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America's Affordable Housing Crisis: Challenges and Solutions

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Chairman Hatch, Ranking Member Wyden, and Members of the Committee, thank you for inviting me to appear today to discuss America's affordable housing crisis, challenges and solutions. I am speaking today from my perspective as a researcher, particularly on affordable housing policy, and from my experience at the Department of Housing and Urban Development, where I chaired the cross-agency Rental Policy Working Group (RPWG) which specifically focused on alignment of federal rental programs and rental affordability.

American's Affordable Housing Crisis

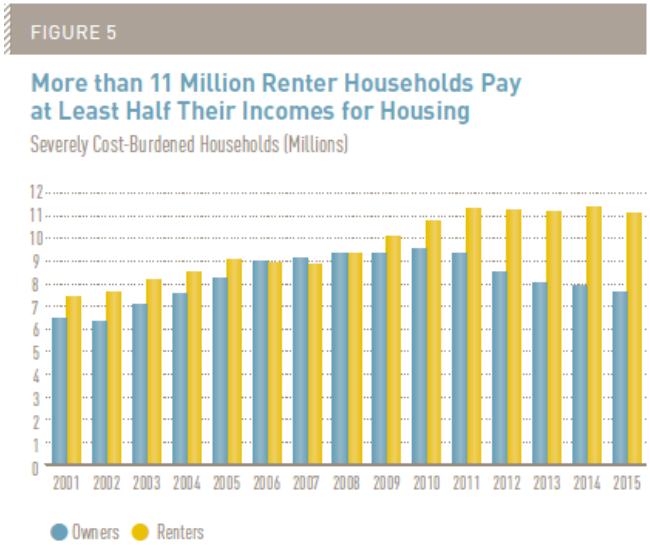
As has been reported widely and frequently in the press, and documented well by the researchers at Harvard's Joint Center, the Furman Center and many others, we have a housing affordability crisis in this country that is not going away. Let me start with just some facts.

- ***Housing cost burdens are extremely high, particularly for renters***

Using the affordability standard of spending no more than 30 percent of income on housing, in 2015 nearly 39 million households were 'cost burdened.'[1] This is about a third of all households in America. And renters are much more likely to face cost burdens. Nearly half (48.3 percent) of all renters were cost burdened in 2015. More than a quarter (25.6 percent) face severe cost burdens, spending at least half of their income on housing.

- ***These rates remain far above pre-housing crisis levels***

While rent cost burdens have declined slightly since their peak in 2011, they remain considerably above pre-housing crisis levels. Focusing on those most burdened, 11.1 million renter households were severely cost burdened in 2015, nearly 4 million more than in 2001.



Source: Joint Center for Housing Studies, The State of the Nation's Housing 2017.

[1] Joint Center for Housing Studies. The State of the Nation's Housing 2017.

- ***Affordability challenges are widespread – beyond highest cost cities and lowest income households***

Affordability issues are not limited to highest-cost markets or a handful of states. With more than 30 percent of its renters experiencing severe cost burdens, Augusta, GA is among the ten metropolitan areas with the highest rates of severe burdens for renters, for example.[2] While Florida, California and Hawaii had the highest shares of renters facing cost burdens, at least 37% of renter households in every state across the nation were cost burdened in 2014.[3] High levels of cost burdens are also not confined to larger metropolitan areas. Almost 12 million households living outside the top 100 metropolitan areas are cost burdened, about half of whom are severely burdened.[4]

The sharpest growth in cost-burdened shares over the past decade and a half has been among middle-income households: burdened households within the middle quintile of the income distribution increased from 13 percent in 2001 to 25 percent in 2014.[5]

Looking specifically at cost burdens for renters by their income levels, in 2015:[6]

- For renter households with incomes below $15,000 – comparable to full-time work at the federal minimum wage – more than 80 percent were cost-burdened in 2015, with 70 percent facing severe cost burdens (spending more than half of income on housing).
- 64 percent of renters with incomes between $15,000 and $30,000 were cost-burdened in 2015, 32 percent severely so.
- Over 40 percent of renters earning between $30,000 and $45,000 were cost-burdened in 2015.

- ***Housing supply is not keeping up with demand***

The country has experienced seven consecutive years of growth in new construction, with 1.17 million housing units added to the national stock in 2016. [7] Even with this, construction is well below the historical annual rates of 1.4 to 1.5 million experienced during the 1980s and 1990s. Housing completions in the last 10 years are lower than any other 10-year period since the late 1970s.

Despite the gains in multifamily construction, rental markets remain extremely tight. Based on the Housing Vacancy survey, the Joint Center reports that rental vacancy rates continued to decline for the seventh year in a row.[8] In 2016, the rental vacancy rate fell to its lowest level in 30 years, 6.9 percent. Throughout the country, rent increases continue to far exceed inflation.

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[2] Joint Center for Housing Studies, The State of the Nations Housing 2017.
[3] Joint Center for Housing Studies. Rental Housing Affordability 2015, Appendix Tables &Additional Web-only Tables, A-5.
[4] Smaller metro and non metro areas. Joint Center for Housing Studies, The State of the Nation's Housing 2017.
[5] Joint Center for Housing Studies. Rental Housing Affordability 2015.
[6] Joint Center for Housing Studies, The State of the Nation's Housing 2017. Chapter 7-Appendix Tables.
[7] Joint Center for Housing Studies, The State of the Nation's Housing 2017.
[8] Joint Center for Housing Studies, The State of the Nation's Housing 2017.

Meanwhile, over the past 15 years, there has been a shift in the rental stock toward the higher end. Nearly half of the 100 largest metropolitan areas reported absolute declines in the number of low rent units, even as their housing stocks increased.[9]

Consequences of high housing costs

There are obvious reasons to be concerned about the escalating costs of housing and the myriad of ways it affects people. Households spending large portions, even half or more of their incomes on housing, face difficult tradeoffs in how to meet their basic needs with what remains. For example, severely cost-burdened families with children who are in the bottom quartile of income spend *75 percent less on healthcare* than non-burdened families in the same income quartile. Low-income and severely burdened seniors also cut back drastically on healthcare, spending 60 percent less than other low-income seniors.

High housing costs affect where people live, and may constrain families with children to neighborhoods and locations that do not support healthy child development, or upward economic mobility.

There may also be aggregate consequences if people are priced out of a high cost but highly productive markets, and choose to live in another area altogether. This affects the wages of that worker, and overall productivity in the nation. Recent work by Berkeley economists estimates that had higher housing costs not inhibited the movement of workers and capital over the past four decades, national output would have been 10 percent higher in 2009.[10] Higher cost housing may be a greater obstacle for low-wage earners, exacerbating inequality and locking in economic differences across states.[11] The differential mobility also may have very long term effects on inequality, because many of the areas to which more highly educated workers may move have higher levels of intergenerational mobility than the areas in which less educated workers remain.[12]

The Federal Role: Low Income Housing Tax Credit

In terms of Federal response, Tax Policy plays a key role in housing markets. For affordable rental housing, this is primarily through the Low Income Housing Tax Credit (LIHTC), the largest source of federal financing for the private production and rehabilitation of affordable rental housing in the country.[13] I will focus my policy comments on LIHTC.

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[9] Joint Center for Housing Studies, The State of the Nation's Housing 2017.

[10] Hsieh, C., & Moretti, E. (2017). Housing Constraints and Spatial Misallocation (Working Paper). Berkeley, CA: National Bureau of Economic Research (NBER).

[11] Ganong, P., & Shoag, D. (2015). Why Has Regional Income Convergence in the U.S. Declined? (Working Paper). Cambridge, MA: Harvard Kennedy School.

[12] Schleicher, D. (2017). Stuck! The Law and Economics of Residential Stability. *Yale Law Journal, 127* (forthcoming).

[13] https://www.huduser.gov/portal/datasets/lihtc.html

Reforming and Streamlining LIHTC

We now have more than thirty years of LIHTC experience to inform reforms – to increase the credit's flexibility and feasibility in a broader set of market conditions, to streamline, and to more effectively meet key policy goals. I would like to highlight three areas for improvement that are also part of S.548 (the *Affordable Housing Credit Improvement Act of 2017*).

(1) Working in a broader set of markets, across a broader set of incomes

LIHTC's federal income and associated rent limits are tied to either 50 or 60 percent of area median income during the application process. Since 2000, states are to prioritize developments reaching lowest income tenants, and indeed, nearly half (47.5 percent) of LIHTC tenants have incomes *below* 30 percent of Area Median Income (AMI), and 58 percent have annual incomes below $20,000.[14] Serving such households with extremely low incomes (ELI) generally requires some form of additional rental assistance, such as project-based or tenant-based vouchers, or other development-level subsidies. Without those additional subsidies, reaching lowest income households is not economically feasible in most markets. Yet those additional subsidies are in decreasing supply, may not be within the control of the HFA or developer, and even if available require coordination and layering across funding streams.

Income Averaging (Section 201) can help address these challenges as well as improve economic feasibility in different market settings.

Income averaging permits developments to employ an 'average income' cap of 60 percent of AMI, with no household's income exceeding 80 percent of AMI. Rents set for 80 percent of AMI can be used to offset the lower rents for those at 30 (or 40) percent of AMI. This means a broader set of incomes can be served in a development, where the additional resources needed to reach lower income households comes from within the finances of the development itself. This 'cross-subsidy' will be useful in high-cost markets, as well as for developments that are part of mixed-income community revitalization plans. It also addresses some of the issues in rural markets, where it may be necessary to serve a broader set of income ranges to be economically feasible. This greater flexibility is one of the most important LIHTC reforms.

Permitting states to increase the maximum basis boost for serving ELI tenants (Section 309) adds a similar flexibility in terms of identifying resources within LIHTC for reaching lowest income households, avoiding additional layering of financing and the associated complexities. Finally, broadening the definition of Difficult Development Areas (DDAs, Section 402) to automatically include Indian areas (along with the increased DDA cap, Section 311) also enable the credit to work in a different, high need environment that it has historically underserved.

[14] "Understanding Whom the LIHTC Program Serves: Data on Tenants in LIHTC Units as of December 31, 2014. HUD USER." 2017. Accessed April 19. https://www.huduser.gov/portal/publications/ LIHTCTenantReport-2014.html.

(2) Achieving Locational Goals

Over time and in practice, at least two (potentially conflicting) locational goals have emerged. On the one hand, there is a desire to avoid locating subsidized housing in neighborhoods in which poverty rates are already high, as this may further concentrate poverty. An additional concern is that high poverty neighborhoods may lack conditions conducive to self-sufficiency and economic mobility. Recent work by Raj Chetty and his co-authors, looking at the adult outcomes for children in assisted housing affirms that neighborhoods matter; children provided access to lower poverty neighborhoods were more likely to go to college and had higher earnings as adults.[15]

On the other hand, the desire to preserve existing affordable housing might drive investments to higher poverty neighborhood, and it is argued that such investments might spur broader community revitalization. This community reinvestment goal was made explicit in 2000, when the Community Renewal Tax Relief Act of 2000 required states to give preference to applications for LIHTC developments in area of lower income/higher poverty (Qualified Census Tracts or QCTs) with concerted community revitalization plans. Recent research provides compelling evidence that LIHTC developments in low-income neighborhoods do indeed have positive effects on the surrounding neighborhood, increasing property values, lowering crime, and attracting a more racially and economically diverse population. [16]

How states are to balance these competing goals remains a live debate. To achieve either locational goal, however – siting LIHTC in higher income/higher opportunity neighborhoods or contributing to neighborhood improvement through LIHTC investments, requires two reforms contained in S548.

In terms of accessing higher income neighborhoods, Section 308 would prohibit local approval and contribution requirements. Beyond the federal requirement that agencies provide notice to local government and a reasonable opportunity to comment on planned LIHTC developments,[17] some states also require proof of local support or provide other competitive points for such support. Such local approvals can, in essence, give jurisdictions the ability to veto developments. Considerable anecdotal evidence from developers and states suggest such 'veto power' creates sizable location barriers in some states.

In terms of prioritizing developments in QCTs with concerted community revitalization plans, no guidance has been provided on who is to define what constitutes such a plan. In the absence of clarity, some states have provided the same prioritization to all developments proposed in QCTs, regardless of evidence of a plan. Clarification that states have the authority to determine the definition of community revitalization plan (Section 307) would encourage states to employ prioritization that is consistent with federal intent.

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[15] Chetty, R., Hendren, N., & Katz, L. F. (2016). The Effects of Exposure to Better Neighborhoods on Children: New Evidence from the Moving to Opportunity Experiment. *American Economic Review*, 106(4), 855-902.

[16] Diamond, R & McQuade, T. 2016. Who Wants Affordable Housing in Their Backyard? An Equilibrium Analysis of Low Income Property Developments.

[17] 26 U.S.C. § 42(m)(1)(A)(ii).

Preservation of existing affordable housing

LIHTC is also used for the preservation of existing affordable housing, primarily through the so-called 4 percent credit. Preserving existing affordable housing is a key (and potentially cost-effective) strategy for narrowing the gap between demand and supply. Due to how the credit formula is calculated, its value actually fluctuates, adding uncertainty to credit deals. While a permanent minimum has been established for the 9 percent credit[18], Section 301 would establish a permanent minimum for the 4 percent credit. Along with modifying building repurchase rights (Section 303), this would improve the ability of the tax credit to be used for preserving existing affordable housing.

Additional Reform

Housing markets and needs vary greatly across jurisdictions and states. LIHTC is a federal credit, but implemented by states to permit tailoring to local conditions. It is possible to add additional flexibility to the credit that could improve cost-effectiveness by permitting a portion of the value of the credits, or of any credit expansion, to finance state (HFA)-issued vouchers. Perhaps modeled on the Tax Credit Assistance Program (TCAP)[19] in which states could apply to provide grants in lieu of credits, the funding in this case would support a set of state-issued vouchers, likely time limited to match the timing of the funding. For those markets in which there is an adequate supply of quality housing across a range of price points, it may be more cost effective to permit states to utilize tenant-based vouchers.

LIHTC Resources

Finally, I want to end by making a point about the level of resources for LIHTC. Due to the nature of how investors in LIHTC properties receive tax benefits -- through both the credit and through losses, any decrease in corporate tax rates also lowers the amount of equity raised by the credit. LIHTC funding is predicted to decline by up to 17 percent under expected decreases in the corporate tax rate if per-capita allocations are not increased to keep pace.[20] Uncertainty over future corporate rates has already led to delays in deal closing and decreases in the price investors are willing to pay for the credit. [21]

This means failure to increase the per-capita allocation is equivalent to cutting LIHTC resources relative to its funding in recent years. This also means that *some amount of increase in the per-capita allocation is budget neutral relative to past years.* Given the

[18] Protecting Americans from Tax Hikes Act of 2015 (PATH).
[19] The American Recovery and Reinvestment Act of 2009.
[20] https://www.novoco.com/notes-from-novogradac/how-congress-could-offset-effects-affordable-housing-production-reduced-corporate-rate
[21] Capps, Kriston. 2017. "Tax Reform Hasn't Started Yet, but Affordable Housing Is Already Taking a Hit." *CityLab*. Accessed May 1. http://www.citylab.com/housing/2017/01/uncertainty-over-tax-reform-is-already-hurting-affordable-housing/514235/.

breadth and depth of affordability issues in the country, now does not seem a time to withdraw federal resources for affordable housing, particularly for LIHTC.

It is, however, an opportune time to make substantive improvements in LIHTC, making it a more effective and efficient program as the nation grapples with a serious and persistent rental affordability crisis.