A Discussion Paper

America's Housing Policy—the Missing Piece

AFFORDABLE WORKFORCE RENTALS

J. Ronald Terwilliger

Urban Land Institute
Terwilliger Center for Housing

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About ULI

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About the Author

J. Ronald Terwilliger, chairman of the ULI Terwilliger Center for Housing, is chairman emeritus of Trammell Crow Residential, a national residential real estate company. He is an honors graduate of the U.S. Naval Academy and received his MBA from the Harvard Business School.

He is past chairman of the Urban Land Institute and is chairman emeritus of the Wharton Real Estate Center. He currently is chairman of the board of directors of the "I Have a Dream" Foundation, chair of Enterprise Community Partners and Enterprise Community Investments, and chair of Habitat for Humanity's $4 billion World of Hope global capital campaign.

Philanthropically, Terwilliger made a $5 million gift to establish the ULI Terwilliger Center for Housing and a $5 million gift to the Enterprise Foundation, creating the Enterprise Terwilliger Fund, which aims to create 2,000 affordable homes annually. His $100 million legacy gift to Habitat for Humanity International will help 60,000 families worldwide access improved housing conditions.

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Executive Summary

In the coming decade, the demand for rental housing will dramatically surge to reflect changing demographics, economic conditions, and housing preferences. The effect of this demand will be strongest in the high-cost metropolitan areas of the United States.

America's leaders should anticipate this emerging reality and adjust federal housing policy accordingly. The affordable rental needs of two groups in particular merit increased federal attention: low-income households (those with incomes below 60 percent of area median income, or AMI) and "workforce" households (those earning between 60 and 120 percent of AMI, whose members often work in the country's most expensive regions).

Homeownership has benefited millions of Americans and their families. Nevertheless, the current policy of oversubsidizing homeownership (even for the wealthiest Americans) and undersubsidizing rental housing for low-income and workforce households makes little sense. In fiscal year 2010, federal support for housing amounted to approximately $207 billion. The federal government devoted more than 75 percent of this amount to supporting homeownership, whereas less than 25 percent was devoted to improving rental affordability.

Rental housing is becoming increasingly unaffordable, putting stress on families and their budgets. Harvard University's Joint Center for Housing Studies estimates that by 2009 the share of at least "moderately cost-burdened" renters (those spending between 30 and 50 percent of their income on housing) had shot up to 49 percent of all renters. The share of "severely cost-burdened" renters (those spending more than 50 percent of their income on housing) also spiked, jumping to 26 percent by 2009. Although these trends have hit the lowest-income renters particularly hard, the increasing expense of rental housing is a big concern for workforce households as well.

Despite these rising costs, the demand for rental housing is expected to increase dramatically in the coming decade. The 78 million–strong echo boom generation (those born after 1986) is about to hit the rental market like a tidal wave. Many of these echo boomers will seek rental housing in city centers, close to employment and transportation. In addition, minorities and households without children—two groups more traditionally likely to rent—are expected to make up an even larger share of new household growth moving further into the decade.

These demographic changes will put tremendous pressure on the demand for affordable rental housing, particularly in high-cost metropolitan markets. Moreover, for many households, renting may in fact be the only option as tighter mortgage underwriting standards preclude homeownership or delay the decision to purchase.

Unfortunately, in many urban markets, the supply of affordable rental housing is likely to be insufficient to meet the expected increase in demand. In recent years, construction of multifamily apartments (buildings with five or more units) has dropped to historic lows as unemployment spiked, wages stagnated, and construction financing evaporated. Although multifamily construction has picked up recently, it is likely to fall far short of what is needed to replace those units that have become obsolete and to match the expected explosion in demand over the coming decade.

If current trends hold true, at least 3 million new multifamily rental units will be needed over the next ten years (2011–2020). Government support is essential to (a) help stimulate private production of affordable rental housing to higher levels, (b) assist in the preservation of existing affordable units, (c) ensure sufficient capital to help finance new multifamily construction, and (d) encourage local communities to eliminate regulatory barriers that restrict higher-density development near transportation and employment centers.

A renewed commitment to affordable rental housing is not just the *right* thing to do; it is the *smart* thing to do. New multifamily rental construction generates significant economic activity that can create hundreds of thousands of new jobs and provide much-needed tax revenue for local communities. In fact, using estimates developed by the National Association of Home Builders (NAHB) one can estimate that building 1 million new multifamily rental units in the nation's metro areas could generate as many as 1.2 million jobs and more than 300,000 additional jobs in the years that follow the initial period of construction.

In today's highly competitive globalized world, America requires a dynamic, mobile workforce that can respond quickly to a changing marketplace. Renting gives working families the flexibility to relocate that a modern economy demands. In addition, using higher-density rental housing to help families live closer to transportation hubs and centers of employment reduces energy consumption and promotes sustainable development.

America's leaders are appropriately engaged in reducing the nation's mounting debt. But as they set new priorities for the country, they should understand that the household budgets of millions of American families, already strained by wages that have lagged behind rental costs, will come under renewed stress as a huge wave of new renters enters the market during the remainder of the decade. If America is to remain committed to providing "a decent home and suitable living environment for every American family"—a goal first articulated in the Housing Act of 1949—then refocusing federal policy to respond to this expected surge in rental demand is the responsible choice to make.

Appendix B suggests several actions that Congress might take as part of this refocusing. These suggestions recognize that federal resources devoted to housing are limited and unlikely to increase in the current budget environment where deficit reduction is the top priority. For this reason, one suggestion is that a portion of those resources currently devoted to subsidizing homeownership through the mortgage interest deduction be redirected to support rental housing production and preservation.

America's Housing Policy

LOOKING AHEAD

The "Great Recession" continues to wreak havoc across America. Nearly 14 million Americans are currently out of work, more than 8 million more are underemployed or looking for a full-time job, and hundreds of thousands have simply withdrawn from the job market, discouraged by their employment prospects.[1]

Although much has been written about the causes of this nation's economic troubles, general agreement exists that unsustainable housing prices were a core issue. Fueled by historically low interest rates, easy credit, regulatory failure, and lax underwriting standards, too many Americans purchased homes they simply could not afford. The issuance of hundreds of billions of dollars' worth of securities backed by these unsustainable mortgages virtually guaranteed that the collapse of the housing market would have devastating ripple effects throughout the U.S. and global economies.

Since early 2007, millions of American families have lost their homes to foreclosure. Some analysts predict that as many as 13 million homes could enter foreclosure by the time the housing market finally bottoms out.[2] To date, the precipitous decline in housing prices has destroyed some $9 trillion in household wealth, with more losses expected.[3]

It is tempting to draw the *wrong* lessons here—to conclude that federal policy has overemphasized housing or that the federal government should withdraw altogether from trying to meet the housing needs of its citizens. These conclusions, although understandable, are fundamentally flawed.

The goal articulated by Congress in the Housing Act of 1949—that every American family should have a "decent home and suitable living environment"—remains valid today. Like food and clothing, housing is essential. We all need a place to live, a place to rest after a hard day at work, a place to raise our families and call home. For our children, decent housing generally means better health, improved educational performance, and stronger ties to community and country.[4] Even as America struggles with its debt crisis, to abandon the aspiration expressed in the 1949 act as unachievable should be unacceptable to the world's wealthiest nation.

Instead, the focus of America's leaders must shift to make room for rent—a renewed emphasis on affordable rental housing, particularly in the high-cost regions of the United States.

Increased Rental Demand

As the homeownership rate has dropped from a high of 69.4 percent in the second quarter of 2004 to 66.1 percent today,[5] the number of renters has increased dramatically—in fact, by almost 4 million since 2004.[6] Millions of Americans now have a greater appreciation for the financial flexibility of renting—no mortgage downpayment, no worries of plummeting home values, lower transaction costs, enhanced mobility, and freedom from regular maintenance and repair work.[7] For many Americans, renting may be the only option as tighter mortgage underwriting standards preclude homeownership or delay the opportunity to purchase.

The demographics of America are also changing: those groups that have traditionally been renters—young adults, minorities, childless households—are expected to make up an even larger share of all new households as we move deeper into the decade. These demographic changes will put tremendous pressure on the demand for affordable rental housing, particularly multifamily housing in large metropolitan markets.

WHAT IS "AFFORDABLE" HOUSING?

The commonly accepted definition of *affordability* is that a household should pay no more than 30 percent of its annual income on housing (including utilities). Families paying more than 30 percent of their income on housing are viewed as "cost burdened." Families paying between 30 and 50 percent of their income are considered "moderately cost burdened," while those paying more than 50 percent are considered "severely cost burdened." Cost-burdened families may have difficulty paying for nonhousing necessities such as food, clothing, transportation, and medical care.

Many experts now recognize that affordable housing by itself is insufficient if it means that families must make long and expensive car trips to get to jobs and other key locations. These experts suggest that the *combined* cost of housing and transportation is a more appropriate gauge of "affordability."

Unfortunately, the supply of affordable rental housing is insufficient in areas where it is most needed. In recent years, construction of multifamily apartments (buildings with five or more units) dropped to historic lows as unemployment spiked, wages stagnated, and construction financing evaporated. Although multifamily construction has picked up recently, it is likely to fall far short of what is needed (a) to replace units that have become obsolete and (b) to match the explosion in demand anticipated over the coming decade. If current trends hold true, an additional 3 million multifamily rental units are likely to be needed over the next ten years (2011–2020).

A renewed commitment to affordable rental housing is not just the *right* thing to do; it is the *smart* thing to do. As the economy recovers, America will rely on a dynamic, mobile workforce that can respond quickly to a changing marketplace. How often has it been said that people say they are "locked" into the homes they own? Renting gives working families the flexibility to relocate that a modern economy demands.

In addition, building higher-density multifamily housing to help families live closer to transportation hubs and centers of employment reduces energy use and promotes sustainable development. It can make for a better quality of life as commute times decline, time with family increases, and the share of the family budget devoted to transportation becomes more manageable.[8]

WHAT IS A "WORKFORCE" HOUSEHOLD?

The ULI Terwilliger Center for Housing defines a *workforce household* as one earning between 60 and 120 percent of AMI. Many workforce households include police officers, firefighters, and workers in high-growth industries such as education, health care, and professional services. Rental housing is a key form of affordable housing for many workforce families, particularly in those communities where the existing stock of for-sale properties continues to be priced well above what they can afford.

Before exploring these issues further, this paper reviews how the federal government has tried to meet the housing needs of its citizens.

A Brief Overview of Federal Housing Policy

The federal government's forays into housing were designed to achieve goals beyond just providing shelter. For example, Congress was focused on aiding the war effort in 1918 when it created the United States Ship-Building Corporation and authorized $100 million for 5,000 homes for defense workers.[9] Similarly, when Congress passed the National Housing Act of 1934 and created the Federal Housing Administration (FHA) to insure single-family mortgages, it was hoping not only to stimulate private lending but also to rescue the country from a wave of foreclosures and unemployment brought on by the Great Depression.

Congress first articulated a national housing policy with the 1949 Housing Act, which authorized production of more than 800,000 housing units for veterans returning from World War II.[10] In the act's preamble, Congress pledged itself to "the realization as soon as feasible of the goal of a decent home and suitable living environment for every American family." This goal has been reaffirmed in subsequent legislation—in the Housing and Urban Development

Act of 1968, the Housing and Community Development Act of 1974, the Housing and Community Development Act of 1987, and the 1990 Cranston-Gonzalez National Affordable Housing Act.[11] The notion that "decent and suitable" housing should also be "affordable" was a key element of these federal initiatives.

So how has the federal government pursued the vision of the 1949 Housing Act over the past 60 years? In short, it has embraced a two-track approach. First, it has made support for homeownership a major focus of federal policy. Second, to a much lesser degree, it has promoted affordable rental housing for low-income families through both tax and cash subsidies. Very little help has been available for workforce households.

Federal Focus on Homeownership

For many of America's citizens, homeownership has been synonymous with the American dream. Their home has been—and for some still remains—their single biggest asset. The federal government has vigorously supported homeownership using a combination of tax benefits, credit enhancements, regulatory tools, and cash subsidies.

Before 1986, all consumer interest was tax deductible, including interest on credit card debt. The Tax Reform Act of 1986 eliminated this broad deduction but preserved two of the most significant federal initiatives supporting homeownership: the mortgage interest deduction allowing homeowners to deduct interest on mortgages of up to $1 million and the deduction for local property taxes.[12] The Taxpayer Relief Act of 1997 went a step further by exempting from capital gains tax any gain up to $250,000 ($500,000 for a joint return) from the sale of a primary residence. All homeowners, regardless of income level, are entitled to these tax benefits.

The insurance programs of FHA and the loan guaranty program of the Department of Veterans Affairs have provided critical credit enhancements for individual mortgages and have made purchasing a home affordable for millions of low- and moderate-income Americans. Congress established Fannie Mae (the Federal National Mortgage Association), and later Ginnie Mae (the Government National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation), to support a "secondary market" for mortgages with the goal of keeping mortgage funds plentiful and mortgage rates affordable.[13] The Community Reinvestment Act of 1977 has encouraged banks to extend mortgage credit to low-income and minority communities. Congress

has also supported homeownership in rural America by authorizing the U.S. Department of Agriculture (USDA) to aid low-income borrowers in rural communities through direct loans and guaranteed mortgages.

SUBSIDY TARGETING BASED ON INCOME

Most of the housing and community development programs of the U.S. Department of Housing and Urban Development (HUD) serve low-income households. HUD differentiates among three levels of low income: low, very low, and extremely low.

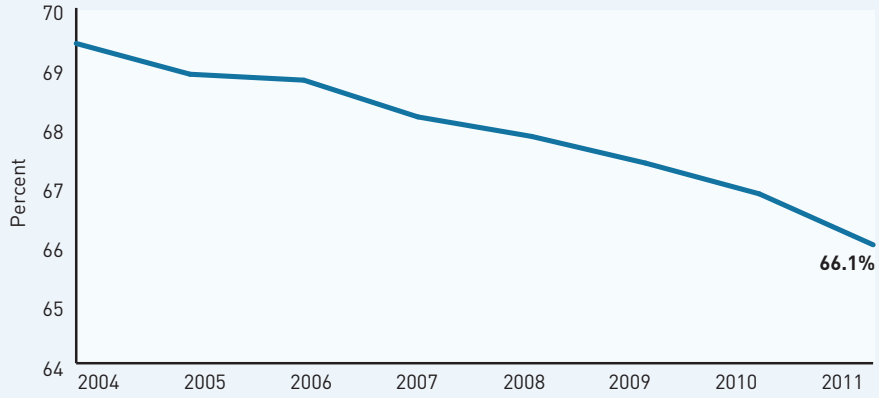
- *Low-income* households earn 80 percent or less than the median income of the county in which they live, also known as area median income (AMI).
- *Very low-income* households earn 50 percent or less of AMI.
- *Extremely low-income* households earn 30 percent or less of AMI.

In determining program eligibility, each of these income levels is normally adjusted based on family size.

Starting in the early 1990s, a central theme of federal housing policy has been to expand homeownership among minorities and in communities not adequately served by the mortgage market.[14] In 1992, for example, "affordable housing" goals were established for Fannie Mae and Freddie Mac, requiring them to purchase mortgages made to low-income borrowers and in underserved communities. Eleven years later, Congress passed the American Dream Downpayment Act, authorizing $200 million annually to help defray downpayment and closing costs for low-income buyers purchasing homes for the first time.

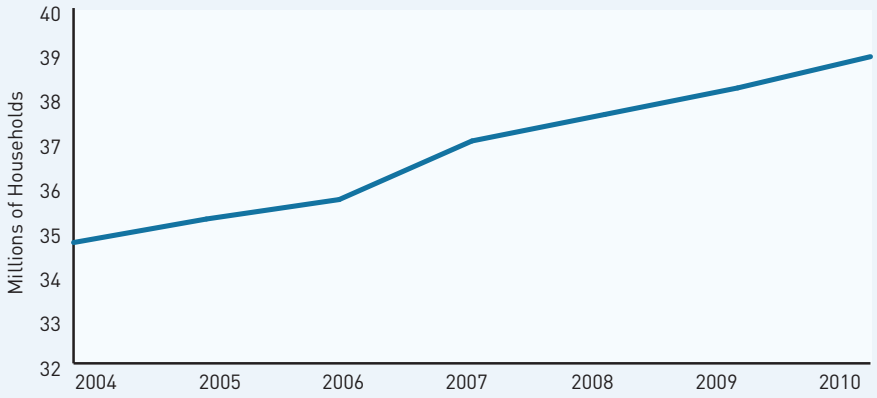
Despite the good intentions of policy makers, the American dream of homeownership has unfortunately turned into a nightmare for far too many families. The potent mix of low interest rates, lax underwriting standards, and in some cases outright fraud, encouraged many people to buy homes they eventually could not afford. Many took out mortgages that offered artificially low "teaser" rates, but which required payments to increase dramatically after only a few years. The presumption often was that owners could refinance into another affordable loan—or sell their home and reap a sizable profit—before the higher payments took effect. However, when interest rates began to rise, home values began to fall, and job losses began to mount, many owners found they could no longer refinance out of a burdensome mortgage. Ultimately, they could not afford to remain in their homes.

FIGURE 1A **U.S. Homeownership Rate**



Source: U.S. Department of Commerce, Bureau of the Census.

FIGURE 1B **U.S. Rental Households**



Source: U.S. Department of Commerce, Bureau of the Census.

With the bursting of the housing bubble, the country is witnessing a continued decline in the homeownership rate that first began in 2004. Not surprisingly, the number of renting households has increased substantially over the same period. (See figures 1a and 1b.)

Subsidized Rental Assistance

Three programs currently help define federal rental housing policy: public housing, Section 8 vouchers, and the Low Income Housing Tax Credit (LIHTC). All three programs are designed to assist low-income and very low-income households. In contrast, no federal program's current primary mission is to help meet the housing needs of workforce families.

PUBLIC HOUSING

First authorized in the Housing Act of 1937, public housing was the nation's first large-scale subsidized housing program. Today, approximately 1.2 million low-income households live in public housing units that are managed by some 3,300 local public housing agencies (PHAs). HUD administers federal aid to these agencies that, in turn, offer subsidized rents for their low-income tenants. Public housing comes in a variety of types and sizes, from large towers to smaller, low-rise apartments and even some single-family houses. In 1993, in response to concerns that public housing had concentrated low-income families into pockets of poverty, Congress enacted the HOPE VI program with the goal of replacing some of the nation's most distressed public housing projects with new, and often smaller, mixed-income developments. By 2006, approximately 150,000 public housing units had been replaced under HOPE VI, though the program has resulted in a net loss of subsidized housing units dedicated to very low-income renters.

SECTION 8

In 1974, Congress passed the Housing and Community Development Act and created the Section 8 Housing Allowance program (later renamed the Housing Choice Voucher program in 1998). Section 8 provides eligible households with a monthly allowance for renting an existing unit in the private market. The allowance is calculated as the difference between 30 percent of the household's income and the "fair market rent" in the area where the unit is located. Housing choice vouchers are administered locally by PHAs. A family receiving a housing voucher from the PHA is responsible for identifying a suitable housing unit where the owner of the unit agrees to rent under the program.

Unfortunately, the benefits of the Section 8 program fall short today. Although more than 2 million very low-income households receive Section 8 vouchers (project based and tenant based), some 10 million households have incomes low enough to be eligible for the program,[15] and hundreds of thousands are on waiting lists to receive vouchers through a lottery system.[16]

LOW INCOME HOUSING TAX CREDIT

Recognizing the need to increase the supply of affordable rental housing, Congress created the LIHTC program as part of the 1986 Tax Reform Act. The LIHTC program enables private and nonprofit developers to raise equity for affordable housing construction by selling tax credits to private corporations. State housing finance agencies administer the program after receiving a per capita allocation of credits that is indexed to inflation. To be eligible for the credits, developers must commit to projects that ensure a significant percentage of the project's rental units are affordable to households earning

60 percent or less of AMI.[17] The rents that can be charged residents for these low-income units are restricted so that monthly housing costs, including utilities, do not exceed certain limits.

The LIHTC program has proven to be very successful, even though demand for the credits dropped off in 2008 and 2009 because of the bad economy.[18] Since 1986, the program has supported more than 2 million affordable rental units, averaging about 100,000 units annually until the economic downturn.[19] Approximately two-thirds of these units were newly built, whereas one-third was substantial renovations of older units.[20]

Among the LIHTC program's features are the leveraging of private capital and the shifting of liability from the federal government to the private sector. Because of the program's household income requirements, however, workforce families with incomes above 60 percent of AMI are ineligible to benefit from its rent restrictions despite the burden of significant housing and transportation costs they may bear. As a result, the current LIHTC program misses an opportunity to encourage the development of mixed-income communities.

Federal Support for Homeownership and Renting

Federal support for housing is achieved primarily in two ways: through subsidies in the federal tax code and through federal spending programs subject to the annual appropriations process. In fiscal year 2010, federal support for housing amounted to approximately $207 billion. As figures 2 and 3 demonstrate, the federal government devoted more than 75 percent of this amount to supporting homeownership, whereas less than 25 percent was devoted to improving rental affordability.[21]

FIGURE 2 **Federal Tax Expenditures for Homeownership Compared to Renting, FY 2010**

Expenditure Category	US$ Millions
Homeownership	
Mortgage Interest Deduction	90,800
Property Tax Deductions	15,500
Capital Gains Exclusion	15,000
Tax-Exempt Bond Interest Exclusion	1,000
Homeownership Tax Credit	8,700
Total	**131,000**
Renting	
Low-Income Housing Tax Credits	5,100
Rental Housing Accelerated Depreciation	5,000
Tax-Exempt Bond Interest Exclusion	800
Total	**10,900**

Source: Tax expenditure data taken from Joint Committee on Taxation, U.S. Congress, *Estimates of Fiscal Year Tax Expenditures for Fiscal Years 2010–2014, JCS-3-10* (December 15, 2010).

FIGURE 3 **Federal Spending on Homeownership Compared to Renting, FY 2010**

Expenditure Category	US$ Millions
Homeownership	
Making Home Affordable Program	2,300
Subsidy Costs of New GSE Credit Activities	21,000
HOME Investment Partnership	798
CDBG (Housing Subsidy Only)	801
Other HUD Subsidy Programs	115
USDA Housing Subsidy Programs	291
Total	25,305
Renting	
Section 8 Housing Choice Voucher Program	18,184
Project-Based Section 8	8,557
Public Housing	7,275
HOME Investment Partnership	1,027
Homeless Assistance (Housing Subsidy Only)	1,268
CDBG (Housing Subsidy Only)	334
Section 202/811	1,125
Other HUD Housing Subsidy Programs	922
USDA Housing Subsidy Programs	1,071
Total	39,763

Sources: E-mail correspondence with CBO staff; Enterprise Community Partners, Housing and Community Development Programs: Budget FY 2009 and FY 2010, http://www.enterprisecommunity.org/public_policy/documents/hud_budget_chart_2010.pdf; The Board Advocacy Project and Common Ground, "Reforming Tax Subsidies Issue Brief," http://www.boardadvocacy.org/docs/Reforming%20Tax%20Subsidies%20issue%20brief%201210.pdf (December 2010).

Note: GSE = government-sponsored enterprise; CDBG = community development block grant.

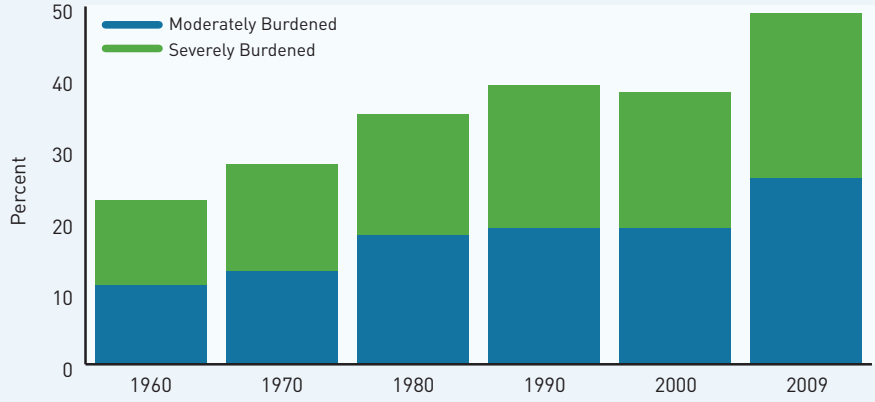
The numbers break down as shown in figure 2, which indicates that the federal tax code strongly favors homeownership over renting by a factor of approximately 12 to 1. The single largest tax subsidy supporting homeownership—the mortgage interest deduction—accounts for nearly $91 billion in forgone revenue, or nearly 18 times the amount supporting the nation's low-income rental housing production program.

Figure 3 lists the federal spending programs for both homeownership and rental assistance. Included in this calculation are two programs initiated in response to the housing market crisis—the Making Home Affordable program and federal support for the single-family mortgage loan guarantees issued by Fannie Mae and Freddie Mac. Even if the expenditures for these programs were not counted, the homeownership share of federal support for housing would still exceed 70 percent.

Increasingly Unaffordable Rental Housing

Unquestionably, homeownership has benefited millions of Americans and their families. Surveys show the attraction of homeownership remains strong despite the collapse of the housing market. Young adults, immigrants, and other groups continue to view owning a home as a ticket to prosperity and

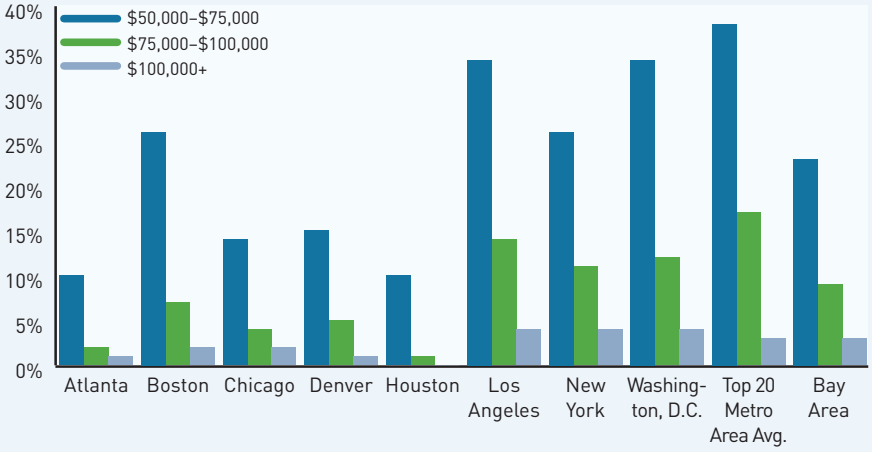
FIGURE 4 **Cost-Burdened Renter Households**



Source: See Joint Center for Housing Studies of Harvard University, America's *Rental Housing: Meeting Challenges, Building on Opportunities* (Cambridge, Mass.: Joint Center for Housing Studies, 2011), 29, with permission from the Joint Center for Housing Studies of Harvard University. All rights reserved.

Note: Rent includes tenant-paid utilities. Moderately cost-burdened renters pay 30 to 50 percent of pretax household income for housing; severely burdened renters pay more than 50 percent of their pretax income for housing. Renters with zero or negative income are assumed to be severely burdened, whereas renters not paying cash rent are assumed to be unburdened.

FIGURE 5 **Percentage of Renter Households Spending 30 Percent or More of Household Income on Rent**



Source: U.S. Census Bureau, American Community Survey 2008.

stability.[22] Nevertheless, the current policy of providing so much subsidy for homeownership (even for the wealthiest Americans) and so little subsidy to support rental affordability for low-income and workforce households makes little sense. Here is why.

Rental housing is becoming increasingly unaffordable, putting stress on families and their budgets. Because of a combination of weak income gains and rising housing costs over the past decade, Harvard's Joint Center for Housing Studies estimates that by 2009 the share of at least moderately cost-burdened renters (those paying between 30 to 50 percent of their income on housing) had shot up to 49 percent of all renters. The share of severely cost-burdened renters (those paying more than 50 percent of their income on housing) also spiked, jumping to 26 percent.[23]

Figure 4 demonstrates how renter affordability has deteriorated over the past 50 years; the share of renters with affordability problems has doubled during this period.

Although these trends have hit the lowest-income renters particularly hard, the increasing expense of rental housing during a period of wage stagnation is also a big concern for moderate-income or workforce households. The Joint Center estimates that between 2007 and 2009 an additional 1.1 million moderate-income or workforce renters were spending more than 30 percent of their income on housing. This problem is particularly acute for workforce households in certain high-cost metro regions, such as Boston, Los Angeles, New York, San Francisco, and Washington, D.C., as figure 5 demonstrates.

Rising rental cost burdens force low-income and workforce families to make difficult choices as they try to manage tight household budgets. Many move to find less expensive housing, even if such a move requires a longer commute to a job. Others may settle for older, poorer-quality housing to live closer to places of employment. Figure 6 illustrates the difficulty workforce families face in affording a basic one-bedroom or two-bedroom apartment in two of the nation's most high-cost areas.

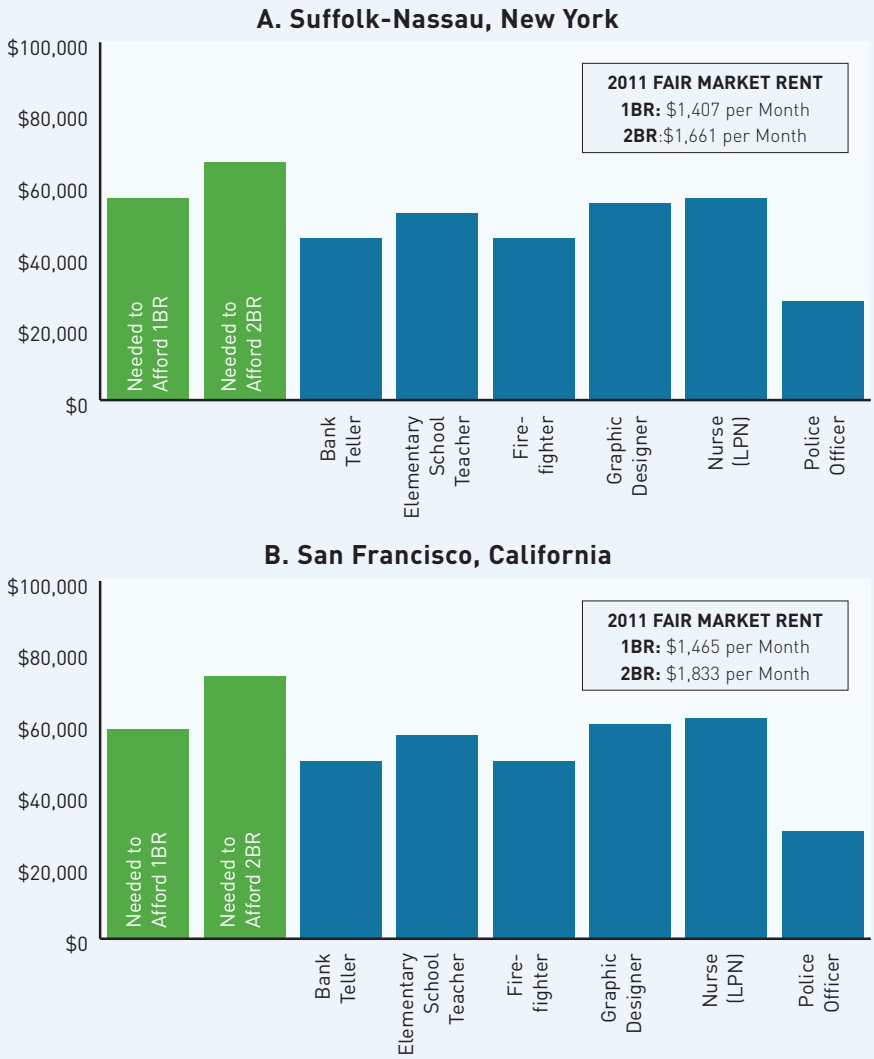
After housing and transportation costs are accounted for, workforce households in these high-cost communities often have to make tough decisions about health insurance, food, and child care with the limited resources that remain.[24] Unfortunately, too many workforce families do indeed live paycheck to paycheck[25] (see figure 7).

Bracing for a Dramatic Increase in Rental Demand

Despite incomes that lag behind rental costs, the demand for rental housing is expected to increase dramatically in the coming decade. In fact, the Joint Center conservatively estimates that population growth alone should result in a net increase of renter households of more than 3.6 million by 2020, as 11.3 million young adult renters enter the market and just 7.7 million older renters leave[26] (see figure 8).

So, who will these new renters be?

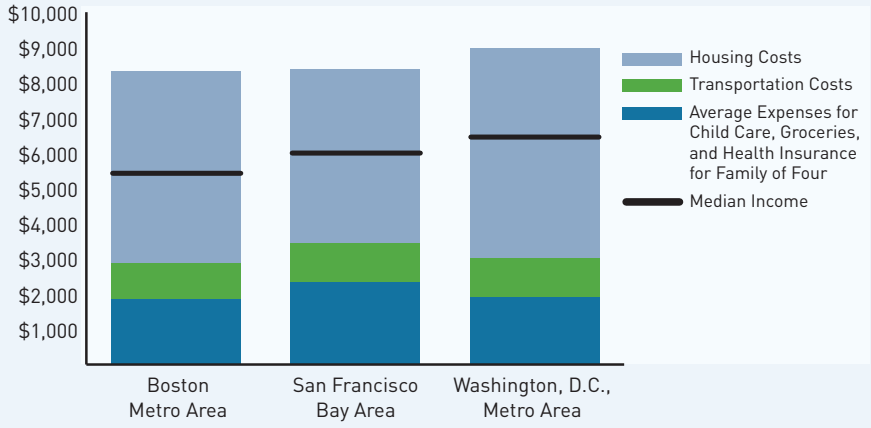
FIGURE 6 **Rent Compared to Salaries**



Source: Center for Housing Policy, *Paycheck to Paycheck, First Quarter Findings* (July 21, 2011), http://www.nhc.org/chp/p2p/.

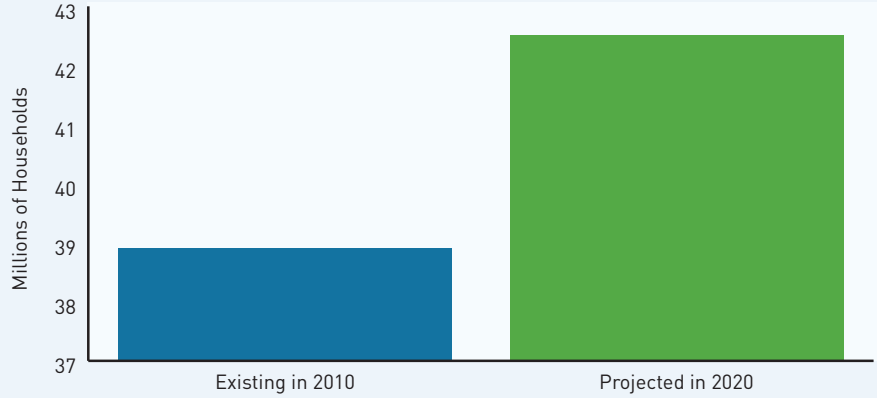
Note: 1BR = one-bedroom apartment; 2BR = two-bedroom apartment.

FIGURE 7 Average Monthly Expenses—Family of Four



Sources: Child care costs based on one infant and one four-year-old, taken from National Association of Child Care Resource and Referral Agencies; grocery costs based on low-cost plan for a family of four (with toddlers), taken from United States Department of Agriculture, Center for Nutrition Policy and Promotion, "Official USDA Food Plans: Cost of Food at Home at Four Levels, U.S. Average, June 2009," Alexandria, Va., http://www.cnpp.usda.gov/Publications/FoodPlans/2009/CostofFoodJun09.pdf; health insurance costs based on family contribution to private employer, taken from Agency for Healthcare Research and Quality, Center for Financing, Access and Cost Trends, Rockville, Md. (2008); median income, and transportation and housing costs taken from ULI Terwilliger Center for Workforce Housing Burden Series: *The Boston Regional Challenge* (2010), *Bay Area Burden* (2009), and *Beltway Burden* (2009).

FIGURE 8 U.S. Rental Households



Sources: Existing rental households: U.S. Department of Commerce, Bureau of the Census; projected households: based on estimates of the Joint Center for Housing Studies of Harvard University.

THE ECHO BOOM GENERATION

Members of the 78 million–strong echo boom generation (those born after 1986) are just beginning to enter the housing market. As the largest demographic cohort in America, echo boomers are expected to contribute 11.3 million new renters in the coming decade. They spent much of the latter half of the last decade sitting on the housing sidelines, many living with their parents or "doubling up" with roommates, as the economy faltered. Now they are beginning to form their own households.

To put this in perspective, from 2000 to 2007, the number of new households formed each year averaged 1.2 million. Yet, as the effects of the Great Recession were being felt, new household growth declined dramatically, averaging only 500,000 annually from 2007 to 2010. In other words, the echo boomers represent a huge pent-up demand for housing that is now just being unleashed.[27] If the job market improves, household formation among echo boomers will increase as well.[28]

Where will these echo boomers gravitate? They will go to major metro areas that satisfy their zeal for career advancement, financial gain, and the amenities of an urban lifestyle. And their preference will be multifamily rental housing.[29]

MINORITY HOUSEHOLDS

About 70 percent of the 11.8 million new households that will form from 2010 to 2020 will be headed by members of minority groups, with Hispanics and non-Hispanic blacks accounting for the largest share.[30] By 2020, minority households are projected to make up one-third of all U.S. households and will account for a growing share of the new, younger renter population.[31] These minority groups traditionally have had lower homeownership rates than their white counterparts. (In fact, the homeownership rate for African American households now stands at 45.6 percent, and the rate for Hispanic households is 47.6 percent, both substantially below the rate for white households, which currently exceeds 73 percent.) With lower average incomes and overall wealth than white households, members of these minority groups are more likely to rent.[32]

CHILDLESS HOUSEHOLDS

Single-person households are expected to account for about 37 percent (4.3 million) of the 11.8 million new households, while married couples without children will likely account for about 42 percent (5.0 million). In addition, unrelated individuals living together but not considering themselves partners will constitute a 12 percent share (1.5 million). These groups are also more likely to rent, with single-person households frequently choosing multifamily apartments.

These demographic trends will be amplified by other factors. Tighter mortgage underwriting standards, impaired credit stemming from the wave of foreclosures, continued economic uncertainty, and a heightened appreciation of the benefits of renting will, at least in the near term, put added pressure on the demand for affordable rental housing.

Single-family homes, buildings with two to four units, and manufactured housing account for more than 50 percent of all occupied *rental* units in the United States.[33] Although the increasing number of single-family homes subject to short sales and foreclosures is likely to become a significant source of new affordable rental housing,[34] many of these homes are generally more suitable for the types of households that left them in the first place—married couples with children who are seeking more space in suburban environments.[35] In addition, single-family foreclosures are concentrated in certain locations throughout the United States that may not be geographically near the jobs and other opportunities sought by the new, young renter population. In fact, the Joint Center estimates that just 5 percent of census tracts accounted for more than a third of all homes lost to foreclosure since 2008.[36]

Why the Current Supply of Multifamily Rental Is Inadequate

If current trends hold true, this paper estimates a minimum need for an additional 3 million multifamily rental units over the next ten years (2011–2020). (See appendix A.) This estimate assumes that the homeownership rate will stabilize at 2010 levels.

But what if the homeownership rate continues on its downward trajectory, perhaps bottoming out at 65 percent, the average rate experienced during the 30-year period between 1965 and 1995?[37] Every percentage point drop in the homeownership rate means an additional 1.1 million renter households.[38] Perhaps half of these new renter households will seek housing in a multifamily setting, thereby increasing even further the need for new multifamily production.

The effects of the increased demand for multifamily housing are already being seen. The national rental vacancy rate soared in 2009 to 11.1 percent but has since dropped to 9.8 percent in the second quarter of 2011.[39] Over the past year, the drop in vacancies has been most significant in multifamily buildings.[40] Not surprisingly, rental vacancy rates in traditionally tight metro markets such as Boston, Los Angeles, New York, San Jose, and Washington, D.C., are well below the national average and have declined significantly over the past year.[41] Rents in these markets are also beginning to recover to, or exceed, their 2008 levels.[42]

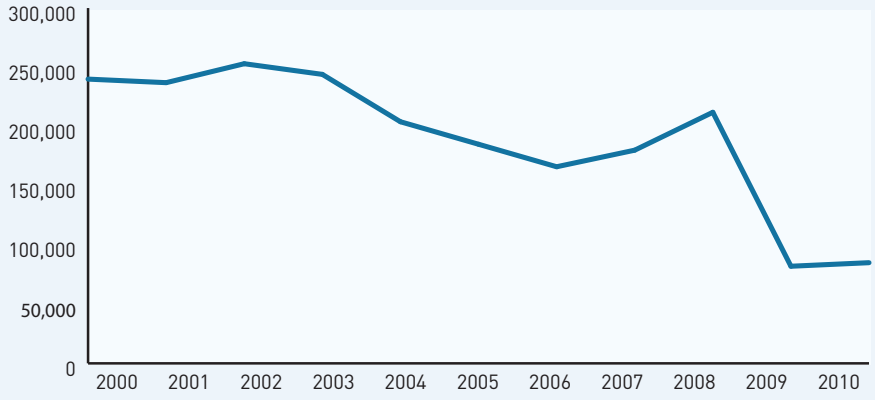
These developments are not surprising because echo boomers are by definition young adults, and younger renters tend to prefer multifamily housing in central-city locations where they can be close to friends, recreational venues, and job opportunities.[43]

A modest recovery in multifamily production is now ongoing,[44] but without government support to help stimulate production to new and higher levels, one has difficulty seeing how enough units will be produced on a timely basis to meet this resurgence in demand.

Yes, one could argue that government help is not necessary because housing developers will simply respond to this new demand by increasing production. That might be true in a perfectly functioning market, but burdensome regulatory requirements, local zoning and land use rules, impact fees, and other artificial barriers often distort the housing market in ways that increase land and construction costs and sometimes prevent the private sector from building and preserving affordable multifamily units in many high-cost metro areas.[45] Eliminating these barriers and restoring more balance to the national housing policy is necessary to help the private sector close the multifamily supply gap.

Closing this gap, however, will not be easy. In 2009, as construction financing evaporated, multifamily rental starts dropped to just 82,000 units—the lowest since World War II. New production barely picked up in 2010, with only 85,000 new starts. These levels fall far short of the annual average of new starts from 2000 to 2008 (232,000) and dramatically lower than the levels of previous decades when annual production often exceeded 300,000 units (see figure 9).

FIGURE 9 **U.S. Multifamily Starts**



Source: U.S. Department of Commerce, Bureau of the Census.

One must consider three additional facts:

1. An estimated 100,000 to 125,000 multifamily units become obsolete each year and are removed from the available rental stock.[46] Production of new units must not only help meet expected demand but also replace those units no longer in use. The preservation and rehabilitation of existing units are critical.
2. A multifamily developer needs years to acquire a site, obtain financing, and build a project. As demand surges, a considerable lag will occur before new units are available for occupancy. At least in the short run, rental vacancy rates in the large metro areas are likely to continue to decline while rents increase. With new construction (excluding LIHTC units) focused on the high end of the market, the rental affordability challenges for low-income and workforce households will likely worsen.[47]
3. According to government estimates, the mortgage restrictions and rental assistance contracts on more than 1 million subsidized units are expected to expire by 2013. Property owners will then have the option to renew contracts or opt out of the subsidy programs. As rental demand surges, the pressure to remove subsidized units from the affordable rental stock will intensify.[48]

In short, without a dramatic increase in the supply of affordable multifamily units, the country is likely to witness a significant increase in rental costs that will put even more stress on the budgets of low-income and workforce families.

More Multifamily Housing Would Support America's Economic Recovery

New multifamily construction generates significant economic activity that can create jobs and provide additional tax revenue for local communities. According to a model developed by the NAHB, building 100 rental apartments in a typical metropolitan area results in the following "one-year" effects:

- $7.9 million in income for residents of the metro area;
- $827,000 in taxes and other revenue for local governments; and
- 122 local jobs.

In addition, building 100 rental apartments in a typical metropolitan area has annual recurring effects resulting from the occupancy of the units and the renters paying taxes and participating in the local economy. NAHB calculates these effects as follows:

- $2.3 million in income for residents of the metro area;
- $395,000 in taxes and other revenue for local governments; and
- 32 local jobs.[49]

What these findings suggest is that building 1 million new multifamily rental units in metro areas throughout the country could generate as many as 1.2 million jobs and more than 300,000 additional jobs in the years that follow the initial period of construction.[50] Clearly, a renewed commitment to multifamily construction not only will help meet America's housing needs, but also can play a significant role in hastening the country's economic recovery.

Federal Housing Policy

Last year, the federal government spent about $207 billion to support housing. As America's leaders work to reduce the country's debt, one should ask:

- Are these funds being spent on the right priorities?
- Can they be spent more effectively and efficiently?
- Are they appropriately anticipating *tomorrow's* needs?

A wise federal housing policy would anticipate the expected surge in multifamily demand and adjust accordingly. The goals of such a policy would be to help:

- Stimulate *private* production of multifamily units to higher levels to meet the expected demand, *including units affordable to low-income and workforce households*;
- Ensure sufficient *private* capital to help finance new multifamily construction;
- Assist in the preservation of existing affordable multifamily units; and
- Encourage local communities to preserve and encourage higher-density affordable housing near transportation hubs and job centers.

To meet these goals, appendix B offers a number of suggestions for policy makers to consider.

Conclusion

America's leaders are appropriately engaged in reducing the nation's mounting debt. But as they set new priorities for the country, they should understand that the household budgets of millions of American families, already strained by wages that have lagged behind rental costs, will come under renewed stress as a huge wave of young, new renters enters the market during the remainder of the decade. Many of these new renters will be seeking housing in multifamily developments, close to jobs and other opportunities.

If the country is to remain committed to the 1949 Housing Act's goal of "a decent home and suitable living environment for every American family," then refocusing federal housing policy to respond to this expected surge in rental demand is the responsible choice to make. This refocusing can also help create hundreds of thousands of new jobs and hasten America's economic recovery. As outlined more fully in appendix B, this paper recommends converting the mortgage interest deduction to a nonrefundable credit on interest of up to $500,000 in mortgage debt on a principal residence, with the resulting savings used for deficit reduction and to support the construction, rehabilitation, and preservation of multifamily rental units affordable to low-income and workforce households.

APPENDIX A

Explanation of Estimated Number of Multifamily Rental Units Needed to Meet Expected Demand by 2020

This paper estimates that the production of at least 3 million new multifamily rental units will be needed to meet the additional demand for rental housing in the coming decade. This conclusion was reached using the following assumptions:

NEW HOUSEHOLD FORMATIONS

The Harvard Joint Center for Housing Studies estimates that 11.8 million new households will be formed by 2020.[1]

NET NEW RENTAL HOUSEHOLDS

The Joint Center estimates that those between 15 and 35 years of age in 2020 (the echo boomers) will form *11.3 million net new rental households* by 2020. A significant portion of these new echo boom rental households will consist of minorities, immigrants, single persons, single-parent families, and unmarried partners and unrelated roommates.

The 11.3 million net new echo boom rental households will be offset by the net loss of 7.7 million older renter households. The estimated number of *net new renter households by 2020 is 3.6 million*, the difference between these two figures.[2]

The following table from the Joint Center illustrates the relationship among these numbers.

Projected Net New Household Formations by Tenure and Age, 2010–2020 (Thousands of Households)

	RENTAL HOUSEHOLDS		OWNER HOUSEHOLDS		TOTAL HOUSEHOLDS	
Age in 2020	**Level**	**Cumulative**	**Level**	**Cumulative**	**Level**	**Cumulative**
15–24	4,927	4,927	1,356	1,356	6,283	6,283
25–34	6,402	11,329	7,650	9,006	14,052	20,335
35–44	–2,809	8,520	5,828	14,834	3,018	23,353
45–54	–1,496	7,024	2,097	16,391	602	23,955
55–64	–833	6,191	1,065	17,996	232	24,187
65–74	–683	5,508	–784	17,212	–1,467	22,720
75+	–1,881	3,627	–9,037	8,175	–10,918	11,802
Total Formations	3,627	3,627	8,175	8,175	11,802	11,802

Source: Joint Center for Housing Studies tabulations using 2010 Low-Series Household Growth Projections.

RENTERS IN MULTIFAMILY DEVELOPMENTS (FIVE UNITS OR MORE)

According to the U.S. Department of Housing and Urban Development's most recent American Housing Survey, in 2009 there were approximately 35.3 million renter occupied units in the United States of which approximately 15.2 million, or 43 percent, were in multifamily developments.[3] Because of the projected demographic growth, this paper estimates that at least half of the 3.6 million net new renter households (1.8 million) will seek housing in a multifamily setting, frequently in central-city locations.

REPLACEMENT OF AGING MULTIFAMILY STOCK

Assuming an annual loss rate of 0.70 percent, the production of approximately 125,000 multifamily units will be needed each year to replace housing stock that is obsolete or in disrepair. Over the ten-year period (2011–2020), that amounts to approximately 1.25 million new units.

TOTAL ESTIMATED NEED

The demand from 1.8 million new renter households combined with the 1.25 million units needed to replace multifamily stock that is obsolete or in disrepair will require the production of at least 3 million new multifamily units by 2020.

CONSERVATIVE ASSUMPTIONS

The Joint Center's estimates of new rental household formations are based on the following two conservative assumptions: First, that homeownership rates by age, race, and household type will stabilize at the 2010 levels. Second, that immigration to the United States will be only half the Census Bureau baseline projection.

If homeownership rates continue to decline or if immigration approaches the full Census Bureau projection, then the number of net new renter households by 2020 could be significantly higher than the 3.6 million estimate. In addition, each percentage point drop in the homeownership rate translates into approximately 1.1 million new renter households, many of whom will seek housing in a multifamily setting.

APPENDIX B

Some Suggestions for Legislative Action

Responding to the rising demand for affordable multifamily rental housing will require money. No doubt, this is a very tall order at a time when Congress and the Administration are looking for ways to reduce federal spending, not increase it.

This paper suggests that the federal government reallocate *existing* federal housing resources now used to subsidize homeownership to support rental affordability. One way to achieve this goal is to reduce the subsidy for homeownership provided through the *mortgage interest deduction* and use a portion of the resulting savings to support rental production programs such as the Low Income Housing Tax Credit (LIHTC) program.

The mortgage interest deduction disproportionately benefits the wealthiest of Americans and has little, if any, effect on increasing homeownership.[1] Today, only about 25 percent of taxpayers claim the deduction, and those with large mortgage debt and high marginal tax rates benefit the most from the write-off. At the same time, the deduction does not help low-income Americans who do not itemize, nor does it provide much benefit to senior citizens who carry little or no mortgage debt.[2] In part to make the mortgage interest deduction more equitable, the National Commission on Fiscal Responsibility and Reform (the Bowles-Simpson Commission) recommended that the deduction be converted to a 12 percent nonrefundable tax credit (available to all taxpayers not just itemizers) on interest up to $500,000 in mortgage debt on a principal residence. Unlike current law, no credit would be allowed for interest on second-home mortgages or home-equity loans.[3]

According to the Joint Committee on Taxation, completely eliminating the mortgage interest deduction could result in federal budget savings in fiscal year 2011 of nearly $94 billion.[4] Another analysis suggests that capping the size of a mortgage for which interest is deductible at $500,000 and converting the deduction to a nonrefundable 15 percent credit would "more than double the number of homeowners with incomes under $100,000 who would get a tax benefit" and result in annual savings of more than $30 billion.[5] The savings generated by either eliminating or restricting the mortgage interest deduction would be substantial and clearly sufficient to serve the dual goals of reducing the deficit and responding to the expected surge in demand for rental housing over the coming decade.

Accordingly, as Congress and the Administration work to reduce the federal budget deficit, this paper recommends (a) capping the size of a mortgage for which interest is deductible at $500,000; (b) eliminating the deductibility of interest on second-home mortgages and home-equity loans; (c) converting the mortgage interest deduction to a nonrefundable credit; and (d) using a portion of the resulting annual savings (estimated at more than $30 billion) to help close the multifamily "supply gap" and make rents more affordable for low-income and workforce households.

The first three proposals outlined below could be financed in this way. If enacted, they have the potential during the remainder of this decade to support the construction, preservation, and rehabilitation of an *additional 1 million* new multifamily rental units affordable to low-income and workforce households.

RECOMMENDATION 1:

Double the Expenditure for the LIHTC Program; Allocate the Additional Expenditure to Help Finance Mixed-Income Developments with a Significant Workforce Housing Component

The LIHTC program is the nation's most significant public/private program supporting the production and rehabilitation of affordable rental units. Units created by the program are targeted at households with incomes at or below 60 percent of area median income (AMI). Rent and income restrictions generally apply for a minimum of 15 years.

With the supply of affordable rental housing expected to lag considerably behind demand in the coming decade, the federal government should *double* the current expenditure for the LIHTC program.

Although investor interest in the credits waned during the recent economic downturn, the average price of the credits is returning to precrisis levels. Demand for the credit will likely be strong as the economy recovers.[6] Today, the universe of LIHTC investors is limited to large institutions such as banks and large corporations. Expanding the eligible investor base to include limited liability companies, closely held C corporations, and private individuals is likely to make the LIHTC market less volatile in the future.[7] Adopting the Administration's proposal to provide qualifying projects with a 30 percent "basis boost" to facilitate preservation and rehabilitation will also trigger more investor interest.

This paper strongly supports the Administration's goal of increasing income mixing at the project level[8] but would go further by allocating the *additional* funding for the LIHTC program to help finance developments affordable to workforce families with incomes up to 120 percent of AMI. This approach is

particularly appropriate for projects in the country's high-cost metro regions. The income-eligibility requirements should also be subject to periodic adjustments to reflect changes in housing costs in the areas in which the LIHTC properties are located.

RECOMMENDATION 2:

Grant States Additional Tax-Exempt Bond Authority to Promote Mixed-Income Multifamily Developments

Today, state and local governments sell tax-exempt housing bonds to help finance mortgages for lower-income first-time homebuyers (mortgage revenue bonds) or to build apartments with rents that are affordable to lower-income families (multifamily housing bonds). Each state's issuance of housing bonds is subject to an annual cap. The 2009 limit is $90 multiplied by the state population, with a state minimum of $273,270,000.[9]

Multifamily developments financed with housing bonds must set aside at least 40 percent of their apartments for families with incomes of 60 percent of AMI or less, or 20 percent for families with incomes of 50 percent of AMI or less. This income-targeting requirement is similar to that of the LIHTC program, and in fact, many multifamily developments are financed with a combination of tax credits and tax-exempt debt.

To attract the private capital necessary to produce more *mixed-income* multifamily developments, the states should be given *additional* tax-exempt bond authority beyond the current volume cap but with less restrictive income-targeting requirements for this additional authority.

One possible approach would be to allow the states to use the additional authority to finance multifamily properties in high-cost metro areas. These properties would restrict rents so that one-third of their units are affordable to households making 60 percent of AMI or less, another third are affordable to households making 90 percent of AMI or less, and the final third are affordable to households making 120 percent of AMI or less. These income eligibility requirements should be subject to periodic adjustments to reflect changes in housing costs in the areas in which the properties are located. In addition, states should use the additional bond authority through an allocation plan (similar to the Qualified Allocation Plan under the LIHTC program) that would target multifamily production to specific areas where employment and other opportunities are available.

This approach would serve the important public purpose of making rents more affordable for a broader segment of the population while encouraging the participation of private capital in developing multifamily housing to meet the expected surge in rental demand.

RECOMMENDATION 3:

Grant "Exit Tax Relief" to Promote the Preservation of Existing Affordable Rental Units

Stimulating the production of new multifamily units is an important first step in meeting today's rental housing challenge. But *preserving* the existing stock of affordable units is an equally important step. An estimated 100,000 to 125,000 multifamily units are lost each year to obsolescence and disrepair. Failing to replace these lost units creates a cycle of never being able to catch up to meet expected demand.

As recognized by the Millennial Housing Commission almost a decade ago, federal tax policies discourage preservation.[10]

PRESERVATION IS A CRITICAL PUBLIC POLICY GOAL

"[I]t is critical that the nation adopt a preservation philosophy to guide its policy going forward. Every newly produced building ultimately reaches the end of its useful life. Federal housing policy must anticipate and plan for this eventuality."

—*Report of the Bipartisan Millennial Housing Commission* (2002)

Depreciation recapture can significantly affect taxes for owners of multifamily properties who are seeking to sell and, in fact, may leave some owners with liabilities upon sale that exceed the property's value. Part of the gain from the sale may qualify for the maximum 15 percent rate on long-term capital gains, but the part of the gain related to depreciation will be taxed at a maximum 25 percent rate. This higher 25 percent depreciation recapture rate discourages long-term property owners from making continuing investments in their properties or selling them to others. The 25 percent depreciation rate should be brought in line with the lower capital gains rate for those sales involving purchasers who agree to maintain the properties as affordable housing.

The following three proposals would also help respond to the expected surge in rental demand without necessarily requiring additional federal spending.

RECOMMENDATION 4:

Provide an Explicit, Appropriately Priced Government Guarantee of Securities Backed by Multifamily Mortgages in Any New Housing Finance System; Such a Guarantee Is Necessary to Promote Liquidity in the Multifamily Market

As policy makers consider how best to reform the housing finance system, they should first do no harm. This begins by understanding that the multi-

family programs of Fannie Mae and Freddie Mac did *not* contribute to the collapse of the single-family housing market. In fact, these programs were in many ways models of success, showing the value of prudent underwriting, standardization, risk sharing, and strong capital standards.[11]

The existence of a government-supported secondary market for multifamily mortgages has lowered the cost of capital, enabling apartment developers over the past two decades to build millions of rental housing units affordable to workforce families. Many of these units are market-rate apartments, supported with no direct federal appropriation or subsidy, and produced at virtually no risk to the taxpayer.[12] Maintaining funding to this segment of the multifamily market will be critical.

Since 2008, with private lenders restricting the flow of credit or leaving the market altogether, the government-sponsored enterprises (GSEs) and the Federal Housing Administration (FHA) have accounted for nearly all of the growth in multifamily lending.[13] Without their support, the multifamily market would have ground to a halt.

Even after the transition to a new housing finance system, an ongoing—and increasingly pressing—need will exist for a federal government guarantee to encourage private capital to participate in the multifamily market. This guarantee should be explicit, should be appropriately priced to protect the taxpayer, and should not unfairly compete with debt financing from private sources.

RECOMMENDATION 5:

Enhance the FHA's Ability to Support Private Lending into the Multifamily Market

As private credit disappeared during the height of the financial crisis, the FHA played an important role in providing liquidity to the multifamily market. From 2008 to 2010, the number of rental units financed with FHA support more than tripled from 49,000 to 150,000.[14] In fiscal year 2011, the FHA has so far endorsed more than $10.5 billion in multifamily rental loans, a new record for the agency, despite complaints that loan application procedures are excessively complicated and processing times unduly long. In recent months, the FHA has responded to this criticism with staffing and workflow changes, revisions to the standard loan closing documents, and publication of new guidelines to reduce the time required to process loan applications.[15] The FHA should continue these important efforts and examine other ways to improve and streamline the multifamily loan application process.

Whether FHA's unique attributes can be leveraged to encourage more *private* lending to the multifamily sector is also a subject worthy of further examination. For example, under current law, the FHA may engage in "risk-sharing" activities only with Fannie Mae, Freddie Mac, and the state housing finance agencies (HFAs). Under the HFA risk-sharing program, loans underwritten by HFAs may receive full FHA mortgage insurance.[16] If a default occurs, the loss is apportioned between the HFA and FHA in accordance with a negotiated risk-sharing agreement.

The risk-sharing program has been successful in financing tens of thousands of affordable multifamily units, with a low default rate and limited taxpayer exposure. Vesting the FHA with the authority to enter risk-sharing agreements with suitable, well-capitalized *private* lenders has the potential of encouraging these lenders to make the leap into the multifamily market while minimizing taxpayer risk.

Other ideas also merit further examination. Should the FHA be allowed to pool multifamily mortgages? And should it have the authority to insure private loans backed by local tax increment financing (TIF) commitments? In some cases, this insurance could jump-start multifamily projects that have received future financing commitments from local TIF districts but that cannot secure the necessary upfront funding from private sources because of the perceived risks.[17]

As part of its plan to reform America's housing finance market, the Administration is appropriately examining an array of options, including greater risk-sharing authority, with the goal of enhancing the FHA's capacity to support private lending for new multifamily projects.[18]

RECOMMENDATION 6:

Leverage Federal Transportation and Housing Funds to Encourage the Development of Affordable Multifamily Housing Close to Jobs and Employment Opportunities

Awareness is growing that housing and transportation policies are interrelated and should work together to meet the affordable housing needs of low-income and workforce families. For example, transit-oriented development (TOD)—the creation of vibrant, livable communities close to transit stops—can help families reduce their transportation expenses by improving access to light rail, subways, and bus lines. The development of new transit stations, however, can also dramatically raise the price of land around these stations and make housing in these communities increasingly expensive. How best to manage these complex issues and ensure a range of affordable housing is available near transit stations is a vital concern for all levels of government.

Congress has recognized the close link between housing and transportation policy.[19] In 2008, it directed the U.S. Department of Housing and Urban Development (HUD) and the Federal Transit Administration (FTA) to "better coordinate public transportation and housing policies and programs" with the goal of ensuring that "affordable housing is located closer to public transportation and employment centers." The creation of the Partnership for Sustainable Communities is a direct response to this call for improved interagency coordination at the federal level. The partnership has since adopted six "livability" principles, including the promotion of "equitable, affordable housing" to help guide its efforts. It also sponsors a capacity-building grant program aimed at assisting local communities with their TOD efforts.

These are all steps in the right direction. But why not take a bigger step by actually rewarding those local communities that adopt proactive housing strategies with greater access to funds under *existing* federal transportation and housing programs?

Today, no program funded through HUD or the FTA *directly* incentivizes local communities to locate or preserve affordable housing near transit stations. This should change. Competitive grant programs such as FTA's New Starts program should affirmatively reward those applicants that come to the table with comprehensive affordable housing strategies. These strategies could include plans to preserve affordable multifamily developments within walking distance to the proposed transit station, plans to use density bonuses to encourage the production of new multifamily housing affordable to low-income and workforce families, or proposals to remove local regulatory barriers that prevent higher-density projects. This approach leverages existing federal dollars without requiring any new expenditure.[20]

Notes

1 Bureau of Labor Statistics, U.S. Department of Labor, "The Employment Situation—July 2011," News Release, August 5, 2011.

2 See Debbie Gruenstein Bocian, Wei Li, and Keith S. Ernst, *Foreclosures by Race and Ethnicity: The Demographics of a Crisis* (Center for Responsible Lending, 2010), 3.

3 See Katie Curnutte, "Early 2010 Housing Stabilization Fizzles; U.S. Homes Set to Lose $1.7 Trillion This Year," *Zillow Blog*, December 9, 2010, http://www.zillow.com/blog/2010-12-09/early-2010-housing-stabilization-fizzles-u-s-homes-set-to-lose-1-7-trillion-this-year/.

4 See Maya Brennan, "Foundation for Success? A Review of New Research on the Effects of Homeownership on Children," *Center for Housing Policy Insights from the Housing Policy Research* (October 2010) (highlights new research suggesting that outcomes for children are not affected by whether they live in an owned or rented home but rather by factors such as residential stability and neighborhood quality).

5 This figure is the seasonally adjusted rate.

6 See U.S. Department of Commerce, Bureau of the Census, "Residential Vacancies and Homeownership in the Second Quarter 2011," U.S. Census Bureau News, July 29, 2011, 6.

7 Christianna McCausland, "Rent or Own? Increasingly Americans Opt for Rental Homes," *Christian Science Monitor,* June 1, 2011.

8 For a fuller discussion of these issues, see ULI Terwilliger Center for Workforce Housing, *The Boston Regional Challenge: Examining the Costs and Impacts of Housing and Transportation on Area Residents, Their Neighborhoods, and the Environment* (Washington, D.C.: ULI, 2010).

9 See Charles L. Edson, "Affordable Housing—an Intimate History" (unpublished document furnished to author, 2010), 1.

10 See John D. Landis and Kirk McClure, "Rethinking Federal Housing Policy," *Journal of the American Planning Association* 763 (2010): 321.

11 See Sylvia C. Martinez, "The Housing Act of 1949: Its Place in the Realization of the American Dream of Homeownership," *Housing Policy Debate* 11 (2000): 467.

12 Interest on up to $100,000 in home-equity debt is also tax deductible, even if the funds are used for nonhousing purposes.

13 See 12 U.S.C. 13-III § 1716 (2010); 12 U.S.C. 11A §§ 1451-2 (2010) (Federal Home Loan Mortgage Corporation Act); 12 U.S.C. 13-III § 1717 (2010).

14 See Landis and McClure, "Rethinking Federal Housing Policy," 326.

15 Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing: 2011* (Cambridge, Mass.: Joint Center for Housing Studies, 2011), 28, figure 26.

16 National Low Income Housing Coalition (NLIHC), *A Look at Waiting Lists: What Can We Learn from the HUD Approved Annual Plans?*, NLIHC Research Note #04-03, Washington, D.C. (2004).

17 The LIHTC program's minimum setaside requires developers to commit that a minimum of 40 percent of the units in the project will be affordable to households earning 60 percent or less of AMI, or alternatively, to commit that a minimum of 20 percent of the units will be affordable to households earning 50 percent or less of AMI. In practice, many LIHTC projects set aside units affordable to low-income households in numbers that exceed these minimum requirements. See www.hud.gov/offices/cpd/affordablehousing/training/web/lihtc/basics/eligibility.cfm.

18 With the bad economy, fewer investors have significant tax liability that could be offset by the credit. Two programs in the American Recovery and Reinvestment Act of 2009 helped cover some of the equity shortfall caused by the reduced use of the credit. See Rebecca Cohen, Keith Wardrip, and Laura Williams, "Rental Housing Affordability—a Review of Current Research," *Center for Housing Policy Insights from Housing Policy Research* (October 2010), 4.

19 Federal Reserve Bank of St. Louis, *Innovative Ideas for Revitalizing the LIHTC Market*, 4 (St. Louis, Mo.: Board of Governors of the Federal Reserve System and the Federal Reserve Bank of St. Louis, 2009).

20 See Joint Center for Housing Studies of Harvard University, *America's Rental Housing: Meeting Challenges, Building on Opportunities* (Cambridge, Mass.: Joint Center for Housing Studies, 2011), 5.

21 In 2009, the Congressional Budget Office (CBO) reached a similar conclusion. According to the CBO, in 2009, "the federal government devoted almost four times the amount of budgetary resources supporting homeownership (about $230 billion) as it devoted to improving rental affordability ($60 billion)." See Congressional Budget Office, "An Overview of Federal Support for Housing," *CBO Economic and Budget Issue Brief* (November 3, 2009). The CBO estimated that in 2009 the subsidy costs of new Fannie Mae and Freddie Mac credit activities were $43 billion and spending under the Making Home Affordable program was $50 billion. For 2010, the CBO substantially reduced its cost estimates for both items to $21 billion and $2.3 billion, respectively.

22 See Paul Starobin, "A Dream Endangered. (Yeah, So?)," *National Journal,* March 2011, 6 ("The Next Economy," special supplement and joint project of *The Atlantic* and *National Journal*).

23 See Joint Center for Housing Studies, *America's Rental Housing*, 4–5, tables A-6 and A-7.

24 See Barbara J. Lipman, *Something's Gotta Give: Working Families and the Cost of Housing* (Washington, D.C.: Center for Housing Policy, 2005).

25 See Maya Brennan and Laura Williams, "Paycheck to Paycheck 2011: Is Housing Affordable for Americans Getting Back to Work?" (Washington, D.C.: Center for Housing Policy, 2011).

26 This estimate assumes homeownership rates will stabilize at 2010 levels and that immigration growth will be just half of what the Census Bureau projects during the coming decade. If homeownership rates continue to decline, then the number of new renter households will most certainly be larger. In addition, if immigration growth over the coming decade meets Census Bureau projections, then the number of new renter households will be significantly larger—by as much as 1.1 million. Foreign-born immigrants to the United States tend to be younger and have lower homeownership rates than native-born households. See Joint Center for Housing Studies, *America's Rental Housing*, 20.

27 For a discussion of this phenomenon, see Joint Center for Housing Studies, *The State of the Nation's Housing*, 1–2.

28 See RREEF Research, *Boomers, Echo's and X's: Generational and Other Structural Shifts and their Impacts on Future Demand for Real Estate in the Coming Decade*, No. 81 (May 2011), 6.

29 Ibid., 7.

30 See Joint Center for Housing Studies, *The State of the Nation's Housing*, 4.

31 See Joint Center for Housing Studies, *America's Rental Housing*, 19.

32 Joint Center for Housing Studies, *The State of the Nation's Housing*, 4.

33 See U.S. Department of Housing and Urban Development and U.S. Department of Commerce, Bureau of the Census, *American Housing Survey for the United States: 2009, Current Housing Reports*, Series H150/09 (Washington, D.C.: U.S. Government Printing Office, 2011).

34 Recognizing this opportunity, the Administration recently issued a "request for information" seeking input on how best to sell the approximately 250,000 single-family properties held by Fannie Mae, Freddie Mac, and FHA. The stated purpose of the request for information is to "explore alternatives for maximizing value to taxpayers and increasing private investment in the housing market, including approaches that support rental and affordable housing needs."

35 See Morgan Stanley Research, "A Rentership Society," *Housing Market Insights*, July 20, 2011, 6.

36 Joint Center for Housing Studies, *The State of the Nation's Housing*, 4.

37 Some private sector analysts, for example, anticipate an additional decline in the homeownership rate by as much as 2 percentage points as a result of such factors as impaired credit, stricter lender requirements, and the "realization by younger households that homeownership entails more risks than previously thought." See Economics Group, Wells Fargo Securities, LLC, "Housing Data Wrap Up: Prices Continue to Tumble as Underlying Demand Remains Weak," May 2, 2011, 2.

38 "State of the Housing Markets," Statement for the Record on Behalf of the National Multi Housing Council and the National Apartment Association before the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 9, 2011, 2.

39 See U.S. Census Bureau News, U.S. Department of Commerce, "Residential Vacancies and Homeownership in the Third Quarter 2011," November 2, 2011, 1.

40 See U.S. Department of Commerce, Bureau of the Census, *Housing Vacancies and Homeownership, Current Population Survey/ Housing Vacancy Survey* (CPS/HVS), Series H-111, Table 3, Quarter 2, 2010 vs. 2011, http://www.census.gov/hhes/www/housing/hvs/hvs.html; see also Joint Center for Housing Studies, *The State of the Nation's Housing*, 23.

41 U.S. Department of Commerce, Bureau of the Census, First Quarter 2011, Table 4, Rental Vacancy Rates for the 75 Largest Metropolitan Statistical Areas, http://www.census.gov/hhes/www/housing/hvs/rates/index.html.

42 For example, in the second quarter of 2011, rents increased in 80 of the 82 markets tracked by Reis, Inc., a leading real estate research firm, with only one market (Jacksonville, Florida) posting a decline. See Wesley Lowery, "Rents Rise, Vacancies Go Down," *Wall Street Journal*, July 7, 2011.

43 See Patricia Kirk, "Developers Give Gen Y What They Want," *Urban Land,* June 24, 2011; see also Ania Wieckowski, "Back to the City," *Harvard Business Review*, May 2010.

44 For example, builders started construction on 135,000 new multifamily units in the first quarter of 2011, up 55 percent from 87,000 units in the fourth quarter of 2010 and up 64 percent from 82,000 units in the previous year. U.S. Department of Housing and Urban Development, *U.S. Housing Market Conditions First Quarter 2011* (May 2011), 5.

45 Twenty years ago, in its landmark study, *"Not in My Backyard": Removing Barriers to Affordable Housing* (HUD-5806, 1991), HUD helped raise public awareness that unnecessary regulations at all levels of government have stifled the ability of the private housing industry to produce a sufficient quantity of affordable housing. This report, as well as HUD's follow-up report, *"Why Not in Our Community?": Removing Barriers to Affordable Housing* (Washington, D.C.: HUD, 2005), have called upon states and local communities to reduce housing costs by streamlining their regulatory processes.

46 Some analysts predict that as many as 166,667 multifamily units will be lost annually from 2011 to 2014. See Peter Linneman, "Commercial Real Estate Pricing Update," *The Linneman Letter* 11 (Spring 2011).

47 Joint Center for Housing Studies, *The State of the Nation's Housing*, 3.

48 See Joint Center for Housing Studies of Harvard University, *America's Rental Housing: The Key to a Balanced National Policy* (Cambridge, Mass.: Joint Center for Housing Studies, 2008), 20, citing the Government Accountability Office; see also Cohen, Wardrip, and Williams, "Rental Housing Affordability," 5.

49 See NAHB Housing Policy Department, *The Local Impact of Home Building on a Typical Metro Area: Income, Jobs, and Taxes Generated* (Washington, D.C.: NAHB, 2009).

50 In other research focusing on the economic impact of the LIHTC program, the NAHB estimates that in recent years the LIHTC program has *annually* created approximately 90,000 new full-time jobs, added $6.8 billion in income (business profits, wages and salaries) to the U.S. economy, and generated approximately $2 billion in federal taxes. As the NAHB explains, these effects are broad based and include jobs, income, and taxes not just in construction but also in sectors such as manufacturing, trade, and services. See NAHB, "The Low Income Housing Tax Credit: The Most Successful Affordable Rental Housing Production Program in our Nation's History," http://www.nahb.org/fileUpload_details.aspx?contentID=151606.

APPENDIX A NOTES

1 Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing: 2011* (Cambridge, Mass.: Joint Center for Housing Studies, 2011), 4.

2 Joint Center for Housing Studies of Harvard University, *America's Rental Housing: Meeting Challenges, Building Opportunities* (Cambridge, Mass.: Joint Center for Housing Studies, 2011), 17–20.

3 U.S. Department of Housing and Urban Development and U.S. Bureau of the Census, *American Housing Survey for the United States: 2009, Current Housing Reports,* Series H150/09 (Washington, D.C.: U.S. Government Printing Office, 2011). For purposes of this paper, a multifamily development is a building with five or more units.

APPENDIX B NOTES

1 See Eric Toder, Margery Austin Turner, Katherine Lim, and Liza Getsinger, *Reforming the Mortgage Interest Deduction* (Washington, D.C.: Tax Policy Center, 2010).

2 See Dean Stansel and Anthony Randazzo, *Unmasking the Mortgage Interest Deduction: Who Benefits and by How Much?,* Policy Study 394 (Los Angeles, Calif.: Reason Foundation, 2011), 6–7.

3 The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform* (Washington, D.C.: The White House, 2010), 31.

4 Joint Committee on Taxation, U.S. Congress, *Estimates of Fiscal Year Tax Expenditures for Fiscal Years 2010–2014,* JCS-3-10 (Washington, D.C.: U.S. Government Printing Office, 2010). 39.

5 See Sheila Crowley, President and CEO, National Low Income Housing Coalition, Letter to the Honorable Xavier Becerra, on behalf of the National Housing Trust Fund Campaign (August 25, 2011).

6 See Peter Lawrence, "The Remarkable Resurgence and Resilience of the LIHTC," *Novogradac Journal of Tax Credits* (May 2011).

7 See Ian Galloway, "Create a More Robust LIHTC Market by Attracting Individual LIHTC Investors," in Federal Reserve Bank of St. Louis, *Innovative Ideas for Revitalizing the LIHTC Market*, 25–27.

8 The Administration's "income averaging" proposal *would* allow new LIHTC projects to be occupied by individuals or families earning up to 80 percent of AMI, so long as they are offset by units occupied by individuals or families earning less than 60 percent of AMI, resulting in an average of 60 percent of AMI. Donna Kimura, "LIHTC Changes Weighed," *Affordable Housing Finance*, April/May 2011.

9 See http://www.ncsha.org/advocacy-issues/housing-bonds.

10 *Meeting Our Nation's Housing Challenges: Report of the Bipartisan Millennial Housing Commission Appointed by the Congress of the United States* (Washington, D.C., May 30, 2002), 20, 31–36.

11 In 2010, the serious delinquency rates for the GSE multifamily programs stood at less than .75 percent with the highest state rate, for Florida, at 2.64 percent, compared to single-family programs at nearly 4.5 percent and as high as 14 percent in Nevada. See Fannie Mae, *Fannie Mae 2010 Credit Supplement* (Washington, D.C., February 24, 2011).

12 See Fannie Mae Multifamily Economics and Market Research Team, *Fannie Mae and Workforce Housing* (Washington, D.C., January 11, 2011), 25. According to Fannie Mae, approximately 87 percent of its multifamily finance currently supports rental housing that is affordable to households earning at or below their area's median income.

13 Joint Center for Housing Studies of Harvard University, *State of the Nation's Housing: 2011* (Cambridge, Mass.: Joint Center for Housing Studies, 2011), 24–25.

14 Ibid., 25.

15 See Jerry Ascierto, "Slowness Kills: FHA Releases New MAP Guide, Hoping to Speed Up Loan Process," *Housing Finance News*, September 2011.

16 The HFA risk-sharing program is authorized by Section 542(c) of the Housing and Community Development Act of 1992.

17 See HUD Ideas in Action, "Insure Local TIF Commitments," http://hudideasinaction.uservoice.com/forums/95655-public-feedback/suggestions/1895659-insure-local-tif-commitments?ref=title.

18 U.S. Department of the Treasury and U.S. Department of Housing and Urban Development, *Reforming America's Housing Finance Market: A Report to Congress* (Washington, D.C., February 2011), 19–21.

19 See U.S Department of Transportation and U.S. Department of Housing and Urban Development, *Better Coordination of Transportation and Housing Programs to Promote Affordable Housing near Transit* (Washington, D.C., August 2008).

20 For a good discussion of this approach, see Jeffrey Lubell, executive director of the Center for Housing Policy, "Transportation Policy Is Housing Policy," blog post on Indiana Association for Community Economic Development site, June 22, 2011, http://www.iaced.org/2011/06/transportation-policy-is-housing-policy/.

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