employing green building techniques or design features to accommodate special needs residents; paying prevailing wage rates paid to construction laborers; and providing on-site resident services such as child care, after-school programs, or health clinics – are also central components of building and op-

erating long-term affordable properties that best serve LMI residents. Because developers must assemble a funding package from an average of five sources per project, with each program source typically carrying its own separate requirements, costs can quickly compound.<sup>12</sup>

Public and political pressures are mounting to reduce development costs, and some developers and advocates worry that this may lead lenders to fund only lower-cost development proposals that ultimately result in lower-quality properties without important service components or long-term affordability clauses. Some also express growing concern about the political vulnerabilities created by an expensive development system that has real cost justifications but is difficult to concisely explain, fearing that it leaves thinly-funded housing programs open to further cuts on the basis of perceived excessive spending.<sup>13</sup>

### Policy And Funding

Drastic program cuts and policy shifts at all levels of government further complicate this cost containment issue, and introduce a layer of uncertainty that hinders an efficient development process. National program cuts,

such as those in 2011 to the HOME Investment Partnerships program and the impact of sequestration on existing Section 8 housing vouchers, compound major state and local losses, such as California's elimination of redevelopment agencies in 2012.

Some researchers argue that existing federal housing policies and programs are not properly designed to channel limited resources into housing interventions that meet the needs of lower-income households, particularly those who rent their homes. Fully 84 percent of federal housing dollars are directed solely toward homeowners.<sup>14</sup> In particular, the mortgage interest deduction (MID) is one of the largest federal housing expenditures, amounting to \$396 billion from 2007 to 2011.<sup>15</sup> Very few LMI homeowners claim the MID because homeowners at this income level typically do not itemize their taxes, the only way that a household can claim the MID. Additionally, far fewer LMI households in the United States own homes at all, automatically excluding the majority of these households from the most substantial U.S. housing credit with no parallel credit opportunity for renters. John Landis and Kirk McClure point out that the MID strongly benefits higher-income homeowners, with 36 percent claimed by households with annual incomes of \$100,000 or more, and another 40 percent claimed by households earning between \$50,000 and \$100,000 annually.<sup>16</sup>

On the development subsidy side, multifamily housing also receives considerably fewer federal assistance dollars than do single-family homes. Between 2007 and 2011, the Federal Housing Administration, the largest public residential development lender in the U.S., made nearly \$1.1 trillion in loan guarantees for single-family homes, while multifamily developments received one-tenth of that amount (\$112 billion). No federal funding is specifically designated for smaller multifamily buildings with five to 50 units, even though one-third of American renters live in this type of housing.<sup>17</sup> Regular cuts to programs including HOME, Community Development Block Grant funds used for housing, and other rental housing development subsidies in each recent annual federal budget cycle further restrict multifamily housing funds and create an unpredictable funding environment for affordable housing developers.

While there are policies and resources that support homeownership among wealthier Americans, there are fewer supports that address the great and growing need for assistance among the nation's lower- and middle-income population. Those with middle-wage incomes are the least likely to receive any federal housing support at all, while those earning over \$200,000 per year receive almost three times the subsidy of all other American households combined.<sup>18</sup> As Landis and McClure concisely state, "the current distribution of homeownership

subsidies disproportionately favors those who would have the least trouble attaining homeownership in the absence of government subsidies."<sup>19</sup>

## Conclusion

These current challenges facing affordable housing are complex, and overcoming them successfully requires innovation and cooperation between multiple sectors and stakeholders. This issue of *Community Investments* presents some of the many creative initiatives now underway or in the planning stages to help increase the supply of affordable homes despite diminished traditional resources. Affordable housing practitioners are thinking outside the box and venturing into new funding and policy possibilities, seeking options that aim to stabilize and improve housing choices for low- and moderate-income households.

Some of these efforts involve new housing finance structures, either through new public-private partnership opportunities such as those described by Heather Hood, or cross-sector models like the housing and health care joint efforts discussed by Kevin Boes. Other ideas work within existing programs; Bill Kelly and Toby Halliday examine ways to streamline and increase the flexibility of governmental programs for wider and more efficient use in affordable housing development and provision. Still other innovative solutions link housing with the transportation and energy sectors to support smart growth goals, or incorporate targeted funding approaches such as social impact bonds.

As the United States continues to rebound from the Great Recession, innovative efforts and partnerships including those discussed in this issue of *CI* can help to ensure that low- and moderate-income Americans are able to access a range of safe and decent housing options. Making connections across sectors is also crucial to the success of future housing initiatives and to supporting strong communities. As Federal Reserve Chairman Ben Bernanke recently observed, "neighborhoods and communities are complex organisms that will be resilient only if they are healthy along a number of interrelated dimensions, much as a human body cannot be healthy without adequate air, water, rest, and food. But substantial coordination and dedication are needed to break through silos to simultaneously improve housing, connect residents to jobs, and held ensure access to adequate nutrition, health care, education, and day care."<sup>20</sup> Moving forward, policy and programmatic initiatives like those described in this issue that weave together housing affordability goals with such arenas as health and environmental sustainability support the value of a stable home as a base for the success and well-being of low and moderate income households and their communities. **CI**

# Endnotes

## Challenges for Affordable Housing in a New Era of Scarcity

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- 13 "High Development Costs Under Scrutiny," Affordable Housing Finance, July 1, 2012.
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- 15 Ibid.
- 16 John D. Landis and Kirk McClure, "Rethinking Federal Housing Policy," *Journal of the American Planning Association*, Vol. 76, No. 3, Summer 2010.
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## Diversification of Capital Creates Fresh Focus

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- 2 Ludwig, Terry, "Pay for Success: Building on 25 Years of Experience with the Low Income Housing Tax Credit," *Community Development Investment Review*, Federal Reserve Bank of San Francisco, Vol. 9, Issue 1, 2013.

## Putting Housing Program Delivery into High Gear

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- 2 These properties had financing from the Department of Agriculture's Rural Housing Service rather than HUD, but most of the same issues applied.
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## Improving Financial Stability by Building the Capacity of the Local Community

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