Addressing the Affordable Housing Crisis

Introduction

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Addressing the Affordable Housing Crisis

BY MARK ZANDI

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Housing shortage

Homebuilding collapsed during the housing crash a decade ago and has been slow to recover. Construction of high-end homes and apartments recovered first, and there is now an oversupply in many urban areas across the country. However, the construction of affordable housing—homes reasonably priced for lower- and middle-income households to rent or own—has only recently begun to increase and continues to significantly lag demand.

The worsening affordable-housing shortage is clear in the low number of vacant housing units, which continues to decline. The percent of the housing stock for rent and sale that is unoccupied has fallen sharply since the housing crash and is now as low as it has been in more than 30 years (see Chart 1).

And this housing shortage is set to get much worse. The current annual supply of new housing units is running an estimated 300,000 below trend new housing demand. Total supply equals new single- and multifamily units and manufactured homes, and trend housing demand equals household formations, new homes needed to replace those that become obsolete, and second and vacation homes. Trend demand abstracts from the near-term temporary ups and downs in demand.

Lack of housing is pushing up house prices and rents, making it even more difficult for low- and middle-income households to find a place to live. Prices and rents have substantially outstripped the growth in incomes for these households for over six years.

Homebuilding constraints

Homebuilders have steadily increased production of new housing since the crash. During the worst of the downturn a decade ago, builders put up only 600,000 homes per year. New construction today is approaching 1.4 million units.

Yet much of the increase in homebuilding has been at the high end of the housing market. Demand by higher-income households recovered more quickly from the recession, and the higher house prices and rents builders could charge these households have been a strong incentive to build more.

The building of affordable housing units has been much slower to recover. Lower- and middle-income households have had more difficulty recovering from the recession, and the prices and rents builders could earn on affordable housing were too low to incent them to build more. This has changed more recently, because lower- and middle-income households are doing better financially, and house prices and rents have increased.

However, there are still significant constraints on building affordable housing units. Construction workers are in very short supply, particularly in the South and West where affordable housing demand is especially strong. This makes it difficult to find needed workers and is driving up labor costs. Labor shortages in the transportation, distribution and manufacturing industries are also making homebuilding more costly and difficult.

The cost of homebuilding materials from lumber to gypsum has also risen sharply in
The American Housing Economic and Mobility Act

The American Housing Economic and Mobility Act provides an average of $50 billion per annum to alleviate the shortage of affordable housing units. This is done through funds to incentivize localities to ease regulations and other building restrictions, provide down-payment assistance, and reduce the burden on households with negative equity in their homes.

Most significantly, the funds are to be used to boost the Housing Trust Fund and Capital Magnet Funds. The HTF and CMF were established by the 2008 Housing Economic and Recovery Act, but funding began only a few years ago. Current combined funding is several hundred million dollars a year based on a fee charged on loans purchased by Fannie Mae and Freddie Mac.

The HTF provides funds to state housing authorities for the development of affordable rental units. Housing authorities have flexibility in allocating these funds, since each has different objectives and goals based on the needs of the local population. The CMF provides funds to Community Development Financial Institutions and other non-profit developers for increasing the supply of affordable housing. CDFIs are mission-driven financial institutions that provide financing for development in underserved communities. The HTF and CMF have the flexibility necessary to significantly increase the supply of affordable housing in real estate markets encumbered by a range of complex and costly problems.

The American Housing and Economic Mobility Act is designed to be deficit neutral on a dynamic basis over the 10-year budget horizon. The costs of these affordable housing initiatives are largely paid for by reforms to the estate tax - some $400 billion of the $500 billion 10-year costs – most importantly by rolling back estate tax exemptions to their 2009 levels. The remainder of the cost of the legislation will be paid for by the tax revenues generated by the additional homebuilding and other economic activity.

Housing and economic impact

The Moody’s Analytics model of the U.S. economy is simulated to determine the impact of the American Housing and Economic Mobility Act on the housing market and the economy.

Our simulation is based on a number of assumptions, including that the legislation becomes law this year and is effective in calendar year 2019. Given the magnitude of the increase in funding for the HTF and CMF, we assume it will take several years to get these programs up to full speed. Each will need some time to expand its infrastructure for evaluating uses of the increased funds and disbursing them effectively.

Another important assumption is that it would cost $175,000 on average nationwide to produce a typical affordable housing unit this year. This is consistent with the cost to produce a unit in a Low Income Housing Tax Credit project. We expect that cost to increase more than 3% per annum for 2019-2021, given the strong economy and higher tariffs on imported homebuilding materials, and to moderate closer to 2% growth by the mid-2020s, consistent with overall price inflation.

The American Housing and Economic Mobility Act does not change current law with regard to how the HTF and CMF operate. Under current law, at least 70% of CMF funds must be used to support affordable housing projects, and no more than 10% of an affordable housing project’s costs can come from the CMF. These and other rules under current law slow the disbursement of funds and are key to why it takes several years to ramp up...
the production of affordable housing. The legislation allows for up to 10% of the funds going to the HTF and CMF to be used to promote homeownership.

Under the new legislation, our model shows that affordable housing construction increases by close to 200,000 units in 2019, to almost 250,000 units in 2020, and to 300,000 units in 2021 (see Table 1). Over the 10-year budget horizon through 2028, affordable housing production increases by about 300,000 units per annum. This is approximately equal to the current annual shortfall in housing supply. If this legislation is signed into law soon, it will at the very least ensure that the current crisis in affordable housing does not get worse.

This will still leave a shortfall in affordable housing. But market forces should work to slowly and steadily increase supply. This is particularly true if the American Housing and Economic Mobility Act eases regulatory restrictions on affordable homebuilding as anticipated. By the end of the 10-year horizon, affordable housing supply should be approximately equal to demand.

Since the legislation significantly increases housing supply, it will have the added benefit of improving housing affordability, particularly for affordable rental homes. Without the legislation, rents are expected to increase by more than 4% per annum. With the legislation, rent growth will be closer to 3% per annum. A decade from now, affordable rents will be approximately 10% lower than they are today, or about $100 per month in today’s dollars. House price growth also slows somewhat as a result of the increased supply, although not nearly as much as rent growth.

More housing construction will increase the economy’s growth rate and the number of jobs as activity increases. In 2019, the increased housing construction will lift employment by 730,000 jobs and by as much as 1.5 million jobs at the peak of the impact in the mid-2020s. Limiting the lift to employment in the near term is that the economy is already operating at full employment, and the increase in economic activity results in somewhat higher interest rates.

There is very little impact on the economy and jobs from the scaling back of the estate tax exemptions and other reforms. The wealthy households that will pay more in estate taxes have substantial financial resources and will not significantly change their spending and saving behavior. Moreover, since the increased tax revenues pay for the expansion of the HTF and CMF and other programs, it ensures that the American Housing and Economic Mobility Act is deficit neutral, with no resulting material impact on interest rates.

This simulation likely understates the economic benefit of the legislation, because it does not consider that the measure will facilitate the ability of low- and middle-income households to move closer to their employment or potential jobs. The housing shortage and erosion in affordability are constraining the ability of low-income households to take the record number of open job positions that are currently available in places where housing is simply too expensive. Affordability is also forcing low- and middle-income workers to live farther away from their work, requiring long and costly commutes, and reducing productivity.

Conclusions

A decade after the housing crash and financial crisis, the nation is still suffering from a housing crisis. A decade ago, the problem was egregious mortgage lending and overbuilding. Today, it is a mounting lack of affordable housing. Low- and middle-income households are struggling to make their rent and mortgage payments, suffering through increasingly long commutes, and unable to take better jobs because they cannot afford housing near the available work. The American Housing and Economic Mobility Act will go a long way toward addressing these problems. It is fiscally responsible legislation that empowers programs that are already in place and shown to be effective in meeting the challenges of providing affordable housing to low- and middle-income households and underserved communities.
About the Author

Mark Zandi is chief economist of Moody’s Analytics, where he directs economic research. Moody’s Analytics, a subsidiary of Moody’s Corp., is a leading provider of economic research, data and analytical tools. Dr. Zandi is a cofounder of Economy.com, which Moody’s purchased in 2005.

Dr. Zandi’s broad research interests encompass macroeconomics, financial markets and public policy. His recent research has focused on mortgage finance reform and the determinants of mortgage foreclosure and personal bankruptcy. He has analyzed the economic impact of various tax and government spending policies and assessed the appropriate monetary policy response to bubbles in asset markets.

A trusted adviser to policymakers and an influential source of economic analysis for businesses, journalists and the public, Dr. Zandi frequently testifies before Congress on topics including the economic outlook, the nation’s daunting fiscal challenges, the merits of fiscal stimulus, financial regulatory reform, and foreclosure mitigation.

Dr. Zandi conducts regular briefings on the economy for corporate boards, trade associations and policymakers at all levels. He is on the board of directors of MGIC, the nation’s largest private mortgage insurance company, and The Reinvestment Fund, a large CDFI that makes investments in disadvantaged neighborhoods. He is often quoted in national and global publications and interviewed by major news media outlets, and is a frequent guest on CNBC, NPR, Meet the Press, CNN, and various other national networks and news programs.

Dr. Zandi is the author of Paying the Price: Ending the Great Recession and Beginning a New American Century, which provides an assessment of the monetary and fiscal policy response to the Great Recession. His other book, Financial Shock: A 360º Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis, is described by the New York Times as the “clearest guide” to the financial crisis.

Dr. Zandi earned his BS from the Wharton School at the University of Pennsylvania and his PhD at the University of Pennsylvania. He lives with his wife and three children in the suburbs of Philadelphia.
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