Affordable Housing in High Cost Areas

An Introduction

By Carolina Reid

It was the buzz of the weekly neighborhood cocktail party. A house down the street–1,200 square feet, with 2 bedrooms and one bath–sold for just over $900,000. It was on the market for two days. While the homeowners on our block happily toasted the Bay Area's red hot housing market (and their growing wealth), the renters among us contemplated our fate with less exuberance. With every record increase in house values, the dream of owning a home slips further away. How is it possible that even with two incomes, we can't afford to buy a house in a neighborhood with a good elementary school and a safe playground nearby?

Mirrored in the disparate reactions of the homeowners and renters on my block, the recent housing boom is a mixed blessing as far as its impact on community and economic development. On the positive side, the last ten years of rising home values have contributed to broad gains in wealth across a large spectrum of homeowners. Neighborhoods long plagued by abandoned buildings and vacant lots are receiving a facelift in the form of new condos and mixed-use developments, spurred on by the increased demand for housing. Housing also continues to serve as a pivotal driver of economic growth, with housing consumption and investment comprising 22 percent of GDP growth in the first three months of 2005.[1] In addition, the housing boom has translated into much needed jobs. Encompassing everything from construction workers to land surveyors to loan officers, the real estate industry added 700,000 jobs to the nation's payrolls since 2001–at the same time the rest of the economy lost nearly 400,000.[2]

On the negative side, however, the explosion in house values has contributed to a crisis in affordable housing, and a growing number of families nationwide are facing critical housing needs. According to the Joint Center for Housing Studies, nearly one in three households spends more than 30 percent of income on housing, and more than one in eight spends upwards of 50 percent.[3] The same study found that the number of low-income households paying more than 50 percent of their income for housing increased by over 1.5 million between 2000 and 2003. Problems with affordability have worked their way up the income ladder, with middle-income families similarly facing high housing costs relative to their incomes (Figures 1.1 and 1.2). Stories abound of firefighters, nurses, and teachers unable to afford to live in the communities where they work. Rising construction and land costs, combined with declines in federal funding, provide a daunting challenge for developers trying to build new affordable units. Concerns are also emerging about the costs of homeownership, particularly as more homeowners take out adjustable rate or risky interest-only mortgages to make ownership possible.[4]

Figure 1.1. Share of Cost-Burdened Households, 2003 (percent)

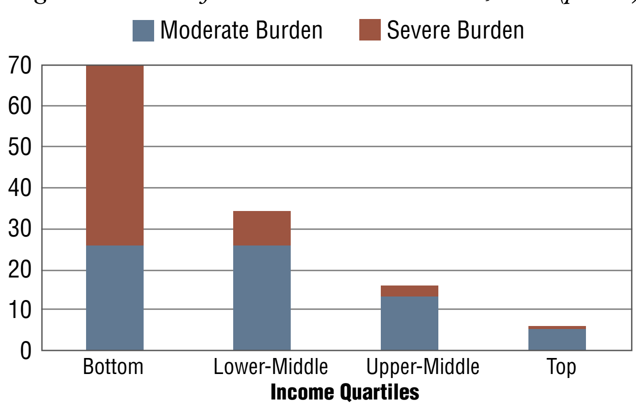
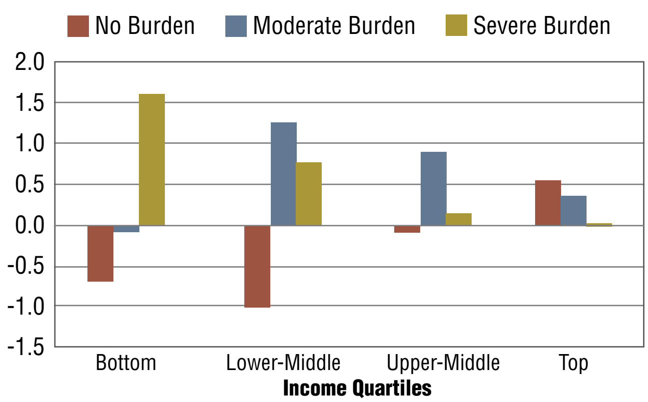


Figure 1.2. Change in Households, 2000-3 (millions)



Notes: Income quartiles are equal fourths of all households sorted by pre-tax income. Severe burden defined as housing costs of more than 50 percent of pre-tax income. Moderate cost burdens defined as housing costs of 30-50 percent of pre-tax income.

Within the Federal Reserve's 12th District, the issue of housing affordability has emerged as a key community development challenge.[5] The District is home to some of the highest cost housing markets in the nation, and low- and moderate-income families across the region are finding themselves among those with critical housing needs.[6] In this issue of *Community Investments*, we explore what it means to provide affordable housing in the high cost areas of the 12th District. This article provides a brief overview of the issue of affordable housing in high cost areas, while the rest of the articles explore various approaches to financing and building affordable housing units.

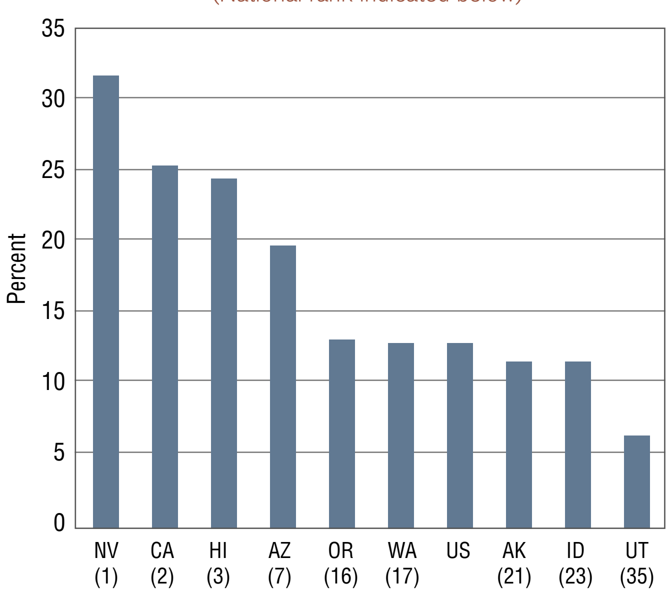
Understanding the Affordable Housing Challenge in the Twelfth District

Nationally, the performance of the residential housing market over the last ten years has been remarkable. According to the Office of Federal Housing Enterprise Oversight (OFHEO), house prices have appreciated nearly 70 percent since 1995.[7] And to the ire of doomsayers predicting the collapse of the housing bubble, the trend toward higher house prices does not appear to be abating. The most recent statistics show that house values increased 12.5 percent between 2004 and 2005, with regions like the Pacific showing even faster rates of growth (21.3 percent).[8]

Within the 12th District, a number of regional and local housing markets have experienced even higher rates of growth. A recent study by the Center for Housing Policy reported that San Francisco is now the least affordable housing market in the country–no surprise to the thousands of working families in the city trying to make ends meet.[9]

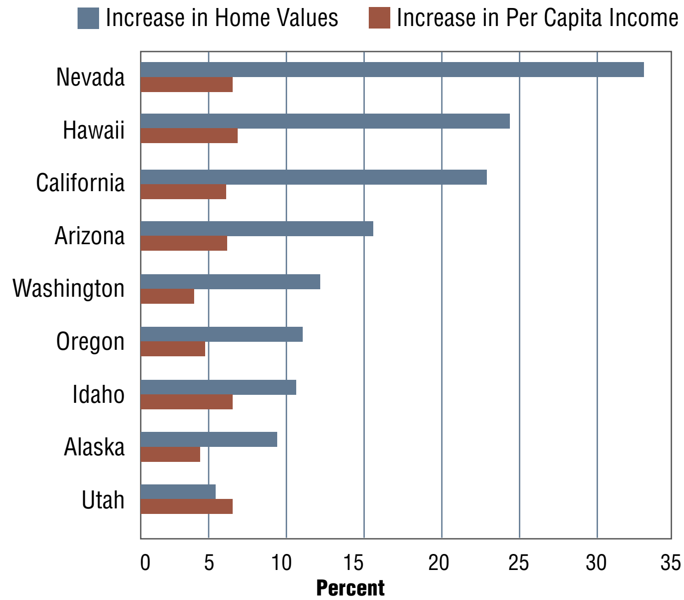
Figure 1.3. Annual Average Home Price Appreciation by State, 2004–2005

(National rank indicated below)



Six of the nine 12th District states have higher home price appreciation rates than the country as a whole.

Figure 1.4. Home Price Appreciation far Outstrips Income Growth



Home prices are growing faster than per capita persona income in many markets. Utah is the only state in the 12th District in which income growth has exceeded home price growth.

But the problem of high cost housing isn't limited to the Bay Area. At the state level, Nevada, California, Hawaii, Arizona, Oregon, and Washington have all seen house prices rise significantly faster than the country as a whole (Figure 1.3). Nearly half of the 55 metropolitan areas experiencing "boom" housing markets–those with real home prices increasing at an average annual growth rate of ten percent over the past three years–are located in the nine states of the 12th District.[10]

Even more striking are the recent statistics from OFHEO, which show that smaller cities in our district, such as Las Vegas, Nevada, and Bakersfield, California, have experienced annual growth rates of over 30 percent, the highest rates of house price appreciation in the country.[11] Once limited to large metropolitan areas and hard to reach places like Hawaii and Alaska, high cost areas now include agricultural regions like California's Central Valley and vacation destinations like Palm Springs, Las Vegas, and Sun Valley. Population growth and in-migration, the rising costs of construction (for both materials and labor), historically low interest rates, and speculation in the real estate market are all believed to be contributing to these rapid rates of growth.

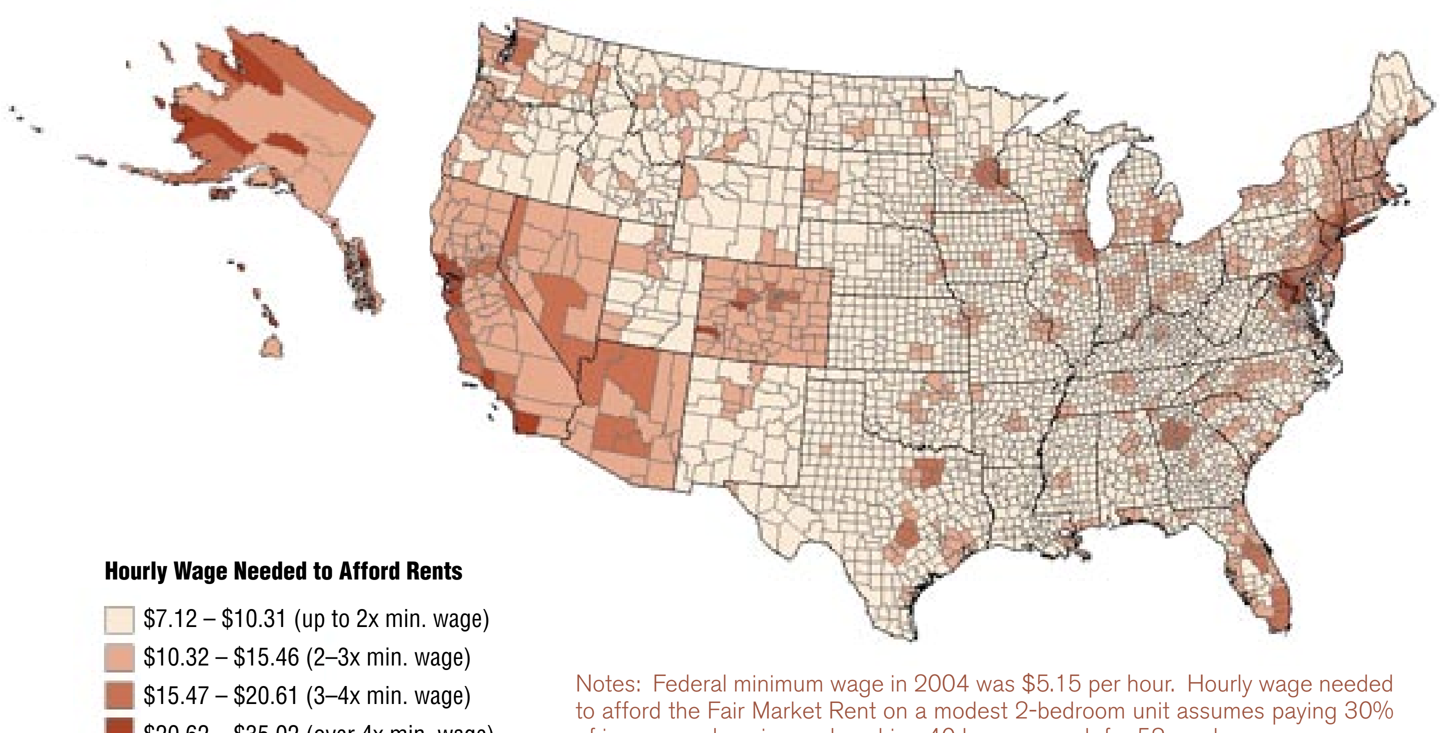
One of the consequences of these rapidly escalating house values is that housing affordability is at a 25-year low.[12] In 37 states (including the District of Columbia), home prices are growing faster than per capita income, creating a large gap between what people earn and what they can afford.[13] In the 12th District, the gap between income and home prices is growing faster than anywhere in the nation, with Nevada heading the list and California, Hawaii, and Arizona all ranking in the top ten (Figure 1.4). Indeed, much of the job growth has been in low wage, service sector positions, and median incomes fall far below a family's ability to afford a median priced housing unit. Put another way, the real estate boom may be creating construction jobs, but for the construction laborer in Los Angeles earning $29,050, his income falls more than $70,000 short of what is needed to qualify for a mortgage on a median priced home.[14] In 49 counties within the 12th District, a two-bedroom apartment rental would only be affordable to families earning the minimum wage if they could hold more than three full-time jobs (Figure 1.5). These sobering statistics likely understate the true magnitude of the affordability problem, as they do not capture the tradeoffs people make, be it living with extended families, commuting long distances, or simply not paying for other necessities like health care.[15]

Housing affordability problems are no longer limited to those with very low incomes. Community development programs and public subsidies for housing–as well as Community Reinvestment Act (CRA) consideration–traditionally have been targeted at those earning 80 percent of the area median income (AMI) or below. In high cost areas, the assumption that someone earning the median income can afford the median price of housing is no longer true. As Linda Wheaton, Assistant Deputy Director of California's Department of Housing and Community Development, notes, "We see more families struggling with housing needs not only at the very low income side of the scale, but also extending all the way to working families earning the median income and above. We have to address the needs of a much broader range of families." While some government programs have adjusted their programs to address the high cost area issue, in many cases the adjustments don't go far enough (Box 1.1: Adjusting Limits to Account for High Cost Areas).

As housing affordability problems work their way up the income ladder, federal subsidies are on the decline. Exacerbating the problem is that the federal subsidies that do exist don't go as far as they used to. High land, labor, and construction costs force up development costs, requiring more public subsidy per unit built. Trends in the use of Low Income Housing Tax Credits (LIHTC) provide an apt example.[16] Between 1993 and 2003, the total annual allocation for the LIHTC increased from $425 to 572 million. However, the average allocation needed to produce a low-income unit has nearly doubled, from $4,000 in 1993 to $7,700 in 2003. One million dollars in tax credits in 2003 only supported the construction of 129 affordable housing units, compared to 244 units just ten years earlier (Figure 1.6).

Moreover, as the largest source of federal funding for low-income housing development, competition for LIHTC allocations is fierce. Antonio Manning, First Vice President and Regional Manager of Washington Mutual, says that "it's becoming increasingly difficult to finance low-income multi-family developments. The lack of land makes project development difficult, and the allocation of Tax Credits is extremely competitive, with a number of groups competing for the same deals. We're all striving to build more affordable units, but particularly in high cost states like California, ultimately it's going to take more public subsidies to leverage private investment." The promise of

Figure 1.5. Even Modest Rental Housing is Beyond the Means of Many Low- and Moderate-Wage Workers



Notes: Federal minimum wage in 2004 was $5.15 per hour. Hourly wage needed to afford the Fair Market Rent on a modest 2-bedroom unit assumes paying 30% of income on housing and working 40 hours a week for 52 weeks a year.

increased federal funding for affordable housing is unlikely to be realized. Although HUD's budget for 2006 seems to have been saved from the immediate chopping block, the Administration will probably continue to propose deep cuts in community development and housing programs in the near future.[17]

Developing Solutions to the Affordable Housing Crisis

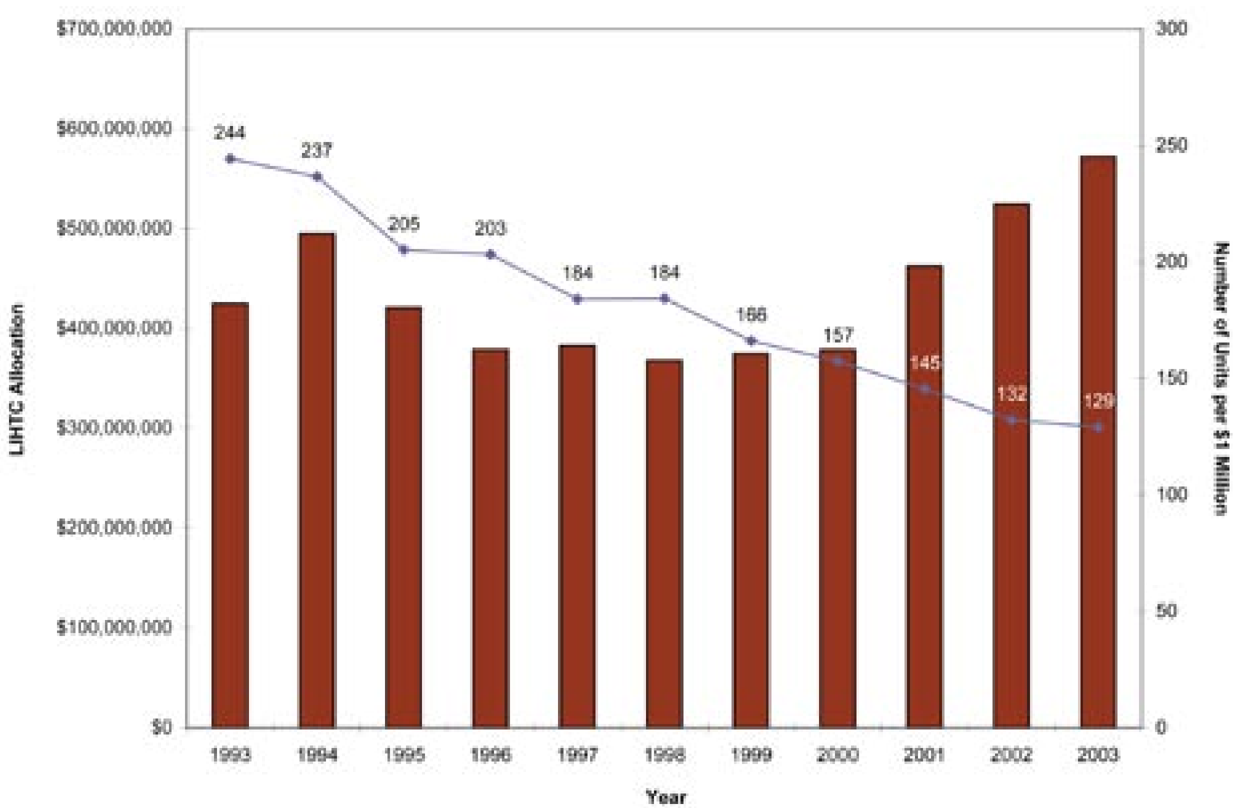
The combination of escalating housing prices, stagnant incomes, and declining federal funds paints a bleak picture, and poses a community development challenge without an easy answer. And while the ultimate solution may not be close at hand, local governments, architects, planners, developers, nonprofits, and financial institutions have all been working together to ease the housing crisis through innovative policies and programs.

The reduction in federal support for housing, for example, has had an unintended consequence: increasingly, local and state governments are stepping in to fill the gap and are using a variety of tools to meet the demand for affordable housing (see article: *"Innovations in Housing Policy"*). One promising approach on the finance side is the development of housing trust funds, which dedicate public funds for the production of affordable housing and help to leverage private capital for housing development. More than 350 local and statewide housing trust funds have been formed in the United States, and debates are underway in Congress to establish a National Housing Trust Fund (see article: *"State Housing Trust Funds"*).[18] Local jurisdictions are also spurring the production of affordable housing through the controversial, though effective, tool of inclusionary housing ordinances, which either mandate or encourage developers to construct affordable units as part of new developments (Box 2.1: Inclusionary Housing). While critics contend that these policies only serve to raise construction costs and force up the prices for market-rate homes, inclusionary housing ordinances nevertheless pursue the important goal of providing affordable housing in high cost communities, rather than forcing low-income families to live in distant suburbs or segregated communities.

In addition to public sector finance and regulations, nonprofits and private developers are pursuing creative solutions that reduce the costs of construction or operating costs, for example, through the use of manufactured housing (see article: *"Some Assembly Required"*), green design, and smaller units (see Boxes 3.1 and 6.1). Private investors have been at the forefront of financing workforce housing initiatives to help middle-income households buy their home in high cost cities in California (see article: *"Stuck in the Middle"*).

Private developers and nonprofits are also looking for opportunities to use vacant land for infill development, or to convert old buildings to new uses. John Stewart, founder and Chairman of the John Stewart Company, a private developer that has extensive experience in providing

Figure 1.6. As Development Costs Rise, Government Subsidies Don't Stretch as Far



affordable housing, notes that building affordable housing in the current environment requires resourcefulness in seeking land for development. "Each community is different, and you need to focus on local needs and opportunities," says Stewart. "You're not going to find a perfect piece of land that can be had for a nickel. Abandoned lots, buildings that are not complying with code, or old warehouses can all be developed into mixed-income housing, to the benefit of the community." Mercy Housing, a national nonprofit housing organization, has been working with community hospitals and medical centers to identify underutilized hospital property that can be converted or redeveloped into affordable housing developments.

Perhaps the most important development has been the growing recognition that neither the public nor private sector can go at this alone. Public/private partnerships that leverage multiple sources of financing are emerging as the hallmark of affordable housing development in high cost areas. "You can give up the idea that you're going to fund the project from one source or one grant. An affordable housing development often requires six or seven layers of financing, from both public and private sources," says Stewart (Box 1.2: North Beach Place). Manning similarly sees partnerships between financial institutions and nonprofits as the key to success. "At Washington Mutual, we work to identify partnerships with nonprofits in order to leverage a wide range of funds and expertise. Partnerships are the name of the game today. None of us can tackle the challenge of building affordable housing alone."

Conclusion

Providing affordable housing in any community is a challenge, requiring the creative, persistent, and collaborative efforts of government, developers, investors, lenders, and community organizations. In high cost areas, the demand for affordable housing challenges these networks to be even more creative and more persistent to ensure that even high cost areas can be home to the full spectrum of workers and families that make a community healthy and vibrant.

Adjusting Limits to Account for High Cost Areas

Box 1.1

To address the specific needs of high cost areas, some government agencies and programs have included special designations to accommodate for geographic variations in house prices. For example:

Low Income Housing Tax Credit

The Low Income Housing Tax Credit program includes a special designation for areas with high construction, land, and utility costs relative to the surrounding region. Known as "Difficult Development Areas" (DDAs), these areas are eligible for Tax Credits at 130 percent of qualified basis, meaning that more of the development costs are borne by the Tax Credit funding than in areas not designated a DDA. HUD determines the DDA thresholds annually by comparing local incomes with housing costs.[1]

The Federal Housing Administration

The Federal Housing Administration (FHA) provides mortgage insurance on loans made by FHA-approved lenders. In high cost areas, FHA will insure loans up to $312,895 for a one-unit mortgage, compared to $172,632 in a non high cost area. In Alaska and Hawaii, limits can be even higher. For example, in Honolulu, Hawaii, the limit for a one-unit dwelling can be as high as $469,342. A complete schedule of FHA mortgage limits for all areas is available at https://entp.hud.gov/idapp/html/hicostlook.cfm.

Raising Conforming Loan Limits for GSEs

Congress is considering a proposal to raise the conforming loan limits for Government Sponsored Enterprises (GSEs) in areas where the costs of buying a home are high. Currently, Fannie Mae and Freddie Mac are governed by a law that puts a ceiling on the size of the mortgages that they can buy. For 2005, the conforming loan limit is $359,650, and it's the same for all contiguous 48 states.[2] By raising the loan limit, Fannie Mae and Freddie Mac would be able to purchase more new mortgages in high cost areas. In theory, the resulting lower interest rates would be passed on as cost savings to home buyers whose mortgage loans are purchased and securitized by the GSEs, although the actual benefit is uncertain.[3]

Even with these adjustments, however, many of the existing or proposed limits still fall short of addressing the costs of housing in places like California. For example, even if the conforming loan limit for GSEs in high cost areas were increased to $539,450 (as under the current proposal), the median price of homes in the San Francisco Bay Area in June of 2005 was 35 percent higher still, at $734,610.

Endnotes

Affordable Housing in High Cost Areas

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4 Foust, D. (2005). The Mortgage Trap. *Business Week*, June 27, 2005.
5 See *Community Investments,* Volume 17, Number 1, January 2005, for a review of the community development needs of the Federal Reserve's 12th District.
6 Critical housing needs is defined as spending more than 50 percent of one's wages for housing–both rental or ownership–or living in substandard conditions.
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9 Barbara Lipman (2005). *Paycheck to Paycheck: Wages and the Cost of Housing in America.* Center for Housing Policy, Washington, D.C.
10 Federal Deposit Insurance Corporation (2005). U.S. Home Prices: Does Bust Always Follow Boom? *FYI Revisited: An Update on Emerging Issues in Banking,* May 2, 2005.
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14 McDonough, S. (2005). Spiraling Housing Costs Hurting Americans. *San Francisco Chronicle,* April 29, 2005. San Francisco, CA.
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16 For an introduction to the LIHTC, see the article in the March 2002 issue of Community Investments.
17 Joint Center for Housing Studies (2005). *The State of the Nation's Housing 2005.*
18 For information on the National Housing Trust Fund Campaign, visit http://www.nhtf.org/.

Adjusting Limits to Account for High Costs Areas *(Box 1.1)*

1 For a detailed explanation of the procedure, see United States Department of Housing and Urban Development (2004). "Statutorily Mandated Designation of Difficult Development Areas for Section 42 of the Internal Revenue Code of 1986; Notice." *Federal Register* 69(229).
2 The original legislation set a higher limit for mortgages on residences in Alaska, Hawaii, and Guam, all thought at the time to have higher than normal costs of building and lower than normal access to credit because of their remoteness. In those areas, the conforming loan limit was set at 150 percent of the limit that applied to the rest of the nation.
3 Miles, B. and M. Jickling (2005). Proposed Changes to the Conforming Loan Limit. *CRS Report for Congress.* Washingon, D.C., Library of Congress Congressional Research Service.

North Beach Place *(Box 1.2)*

1 Adapted from Keat Foon (2004). "Golden Gate Bridging: Super-Sized Affordable Project In San Fran Layers on the Financing," *Multi-Housing News,* December 1, 2004; "Citibank and BRIDGE Housing Celebrate Creation of 341 Affordable and Senior Citizen Housing Units at North Beach Place," Citibank Press Release, June 17, 2003; and personal communication, John Stewart of the John Stewart Company.
2 Ilene Lelchuk (2005). "They Don't Call the Project Outta Control Anymore: Success of Renewal Using HOPE VI is Evident All Around," *The San Francisco Chronicle,* March 28, 2005.
3 U.S. Department of Housing and Urban Development, Fair Market Rents Schedule B, Fiscal Year 2006, available at: http://www.huduser.org/datasets/fmr.html.
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Endnotes

Inclusionary housing *(Box 2.1)*

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4 David Paul Rosen and Associates (2002). *City of Los Angeles Inclusionary Housing Study.* Prepared for: Los Angeles Housing Department, September 25, 2002.

5 Homebuilders of Northern California vs. City of Napa, 90Cal.App 4th188.

State Housing Trust Funds

1 The Non-Profit Housing Association of Northern California (2005). *Making the Bay Area A More Affordable Place to Live: Progress Report on the Housing and Emergency Shelter Trust Fund Act of 2002,* May 2005.

2 Data on the number of housing trust funds are collected by the Center for Community Change. Because the field is changing so rapidly, it is hard to get an exact count of the number of housing trust funds in the United States.

3 In their original intent, housing trust funds were designed to be sources of public funding for affordable housing, and do not rely on corporate contributions, foundation grants, or bank commitments to be sustainable. Still, as employers increasingly recognize that housing affordability has a serious impact on their workers, promising models for cross-sector collaboration in the establishment of affordable housing trust funds are emerging.

4 Jeff Gray, Arizona Department of Housing. Personal communication 8/25/2005.

5 Arizona Department of Housing (2005). "Governor Announces Continuation of State Funding for Tribal Housing," *Information Bulletin,* August 15, 2005.

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11 PolicyLink (2005). *Expanding Opportunity: New Resources to Meet California's Housing Needs.* PolicyLink, California.

Not just your granny's flat *(Box 3.1)*

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Figures

Figures 1.1 & 1.2: JCHS tabulations of the 2000 Census Supplemental Survey and the 2003 American Community Survey. Reprinted from *The State of the Nation's Housing 2005* with permission from the Joint Center for Housing Studies of Harvard University. All rights reserved.

Figure 1.3: Office of Federal Housing Enterprise Oversight (OFHEO). "U.S. House Prices Continue to Rise Rapidly," June 1, 2005. Data are reported for period ending March 31st, 2005.

Figure 1.4: Federal Deposit Insurance Corporation, *2005 State Profiles,* accessible at http://www.fdic.gov/bank/analytical/stateprofile/index.html. Data are for December 2004 and reflect the average annual growth for the preceding year. Washington data are for September 2004.

Figure 1.5: HUD's Fair Market Rents for 2004, based on methodology developed by the National Low Income Housing Coalition. Adapted from *The State of the Nation's Housing 2005* with permission from the Joint Center for Housing Studies of Harvard University. All rights reserved.

Figure 1.6: U.S. Department of Housing and Urban Development, Low Income Housing Tax Credit Database.

Figure 3.1: Center for Community Change (2005) www.communitychange.org