Housing Affordability

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When it comes to housing as a distinct segment of the economy, the casual observer in the United States cannot help but feel overwhelmed by the dynamics. People are everywhere on the move. The out-migration from the older, factory-dominated, city neighborhoods continues into its fourth decade, offset to some extent by an in-migration to the residential neighborhoods within and adjacent to the central city business corridors and waterfronts. There is an out-migration from older suburban bedroom communities, where housing costs have long been high and are again rising, to more rural and sparsely populated areas still within reasonable commuting time (distance is no longer the measure) to the suburban employment and shopping centers. Small, rural towns at the outer edges of commuting times are experiencing increases in population—generally of higher income households who bring their spending power but also bid up the price of housing. In regions not connected in this way to the nation's large metropolitan rings, other rural towns are dying off as a consequence of the consolidations in the agricultural sector. Corporate agribusinesses spent little locally. With the disappearance of every family farm, the threat to the communities the farmers support increases. Vacant homes and closed shops on small town main street is the unfortunate result.

Everywhere one looks there is a growing percentage of households who cannot afford to achieve homeownership or are being pushed out of existing homes by rising property taxes. Housing affordability is best reflected in the form of an equation, of the relationship between the cost of housing, household income, the market rate of interest charged for long-term mortgage financing, and other annual costs of owning a home (including property taxes, mortgage insurance premiums, utility costs, condominium fees).

The United States has an enormous stock of housing units available for owner-occupancy. Some 65 percent of the households in the U.S. are homeowners (although fewer than 25 percent own homes free and clear of mortgage debt). Buildings containing one, two, three or four dwelling units are categorized by mortgage lenders and others as "single family" structures. Those with five or more units are (somewhat arbitrarily) categorized as "multi-family" structures, owned generally by investors rather than by owner-occupants. In every year since at least as far back as 1950 the U.S. has added more than one million new housing units, with several years in the early 1970s climbing well over two million. On the other side of the equation, the rest of the housing stock is aging. Many units, particularly those located in places where household incomes are low, are what appraisers call "functionally obsolete" (meaning that they are in poor condition generally and far below the standard for new construction). The worst of this group is vacant, absentee owned and abandoned.

Many people seeking a place to live have few choices because their incomes have not kept pace with the price for well-maintained housing in neighborhoods considered as desirable places to live, work and play. Inner city neighborhoods are populated by households overwhelmingly at or below 80 percent of the area median income level. Older, long-time residents in these neighborhoods are slowly turning properties over (as they move in with relatives, move into retirement communities or leave the properties to heirs). More and more, these properties are remaining vacant for long periods of time, becoming targets of vandalism. Speculators and slumlords purchase the properties, divide them into apartment units and lease them to low income households, dedicating very little to maintenance until the properties become uninhabitable and are condemned by the municipality. Absent the influx of households with incomes high enough to maintain or rehabilitate these properties, the fabric of the community disintegrates. The fall in housing prices to below replacement cost of the dwelling means that homeowners (or potential purchases) cannot obtain sufficient financing to acquire distressed properties and rehabilitate them. On a piecemeal basis, government subsidies have been introduced to fill this gap; however, the need overwhelms the resources made available for the task.

In the suburban areas the problem is rather different, although subsidies here also provide the primary means of mitigation. A large percentage of younger adults are hampered in their efforts to achieve homeownership not so much because of household income (although this is certainly true of some, particularly single heads-of-household, and more particularly female heads-of-household) but because they are not able to accumulate enough savings for a down payment and closing costs. The public policy response has been been two-fold: (1) require developers to dedicate some percentage of the land they hold to the construction of housing units affordable to moderate income households; and (2) to provide income eligible (generally homebuyers whose household income is less than 80 percent of the area median) with conditional grants or loans to supplement savings. Typically, the homebuyers must contribute 3 percent of the purchase price of the property. A total down payment of 5 percent is required under the financing terms, which means that these grants—and, in many cases, gifts from parents or other close relatives or nonprofits—cover the remaining amount of cash needed for the purchase. Homebuyers with exceptionally good credit may qualify for 100% financing, under which they may be required to contribute some minimum amount out of savings but not be required to make a down payment. The introduction of this level of financing has been made possible by the use of computers to calculate "credit scores" based on decades of data accumulated on how people handle repayment of debts. Interestingly, there seems to be no direct correlation between household income and debt management. As many lower income households as higher income households (by percentage) have excellent to good credit scores.

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Another expanding initiative in the cause of creating permanently affordable, decent housing for lower income households is the creation of "community land trusts" (CLTs). Here, again, the strategy in some areas is very different from others. Within older neighborhoods and the inner cities, the CLT is able to acquire properties at relatively low (or even no) cost; however, the cost of rehabilitation is generally greater than what the "as completed" market value of the property will be. By placing the land in a CLT, by imposing owner-occupancy requirements on the buyers and by establishing resale formulas that limit any future gain on sale of the improvement, the CLT model achieves the goal of long-term affordability. In high cost areas, the CLT's role is to remove the land cost component from the homebuyer's cost of acquisition. This does make homes more affordable, of course, but requires a huge acquisition fund (or access to financing). Because of the costs involved, the CLT inroads into housing have thus far been minor.

Readers of Groundswell well appreciate the true nature of the problem. I often describe the dynamics this way: Where land markets are concerned, price is not an effective market clearing mechanism. If we look at the component parts of the housing affordability equation—and break down housing costs into land, labor and materials—what we see can be represented in the supply-demand graphs economics professors like to draw on the classroom boards. The supply curves for labor and materials lean to the right, meaning that as the price others are willing to pay for them goes up so does the supply (all other things being equal). The supply curve for credit also leans to the right (although the way the credit markets have evolved to globally move credit from where there is more than enough to where there is less than enough has meant that almost as much credit is available at lower rates of return as at higher rates of return in the U.S., which has returned to its pre-OPEC status as the "safe harbor" for investing surplus financial reserves). But, the supply curve for parcels of land leans to the left, meaning that as the price people are willing to pay for land rises the supply offered tends to fall. The reason, of course, is that every parcel of land has a rental value in the market. This rental value accrues to owners of land as imputed income. To the extent this imputed income is left untaxed, the untaxed amount is capitalized into a selling price. The lower the annual tax on imputed income in the face of rising demand for parcels of land, the easier it is for owners to hold land off the market in anticipation of buyers willing to pay even more.

We need to brace ourselves for the next land market-led downturn. Where will it occur? Look to where land prices are rising the fastest — in places such as California' Silicon Valley. Housing affordability is already severely stressed. Land costs are so high that businesses are looking elsewhere when they need to expand and may begin to downsize their work forces in Silicon Valley in order to lower the cost of doing business and compete internationally. When the median price of housing hits $300,000, then $500,000, employers must be willing to pay enormous salaries in order to attract talented workers. At some point these salaries cannot be sustained, the lease payments for office space become too onerous and the costs cannot be passed on (or absorbed by increases in productivity). The first signs of weakness in the regional economy is a higher vacancy rate in newly constructed office buildings and an increasing number of defaults on bank loans. The softened commercial real estate market tends to have a domino effect in a softening of the residential real estate market. The last significant crash occurred just a few years ago in the Los Angeles area (as high land costs drove employers and residents to Nevada, Portland and Seattle). Before that—from 1988 until around 1993, Boston and other parts of New England were hit. And, before that the Southeast. And, before that Texas and the Oil Belt; And, before that...