US PARTNERSHIP ON MOBILITY FROM POVERTY

# Why Isn't There Enough Affordable Housing for the Families Who Need It Most?

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The ability to afford a decent stable home is a primary concern for families seeking to achieve mobility from poverty. This memo describes the scope of the housing affordability crisis, the market challenges that impede affordability, current policy responses, and options for improving affordability for low-income households.

## The Affordable Housing Crisis and Mobility from Poverty

The US has an affordable housing crisis. Between 2005 and 2015, rental demand rose among households of all incomes.[1] The supply of housing renting for less than $800 a month dropped, and the national rental vacancy rate fell to a 30-year low.[2] The situation is even more dire for extremely low–income households (those with incomes below 30 percent of an area's median income or up to the federal poverty level, whichever is higher).[3] No county in the US has enough housing affordable for extremely low–income households.[4] More than 90 percent of renters with extremely low incomes spend more than half their income on housing (known as a severe housing cost burden), live in severely inadequate housing, and/or rely on government housing assistance.[5]

The US Partnership on Mobility from Poverty defines mobility as including three core principles: economic success, power and autonomy, and being valued in the community.[6] Closing the housing affordability gap can support all three principles in the near term as well as across generations. When households can afford the rent, they have more of their budget available for immediate and future needs.[7] Low-income families with affordable rents spend more on child enrichment, such as books or extracurricular lessons.[8] Affordable rents reduce the likelihood of eviction, which is associated with job loss for low-income workers.[9] Evidence suggests that housing affordability also reduces threats to low-income people's autonomy and sense of being valued in the community. For example, affordable rents reduce the risk of homelessness[10] and help families leave homelessness and retain stable housing.[11]

Evidence from housing subsidy programs reinforces the importance of affordable rents for mobility from poverty. Even without moving to a more economically supportive neighborhood, children from low-income families earn more by young adulthood when they spend more of their childhood in an affordable home.[12] Childhood lead poisoning risks are lower among families with a housing subsidy.[13] Contrary to economic theory, housing subsidies do not appear to substitute for work. After five years with a rent subsidy, low-income households worked more than similar unsubsidized households.[14]

If we know that affordable housing supports upward mobility for very low–income families, why aren't communities adding and retaining enough of it? The affordable housing shortage stems from a combination of market challenges that impede affordability and public policies that fail to sufficiently counteract these effects—and sometimes exacerbate affordability problems.

## Market Challenges

Whether operating as for-profits or nonprofits, private developers need enough rent revenue to cover their costs. Yet low-income families cannot afford rents that are high enough to pay for new housing construction under typical conditions.[15] Extremely low–income households cannot even afford rents high enough to pay a building's basic operating costs. The premium for new construction means that new rental developments typically enter the market with rents well above the local median. In fact, nearly half of newly constructed apartments charge rents in the top quartile for their market.[16]

Regulations such as building codes, restrictive zoning, minimum lot sizes, parking requirements, and density limits contribute to higher development costs. While they often serve legitimate public purposes, local land use regulations may also be deliberately exclusionary. For example, a neighborhood can effectively create an income or asset test for new residents by adopting single-family zoning and large lot sizes. Since regulations vary between and within jurisdictions and are not uniformly enforced, accurately measuring their combined and individual effects on housing prices is difficult.[17] One estimate finds that development costs go up nearly $7 per square foot when regulations lengthen the permitting process (for example, moving from a 3–6-month permitting wait to a 7–12-month wait).[18] Opposition to new development in a community also adds time and uncertainty that translate into a reduced housing supply and higher costs. While some cost drivers are common to all housing or to all multifamily housing, others are unique to publicly subsidized housing development, which is subject to additional oversight, can generate strong local opposition, and often carries an array of project requirements that extend beyond the central goal of decent shelter.[19]

Housing can become affordable over time as older rental housing filters down the income spectrum, but this process rarely meets the needs of the lowest income households. When filtering works, households in higher income bands move into newer units or more desirable locations, reducing the demand for older apartments and lowering rents. But across market types, mismatched supply and demand have disrupted this process. Older rental housing in strong markets is becoming unaffordable as properties are renovated to meet higher-income demand.[20] Meanwhile, older properties in weak markets are deteriorating past the point of habitability, leaving low-income households with either substandard housing or fewer places to live.[21] When properties filter down to become affordable for extremely low–income households, the rent levels alone put the property at risk of disrepair. The amount of rent that is affordable to households experiencing poverty typically is not high enough to support the basic repair and maintenance needs of older housing.

## Current Policy Responses

The solutions in place today mitigate what would otherwise be an even deeper housing affordability crisis but come far short of delivering affordability for the nation's lowest-income renters. The policies for improving affordability take two primary forms: subsidies and regulatory reforms (table 1). Housing subsidies can make rents affordable for the lowest-income renters, but current funding levels allow only a fraction of eligible households to receive assistance. Regulatory approaches contribute to affordability by overriding exclusionary policies, encouraging owners to offer some below-market apartments, or removing rules that make housing development costlier than necessary, but regulatory reform alone is unlikely to lead to affordability for extremely low–income households.

TABLE 1

**Current Affordable Housing Interventions**

| Intervention type | Description | Examples | Assists extremely low–income households? |
|---|---|---|---|
| **Demand-side public subsidies** | Subsidies that increase tenants' ability to compete in the private rental market | ▪ Housing Choice Voucher program<br>▪ State/local vouchers or rent subsidies | Often targeted to extremely low–income households |
| **Supply-side public subsidies** | Subsidies (or tax expenditures) that reduce capital or operating costs for affordable housing developments | ▪ Public housing<br>▪ Project-based rental assistance<br>▪ Low-Income Housing Tax Credit<br>▪ Housing trust funds<br>▪ Property tax abatements | Public housing and project-based rental assistance target extremely low–income households; other supply-side subsidies are less targeted to the lowest-income groups |
| **Incentive-based regulations** | A noncash benefit to developers to stimulate production of affordable rental units | ▪ Inclusionary zoning<br>▪ Community benefits agreements | Unlikely to reach extremely low–income households without a special emphasis |
| **Enforcement-based regulations** | State or federal regulations or court actions that require local governments to provide affordable housing | ▪ Fair housing settlements<br>▪ Affirmatively Furthering Fair Housing rule<br>▪ State "fair share" housing programs<br>▪ State housing elements<br>▪ Overrides of local zoning | Varies with the program emphasis |
| **Deregulation** | Interventions that reduce land use restrictions, thereby making development feasible at a lower cost | ▪ Up-zoning (e.g., increasing allowable density)<br>▪ Building code reforms<br>▪ Streamlined approvals<br>▪ Reduced parking requirements<br>▪ Accessory dwellings | Unlikely to reach extremely low–income households, but can allow subsidies to stretch farther |

## *Subsidy Programs*

Housing subsidies either support a household directly through tenant-based (i.e., demand-side) assistance or reduce costs for a specific property through operating or capital (i.e., supply-side) assistance.

**Demand-side subsidies.** Most tenant-based subsidies come from the federal Housing Choice Voucher program. In 2016, 2.2 million households used federal housing vouchers to rent housing in the private market. The renter is responsible for finding an available rental unit with a landlord who is willing to take the voucher. The subsidy typically allows a household to pay rent equal to 30 percent of income, while the landlord receives the remainder of the rent through the voucher. Because of the severity of the housing affordability crisis, some state and local governments provide rent subsidies to additional households through separate programs modeled on the Housing Choice Voucher.[22]

Despite randomized controlled trials that support vouchers as an effective housing assistance strategy, federal funding for the voucher program has not increased with demand. In recent years, the federal government has limited voucher funding to renewals or new assistance for a specific population, such as homeless veterans.[23] Under a federal budget process that imposed mandatory spending reductions, even these funds were cut.[24]

For households who receive a voucher, finding a suitable rental property where the landlord will take the voucher can be difficult. The voucher approves a household for a specific number of bedrooms and sets the acceptable market rent, which is typically below the median rent for the region. Properties must also pass a health and safety inspection. Larger households are less likely to successfully rent housing with a voucher.[25] This could reflect the nature of demand-side assistance: the subsidy only works if there is a sufficient supply of apartments that fit within the program's rent and quality guidelines. In addition, landlords in most communities can legally refuse to accept vouchers, and the available evidence suggests that many do.[26]

**Supply-side subsidies.** Several programs, including public housing, project-based rental assistance, and the Low-Income Housing Tax Credit, use public funds to reduce the rents in housing developments. Subsidized properties may be owned and operated by public, nonprofit, or for-profit entities, and they may have various affordability levels. The subsidy allows a property owner to provide housing to households earning low or moderate incomes at lower rents than a similar unit would command on the market.

- Nationally, around 1.1 million homes have income-based rents through the **public housing** program. This is down from 1.4 million units in 1994. As funding for public housing declined, some public housing residents transitioned to demand-side subsidies through the voucher program.

  The federal government provides public housing authorities with per-unit operating subsidies that vary with household income, and most housing authorities have a separate fund for capital improvements. Annual funding for capital improvements fell to less than $1.8 billion in 2013 from an inflation-adjusted $3.9 billion in 2000.[27] In total, public housing needs an estimated $21 billion in repairs.[28] Short-funding of the capital budget has left apartments vacant owing to physical deterioration. The Rental Assistance Demonstration may help with the capital backlog by transferring public housing developments to private owners—along with an affordability requirement—who can leverage project-based assistance to obtain private financing for repairs.

- Under **project-based rental assistance**, privately owned apartments receive contracts from the US Department of Housing and Urban Development (HUD) or the US Department of Agriculture (USDA) to serve low-income households for a defined time. HUD is not creating new housing through project-based rental programs, and rural housing development through USDA is waning. More than 1.2 million households use project-based rental assistance from HUD, and approximately 269,000 live in USDA-subsidized multifamily developments with Section 525 rental assistance.[29] Affordability restrictions typically last 30 years, after which the owner can choose to renew or opt out of the subsidy. If the owner opts out, the property may transition to market-rate housing. More than one million units of privately owned but federally assisted rental housing have affordability requirements that will expire between 2017 and 2026.[30]

- The **Low-Income Housing Tax Credit** (tax credit) is the main source of new rent-restricted housing. Unlike public housing and rental assistance contracts, the subsidy is not based on household incomes, but rather a portion of the development costs. States (and occasionally local governments) distribute their allocation of tax credits competitively, assigning points to various features or priorities. The developers convert the subsidy into upfront development funding by working with third-party syndicators to sell the tax credits to investors. Units subsidized with the tax credit are available to households earning no more than 60 percent of area median income. Since subsidy levels do not vary with income, tax credit housing is typically not affordable to households experiencing poverty without an additional tenant-based or project-based subsidy.

  Whether communities can add affordable rental housing through tax credit developments depends on the availability of tax credits and the capacity to attract investors. In 2017, expectations of corporate tax cuts reduced the price that investors were willing to pay for these credits.[31] Some research suggests that tax credit housing replaces other development that would have occurred, rather than adding net new units.[32] The units, however, have extended rent restrictions and tend to offer higher quality than unsubsidized housing serving the same income group.

- **State and local supply-side subsidies** include housing trust funds, tax abatements, and donated public land. Trust funds are more feasible in high-cost markets since they often rely on fees on market-rate real estate development and transfers. These markets are also more likely to need the additional subsidy because of wider gaps between market-rate and affordable rents. Local governments can also incentivize multifamily or affordable housing development by offering property tax abatements. The lower tax bill allows owners to charge lower rents, but tax abatements seldom make rents deeply affordable on their own.

  Governments at all levels are major land owners, and some government agencies already offer underused publicly owned land to serve various purposes, including affordable housing development. Deed restrictions, land leases, and transfers to community land trusts are among the viable mechanisms for ensuring long-term, mission-driven control of the land—and therefore the capacity to improve housing affordability in those locations for decades to come. These options work best in areas that are built-out, already have high land values, or have a foreseeable risk of sharply rising housing demand. Budgetary pressures or local requirements that any such sales or leases go to the highest bidder may impede such solutions unless a state or local rule specifically authorizes an exception for affordable housing.

- Through block grants and the National Housing Trust Fund, the federal government provides **flexible subsidies** to states and localities for housing or related activities. The National Housing Trust Fund, which made its first allocations to states in 2016, is exclusively for supply-side assistance and prioritizes extremely low–income renters. The HOME Investment Partnerships Program can fund either supply-side or demand-side subsidies for renters or owners but does not target extremely low–income households. The final major flexible assistance program is the Community Development Block Grant, which supports housing affordability and neighborhood improvements either through supply-side subsidy or by funding infrastructure improvements that make developments feasible.

### *Regulatory Reforms*

Local and state governments establish the ground rules for development and can use their regulatory capacity to improve the conditions for affordability.

**Inclusionary zoning.** Inclusionary zoning programs, which may be voluntary or mandatory, can be an effective source of new affordable housing by incentivizing developers to create a certain number of affordable units (or pay a suitable in-lieu fee) when building market-rate housing. The evidence shows that mandatory inclusionary zoning is more effective than voluntary.[33] Inclusionary zoning rarely brings rents down to the levels needed by very low–income households, unless doing so is both mandated and funded. Local government may use tax abatements or fee waivers to indirectly fund developers who add units for very low–income households, or the additional subsidy could be more direct: for example, under the Montgomery County, Maryland, inclusionary zoning program, the public housing authority may buy a portion of the apartments to use as scattered-site public housing.[34] Inclusionary zoning programs are more effective in high-cost markets where demand for new development is strong. Inclusionary zoning programs have been spreading, but some states have used preemption laws to prevent local governments from adopting them.[35]

**Deregulation**. State and local governments can also reduce costs of housing construction by easing land use restrictions, such as parking requirements or minimum lot sizes. Deregulation can reduce the cost for all residential development or special development rules can support affordable housing. Deregulation can be appealing to local officials, since a rule change does not require direct subsidy. But it can be contentious if residents see the regulatory change as affecting "community character," harming the environment, or other concerns.

**Enforcement-based regulations.** Court actions or regulations from the federal or state government can require localities to add affordable housing to counteract prior discrimination or provide their "fair share" of the region's needed supply. These actions take many forms, including legal settlements that require new housing development in a specified community, state overrides of local zoning, and the federal Affirmatively Furthering Fair Housing rule.[36] Community opposition to such requirements can impede or delay enforcement.

## Current Policy Challenges

The current landscape of policies leaves market challenges largely unaddressed. Government incentives to add private-market affordability, such as through inclusionary zoning, rarely make rents affordable to extremely low–income families. The supply of federally subsidized apartments may shrink owing to a lack of ongoing repair funds or expiring subsidies. Meanwhile, federal rental assistance has not kept pace with the housing crisis. The number of renters receiving housing assistance increased 7 percent between 2005 and 2015, while the number of low-income households who need assistance to avoid severe housing quality or affordability problems increased 24 percent.[37] Just 16 percent of low-income renter households receive federal rental assistance—despite having incomes within the eligibility limits.

## Where Do We Go from Here?

The scope of the crisis calls for innovative solutions that include *both* expanded access to subsidies for very low–income households *and* regulatory reforms that keep costs down and encourage new affordable supply. Already, states and localities often blend regulatory and subsidy approaches, but what might larger-scale solutions look like?

How to expand housing solutions enough to enable mobility from poverty is essentially a political question. In 2013, a bipartisan commission recommended increasing funding for federal housing vouchers and converting the program into an entitlement for extremely low–income households.[38] However, expanding income-based rent subsidies would be extremely difficult in the current federal landscape. Novel subsidy programs could generate more interest simply by being new. Various proposals have emerged that would deliver rental assistance through the tax code, providing deeper subsidy than the tax credit program while still maintaining various tax credit features that have bipartisan support. For example, a new housing tax credit that delivers income-based rents could be designed as an earned income tax credit housing supplement, a refundable credit to eligible renters, or a credit that compensates owners for charging income-based rents.

If federal subsidies expand to address the affordability crisis without states and localities acting to reduce costs, the need for federal subsidy will continue to rise and funding battles will grow. Cost reduction needs to be part of the picture. With state incentives or heightened grassroots pressure to act, localities can begin to identify their own combination of land use regulations to reform. Doing so will also allow subsidy programs to stretch further. Policymakers could even attach a requirement or strong incentive for regulatory reform as a component of an expanded federal subsidy program.

Deregulation can reduce the amount of subsidy needed to make housing affordable for very low–income households. Will the remaining affordability gap be small enough to solve through inclusionary zoning, modest levels of assistance from housing trust funds, or tax abatements? Will donations of publicly owned land fill the affordability gap? Or will the gap require the larger purse of state or federal governments? The answer will likely vary with the market, but exploring these questions may hold the key to generating effective and feasible housing solutions.

## Notes

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## ABOUT THE US PARTNERSHIP ON MOBILITY FROM POVERTY

With funding from the Bill & Melinda Gates Foundation, the Urban Institute is supporting the US Partnership on Mobility from Poverty. Led by chair David Ellwood and executive director Nisha Patel, the Partnership consists of 24 leading voices representing academia, practice, the faith community, philanthropy, and the private sector.

The Partnership's definition of mobility has three core principles: economic success, power and autonomy, and being valued in community. Our collective aspiration is that all people achieve a reasonable standard of living with the dignity that comes from having power over their lives and being engaged in and valued by their community.