Fiscal Federalism and Middle-Income Housing Subsidies

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When only one in four low-income households receives a rent subsidy from the federal government, it seems patently unfair to spend scarce federal housing dollars to support households with higher incomes. Although moderate- and middle-income households increasingly struggle to pay their housing costs, their burdens are far less extreme. Consider that, across the country in 2013, 36 percent of low-income renter households (those earning less than 80 percent of the Area Median Income [AMI]) and 62 percent of extremely low-income renter households (those earning less than 30 percent of AMI) paid more than one-half of their incomes on rent. Meanwhile, only 2.4 percent of renters earning between 80 and 120 percent of AMI paid more than one-half of their incomes on rent (Steffen et al., 2015). Further, even when paying the same share of their incomes on rent, moderate- and middle-income households enjoy significantly higher residual incomes than their lower-income counterparts.

In addition to the differences in needs, moderate- and middle-income households are far more likely than low-income households to own their homes and receive federal homeownership tax benefits. Whereas the benefits of the mortgage interest deduction accrue disproportionately to high-income households, about one in five households earning between $50,000 and $75,000 claimed the mortgage interest deduction in 2014 and received about $4 billion in benefits. Households earning less than $30,000, by contrast, received less than $200 million from the mortgage interest deduction, despite filing nearly three times as many returns (JCT, 2014).

Thus, it is hard to argue for spending long-term federal housing subsidies on anyone but those most in need, although some tapering is prudent so households are not cut off of assistance as soon as their incomes rise. That said, we might arrive at a different answer when considering short-term, emergency assistance that enables moderate- and middle-income households to stay in their homes when they hit a bump in the road, such as a job loss or an unexpected medical bill. Such assistance would be necessarily short term and would not drain many resources away from other, more needy households. Plus, the marginal benefit of such assistance would be enormous, saving families from evictions and even potentially homelessness, which could destabilize their lives.

We might also arrive at a different answer when considering whether potential justifications exist for *local* governments to use *local* resources (for example, local subsidies, density bonuses, and property tax breaks) to support housing targeted to these higher-income households.

First, local governments have an interest in revitalizing distressed neighborhoods, and attracting moderate-income as well as low-income households will likely aid such revitalization. Research has documented that New York City's investments in neighborhoods marked by abandonment during the 1970s helped to breathe new life into these communities, through repopulating streets with stable residents, constructing attractive new buildings, and removing pockets of blight that can discourage other private investment (Schill et al., 2002). The housing supported by the city's programs explicitly targeted households earning a range of incomes, from extremely low-income households to those earning up to 165 percent of AMI.

Second, and more generally, supporting housing for moderate-income households may be crucial for the economic development and long-run growth of cities. Many cities around the country have seen a hollowing out of the middle of the income distribution (Capperis et al., 2014). In this environment, city leaders might want to retain the moderate-income workers who educate our children, keep our streets safe, take care of us in hospitals, and produce the art and cultural vitality that make cities so exciting. Moderate-income workers are also essential to a city's private businesses, which depend on a diversity of workers.[1]

Third, considerable research shows that firms in larger and denser cities with more diverse economic activity are more productive, and more housing, serving a range of incomes, is key to enabling that density and diversity (Glaeser, 2011; Kolko, 2010; Quigley, 1998). Because the agglomerations of businesses in cities help to fuel growth in metropolitan areas as well, states might also have an interest in supporting such subsidies.

Finally, subsidizing housing for low-income households is expensive and would likely require higher local taxes (in addition to any land use changes). Raising taxes to support redistributive programs can be a tricky business for local governments, as higher taxes may prompt higher-income households and businesses to relocate to lower-tax jurisdictions.

Thus, cities have good reasons to provide housing support to moderate-income households, to ensure economic diversity in individual neighborhoods and in the city as a whole. This incentive is all the more true given the growing affordability strains that these households face in high-cost, growing cities. Consider that between 2000 and 2012, the share of New York City renters with incomes between 80 and 120 percent of AMI who paid more than 30 percent of their income on rent rose from 14 to 30 percent (Capperis et al., 2014).

In short, given the enormous unmet needs, I would reframe the question to be whether *any* circumstances exist in which public dollars should be used to subsidize the housing costs of moderate-income households. The answer to that question is yes, in the case of time-limited subsidies, and yes, for local governments, to the extent that subsidies for middle-income households help to preserve economic diversity and advance local economic growth.

[1] Although workers can potentially commute from more affordable areas beyond city limits, such long commutes may not be sustainable.

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