Cost Burden Should Not Define Housing Policy

About a year ago I wrote about what I learned about housing issues related to Medicare when my mom wound up in the hospital in my home town of Albuquerque. Her health issues have kept me coming back to my home town and on this trip, I dug into housing issues here. What I found was a City government working to find innovative solutions to housing issues and especially homelessness. But I also found the evidence of the broader problems with organizations that offer measures of what a city's housing problems are. The Urban Institute dis a study last year title, "Albuquerque Affordable Housing and Homelessness Needs Assessment." While the report has some good and not-so-good ideas, it makes what I have previously called, The Seattle Mistake, using aging United States Census data to define a number of cost burdened households and concluding that the number represents the number of units needed.

Methodology, Change, and Cost Burden Leap

The Urban Institute (Institute) uses a methodology that has become de rigueur for any group assessing housing price issues in a community. The Institute "used American Community Survey data, including specially tabulated Comprehensive Housing Affordability Strategy (CHAS) data for 2006–10 and 2012–16 (the most recent available) from the US Department of Housing and Urban Development (HUD)." Using this data, the Institute developed a "cost burden" figure that is problematic as I point out below.

There are three problems with this methodology. First, where people live, how much they paying for housing, and the HUD standard is constantly changing. For example, the Institute uses 2016 HUD standards which pegged 50 to 80 percent of Area Median Income (AMI) for a family of 4 at $30,801–49,300. The most recent standard, for 2021, is $33,750 to 54,000. The problem with using American Community Survey (ACS) data is that it is at best a snapshot of one moment in time.

Second, the HUD standard is arbitrary. The "30 percent rule" that sets a normative standard for what a household should pay from gross monthly income does not account for other expenses like taxes, food, and other costs of living. For example, gross income figures don't consider money withheld for taxes, health care, and other items that might be taken from paychecks. Also, some families choose to pay more to be closer to school or day care. Other households pay less (something the Institute does quantify) to save money.

Finally, the numbers yielded by this analysis – usually called "cost burdened households" – is followed by a leap.

"Overall, at the extremely low-income affordability level, Albuquerque had a gap of about 15,500 rental units. The gap is the difference between the supply of units affordable to households at that income level (6,900) and the demand for them (22,300 households). We know the need for more affordability is even greater—20,200 renter households with extremely low incomes were cost- burdened in 2012–16, including 18,200 households who were paying more than 50 percent of their income in rent. We estimate that Albuquerque has only enough deeply affordable assisted housing units in public housing and project-based Section 8 or vouchers to serve 28 per 100 households with extremely low incomes."

The assumption is that "demand" is represented by households that are paying more than 30 percent of their gross income for housing and "supply" by housing priced at that level. The Institute and most planners assume, arbitrarily, that a housing "crisis" would end when every single household in the ACS catchment area sorted perfectly into units priced exactly at 30 percent of AMI, a state of affairs that is neither possible or desirable.

To address this, the "gap" between "supply" and "demand" becomes the number of units needed. Producing subsidized housing is costly in both time and money. The Institute itself points this out at its website,

Development costs a lot of money. Developers rely on loans and other sources to fund construction before people move in and start paying rent. But developers can only get those loans and equity sources if the development will produce enough revenue to pay back the loans and pay returns to investors. The gap between the amount a building is expected to produce from rents and the amount developers will need to pay lenders and investors can stop affordable housing development before it even begins.

My own analysis found that in Seattle, the cost of producing a unit of non-profit housing can be as high as $500,000 per unit and take as long as 5 years to produce. **So, the Institute is recommending 15,500 units, which if priced at just $100,000 would cost more than $1,500,000,000. The City of Albuquerque's entire operating budget for 2021 is $711,000,000, less than half of the amount needed to build bargain basement units years in the future**. Also, according to data from the Federal Reserve Bank, for the entire period of 2016 to 2021, five years, Albuquerque permitted about 12,000 units. Building 15,000 units in the same period would require a doubling of production and permitting. But many families need help now. And the estimates used by the Institute are based on numbers from 5 years ago. What will the picture look like 5 years from now and in the years in between?

<u>Inclusionary Zoning</u>

The Institute correctly recommends that the City "support market-rate rental housing development: Developers want to build rental housing in Albuquerque." But it calls for the use of an inflationary tool, inclusionary zoning, a mandate to include rent restricted units in market rate projects or requiring fees instead. Inclusionary zoning is a fad sweeping the country that appears to force private developers to subsidize renters with incomes in the 30 to 40 percent AMI category.

But the apparent benefits of inclusionary zoning are illusory. When mandates to provide rent restricted units or fees in lieu of performance are put into effect, the mandates increase costs. When new developments are forced to provide subsidized units there are two options: avoid the requirement by building beneath the threshold that triggers the requirement, or subsidize the rent restrictions with higher rents in market rate units. Fees in lieu of inclusion are paid by higher rents, and the money collected ends up being consumed by inflation, administrative costs, and lost time for production.

Albuquerque should avoid an inclusionary scheme that would produce only a small number of units or generate funds that would be spent on high cost and slow capital construction, each of which would be paid for with higher housing prices in the city.

Some Good Ideas From the Report

- **"Act aggressively to preserve existing subsidized and market-rate affordable units."**

One of the biggest threats to existing low priced housing is lack of maintenance and rising land values. This has two elements. Contrary to popular conception, housing providers strive to keep their rents as low as they can to stay competitive. Many providers subsidize lower rents with deferred maintenance. Eventually the costs to make repairs becomes unsupportable.

When land values rise with growing demand, providers often sell their properties which have risen in value. The investor that purchases the property then has to make repairs or demolish the substandard – but affordable – housing with units that will generate higher rents. **This is entirely avoidable if the City uses some of its resources to provide low-interest loans to better maintain affordable buildings without raising rents.**

- **"Create a landlord mitigation fund in exchange for the relaxing of screening requirements by landlords."**

Housing providers will rent to anyone who they think will pay the rent regularly. But how do they make that decision? Most use typical tools, like credit checks and criminal background screening. Some jurisdictions have wrongly decided to abolish these, but that doesn't help. Providers simply raise rent to offset the risk and uncertainty.

A risk mitigation fund would insure against possible losses created by renting to people with less than perfect credit or criminal backgrounds. The City could also work with corrections and service providers to provide a path with training and education to place higher risk renters in lower cost, affordable private housing**. A risk mitigation fund paired with credit repair and pre-release renter education would be a real path to self-sufficiency for people struggling with poverty and criminal records.**

- **"Develop an inclusive process to set a shared vision for increasing housing affordability and reducing homelessness. Public agencies, service providers, and foundations have a difficult time seeing how their work fits within a system-wide effort."**

Such an effort in Albuquerque should avoid the methodology used to calculate a unit count that will tend to focus the discussions on money rather than housing solutions. Resources are important, but the discussion should begin with qualitative and quantitative needs, not a "body count" of units and insurmountable costs to get them.

Other Good Ideas

- **Cash for rent**. If the City does want to have an immediate impact on cost burden, then vouchers and direct cash benefits should be used to cover the difference between normative rent and what households are actually paying. These households are already housed, a cash for rent program would keep them housed now rather than in line for a newly constructed and expensive subsidized someday.

- **Use tax exemptions as an incentive for inclusion.** Cities like Seattle have had great success in the past creating inclusion rates of rent restricted housing as high as 20 percent by granting tax exemptions to market rate housing projects. The Multifamily Housing Tax Exemption (MFTE) has created thousands of units of rent restricted housing (from 50 to 80 percent AMI) without the costs of land, financing, construction, or operations.

- **Expand the use of 4 percent tax credits.** The 4 percent Low Income Housing Tax Credit (LIHTC) is an underutilized tool with many private housing developers finding it too difficult to create feasible projects. Housing New Mexico should be tasked with finding ways to increase private market rate use of tax credits.

- **Use Tax Increment Financing (TIF) to offset infrastructure costs.** New sidewalks, drainage, water, sewer, traffic mitigation, and other costs often make new development costly. Using TIF to reduce the cost of new infrastructure and passing on rent savings to residents could be a good strategy to create affordable housing.

- **Social Impact Bonds (Value Capture).** Energy efficiency projects will often use future energy savings to service debt used to pay for upgrades or efficiency improvements. If the City can identify costs associated with chronic homelessness, funds raised from bonds could be used for interventions to reduce those costs. The savings in reduced hospital visits, law enforcement, and other costs can be used to pay back the borrowed money and when the debt is retired, tax payers keep the savings; this is both compassionate and efficient.

Something to Avoid: "Tenant Protections"

Eviction is an unfortunate consequence of either lease violations or non-payment of rent. Fortunately, it is relatively rare because most housing providers – non-profit, for-profit, and public providers – all do what they can to avoid the costly process of eviction. Actual removal of a resident from housing requires legal process and the decision of a judge, it doesn't just happen to people.

In the case of non-payment, the best "tenant protection" is offering resources to pay the rent. If a resident is struggling financially, subsidies should be used not for lawyers, mediators or other interventions but cash. Other changes to tenant-landlord law usually increase risk and uncertainty, something that can only be offset by higher rent, something that is not helpful to people already struggling.

In Albuquerque and everywhere, if a community wants to tilt the power balance in favor of people who rent and away from people who own rental property, the best way to do this is to allow and create an abundance of housing options which means providers competing with providers with lower rents and better lease terms.