June 27, 2024

<u>Deep-rooted problems, difficult solutions</u>:

Eating away available income, the rising cost of housing is a hot point for US voters

Karl Polzer, <u>Center on Capital & Social Equity</u>

Summary:

As housing costs absorb more household income, the lack of affordable housing has become a focal point in the fall elections. Proposed solutions – including increasing the supply of multi-unit housing, targeting more subsidies to low-income renters, and pushing up wages – face strong political resistance and budget constraints. Policy changes also must work uphill on an uneven playing field stemming from monopoly power associated with ownership of land and property on it. Increased federal subsidies might end up in landlords' pockets rather than increasing the supply of affordable housing. The federal government has limited influence over changes in zoning restrictions needed to increase supply. Planning and zoning are a state and local government responsibility. Higher-income homeowners are resisting changes they see as threats to their property values and exclusive access to higher quality schools.

Expiration of the Trump tax cuts provides the next Congress with an opportunity to increase, or better target, housing subsidies to lower- and middle-income people. Political deadlocks and budget constraints, however, will limit what can be done. Perhaps the greatest changes in the housing landscape will result from how Americans adapt to cost pressures regardless of what the government does. The growth of intergenerational households and shared living arrangements will likely continue. In coming years, there is a strong possibility that more people who cannot afford to pay the lowest available rent will be sleeping in cars, shelters, tents, and on the streets.

Across the United States, the ability to buy a house or pay the rent is becoming more precarious even with recent rises in average income, according to a barrage of recent studies and reports. Since the start of 2020, home prices have surged more than 47% – the fastest pace of growth since the financial crisis more than a decade ago. A household earning the local median income would be able to afford a home in about 60% of counties nationwide – a 30-percentage-point drop compared to five years ago.

People with low- and middle-income are being squeezed the hardest. "As housing costs have outpaced income gains by a widening margin, lower-income renters have less left over after paying for housing than ever before," reported Harvard University's housing studies center. "In the years since the COVID-19 pandemic, the rapid increase in rents combined with widespread financial hardship have pushed the number of cost-burdened renters to a record high of 22.4 million households in 2022. In 2022, the median residual income remaining after rent payment fell to a record low of just $310 each month for lower-income renters, far below the minimum needed to afford an adequate standard of living."

High Housing Costs Are Consuming Household Incomes

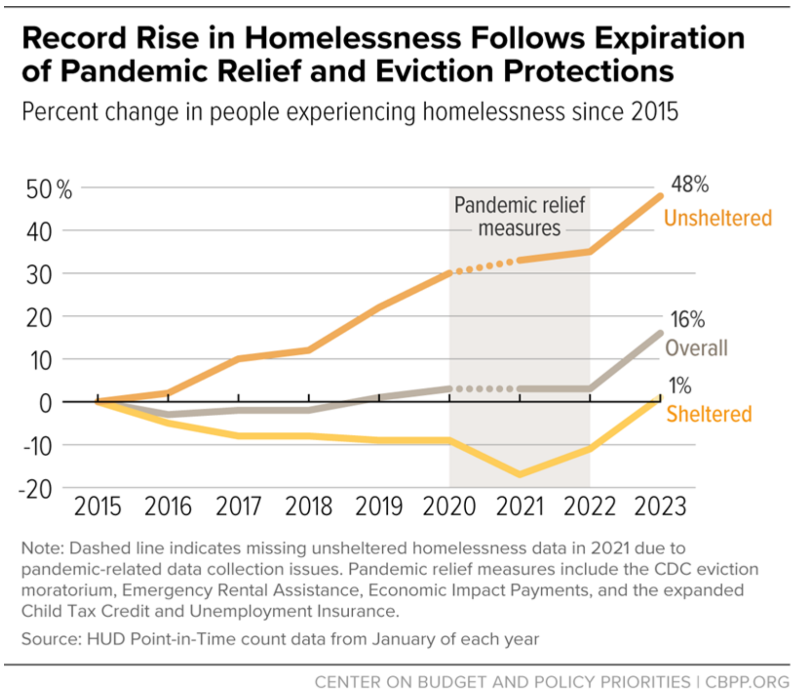
Source: Harvard JCHS

The center's latest rental housing report points to an escalating affordability crisis. Rents have grown rapidly across all income groups. Between 2001 and 2022, the median rent increased by 21 percent, while the median renter household income increased by just two percent, after adjusting for inflation.

The Center on Budget and Policy Priorities (CBPP) finds a similar pattern leading to a rise in homelessness:

> "Pandemic relief measures mitigated the increase in need from rising rents and job losses. But those measures were temporary, and first-time homelessness rose well

above pre-pandemic levels in fiscal year 2022 as temporary assistance largely expired and the gap between renters' incomes and rent costs persisted. Between January 2022 and January 2023, homelessness rose 12 percent, reaching its highest level on record in data back to 2007. The rise in unsheltered homelessness, a 48 percent increase since 2015, has been particularly steep."



Long-term impact of monopoly rents

Before discussing proposals to make housing more affordable, it is important to understand that owners of the most productive and desirable land, and the housing on it, tend to have a favorable bargaining position in an uneven political economic playing field. Amidst the background noise of economic events, encroachment of housing costs on household income may appear to be a novel phenomenon. It is actually a long-established tenet in classical economics. More than two centuries ago, political economists Adam Smith and David Ricardo connected the ownership of land, which is a finite natural resource, with monopoly power. Ricardo described this tendency for high-yielding agricultural land. It also applies to real estate in or with access to highly productive urban areas. A recent study detected monopoly effects in the Manhattan rental market and a relationship between zoning restrictions and monopoly pricing. Researchers found that a 10 percent increase in Census tract level ownership concentration correlates to roughly a one percent increase in building rents.

In economic parlance, “monopoly rents” are extracted over and above normal profit levels in more competitive parts of the economy. If classical theory holds true, over time, the price of buying or using land will tend to rise to whatever the buyer can afford given available options. While monopolists cull these excess rents, Ricardo asserted that wages, especially for workers with the least bargaining leverage, tend to fall toward subsistence levels. Smith recognized that economic growth and public policy played roles in pushing wages up to levels that can provide a decent standard of living.

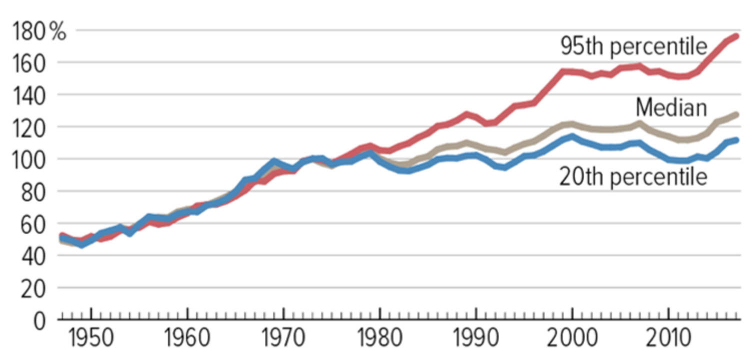
Though estimating housing inflation is nettled with measurement issues, it’s clear that US housing prices have risen much more than other goods and services.   Since 1963, the first year for which the Federal Reserve Bank has data on housing prices, the median sales price of a home rose almost three times as much as the Consumer Price Index. Average rent inflation has been more in line with changes in other household costs with the caveat that it can vary widely by region.

Renters and homeowners differ in median income by over $30,000 -- $40,500 for renters compared to $72,615 for owners, the housing industry reported recently. One reason that the cost of buying has outstripped the cost of renting may be that income has grown unequally. There has been much more income growth to absorb at the top of the pyramid.

From the late 1940s to the early 1970s, incomes across the distribution grew similarly. Since the 1970s, income disparities began to widen, with income growing much faster at the top of the ladder than in the middle or bottom. Household (as opposed to family) income data, which are available only since 1967, show a similar pattern of widening inequality and scant growth in median income.

Income Gains Widely Shared in Early Postwar Decades — But Not Since Then

Real family income between 1947 and 2017, as a percentage of 1973 level



Note: In 2014 Census split its sample of survey respondents into two groups to test a set of redesigned income questions. In 2015 (reporting on 2014 income using the new questions), Census released two estimates of 2013 incomes, one based on the old questions and one on the new. The chart uses the estimate based on the old questions, based on CBPP's judgment that, due in part to sample size, it is likely more accurate for 2013.

Source: CBPP calculations based on U.S. Census Bureau Data

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

In addition, income from ownership of capital – which mainly flows to people at the top – has grown faster than wages and enjoys favorable tax treatment.

Many sources of monopoly power impact the housing market. Along with land scarcity, concentration of ownership and access to capital can drive up prices. Using government-backed loans, private equity acquisitions by a few large companies may be helping drive consolidation in the rental industry. "Private equity firms often act like a corporate version of a house flipper: They seek deals on apartment buildings, slash costs or hike rents to boost income, then unload the buildings at a higher price," ProPublica reported. "The influx of private equity comes during a national affordable housing crisis and has dire consequences, tenants and their advocates say."

Monopoly profits can also result from bottlenecks in the financing system. For example, Three firms dominate credit reporting and just one company (which sells the FICO score) handles algorithms. "Mortgage lenders in the U.S. increasingly face a lack of competition when it comes to accessing data and reports needed for loan origination," Rohit Chopra, director of the Consumer Financial Protection Bureau, said at a bankers' conference recently. "In many cases, a handful of firms have cornered the market, allowing those companies to levy a tax on every mortgage application or transaction in the country."

Affordable Housing Policy Proposals

The rising price of housing along with high mortgage payments are helping to fuel one of the most volatile issues in the coming elections: persistent inflation. Voter concern has spurred a flurry of housing policy proposals. Keeping in mind that monopoly pricing may create an uphill struggle that can limit their effectiveness, the proposals typically involve expanding housing supply or subsidizing demand.

***Expanding supply**:* The conservative American Enterprise Institute (AEI) and other think tanks have urged policymakers to unbottle market forces restraining supply by removing zoning barriers to building multi-unit dwellings in the suburbs. According to AEI's Ed Pinto:

> "We're living through one of the greatest housing crunches the U.S. has ever known. It's resulted in record numbers of homelessness and entire generations certain they will never become homeowners, that critical milestone of the middle class. But there is a simple solution to the problem. The answer to our housing crisis is to legalize duplexes, triplexes, and other forms of light-touch density (LTD) housing, allowing the market to build more affordable housing options for more Americans."

Most of these type of supply-side policy changes occur at the state and local levels. States such as California, Washington, Oregon, Vermont, and Montana and some localities have scaled back exclusionary single-family zoning laws and legalized LTD zoning. Deregulatory efforts, however, have met with strong resistance from single-family occupancy owners including in Arlington, Virginia just across the Potomac River from Washington, DC.

In the past, zoning restrictions were one way to engineer racial segregation. While explicit red lining is illegal today, elevated housing prices in single-family-zoned suburbs form a similar barrier to low-income buyers regardless of racial or ethnic background. African American and other minorities, incidentally, have lower than average income.

In many areas facing political pressure to relax zoning barriers, market forces are making single-family housing less affordable as developers demolish older homes and replace them with much larger and more expensive ones. Profit margins are higher at the top end of the market.

Home prices and rents are connected, though not always tightly. If prices and profitability rise for higher-priced houses, investment may shift away from lower-priced houses and rental properties, creating shortages and higher prices at the bottom of the market.

Subsidizing demand: The left-leaning CBPP proposes expanding federal rental assistance to eventually reach every person with low income who needs it, beginning with people at 15-30 percent of area median income and below who are most at risk of experiencing homelessness. CBPP also supports funding for supportive services including "housing navigation services (which help people search for housing that meets their needs), tenant support services (such as help understanding lease terms), community-based health care services, and other social services such as affordable childcare."

In March, the Biden Administration unveiled a $258-billion grab bag of initiatives to make housing more affordable as part its proposed budget. Aimed at both at demand and supply, the list includes promoting multi-family housing, tax credits for low-income housing and new construction, tax credits for very low-income renters, expanded bank financing for low- and moderate income households, and more public housing. Conservative analysts have criticized Biden's plan, saying it would make things worse. According to Judge Glock of the Manhattan Institute:

> "The fundamental problem with housing today is that federal, state, and local regulations constrict supply, which drives up prices. Biden's backwards solution is to subsidize demand by handing out more government money to buyers, renters, and developers. These subsidies would further drive up prices, waste public money, and drive home ownership even farther out of reach for many Americans."

No matter who wins in the fall election, any legislation including expanded funding for housing will face strong political headwinds. As the 2017 Trump tax cuts expire, the next president and Congress will be engorged in a major tax and spending debate. Meanwhile, the national debt is projected to hit historic highs. CBO estimates federal debt will reach 106.2 percent of GDP by the end of fiscal year 2027 – a new record – and 122.4 percent of GDP by the end of 2034.

A key issue in next year's tax debate will be the future of the mortgage interest tax deduction, a hefty subsidy disproportionately benefiting high-income taxpayers. Among the reasons for its regressivity is that higher-income households are more likely to itemize, which is necessary to claim the mortgage interest deduction. Also, higher tax rates result in higher deduction amounts. According to a Congressional Research Service analysis:

> "The deduction's effect on homeownership is also likely limited because it is not well targeted toward the group of potential homebuyers most in need of assistance—lower-income households. This group includes younger potential first-time buyers, who have difficulty accumulating funds for a down payment. Homeowners must itemize their deductions when filing their tax returns to benefit from the deduction. Historically, lower-income households have itemized their tax returns at an extremely low rate. The itemization rate among all households is currently much lower than in the past (10.9% in 2018 compared to 30.6% in 2017) due to the TCJA (P.L. 115-97), which nearly doubled the standard deduction. This has caused the number of itemizing households to become more concentrated at the upper end of the income distribution than in the past. Thus, fewer households benefit from the mortgage interest deduction, and even fewer lower-income households do so."

Although Congress trimmed the mortgage interest deduction in the 2017 tax legislation, it continues to stimulate the purchase of ever larger homes at the top end of the market. The Treasury estimates the mortgage interest tax deduction will cost the government $39 billion in FY 2025, jumping to $109 billion the following year if Congress allows the Trump tax legislation to expire.

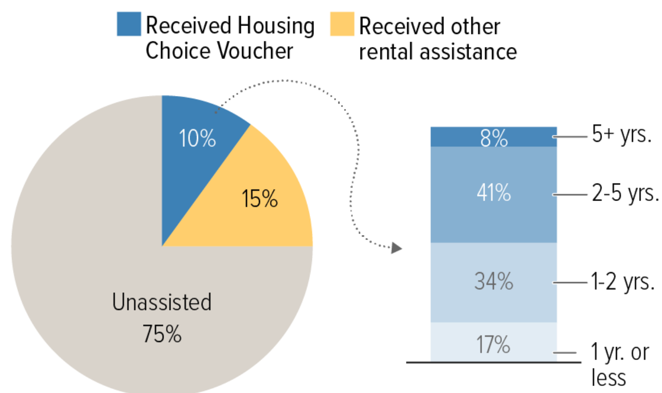
HUD housing vouchers fall short

At the bottom end of the pecking order, lack of federal funding has hamstrung the nation's largest rental assistance program. In 2021, the Housing Choice Voucher program enabled roughly 2.3 million households with low incomes to afford decent, stable housing. But only one in four households eligible for rental assistance received it. In 2019, more than 16 million *unassisted* renter households paid more than 30 percent of their income for housing or lived in substandard or overcrowded homes. Due to limited funding, families typically must wait for years before receiving a voucher, according to a CBPP analysis of Department of Housing and Urban Development (HUD) data.

Under the voucher program, a family pays about 30 percent of its income for rent and utilities, a widely used standard for the amount a household can reasonably be expected to pay for housing. The voucher covers the rest, up to a cap based on HUD estimates of typical market rents in the local area.

Small Share of Eligible Households Receive Vouchers and Typically After Long Wait

Share of eligible households receiving rental assistance and agency's average wait time for voucher recipients



Source: HUD custom tabulations of the 2019 American Housing Survey; 2018 HUD administrative data; FY2020 McKinney-Vento Permanent Supportive Housing bed counts; 2019-2020 Housing Opportunities for Persons with AIDS grantee performance profiles; and the USDA FY2020 Multi-Family Fair Housing Occupancy Report; HUD 2020 Picture of Subsidized Households

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

People adjust

The shrinking margin between income and the cost of housing is a major factor in the growth of intergenerational and other types of shared living arrangements. In 2022, 55% of women and 57% of men aged 18 to 24 lived with their parents. The Census Bureau reported: "Young adults are experiencing the traditional markers of adulthood, such as leaving the parental home, starting a family, and establishing stable careers, later in life than previous generations did." Fewer than half of young adults ages 18 to 34 (45%) say they are completely financially independent from their parents, according to Pew research.

More parents are moving in with their adult children. And about one million people over the age of 65 now live with unrelated housemates or roommates. In 2017, a real estate company estimated that 3.6 million vacant bedrooms in baby-boomer households could be rented out in the 100 largest U.S. metro areas.

In 2022, 14.4 million of the 79 million Americans in shared households were living with roommates. Some policy proposals nostalgically mention the disappearance of boarding houses which once provided affordable living quarters for people of all incomes, often with meals. Ubiquitous in the United States at the beginning of the 20th Century, very few still operate. One can get an impression of life in a boarding home by reading Thomas Wolfe's semi-autobiographical novel "Look Homeward Angel." The main character returns from college and falls in love with a 21-year-old woman living in his mother's boarding house. The setting is a fictionalized North Caroliina city resembling Ashville, where Wolfe grew up.

As more workers are priced out of the housing market, governments at all levels could provide subsidies – or ease regulatory restrictions – to facilitate extended family and communal living arrangements, particularly for people with disabilities. For example, Social Security's back-up program for people with disabilities and very low income – Supplemental Security Income (SSI) – is nettled with complex restrictions on food and shelter that families can provide to beneficiaries.

SSI helps states offer assisted living and group home options to low-income seniors and people with disabilities who otherwise would have to live in a nursing home or psychiatric facility. Under federal law, Medicaid pays for room and board in nursing homes but not assisted living or group homes. States use SSI to fill in the housing-cost gap, but the amount is often insufficient to cover provider costs. As a result, supply and consumer choice of non-institutional housing-with-care options are usually limited. SSI eligibility, and losing it, can open or shut the door to other safety net programs, particularly Medicaid and food stamps. Worries about meeting complex income and asset tests can dampen incentives to work and save. Recipients with mental impairments may not have the capacity to meet the letter of the law and attendant paperwork that comes with complex restrictions.

Record number of homeless

According to HUD's latest estimate, homelessness rose 12 percent in 2023. More than 650,000 people were unhoused, the highest number since data collection began in 2007. The department found an increase in nearly every state and also for both sheltered and unsheltered homelessness.

According to Harvard's JCHS:

> "The growing number of unhoused people is driven in part by the expiration of many pandemic-related relief measures and an influx of migrants. However, the most fundamental driver of the nation's growing homelessness is the ongoing housing affordability crisis that has left a record number of renters cost-burdened, spending more than 30 percent of income on housing and utilities, as detailed in our latest report, *America's Rental Housing 2024*."

More people lacking the means to pay for housing are sleeping on sidewalks, in parks, along roads, in tent cities, in their cars, and in shelters. Many have mental or other disabilities that limit their ability to work. Older adults make up almost half of the homeless population and are its fastest-growing segment.

The wear and tear that comes with homelessness takes a toll on health and can shorten life. A recent study found that people who have experienced homelessness face 3.5 times the mortality risk of people who are housed. The mortality gap related to homelessness exceeds the mortality gap between black and white housed individuals (relative hazard of

1.4) and between poor housed and all housed individuals (2.2). A 40-year-old homeless person has life expectancy similar to a housed person nearly twenty years older.

California writer Dale Maharidge describes how Sacramento's homeless population has multiplied over the past 45 years:

> "In 1980, I reported on Sacramento's 'public inebriates.' Most of them, a few hundred in all, lived in flophouse hotels. But some slept 'in the weeds.' I walked the wooded banks of the rivers that converge in the capital and found just a few dozen spots where men had bedded down on simple mats of cardboard or newspaper. There were no tents or camps. The word 'homeless' was rarely used then. It didn't appear in my article for the Sacramento Bee.
>
> "By 1982, amid a recession, newcomers who had lost their jobs began to appear in the weeds. In 1985, after three years of reporting on the subject, I co-authored one of the first books on contemporary homelessness. In 1988, I spent a week walking 10 miles of Sacramento riverbank and found 125 elaborate camps. This was new.
>
> "I returned to Sacramento more recently amid the COVID-19 pandemic. Now the tent cities in the woods along the rivers stretched as far as the eye could see, rivaling those photographed by Dorothea Lange during the Great Depression. The most recent federally mandated survey found more than 5,000 unsheltered homeless people in the city."

Responsibility for dealing with cost and frictions stemming from homelessness mainly devolves to local governments. As complaints about people living in public areas mount, more cities and states are turning to punitive measures to force homeless people to sleep in shelters or to move somewhere else. The US Supreme Court is expected to rule soon on a challenge to an Oregon city law making it a crime for anyone without a permanent residence to sleep outside.

Some states and cities are trying creative options for homeless people such as building "micro communities" offering wrap around services and retrofitting hotels and office buildings. Denver has opened three micro communities and converted another five hotels for people who used to be homeless. Austin, Texas has developed three villages of "tiny homes." A 232-unit complex in Los Angeles comprises two three-floor buildings of stacked shipping containers. Atlanta used shipping containers to convert an empty parking lot into a micro community of 40 insulated studio apartments, each featuring a single bed, HVAC unit, desk, microwave, small refrigerator, TV, sink, and bathroom. There is also a dog park.

Some advocates for low-income people say the federal government should take much more responsibility for reducing homelessness through measures that close the gap between wages and housing costs and target limited resources to people most in need. CBPP suggests:

> "The federal government should ultimately guarantee rental assistance for *all* eligible low-income people. In the meantime, federal policymakers can expand rental assistance for people with the lowest incomes, such as people with incomes at or below 30 percent of area median income. Expanding assistance based on income, instead of for certain subpopulations, is a more equitable and comprehensive approach for expanding federal rental assistance and is an important strategy for reducing homelessness."

Other federal policies can help to reduce homelessness, such as expanding public benefits including SSI, child tax credits, and Medicaid coverage, and raising wages for low-income workers. While many states have done so, Congress has not increased the federal minimum wage of $7.25 an hour for 15 years. Since then, the cost of living has risen more than 40 percent.

Concluding Observations

As housing costs absorb more household income, the lack of affordable housing has become a focal point in the fall elections. Proposed solutions – including increasing the supply of multi-unit housing, targeting more subsidies to low-income renters, and pushing up wages – face strong political resistance and budget constraints. Policy changes also must work uphill on an uneven playing field stemming from monopoly power associated with ownership of land and property on it. Increased federal subsidies might end up in landlords' pockets rather than increasing the supply of affordable housing. The federal government has limited influence over changes in zoning restrictions needed to increase supply. Planning and zoning are a state and local government responsibility. Higher-income homeowners are resisting changes they see as threats to their property values and exclusive access to higher quality schools.

Expiration of the Trump tax cuts provides the next Congress with an opportunity to increase, or better target, housing subsidies to lower- and middle-income people. Political deadlocks and budget constraints, however, will limit what can be done. Perhaps the greatest changes in the housing landscape will result from how Americans adapt to cost pressures regardless of what the government does. The growth of intergenerational households and shared living arrangements will likely continue. In coming years, there is a strong possibility that more people who cannot afford to pay the lowest available rent will be sleeping in cars, shelters, tents, and on the streets.

Karl Polzer is founder of the Center on Capital & Social Equity.