the importance of

AFFORDABLE HOUSING TO ECONOMIC COMPETITIVENESS

By David Schwartz

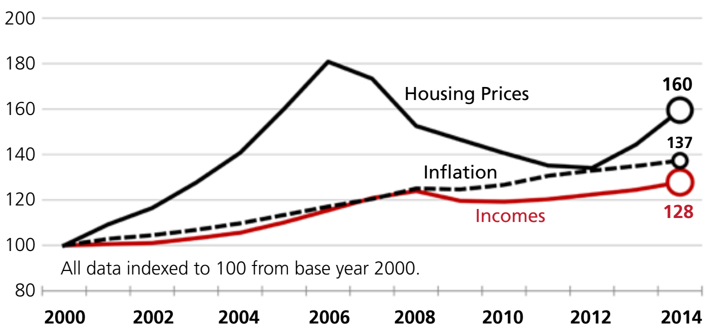
HOUSING AFFORDABILITY CHALLENGES AND ITS CONSEQUENCES

the availability of housing, meeting need and demand for the full spectrum of household affordability, should be viewed as an integral part of any successful region conferring economic, social, and environmental benefits that underpin sustainable growth and stable communities.

It is commonly recognized that home ownership is important for local political and social stability, as well as for wealth generation. But it is often overlooked that housing affordability, in general, is critical for the development and expansion of a local workforce. Although housing affordability can mean different things to different people, this discussion spans a wider spectrum, intended to characterize a problem experienced by everyone, not just the lowest incomes. The objective of this article is to identify how communities can craft policy and strategies that more effectively address the complexity and uniqueness of local issues. The article first discusses housing affordability challenges, its consequences, and which supply and demand factors contribute to or exacerbate them. The article continues with a discussion of how this affects a community's economic competitiveness and strategies that are typically used to address the situation. Finally, the discussion ends with case study examples and questions that communities should answer in creating locally-tailored strategies that do not deteriorate their economic competitiveness.

FIGURE 1.

Trends in U.S. Housing Prices, Inflation and Incomes



[Note 1]: Historical household median income data collected from: https://www.census.gov/hhes/www/income/data/historical/household/

[Note 2]: Case-Shiller indexes collected from: http://us.spindices.com/indices/real-estate/sp-case-shiller-us-national-home-price-index

[Note 3]: CPI data collected from: http://www.bls.gov/cpi/#data

Challenges

In recent years, many communities have seen increased demand push rents and home prices beyond levels considered affordable to households earning median income. This situation can present challenges to cities, such as overcrowding and financial cost-burdening, or force households to move away from their traditional homes and places of employment.

On one hand, incomes have not risen with the general cost of living, a sign of decreased purchasing power. **Figure 1** illustrates that U.S. household median income in 2014 was 28 percent higher than it was in 2000, but the cost of living in 2014, measured by the Consumer Price Index (CPI) for urban consumers, was 37 percent higher. On the other hand, though the CPI includes housing expenditures, the average price of housing in 2014, even after the market corrected following the recession, stands 60 percent higher than average prices in 2000. This means that new owner and renter households face an environment in which a greater portion of their income will be consumed by housing costs.

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THINKING CRITICALLY ABOUT THE CHALLENGES

Nationally, housing costs continue to escalate faster than incomes, creating a wide spectrum of affordability and quality-of-life problems. Not only are there challenges in dealing with the problem and its supply and demand circumstances, but there are challenges in avoiding the consequences that exacerbate problems and deteriorate a community's economic competitiveness. While many communities react with due urgency, the strategies and tools adopted under such circumstances can often overlook the complexity and uniqueness of local issues and resources. Without localized strategies, the economic opportunities and quality-of-life aspects that originally led to high housing demand and high property values will be lost.

How does a growing gap between housing costs and incomes arise? While it may be expedient (and true) to say that working households simply are not paid enough, the situation is more complex, because neither housing costs nor incomes are isolated variables.

A lack of affordable housing is not an isolated problem; it can affect all aspects of our economic and social lives, and is a problem for a wide range of workers including those in service sector jobs and government employees. The availability of a range of housing options affordable to a range of income levels is essential to sustaining our communities and must be addressed at both the regional and local levels. Without localized strategies to maintain housing options and affordability, the economic opportunities and quality-of-life aspects that originally led to high housing demand and high property values will be lost.

It's often a presumption of housing affordability studies or policies that the free market is not providing for the affordability needs of communities. The motivation behind any assessment of housing market and economic conditions should be to assess to what extent the private market should be called to do something about it and whether or not it can be leveraged in the context of regulatory and/or financing strategies.

Circumstances

There are not only challenges in dealing with the problem itself but also challenges in dealing with the circumstances that led to the problem. Most apparent is the expanding gap between incomes and housing costs, as illustrated in **Figure 1**. This presents an almost insurmountable challenge that has few political or economic solutions under a city's purview. Some communities have attempted to address the challenge by entering the debate over higher minimum wage, and many have passed ordinances (e.g. recently Seattle (WA), Los Angeles, and numerous other cities in California). Aside from the lawsuits contending the legality of such ordinances in several cities, it also remains to be seen whether the intended consequences (higher incomes) will outweigh the unintended consequences feared by some (lost jobs).

How does a growing gap between housing costs and incomes arise? While it may be expedient (and true) to say that working households simply are not paid enough, the situation is more complex, because neither housing costs nor incomes are isolated variables. On one hand, there are positive circumstances (of supply and demand) that can alone or in combination result in housing affordability challenges. On the other, there are negative circumstances that can lead to and exacerbate affordability challenges.

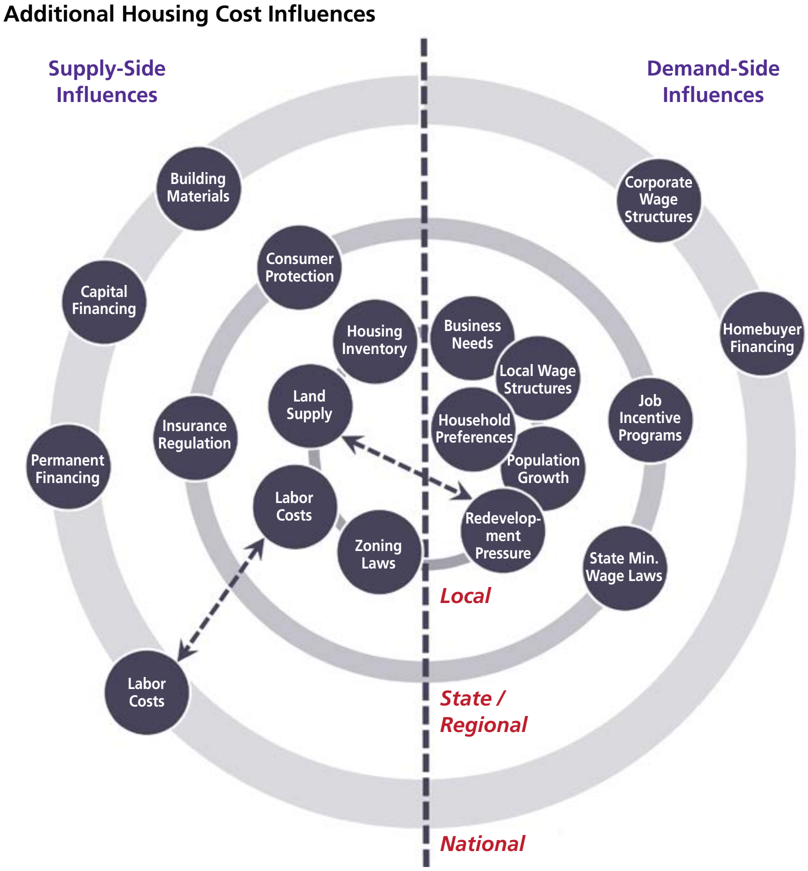
This situation can be a part of an otherwise positive economic cycle – i.e. markets experiencing a product of their own success. Strong employment growth can drive up costs. Strong population growth stimulated by quality of life factors can also contribute to rising costs. Strong investment, reinvestment, and redevelopment of community infrastructure and amenities can also be positively impacting values. Also complicating matters in an otherwise positive set of circumstances are supply-side conditions. For example, problems arise if: regulatory structures (i.e. zoning laws) are inadequate or onerous or legal structures create risks that impact the cost of construction.

For example, a few states such as California and Colorado have experienced an evolution in homebuyer protections laws. While positive for homebuyers, giving them recourse in the event of defective construction, unintended consequences can arise. The abuse and risk of costly litigation in these markets can translate into higher general liability insurance costs for developers, a cost which is passed directly on to the buyer or renter. Problems also arise where infrastructure (i.e. roadway and transportation networks) may be deficient, the existing supply and pipeline of housing is deficient, and where land is a scarce resource.

Other Factors

There are also numerous supply and demand conditions at the local, state, and national level that complicate the situation. As illustrated on the left side of **Figure 2** depicting some additional supply side factors, the cost of housing is affected at the national level by trends in the cost of building materials, capital lending and permanent financing terms, as well as labor costs or shortages. At

FIGURE 2.
Additional Housing Cost Influences



the state or regional level, consumer protections and insurance regulations can impact the availability of inventory. At the local level, housing inventory, availability of land, local labor costs and availability, as well as land use regulation can all impact the cost of housing.

On the right side of **Figure 2**, depicting additional demand side factors, corporate wage structures and homebuyer financing terms at the national level can affect housing costs. At the state level, economic development and job incentive programs, as well as state minimum wage laws can have an impact on the cost of housing. And at the local level, business labor needs, local wage structures, household preferences, population and employment growth, as well as redevelopment pressures that result can have substantial impacts on the cost of housing.

In terms of taking action, however, what is actually in a community's purview to address? Taking time to understand some of these influences is helpful in airing concerns and fleshing out what really can be done. On the supply side, can you open up land for development? Can you increase your zoning densities? Can you change the cost of construction? On the demand side, can you control population or employment growth? Can you increase incomes? Can you change household preferences? Can you influence development pressures? Can you change general labor needs? Can you change homebuyer financing terms?

Consequences

In the process of identifying what the challenges are and where a community has purview, most find that documenting housing and economic conditions and magnitudes of need suffices for policy formation. But while important in the overall scope, it frequently understates the breadth of the challenges and leads to strategies that aren't fully integrated.

One of the more overlooked elements of housing policy is the role it plays in the broader economic competitiveness context. Before looking at how to define economic competitiveness, let's look at some of the overlooked or underestimated consequences of affordability challenges.

First, when housing costs in a preferred location are too high, households look elsewhere. A longer commute, with or without lower housing costs, means households spend more on transportation than other things leading

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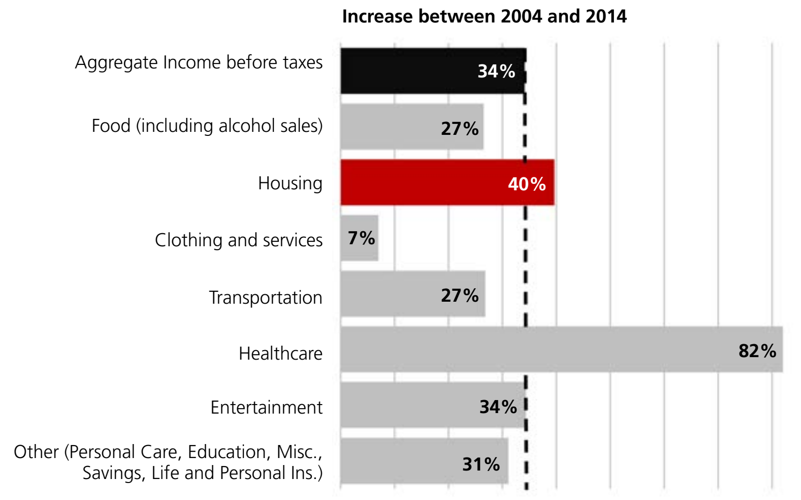
FIGURE 3.
Increases in Aggregate Income and Consumer Expenditure



to diminished quality of life measures. According to urban economics literature (Angel and Blei, 2015; Clark, Huang and Withers, 2003), commuters seem to have a tolerable commute distance of 30 to 45 minutes each way. In 2014, according to the U.S. Census, 37 percent (51.4 million people in a working population of 139.3 million) of the working population commuted 30 minutes or more each way, 6.5 million more than a decade earlier.

Second, and aside from the subjectivity of quality of life, when household budgets are squeezed (with or without higher transportation costs), people have less money for other things. **Figure 3** illustrates an analysis of data collected from the Bureau of Labor Statistics Consumer Expenditure Survey for 2004 and 2014. The top column of the graphic shows that aggregate U.S. household incomes increased 34 percent during this 10-year period, but that aggregate spending on housing increased 40 percent. In high-growth cities, data show greater disparity between these two measures. The graphic also shows that spending in more elastic categories such as food, clothing and services, personal care, and even savings has declined.

While the causality of these shifts is debatable, it is reasonable to say that in terms of behavior households do make trade-offs. Some choose a larger house farther away from work, and some choose a smaller house closer to amenities and work. But because people rarely have the resources to buy the perfect house in the perfect location, multiple trade-offs are made. Quality of life and economic competitiveness problems arise when households spend so much more of their income on housing (and transportation) that they make trade-offs with expenditures in other categories, a pattern that ripples further afield.

Third, as these conditions persist, businesses increasingly struggle to find, keep, or expand their workforce. This is a common struggle for the service sectors, especially retail, accommodations, hospitality, healthcare,

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banking, government, and emergency services. Typical wage structures may be ineffective at keeping workers, and businesses may endure high turnover rates. Even for communities luring new industries, top among a prospective business' concerns, along with a skilled labor force, is the cost of housing. Among the reasons the Dallas/Fort Worth area has been so successful attracting business relocations and attractions is the relatively low cost of housing compared to other western and southwestern metro areas.

The blend of high housing (and transportation) costs, lower discretionary spending, and increasing business labor force struggles are challenges that communities can endure only so long before other social problems arise. Neighborhood and community instability can occur when housing and land appreciation lead to displacement caused by redevelopment pressures. Property owners in desirable locations approached with redevelopment offers often impact lower-income, minority, or elderly households. Any number of outcomes can occur, such as households that move in with family (displacement and over-crowding) or continue to live in costly housing nearby (cost-burden) to stay close to their jobs. They might move farther away to find similar housing costs (a mere shift in budget expenses). Whatever the situation, it results in greater quality of life challenges and discretionary spending being traded off for the sake of housing costs, which can lead to greater community unrest.

IMPACTS ON ECONOMIC COMPETITIVENESS AND WHAT TO DO

In the process of identifying strategies and tools, some communities react quickly and take action with what may appear to be good policy tools. But such efforts can be more effective if communities take time to understand how policies interact with and affect competitiveness.

From a governance perspective, economic competitiveness might mean balancing public revenues with the cost of investing in and providing public goods and services, such as: emergency services, water, utilities, etc.; transportation (roadway networks, public transportation, etc.); and strengthening and improving schools, among others. From a regulatory perspective, it might mean having appropriate land use development and zoning regulations.

From an economic development perspective, it might mean being able to attract, retain, and expand employment opportunities. That means having the resources (for incentives) and the type of desirable environment (educated and skilled workforce, high quality of life, good investment in infrastructure, etc.) to sell your community to prospective employers. It also means keeping an eye on the cost of doing business.

From a civic perspective, it might mean having a vibrant living environment where a community's residents can enjoy dining out, shopping, finding entertainment, and where they generally feel safe. If large sectors of the workforce leave an area in search of more affordable housing, a combination of outcomes can occur: a palpable shortage of labor; increased traffic and air quality problems as workers commute long distances to their jobs; and as quality-of-life measures decline, new industries may be deterred from moving to the area and existing businesses may decide to relocate, recognizing that they are not able to attract the labor they need.

As mentioned earlier, without locally-tailored strategies to maintain housing options and affordability, the economic opportunities and quality-of-life aspects that originally led to high housing demand and high property values will be lost.

Conventional Strategies

Understanding how to deal with this situation and remain competitive isn't easy. Behind adoption of many of these policies is often the objective to build more housing, especially for lower-income households who are usually disproportionately affected, but the techniques by which those are accomplished are basically variations on a few themes. A handful of approaches are in practice today, but application of uniform techniques can and often do overlook the complexities of local issues.

The first are conventional funding techniques that address very low and low income needs. The most common source of funding has been Department of Housing and Urban Development entitlement funds, i.e. Community Development Block Grant (CDBG) and HOME funds. While critical to communities' strategies for addressing affordability challenges, these programs are restricted for the most part to assisting households under 60 percent

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of median income. And apart from funding services through CDBG dollars, only HOME funds are used directly for predominantly rental construction. This is not to say that the federal funding is a problem, although it is a problem that funding for these programs continues to decline as **Figure 4** illustrates. On the contrary, they are essential. The point is that insufficient as this source is even to remedy the problems faced by low income and special needs populations, it is not at all capable of addressing broader, more complicated local issues.

Another conventional tool used is the federal Low Income Housing Tax Credit (LIHTC) program administered by state housing finance agencies. Equity is placed through these agencies as capital for new, rehabilitated, or preserved affordable rental projects (including homeless shelters and transitional housing) that meet specific income targets, i.e. under 60 percent of median income. Like CDBG and HOME funding, LIHTC meets an important need but only addresses a fraction of the broader problems being experienced by many communities.

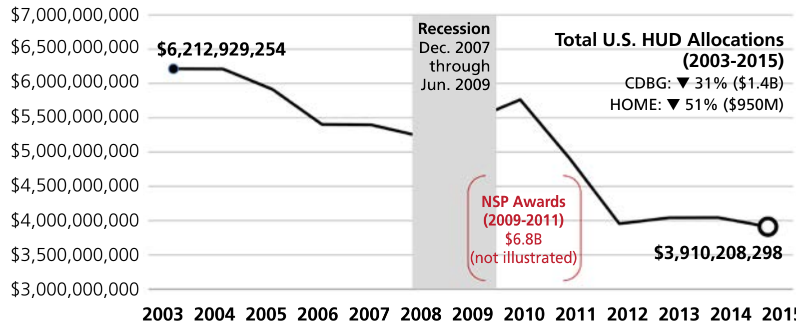
There are also a handful of regulatory approaches intended to leverage the momentum of development. One of these approaches, inclusionary zoning, seeks to remedy supply-side issues through mandates or voluntary compliance, i.e. the use of incentives. Either way, such regulation looks to increase the supply of affordable housing by compelling the development community to reserve some portion of their residential project as affordable to lower income households, usually 60 percent of median income if applied to a rental development and 80 percent of median income if applied to a for-sale development.

There is considerable debate about the effectiveness of these programs, not to mention ongoing legal challenges. Because they add a "cost" to construction, questions arise over the extent to which they are passed on to the "non-affordable" housing buyers, and whether this ultimately exacerbates broader challenges.

Commercial linkage, another approach intended to increase the affordable housing supply, is motivated by the recognition of the jobs-housing linkage, i.e. that non-residential development creates demand for affordable housing through creation of low-paying jobs. Commercial linkage programs require new non-residential developments to pay a fee that mitigates a portion of demand for affordable housing from a development's lower income jobs, quantified as the difference between the price of market-rate housing and the price of affordable housing for those lower income jobs.

The fees are then used to build or offset the cost of building affordable housing in the community. These fee-based programs take their cue from development exactions jurisprudence stemming from two U.S. Supreme Court cases, Nollan (1987) and Dolan (1994), often referenced together, which established the rational nexus and rough proportionality tests, respectively. While state courts interpret and further clarify these precedents, linkage fees are established through "nexus" studies (reflecting their origins in Nollan) to document the connection between the scale and type of development and the

FIGURE 4.
Trends in Total U.S. HUD Allocations



Source: HUD; NBER; Economic & Planning Systems

magnitude of affordable housing demand created. While there are not as many legal challenges to these policies, there is still considerable opposition from the business and development communities because they add a cost.

The limitations of these tools can be characterized by the reality that they are not structured to address the breadth and complexity of a community's challenges. In terms of the regulatory approaches, in addition to the question of the extent that this becomes an additional "cost" passed on to the end user, exacerbating affordability conditions and the "cost of doing business," a primary criticism from the development community centers around the notion of being burdened with a problem whose solution should be shared by the whole community. Moreover, the uniformity of these policies around the country suggests they are not the product of individual (local) grassroots processes to develop locally-tailored approaches.

A Need for Locally-Tailored Approaches

Conventional federal funding sources are inadequate and quickly diminishing, and because conventional regulatory approaches are ill-equipped to address the complexity of local issues, there is an urgency to craft locally-tailored approaches.

Communities that center their attention on creating a common vision and answering some key questions are better positioned not only toward generating consensus, but toward setting better goals and achieving more meaningful results.

1. Assess the extent of the problem (causes and consequences);
2. Set the collective vision on goals that everyone (especially elected leadership) can buy into; and
3. Take inventory of a community's challenges and points of leverage.

At that point, the process of evaluating strategies should involve gauging their potential for effectiveness, their ability to respond directly to the challenges, avoid unintended consequences, leverage unique local or regional resources, leverage partnerships, and their ability to allow for local flexibility and control.

Communities need to approach such a process openly and cautiously, not placing too great an emphasis on the effectiveness of any one approach. That is, addressing affordable housing challenges requires multiple solutions that will vary by jurisdiction and region, such as:

1. Increasing the supply of new market rate housing in appropriate locations (in some cases, affordable by design);
2. Regulatory support for and multiple funding sources to support workforce housing development;
3. Complementary funding for low-income housing development; and
4. In select cases, the revitalization of existing public housing using state and federal funding sources in combination with public/private partnerships.

Reflecting on some of the techniques presented above, it is helpful to think of them under two broader categories: those that seek to harness the momentum of development activity (i.e. development-based approaches); and those that seek to harness the power of the many (i.e. community-based approaches).

In the first category, a community often needs an increase to the supply of housing (there are really few options for communities to manipulate the demand side of housing.). Such approaches stem from the view that because the development community builds housing (and thus, whose housing prices are a part of the problem), they are equipped and should be responsible. Such is the case with the inclusionary zoning and linkage programs discussed previously.

Economic leverage is an essential part of ensuring compliance. Broadly, economic leverage is something that a community has to offer that the development community finds value in, such as:

1. Financial resources, like one-time general fund allocations for capital or assistance programs;
2. General obligation bonds, dedicated funding sources, use of tax abatements; and
3. Publicly-owned land and entitlements, such as density.

These mechanisms need strong leadership and political will to succeed.

In the second category, for a growing number of communities, strong leadership and political will are translating into the recognition that a policy that broadens the responsibility of addressing complicated challenges across the community not only lowers the financial burden placed on any one portion of the community, but, because it is locally generated, results in greater flexibility of its use.

A frequently-cited success story in the adoption of a local funding source is Seattle. Since 1981, city voters have passed one housing bond and four housing levies, which have collectively produced more than 10,000 affordable apartments, provided first-time homebuyer loans and rental assistance to more than 4,000 households. In 2009, the most recent seven-year levy, a dedicated property tax (limited to $0.17 per $1,000 of assessed valuation) was adopted to generate $145 million

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for a variety of affordable housing goals, including supportive services. According to the city's 2014 Housing Levy Annual Report, this levy has produced nearly 2,000 rental units (exceeding its 1,700-unit goal), provided funding for acquisition, operations and maintenance, and homebuyer assistance affecting nearly 600 households, and provided rental assistance and homelessness prevention to approximately 1,900 households. As for its cost to the city's property tax payers, the levy is estimated to cost the typical homeowner with a house of median value ($473,000 in 2014) approximately $80 per year.

Another example of voter and elected official buy-in is Cambridge, where with the support of a state tool, the Community Preservation Act (CPA), the Cambridge Affordable Housing Trust (CAHT) uses a combination of local and state matching funds. The CPA was established as a financing tool for Massachusetts communities to expand the supply of affordable housing, protect historic sites, and preserve open space using a small voluntarily adopted property tax. In fiscal year 2014, the CAHT received $8.2 million through the CPA appropriation.

A different sort of one-time funds is the use of General Obligation bonds. The city of Austin, for example, has issued several general obligation bonds to support affordable housing. In 2006, the city issued an affordable housing bond for $55 million, all of which was utilized by 2011, producing more than 2,400 affordable units. Also funded through a time-limited property tax, this GO bond was estimated to have cost the average homeowner less than $9 annually. Austin passed its most recent bond in 2013, a $65 million bond to address a broader variety of production and service needs.

Some communities have even leveraged institutional partners to address affordability challenges. In Durham (NC), the Duke-Durham Neighborhood Partnership was founded in 1996 and has raised more than $12 million to invest in partner neighborhoods, including a $4 million investment in Self-Help, a community development lender to support development of affordable housing. In Chicago, the University of Chicago subsidizes housing for low-income residents in surrounding neighborhoods with projects in Woodlawn and Jackson Park Terrace. It owns and maintains 2,000 rental units on the south side of Chicago for student and faculty housing, and it estimates that 65 percent of the university's faculty and 3,000 staff members live in these neighborhoods. Harvard University also launched an initiative in 2000 that committed $20 million of low-interest financing to support affordable housing in both Cambridge and Boston. It also administers a $6 million revolving loan fund.

Another tool used to generally lower the cost of housing for people is the community land trust (CLT). There are more than 250 CLTs nationally. They can purchase, acquire, develop, own, and operate housing, but their most common function is developing and selling housing with a leasehold interest in the land. In Montana, a number of CLTs existed throughout the state with small inventories and were struggling to stay in operation. In 2014, after a study process considered what the problems were and available options, Trust Montana was established and now functions as an umbrella organization over the state's land trusts. By centralizing some of the administration and operational costs, the state's land trusts were able to continue their function of providing lower-cost housing.

Where to Go from Here

There is a great need for communities to develop unique approaches to local problems. Not only are most of the uniform tools in practice blunt instruments that don't respond flexibly enough to local challenges, they also don't address the complexity of those issues. Because we always like to know what our peers are doing, here are some tips that might serve communities well in looking at best practices.

- Don't overlook the basics – local and regional economic trends;
- Look closely at whether land use regulations may be creating unintended consequences (e.g. restrictions on lot sizes, dwelling unit sizes; parking requirements, setbacks; maximum densities, etc.);
- Think about the balance or imbalance between the location of your housing supply and the location of your jobs or amenity centers;
- Assess whether and how much development can be encouraged along transit corridors;
- Assess the legal and regulatory structure to understand where obstacles lie;
- Identify where there might be opportunities to leverage public finance resources (and political will); and
- Look at the capacity, capability, and interests of providers, as well as private or institutional partnerships.

When discussing and crafting policy, make sure that it leverages the community's unique resources and structures. Ensure that where resources are leveraged, they provide value at least equal to or greater than the alternative (i.e. opportunity cost) of not complying. Ensure that structures are facilitating, not inhibiting positive outcomes, and estimate the extent to which such strategies could have unintended consequences, weighing them against a strategy's presumed benefits. With good leadership and smart planning, such strategies should enable communities to become their own best practices.