



Comprehensive rental housing policy promotes outcomes that result in improved opportunities for children.

Farmworker Housing Development Corporation

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## Informing the Next Generation of Rental Housing Policy

Falling home prices, tightened credit markets, and record foreclosures have forced many Americans to reconsider what has long been considered a hallmark of the American dream: homeownership. Partly as a result, an ever-increasing number of renters are facing a shortage of decent, safe, and affordable homes. Yet, not since the 2008 publication of *Revisiting Rental Housing* — before foreclosures reached their peak — have we examined our national rental policy.

The housing crisis is not the only impetus for such a national reckoning.

Derek R.B. Douglas, a special assistant to the president who serves on the White House Domestic Policy Council and leads an interagency rental policy working group, reflected:

It is not just homeowners who are struggling in the economy; a third of the population rents. We need to start the conversation, and the thinking, about what we can do at the federal level, and what can be done by the state, local, and private sectors to support those renters who are now looking for affordable housing options, or having trouble making

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## Message from the Assistant Secretary

We are at a critical juncture for expanding housing choices. The financial crisis made clear that aggressively pursuing universal homeownership does not always result in the American dream. The loss of wealth — Americans lost \$6 trillion in home equity over the course of the crisis — and the ongoing distress — more than one in five mortgages are in a negative equity position — show that “ownership at any cost” is not a winning strategy. Although there has been much focus on the difficulties in the ownership market, significant stresses also exist for America’s renters. Half of all renters currently spend more than a third of their income on housing. And according to HUD’s *Worst Case Housing Needs 2009: A Report to Congress*, there has been a 20 percent increase in renters experiencing worst case needs — very low-income renters without government housing assistance spending more than half of their income on rent or living in severely inadequate

conditions, or both — from 2007 to 2009. This increase in rent burden has been driven, in part, by the ownership crisis and the job loss associated with the deep recession. These current problems are compounded by the fact that demand for rental housing will likely rise substantially in this decade due to a rapidly expanding senior population.

Because of these economic and demographic changes, we need robust, deeply engaged debates to leverage these current challenges so that we can develop a long-term housing policy agenda. We have a once-in-a-generation opportunity to re-imagine the role that housing plays in our lives — and the role that government plays in housing.

That’s why HUD partnered with the White House to hold the Next Generation Housing Policy Conference (described in this issue), where prominent housing experts outlined proposals for improving life outcomes for children through housing, addressing financial challenges to rental housing, and breaking down silos in the American social safety net, among other topics. Larry Summers, former director of the National Economic Council, noted in his keynote address to the conference that economic realities require that rental housing be supported equitably by federal housing policy. Because of fundamental labor market shifts, the average American may hold as many as 11 jobs over the course of a lifetime, and the need for mobility may make leasing more attractive than owning. But even beyond this, Summers observed that a simple imperative drives us to rethink rental housing policy; renting is not unique to any single demographic. We are all renters at some point in our lives.

The conference was a strong step toward envisioning the future of our rental housing policy. HUD continues this interagency effort on an ongoing basis as partners in the White House Domestic Policy Council’s Rental Policy Working Group. We’re also considering a variety of proposals to recognize subsidized rental housing’s potential to connect families to opportunity and choice, including supporting an income averaging proposal for properties that use the Low Income Housing Tax Credit to ensure that the credit reaches very low-income households, using housing as a platform for delivering supporting services, and incentivizing employment through efforts like our Family Self-Sufficiency Program. At HUD, we must help ensure that a flow of market-rate capital is available to meet the rising demand for rental homes and to keep those homes affordable for the families who need them. The Federal Housing Administration Office of Multifamily Housing Programs has successfully stepped up to play a stronger role in this marketplace.

Affordable rental housing is a critical part of our nation’s housing supply, and that’s why we’ve made it the subject of this issue of *Evidence Matters*. As we continue to respond to current challenges in the housing market, we will promote evidence-based policies that respond to different market types, housing forms, and modes of being housed (that is, renting or owning, which academics refer to as “tenure”). We will look outside the federal government for solutions and leverage the efforts of private enterprise, nonprofits, and state and local governments to remove barriers and create opportunities for the preservation and creation of affordable rental homes. Together, we can seize this uncertain moment and create a stronger, more balanced housing policy.

— Raphael Bostic, *Assistant Secretary for Policy Development and Research*



## Editor's Note

In this issue, we aim to reflect the role rental housing policy plays in housing and community development. In America, rental homes shelter people across the age continuum. The lead story, “Informing the Next Generation of Rental Housing Policy,” focuses on how affordable rental homes can improve life outcomes, particularly for children, families, and the homeless. Evidence shows that poverty and the stresses it creates can have lasting impacts on the ability of children to learn and of families to build resources, and HUD is committed to linking affordable housing in neighborhoods of opportunity with other supports that can enhance the life chances of children.

Rental homes are also a platform for community and economic development at multiple scales. In this issue, we examine rental housing market dynamics, the role of banks in financing affordable housing, and the debate over a key piece of housing tax policy. “A Spotlight on Rental

Market Research” sheds light on current rental conditions broadly and challenges prevailing assumptions about the size and scale of the rental stock and the availability of affordable rental homes. “Multibank Consortia Sustain Communities by Advancing Affordable Rental Housing” highlights the key role of partnerships between banks in creating and preserving affordable rental homes, often without government subsidy. And finally, we are honored to have three prominent economists, Edward Glaeser, David Crowe, and Todd Sinai, present their perspectives on the mortgage interest deduction.

I hope you enjoy our second issue of *Evidence Matters*. Your opinion is important to us, so please provide your feedback at [www.huduser.org/forums](http://www.huduser.org/forums).

— Erika C. Poethig, *Deputy Assistant Secretary for Policy Development*

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rents, or living in communities where rental prices are going up, as more people who were homeowners move into the rental markets.<sup>1</sup>

To that end, in October 2010 the White House, along with the Departments of Housing and Urban Development, Treasury, and Agriculture, invited leading thinkers and practitioners to discuss next-generation rental policy. More than a dozen experts from the nonprofit, development, financial, and academic worlds offered budget-neutral policy initiatives under three different rubrics: rental housing and low-income households, the relationship between rental housing and neighborhoods, and the financial and regulatory barriers inherent to the industry. These research- and experience-based visions offered ways to ensure equitable housing choices and options for as many Americans as possible. Presenter Rosanne Haggerty, MacArthur Fellow and founder and president of Common Ground, a nonprofit committed to ending homelessness, praised these “well-honed, proven ideas, which ought to be replicated, and ought to be shaping

## Highlights

- Rental housing is a platform through which better outcomes for children can be delivered.
- Because net worth is a key predictor of long-term educational attainment, asset building among low- and middle-income families is necessary to increase college attendance rates, economic mobility, and net worth of the next generation.
- A balanced housing policy that utilizes interagency collaboration is key to establishing effective supportive housing.

opportunities for decent housing in all parts of the country.”

Some of the more ambitious proposals positioned rental housing as a basis for achieving such broad mandates as better outcomes for children, asset-building for low-income families, and the means to end chronic homelessness. Julia Stasch, vice president for U.S. programs at the MacArthur Foundation, a cosponsor of the conference, commended such suggestions, which “enhance the positive role that rental housing can play in promoting outcomes across a whole array of domains — good schools, better outcomes for kids, better neighborhood conditions. It has not been easy to see housing, and

even more narrowly rental housing, in these other positive outcomes.” Stasch also praised the commitment to interagency cooperation and collaboration evidenced by the presenters and the administration alike. The conference, she said, demonstrates the “administration’s continued efforts to press for a less-siloed type of thinking,” and for “more cross-function, cross-agency problem solving.”

## The Platform That Delivers: Rental Housing + Children

Nancy O. Andrews, president of the Low Income Investment Fund, was one of several presenters to propose using rental housing as a platform for creating better outcomes for children of

low-income families. Specifically, she envisioned a “children’s healthy start voucher” that would link affordable housing to an array of early interventions: prenatal nutritional support; quality early childcare; community health care; replications of the family nurse visitation program, which trains caregivers to parent effectively; and quality schools.

Evidence exists for the efficacy of many of the services included in the proposed voucher. Research suggests that nutritional support programs such as the Special Supplemental Nutrition Program for Women, Infants, and Children, as well as increases in family income in the early childhood years, have more long-term effects than similar initiatives aimed at adults. Likewise, studies and experiments “have shown long-term



A “children’s healthy start voucher” would link affordable housing to early interventions such as quality early childcare.

effects — effects into adulthood — of high-quality early childhood education,” said Jeanne Brooks-Gunn, a social scientist at Columbia University Teachers College. Finally, each early intervention initiative “saves government spending later” on remedial programs, criminal justice, unemployment, and welfare, said Tama Leventhal, assistant professor of child development at Tufts University.

Cornell professor Gary Evans’ 17-year longitudinal study, which suggests that the stresses of poverty pose a serious

threat to children’s brain development, inspired Andrews to conceive the idea of rental housing as the delivery platform for a healthy start voucher. Evans’ research, said Andrews, shows that the high stresses of poverty on children “actually create physical impairments in child brain formation. In other words, poverty poisons children’s brains.”<sup>2</sup> Specifically, Evans demonstrated that these stresses inhibit executive function and working memory, the parts of the brain used in learning. Making matters worse is that the diminished function appears to be long lasting, perhaps permanent. The key point, said Andrews, is that the findings showed these mental impairments to be “the consequences of stress from poverty, and poverty alone.”

According to Andrews, Evans’ research is significant because it puts the results of the Moving to Opportunity experiment and Welfare to Work housing studies in a new light. Those two studies showed that families who moved to higher-opportunity neighborhoods experienced reductions in stress-related problems, including anxiety disorders, obesity, and depression. In the past, the results seemed disappointing “because we’d hoped for income and economic mobility.... But with Evans’ research on the impairment in child brain development, the importance of housing affordability and safe, quality communities came into sharp relief,” she said. “I began to see the connections among housing, community, and human potential.” When implemented together, the services embedded in her voucher concept will counteract the stresses on children’s brains and the resultant deficits. As a result, Andrews believes that lower-income children will enter kindergarten ready to learn, which may help diminish the achievement gap over the long term.

### Asset-Building Among Low- and Middle-Income Families

Over the past few decades, income disparity in the United States has widened — in fiscal year 2006–2007, 61.4 percent of all earned income went to the

top 20 percent of earners. Distressing as those numbers may be, the distribution of assets is far more unequal; during that same period, 85 percent of total net worth belonged to the top 20 percent of wealth holders. The disparity is even greater between white households and communities of color; according to Brandeis University’s Institute on Assets and Social Policy, African-American households have only 10 cents for every dollar of net worth in a white household. Even more striking, according to Andrea Levere, president of the Corporation for Economic Development, 22.5 percent of families would not be able to survive for 3 months at the poverty level if their main source of income were disrupted.<sup>3</sup> Notably, the data used to compute this statistic were collected *before* the current economic crisis, she said.

Although it may not seem as critical as quality childcare or education, research shows that net worth is a key predictor of long-term educational attainment. According to Youngmi Kim and Michael Sherraden, “Parental net worth has a significant effect on total years of schooling, post-high school years of schooling, and college attendance.”<sup>4</sup> For instance, a 2003 study that used data from the National Survey of Families and Households determined that savings of \$3,000 or more positively affected children’s high school graduation rates.<sup>5</sup> Net worth and nonliquid assets also affect whether parents can take out loans to support their children’s college attendance. Even when other factors are taken into account — parental involvement in children’s education, for example — net worth remains critical.<sup>6</sup>

Net worth, and its impact on educational attainment, appears even more significant in light of the link between a college degree and average income. Studies show, for example, that the average income for a person holding a college degree (\$58,613) is nearly double that of a person without one (\$31,283). In that way, the relationship among net worth, college attendance, and economic

mobility is cyclical; parental net worth exerts a major influence on whether one attends college, and college attendance affects parental net worth for the next generation.<sup>7</sup>

To help build assets among the 4 million people receiving rental assistance and the 8 million families who spend more than half their income on rent and utilities, Levere proposed embedding asset-building strategies within rental housing. In her vision, these strategies will complement other poverty-alleviation and social services already in place.



Farmworker Housing Development Corporation

Asset-building strategies for renters, such as credits for helping to manage a property or reducing energy consumption, can help families secure their financial future.

“There’s no silver bullet to ending poverty or to building economic security,” she said. “We need multiple strategies that work together...to really help a household succeed financially.” First, she proposed creating opportunities for renters to build assets through positive behaviors: contributing to a building’s maintenance, paying rent on time, helping to manage properties, and reducing energy usage for individually metered apartments. These activities would be rewarded with credits, convertible to

cash, that are deposited in savings accounts. Residents who receive financial counseling can borrow against these credits. They are advised to use the loans for asset-building investments, including education, debt reduction, homeownership, and launching a business.

Levere’s proposal, inspired by the Cornerstone Renter Equity program, has a bonus: it encourages buy-in among tenants of rental properties. In other words, and in addition to the tangible assets that her proposal can build, Levere’s vision engenders “a sense of pride and quasi-ownership in a multifamily building” — qualitative assets that are difficult to quantify but highly important to quality of life.

To enact such programs on a large scale, Levere envisions making use of appropriate HUD resources, specifically Sustainable Communities Initiative, Community Development Block Grant, and HOME Investment Partnerships funds. She added that rebalancing America’s expenditures on asset building so that they more equitably provide for low- and middle-income families would create further funding opportunities. For instance, nearly half of the \$400 billion spent on asset-building programs in 2009 — for retirement, small-business loans, making college tuition affordable, and homebuying — went to the top 5 percent of taxpayers. That disproportionate figure, Levere said, demonstrates the need to repurpose “those investments to help low- and moderate-income families build assets.”

Finally, Levere suggested expanding the Family Self-Sufficiency program. Typically, an applicant for subsidized housing must meet income limits and cannot have more than \$2,000 to \$3,000 in assets. These requirements essentially mean that one cannot have a savings account or even a car, said Levere. Income limits also discourage people from earning more money, because doing so will force them to leave their subsidized rental homes. Levere explained that these constraints

unintentionally conspire to inhibit economic mobility. But the Family Self-Sufficiency program makes it possible for people to stay in subsidized housing as their income rises and bank those extra funds in escrow accounts. Those accrued savings ultimately enable residents to put a downpayment on a house or a deposit on a market-rate apartment. As a result, people are encouraged and enabled to move out of subsidized housing, freeing up apartments for others who need them. The most recent report on the Family Self-Sufficiency program found that the 24 percent of participants who had graduated from the program by the end of the study period received an average escrow balance of about \$5,300, more than twice the average escrow account balances for the 37 percent of participants who exited the program before graduating, forfeiting their escrow.<sup>8</sup>

## Interagency Collaboration for Effective Supportive Housing

Like Levere and Andrews, Common Ground’s Haggerty envisions using housing as the means to provide a range of social services. Specifically, she proposes blending nine different housing and services programs to create long-term supportive housing with the ultimate goal of ending long-term homelessness. To do so, Haggerty explained, mental health, health care, and other programs would share risk and pool their resources.<sup>9</sup> “If you can get those services tied to the places where people live, the evidence of the effectiveness of supportive housing is overwhelming,” she said. “It’s not just effective in that vulnerable people don’t lose their homes; it’s far more cost-effective than letting people linger on the streets or in institutions, whether it’s hospitals or shelters or other types of institutions.”

As evidence for the efficacy of supportive housing, Haggerty points to a recent 3-year study of 1811 Eastlake, a supportive housing development for homeless alcoholics in Seattle. That research, funded by the Substance Abuse Policy Research Program of the Robert

Wood Johnson Foundation, found that the development saved taxpayers more than \$4 million in its first year — funds that would otherwise have gone toward emergency care, the criminal justice system, and other services. Remarkably, the development realized cost savings in the first 6 months of its existence, even after taking into account the costs of administering housing for its 95 residents.<sup>10</sup> Haggerty also cited research by Dennis Culhane, a professor at the University of Pennsylvania, that compared the costs of housing a homeless person with the systemic costs of homelessness (costs borne by hospitals, law enforcement, and other crisis services). That study, she said, showed that the costs of housing a homeless person for one year were nearly the same as the systemic costs of the individual remaining homeless for a year.<sup>11</sup> These studies complement other research that has shown significant savings to hospitals and the criminal justice system. Supportive housing, Haggerty concluded, is a “basic model that works. Just about everybody succeeds, even people with very challenging histories.”

As a model for how to implement supportive housing, Haggerty points to the New York/New York III Supportive Housing Agreement, signed in November 2005, which will create some 9,000 new units of supportive housing in New York City by 2015. This city-state partnership reaches a broader group of homeless and at-risk persons than its precursors, including chronically homeless families

and young adults aging out of foster care. “One of the elegant things about the New York/New York III agreement... is that it integrates the activities and the resources of 10 different city and state agencies,” Haggerty said. Haggerty believes that its specificity provides a blueprint for how such a proposal might operate on a large scale. “It goes into what amount of money is to be invested by each agency to get clearly articulated results, and who specifically benefits, who has the decision rights, how the process works,” she said. “It’s been remarkable in achieving silo-busting in a practical and implementable way.” To establish the program in other cities, or even on a national scale, conceptually, one need only “substitute different federal agencies and different state agencies” for the New York-specific entities the agreement currently describes.

Although she has focused on its potential to end long-term homelessness, Haggerty added that supportive housing “is an approach to housing that is relevant to so many more people and families than the homeless. All of us at some point are going to need supportive housing — to have options other than nursing homes or being a burden to our kids. Individuals and families are able to lead more stable and productive lives when they have a secure home and the help that they need to manage challenges, whether they be related to health or employment.”<sup>12</sup>

## A Milestone Conference, but Was It Bold Enough?

MacArthur’s Stasch, who calls the conference a “milestone,” praised the administration’s commitment to rental housing. “Simply having high-level administration officials put a spotlight on rental housing was very rewarding,” she said. At the same time, she cautioned that the conference was not meant to signal that “homeownership has lost its luster.” Rather, a more balanced approach signifies that “rental housing is a significant element of our economy. It’s a form of housing arrangement that many,

many people — and most people at some time during their lifetime — take advantage of. Some people do it through choice. But other people do it because that is the only type of housing arrangement that’s available to them.”

Nevertheless, said Stasch, the proposals “could have been even a little bolder and a little more long term. While it’s really hard to get work done in a day-to-day environment, we need to remember that it’s not all about the present. We need to be thinking about the framework for housing policy for the next 20-plus years.” Such an approach, she said, demands an understanding of “how society is changing: how it’s aging, how it’s becoming more diverse, what the impact of technology is, and the globalization of capital. We have to keep pushing ourselves to consider what types of new approaches and priorities are going to be important, not just today and tomorrow, but for the long haul.” *EM*

<sup>1</sup> Interview with Derek R.B. Douglas, January 2011.

<sup>2</sup> Interview with Nancy O. Andrews, January 2011.

<sup>3</sup> Interview with Andrea Levere, March 2011.

<sup>4</sup> Youngmi Kim and Michael Sherraden. 2011. “Do parental assets matter for children’s educational attainment? Evidence from mediation tests,” *Children and Youth Services Review*, 33:6, 969–79.

<sup>5</sup> Trina Williams Shanks, Youngmi Kim, Vernon Loke, and Mesmin Destin. 2009. “Assets and Child Well-Being in Developed Countries,” Working Paper 09–66, Center for Social Development at Washington University in St. Louis.

<sup>6</sup> Kim and Sherraden.

<sup>7</sup> For further evidence of the relationship between net worth and economic mobility, consult the Pew Economic Mobility Project, which showed that among students in the bottom quintile for income, holding a college degree increased the chance of moving up economically.

<sup>8</sup> U.S. Department of Housing and Urban Development, Office of Policy Development and Research. 2011. *Evaluation of the Family Self-Sufficiency Program: Prospective Study*, ix.

<sup>9</sup> Interview with Rosanne Haggerty, March 2011.

<sup>10</sup> Substance Abuse Policy Research Program, “Housing for Homeless Alcoholics Can Reduce Costs to Taxpayers,” press release, 31 March 2009.

<sup>11</sup> Dennis P. Culhane, Stephen Metraux, and Trevor Hadley. 2002. “Public Service Reductions Associated with Placement of Homeless Persons with Severe Mental Illness in Supportive Housing,” University of Pennsylvania School of Social Policy *Departmental Papers*.

<sup>12</sup> In its potentially universal application, Haggerty’s notion of supportive housing echoes the rental housing concept offered by Larry Summers, former director of the National Economic Council, who gave the keynote speech: at some point in our lives, all of us will need rental housing.



Reach CDC; Traci Hill

Multiple support services provide for neighborhoods of opportunity.

## A Spotlight on Rental Market Research

During his presentation at the White House’s Next Generation Housing Policy Conference, University of Southern California economist Richard Green suggested that rental housing might need to be “rebranded” — that “rent” carries a negative connotation and should be replaced with an alternative term such as “leased housing.” His comment underscores a broader issue about perceptions and misconceptions surrounding rental housing. For example, in policy circles and in the public consciousness, rental housing, and affordable housing in particular, often evokes images of towering multifamily structures, when in fact such projects make up only about one-tenth of the rental housing stock.

### Defining Rental Housing

Rental housing is defined by tenure choice, not structure type. Rental housing units are available in a variety of structures, from detached single-family homes to large multifamily buildings. Real estate underwriting has driven the definition of “single-family” properties as one- to four-unit buildings and “multifamily” properties as projects of five or more units. Although most multifamily properties are rental housing, small single-family properties make up roughly half of all rental housing. About 30 percent of rental units are a part of developments larger than 50 units, and only 12 percent of rental units are in structures larger than 50 units. Cumulatively, single-family properties (1 to 4 units) and small rental properties (5 to 49 units) account for nearly 70 percent of all rental units. Therefore, policies tailored to massive multifamily developments will affect only a portion of the rental stock.

## Highlights

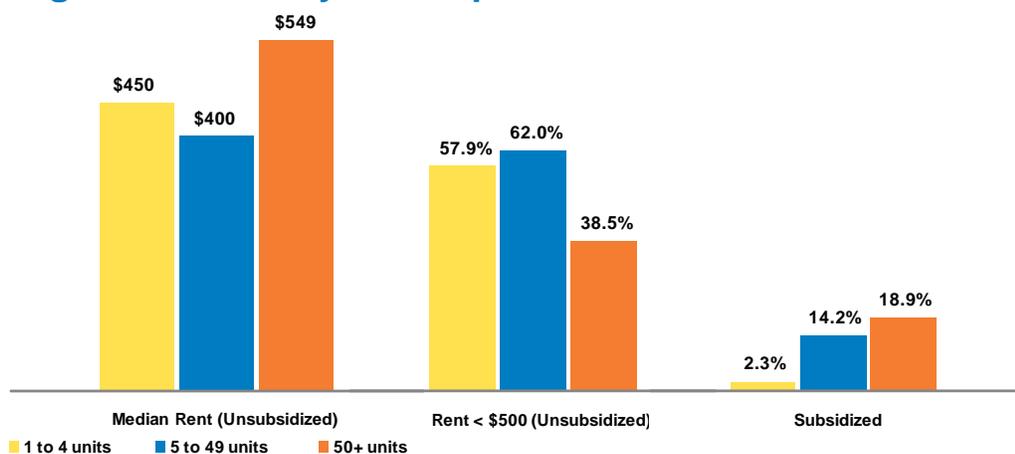
- Although most multifamily properties are rentals, small single-family properties make up roughly half of the rental housing stock.
- Housing is the largest expense for the majority of low-income households, 70 percent of whom rent. In 2009 there were 10 million extremely low-income renter households, and only 3.6 million units were affordable and available to them.
- Local market nuances — including population change, economic growth, demographics, and regulatory and geographic constraints on new construction — cause significant regional variation in the demand for, and availability of, affordable rental homes.

In the same way that rental housing is conflated with multifamily housing, affordable housing is frequently assumed to be subsidized housing. Although many of the most affordable rental units are subsidized, most units that are affordable to a household earning 50 percent of the area median income (AMI) are not subsidized. Precise measurement of rental assistance in census data is difficult, but evidence from the American Housing Survey suggests that, of the 17 million rental units affordable to households at 50 percent of AMI, only about 5 million units, or approximately 30 percent, are subsidized. In urban areas, this unassisted affordable stock tends to be older, smaller properties located in low-income neighborhoods that are typically owned and operated by “mom and pop” landlords. For years federal housing policy largely ignored small property operators in favor of larger, more standardized multifamily

assets, so local community development financial institutions and bank consortia have stepped in to provide affordable financing for these vital affordable units. (Bank consortia are described in this issue’s *In Practice*, page 11.) These small properties have lower median rents and higher shares of affordable units than larger buildings (fig. 1), making them a critical source of adequate, affordable units to low-income renters who do not receive rental assistance. Because of their age and location, these buildings operate at modest rents, which benefit low-income tenants but jeopardize the long-term financial viability of the properties, and their accumulating unmet maintenance needs eventually result in high loss rates.<sup>1</sup> Preserving these structures is an important element of a broader strategy to ensure quality, affordable rental homes for low-income Americans, but it is not a substitute for basic rental assistance.

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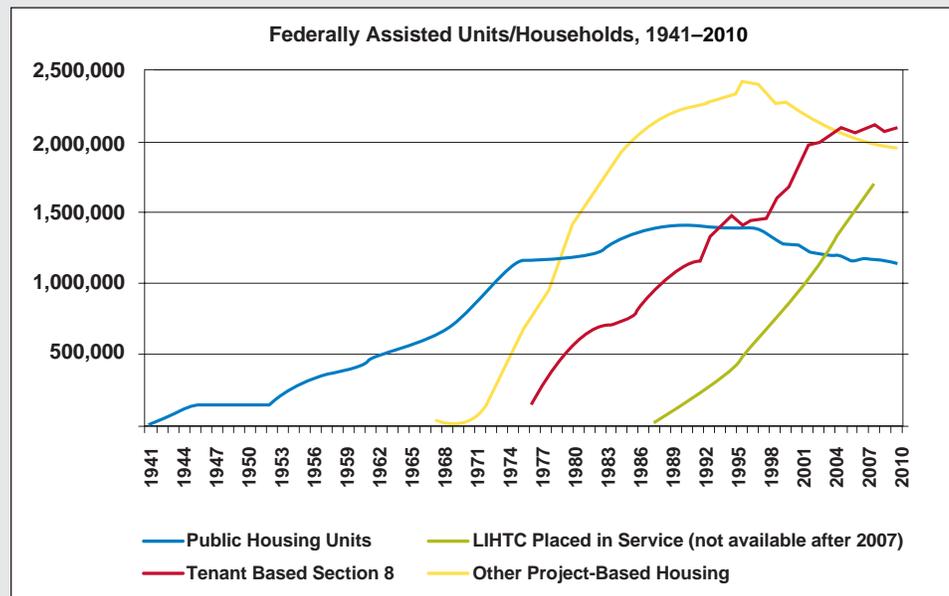
Figure 1: Rents by Development Size



Source: U.S. Department of Housing and Urban Development, Office of Policy Development and Research Tabulations of HUD Residential Finance Survey, 2001

## Federal Involvement in Rental Housing Markets

Government involvement in the nation's rental housing markets began in earnest in the early 1940s with the implementation of the Housing Act of 1937, which authorized the construction of the nation's first public housing. Initially, public housing construction was intended as a Depression-era stimulus. Construction of public housing accelerated from the 1940s to the 1960s to address postwar housing shortages, raze slums as part of urban renewal strategies, and improve housing quality for the poor. However, by the late 1970s conditions in public housing had deteriorated rapidly, with many developments transforming into dense concentrations of impoverished, exclusively minority families surrounded by drugs and violence amidst a crumbling, neglected housing stock.



Public housing became a highly visible target for critics of the social welfare programs of the late 1960s. Following a moratorium on HUD programs in the early 1970s, several new rental assistance programs were introduced in the late 1970s that favored private-sector involvement through project-based contracts to private landlords or housing vouchers for the private rental market. The Tax Reform Act of 1986 dramatically changed the landscape for multifamily rental housing. It lengthened the depreciation schedule for rental housing — reducing the tax benefits of rental housing investment — but it also created the Low Income Housing Tax Credit (LIHTC) program, a tax credit to stimulate private investment in affordable housing projects.

Through the 1990s and 2000s, the tenant-based Housing Choice Voucher program (formerly Section 8) grew to become the largest rental assistance program in the country, and the LIHTC became the primary affordable rental housing production tool (see fig.). Housing vouchers have been favored as a tool to enable mobility to deconcentrate poverty, whereas the LIHTC has been effective at attracting private capital. The introduction of private capital has created stronger asset management through additional oversight from investors and syndicators concerned with compliance and from lenders focused on ensuring proper repayment. LIHTC has created and preserved a large number of high-quality, affordable units but cannot affordably serve the lowest-income housing without additional subsidy sources and may produce near-market-rate housing in softer, low-cost markets.

Today the largest federal rental housing program remains the Housing Choice Voucher program, but cumulatively, project-based subsidy programs (including public housing and project-based Section 8) are larger in both unit counts and budget authority. Most project-based inventory is now more than 40 years old and requires substantial capital infusion to remain viable. A 2010 HUD-funded study by Abt Associates estimated a capital backlog in public housing inventory of more than \$30 billion.<sup>1</sup> Recognizing that this backlog will likely never be adequately covered through appropriations, HUD has made one of its signature initiatives the conversion of public housing contracts to a more flexible rental assistance subsidy that would allow housing authorities to leverage private capital for the physical improvements needed to preserve existing inventory. Although this model is still untested, HUD asserts that it would bring public housing and other smaller programs in line with modern affordable housing finance.

<sup>1</sup> U.S. Department of Housing and Urban Development, Office of Public and Indian Housing. *Capital Needs in the Public Housing Program*, forthcoming in May 2011.

## Rental Affordability Dynamics

More than 70 percent of HUD’s budget is devoted to some form of rental housing assistance. This assistance prevents homelessness, ensures safe and decent housing, and enables the poor to move to high-opportunity neighborhoods by easing the burden of high housing costs. Rental housing affordability is the most widespread and measurable housing problem that HUD programs address.

No consensus exists on how best to measure rental housing affordability, but the approach that many government officials, researchers, advocates, mortgage lenders, and property managers have adopted has been to gauge affordability based on rent-to-income ratios.<sup>2</sup> This method is useful because it aligns with HUD program eligibility rules and allows for relatively easy historical comparisons.

For the past several decades, the affordability “standard” against which a unit is judged has been whether gross rents account for less than 30 percent of the

tenant’s monthly income. HUD’s Office of Policy Development and Research has developed and refined various measures to capture rental housing affordability need. One measure is worst case housing needs, which consists of very low-income renters (those earning less than 50 percent of AMI) who do not receive assistance and who pay more than 50 percent of their income for housing or live in severely inadequate housing, or both. In 2009 the recession drove worst case housing needs to nearly 7.1 million households, the highest level on record in both absolute and percentage terms (fig. 2).<sup>3</sup>

Another metric, which more directly takes into account the availability of the rental stock, is the difference between the numbers of low-income renters and units affordable to those renters. For instance, in 2009 there were 10 million extremely low-income renter households (those earning less than 30 percent of AMI) and just 6.2 million units that were affordable to those households if they were paying no more than 30 percent of their income for housing. Adding the dimension of availability,



Single-family homes represent a significant portion of the rental housing stock.

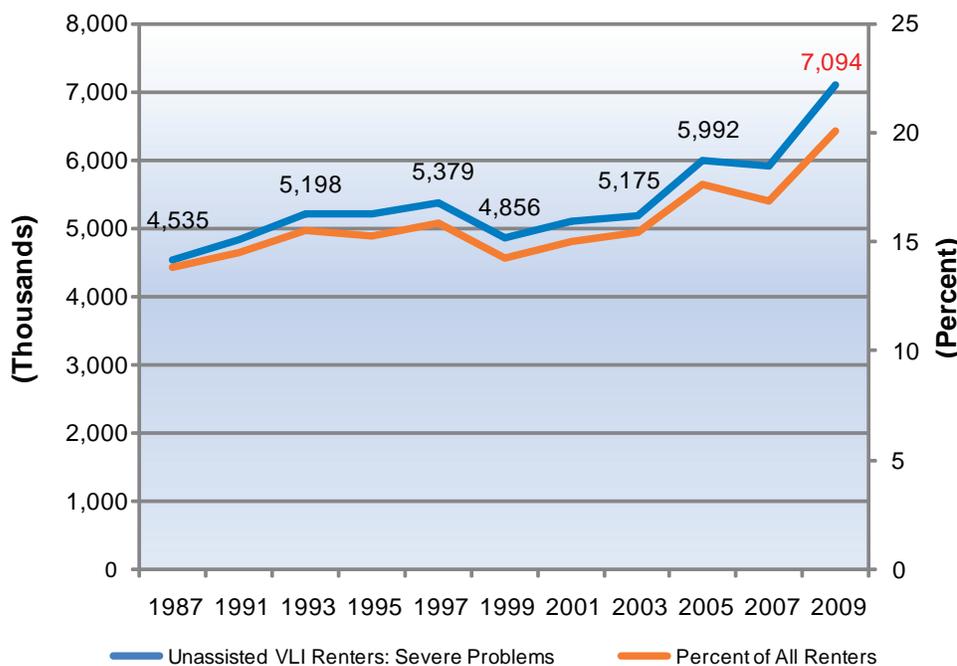
which addresses how higher-income households might outcompete low-income tenants for cheap units, just 3.6 million affordable and available units existed, or just 36 per 100 extremely low-income renters.<sup>4</sup> This gap narrows some for very low-income renters at about 68 affordable and available units per 100 very low-income renters.

## Regional Variation

Because housing markets are inherently local, describing rental housing affordability at the national level misses important local nuances. Some markets have significant regulatory and geographic constraints to new construction, whereas others are relatively unconstrained. Demand for rental housing also varies dramatically depending on the location’s employment growth, immigration, housing prices, and demographics. These factors create frictions in housing markets that often exacerbate rental affordability stresses.

Figure 3 shows how these affordability stresses differ across markets. Renters at 30 percent of AMI face housing cost burdens in nearly every market. Very low-income renters at 50 percent of AMI have few options in high-demand, supply-constrained markets such as Los Angeles and New York, where there are fewer than 50 affordable and available units per 100 renters even at 50 percent of AMI. Markets that have excess housing because of significant population loss, such as Detroit, Buffalo, and Cleveland, are far more affordable for low-income renters above the poverty line, with

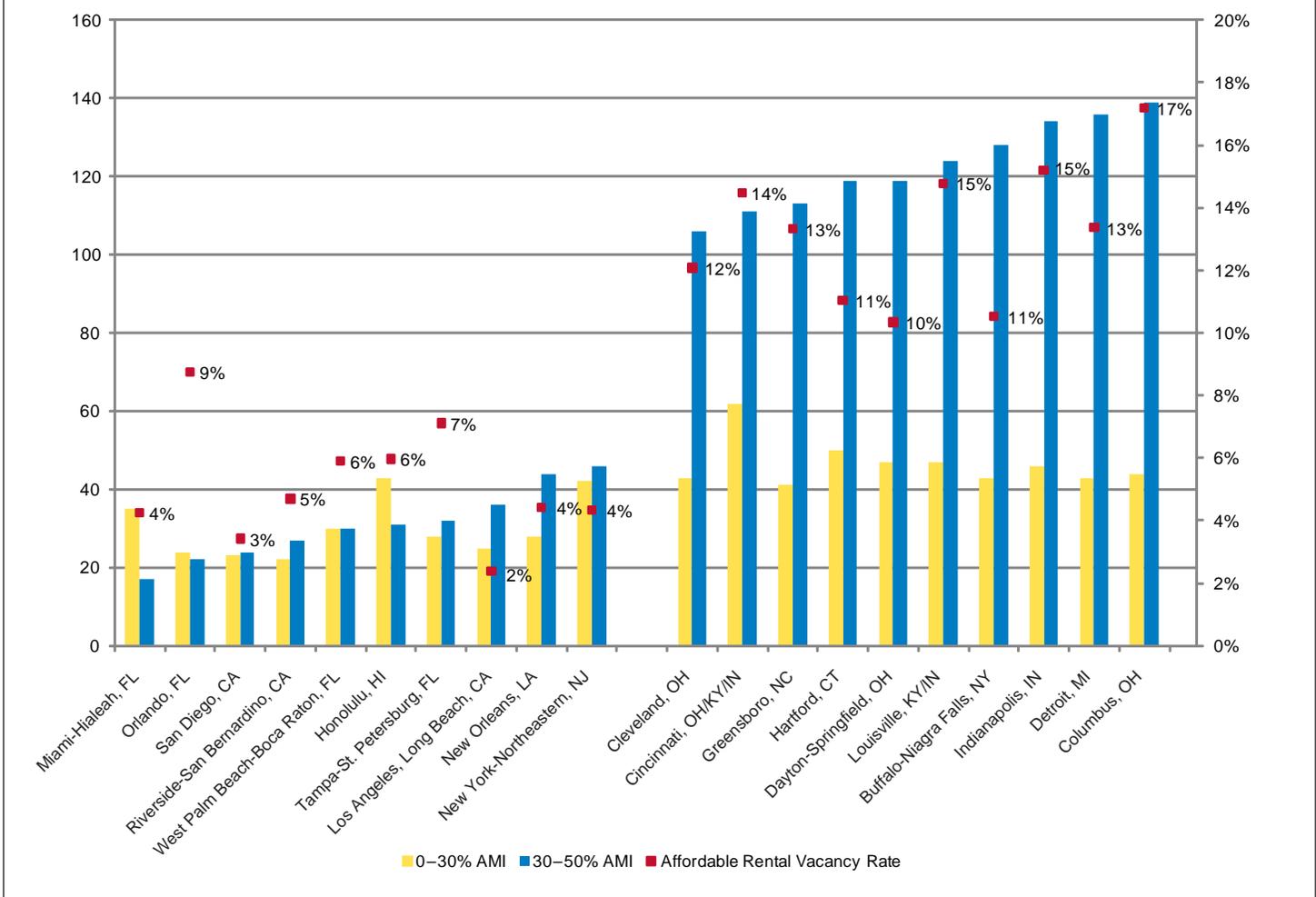
Figure 2: Worst Case Housing Needs: 1987–2009



Severe problems = Paying more than 50% of income for housing, or in severely inadequate housing, or both.

Source: American Housing Survey, 1987–2009

Figure 3: Affordable and Available Units Per 100 Renters



more than 100 affordable and available units per 100 very low-income renters. These markets have high vacancy rates even in more affordable units (those renting at 50 percent of AMI).<sup>5</sup> Federal housing policy should promote market-sensitive investments with the appropriate mix of rehabilitation activity and new construction so that rental housing policy facilitates balanced, stable markets.

Rental housing policy is of great interest to social policymakers because it is, at its core, low-income housing policy. Nearly 70 percent of the country's poor live in rental housing, and housing is the single largest expense for nearly all of them. High housing costs reduce discretionary income, create housing instability that can lead to homelessness, and deter households from locating in neighborhoods of opportunity. In the HUD-funded Abt Associates study *Effects of Housing Vouchers on Welfare Families*,

the most rigorous research to date on the effects of rental assistance, providing rental assistance to poor families is shown to reduce street homelessness and doubling up and to move families to less-segregated neighborhoods with reduced poverty, unemployment, and number of people receiving public assistance.<sup>6</sup> Housing assistance remains an attractive vehicle to improve the material well-being of the poor because housing is such a sizeable expense. However, although evidence is somewhat mixed, rental housing assistance receipt has been shown to have a modest negative earnings effect, which typically dissipates over time. In contrast, other income supports, such as the Earned Income Tax Credit (EITC), have positive employment effects.<sup>7</sup> Whether cash transfers such as the EITC are a complement or substitute for rental assistance is part of a broader debate about how to best assist poor households. **EM**

<sup>1</sup> William Apgar and Shekar Narasimhan. 2006. "Enhancing Access to Capital for Smaller Unsubsidized Multifamily Rental Properties." Prepared for the Revisiting Rental Housing: A National Policy Summit, Cambridge, MA.

<sup>2</sup> Some academics have criticized this approach, offering alternatives based on the divergence of price and marginal cost or residual income (assessing affordability change based on changes in real income after housing expenses).

<sup>3</sup> U.S. Department of Housing and Urban Development, Office of Policy Development and Research. 2011. *Worst Case Housing Needs 2009: A Report to Congress*.

<sup>4</sup> Unpublished tabulations of 2009 American Housing Survey data by the U.S. Department of Housing and Urban Development, Office of Policy Development and Research.

<sup>5</sup> Unpublished tabulations of 2009 American Community Survey Public Use Microdata Sample (PUMS) data by the U.S. Department of Housing and Urban Development, Office of Policy Development and Research.

<sup>6</sup> U.S. Department of Housing and Urban Development, Office of Policy Development and Research. 2006. *Effects of Housing Vouchers on Welfare Families*.

<sup>7</sup> Ibid; Brian A. Jacob and Jens Ludwig. 2008. "The Effects of Housing Assistance on Labor Supply: Evidence from a Voucher Lottery," Working Paper 14570, National Bureau of Economic Research; Deven Carlson, Robert Haveman, Tom Kaplan, and Barbara Wolfe. 2009. "Long-Term Effects of Public Low-Income Housing Vouchers on Labor Market Outcomes," Discussion Paper 1363-09, Institute for Research on Poverty.

# Multibank Consortia Sustain Communities by Advancing Affordable Rental Housing

*Housing stability is a crucial foundation for job stability. When I was at Portland Habitat for Humanity, I saw firsthand how having a place to call home helps families to thrive. While homeownership is important, affordable rental homes are also essential. Private capital has an essential role in the development and preservation of affordable housing. In Oregon, the Network for Oregon Affordable Housing brings together member banks with capital and its in-house technical expertise to underwrite development deals to bring affordable housing to all regions of Oregon. NOAH serves as a great model that other states would do well to emulate.*

— Senator Jeff Merkley (D-Oregon)

Private dollars are helping alleviate the shortage of quality, affordable rental housing, especially in the burgeoning field of community development finance, in which bankers form partnerships to finance community development activities. Among the important players in this field are multibank consortia, which pool their funds to finance affordable multifamily housing. With the advent of the federal Low Income Housing Tax Credit (LIHTC) program in 1986, commercial banks accustomed to working primarily with short-term capital were asked to provide long-term capital,

## Multibank Consortia and Affordable Housing

Guided by the principle that banks do well when their communities do well, banks form consortia so that community development investments, at lower cost and risk, can be tailored to meet local needs such as affordable rental housing while also meeting the requirements of the Community Reinvestment Act of 1977 (CRA). CRA charges national banks to provide ongoing deposit and credit services and to meet continuing credit needs of the communities in which they are chartered to do business. Federal

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**Banks do well when their communities do well. Banks form consortia so that community development investments, at lower cost and risk, can be tailored to meet local needs such as affordable rental housing.**

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permanent mortgages, and related services to affordable housing projects. In the early 1990s the first multibank consortia formed to address this challenge. The consortia not only share the risk and reduce the cost of lending to any single member but also pool their expertise on behalf of affordable housing in their respective communities.<sup>1</sup>

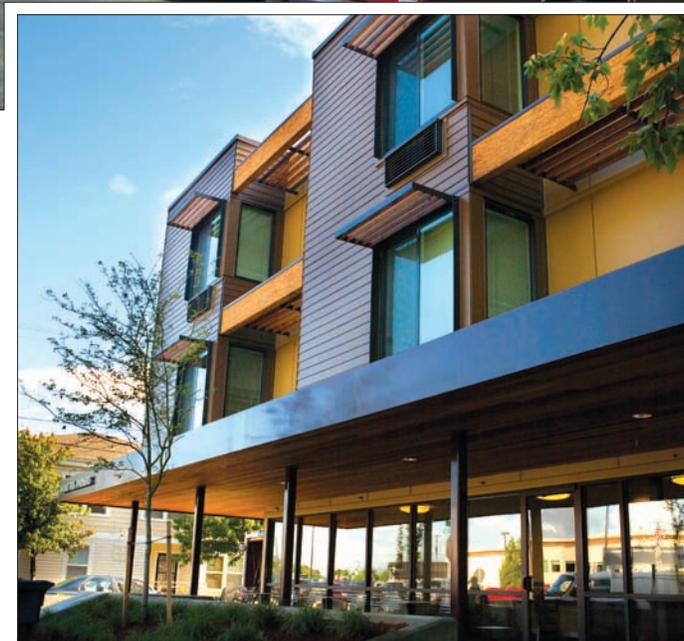
regulators assess each financial institution's compliance with the CRA, and the results are considered if the institution applies to open a branch, merge with another, or become a financial holding company. The performance standards used in the assessments include community development investments and services that are not required but can boost an

- Multibank consortia share the risk, reduce the cost of lending, and pool their expertise to meet the affordable housing development needs of their respective communities.
- As a bank consortium, NOAH uses financing and technical assistance tools to increase housing opportunities for low- and moderate-income households and preserves the state's at-risk stock of affordable housing.
- Implementing affordable housing has a significant, positive impact on local economies that provides jobs, stimulates business, and enhances government revenues.

institution's rating from satisfactory to outstanding. These voluntary community development activities include affordable housing and community services for low- or moderate-income (LMI) people, activities that promote economic development by financing small businesses or small farms, and activities that revitalize or stabilize LMI areas.<sup>2</sup>

Consortia with community development as a primary objective can expand their resources beyond those brought by member banks and investors by qualifying as a Community Development Financial Institution (CDFI), as certified by the U.S. Department of the Treasury. CDFI institutions that provide capital, credit, and financial services in underserved communities can apply for funds to be used for economic revitalization and community development.<sup>3</sup>

Bank consortia can be flexible in their approach to community development activity so long as it profits the public and is inclusive of LMI members of the community. The Office of the Comptroller of the Currency explains that community development investments by consortia might include forming community development corporations or partnerships with community-based



Before (top) and after pictures of Walnut Park illustrate the result of NOAH's financing and technical assistance that helps preserve and build affordable housing for low- and moderate-income families, seniors, and special needs residents.

Farworker Housing Development Corporation

organizations; creating loan pools to provide capital for affordable housing development; revitalizing LMI areas or underserved rural areas; and participating in tax credit programs like LIHTC, New Markets Tax Credits, and Historic Rehabilitation Tax Credits. The actual form that a multibank consortium takes is determined by the “specific credit issues that need to be addressed and the economic, social, and political climates that are contributing to challenges and solutions addressing those needs.”<sup>4</sup> The bank partners themselves decide how the consortium will contribute to

those solutions and what financing gaps it will address.

Services provided by bank consortia are generally of two types: (1) capital-based services focused on financial backing of loans and (2) knowledge-based services realized through technical assistance; guidance; and expertise in underwriting, loan servicing, and assets management. The member banks determine their geographic coverage area, a crucial decision that must take into account adequate coverage, the potential to expand and diversify borrowers,

and the ability to spread risk. As John Epstein, division manager of community lending and investment at Wells Fargo, explains, “Selecting an appropriate geographic area for consortium services is key to achieving a critical mass of expertise, advocacy, and support for affordable housing.”<sup>5</sup> Consortium members also decide the lineup of investors and other partners pertinent to the mission, products and lending strategies to offer, appropriate organizational and operational structures, and service targeting consistent with consortium objectives.<sup>6</sup>

## A Look at the Network for Oregon Affordable Housing

The activities and products developed through these partnerships are as diverse as the local and state community development needs they are designed to meet. One such partnership, the Network for Oregon Affordable Housing (NOAH), is a 22-member nonprofit bank consortium that directs its energies and resources to the affordable housing challenges in Oregon, which ranks among the country's least affordable rental markets.<sup>7</sup> More than 63 percent of Oregon renter households are low-, very low-, or extremely low-income households. One-quarter of renter households in the state spend more than 50 percent of their income on rent.<sup>8</sup> Federally subsidized rental housing stock in the state is shrinking at an alarming rate; contracts for 8.1 out of 10 privately owned and federally subsidized rental units are scheduled to expire unless renewed within the next 5 years.<sup>9</sup> An additional 2,700 households in need of affordable housing were displaced by manufactured home park closures between 1997 and 2008, further intensifying the demand.<sup>10</sup>

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Bank consortia like NOAH, which stimulate the available supply of affordable rental housing with capital loans, are an integral part of safeguarding the future well-being of American communities.

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In this environment, NOAH's primary mission is to revitalize underserved communities by increasing housing options for LMI households and preserving Oregon's at-risk stock of affordable housing. Established in 1990 under the leadership of the Oregon Bankers Association, the statewide nonprofit corporation uses various financing and technical assistance tools to help developers build and renovate multifamily affordable housing developments throughout Oregon, including senior residences, farmworker housing, special needs facilities, and mixed-income housing.

NOAH is governed by a 12-member board of directors consisting of bankers, professionals, and community

group members. The loan pool formed by the member banks is a blind pool, meaning that the banks participate in any loan that the board's loan committee approves. In addition to bankers, the loan committee includes two public-sector representatives charged with evaluating the public benefit of any loan under consideration. NOAH's 10 staff members work through the intricacies of financing, negotiate with member financial institutions, and engage local leaders and the housing development community.

At the heart of NOAH is a permanent loan program funded by its member banks. As of June 30, 2010, 6,445 units of housing had been financed with 139 permanent loans since the consortium's inception. These loans, totaling more than \$158 million, were leveraged to cover \$726 million in total project costs. NOAH also offers predevelopment loans and a tax-exempt bond financing program that is now dormant because of poor bond market conditions. Finally, NOAH staffs a statewide initiative to preserve at-risk federally subsidized rental properties. The consortium's Oregon Housing Acquisition Fund loans had preserved 416 units of federally subsidized housing as of December 31, 2010.<sup>11</sup>

Nationwide, consortia such as NOAH play key roles in addressing affordable housing challenges in their own communities and may partner with other consortia. NOAH, for example, is one of 12 statewide consortia encompassing 450 participating financial institutions



Nationwide, consortia play key roles in addressing affordable housing challenges in their own communities.

## Outcomes of Affordable Housing

Recent impact studies verify the multiplier effect of affordable housing. HUD uses the IMPLAN model to quantify the income and employment impacts of multifamily projects.<sup>1</sup> HUD estimates that the initial local impact of building 100 multifamily units in a tax credit project includes \$12.3 million in income, \$1.6 million in taxes and other revenue for state and local governmental jurisdictions, and 220 jobs. Most of the income, jobs, and taxes generated remain in the local area. In addition, after the first year of a project, spending by the new tenants generates annually recurring impacts that support additional jobs throughout the local area.

A recent research literature review by the Center for Housing Policy also seems to confirm that affordable housing stimulates employment and the economy.<sup>2</sup> The organization identifies some of the factors that can contribute to the multiplier, or ripple, effect of affordable housing:

- States and cities experience advantages during the initial phase of a project, including revenue from the necessary permit and impact fees as well as the taxes on building materials, builders' profits, and construction workers' wages.
- Businesses are in an improved position to attract and retain employees, thus influencing business decisions and the "pull" exerted on workers seeking jobs in areas with lower housing costs. One study found that, of the metropolitan areas ranking highest in housing costs between 2000 and 2006, two-thirds lost an average of 6 percent of their population to lower-cost housing markets.
- Home values may appreciate near affordable housing developments, resulting in a stronger local tax base.
- When they secure affordable housing, LMI families double the amount of money available for items other than housing, utilities, and transportation.



<sup>1</sup> IMPLAN is a well-respected input-output model developed in collaboration between the University of Minnesota and the U.S. Forest Service.

<sup>2</sup> Center for Housing Policy, "The Role of Affordable Housing in Creating Jobs and Stimulating Local Economic Development: A Review of the Literature," 2011.

loosely organized as the Association of Reinvestment Consortia for Housing. The participating members network to share knowledge and best practices as well as assist policymakers on legislative and regulatory issues.<sup>12</sup>

According to NOAH's executive director, Bill Van Vliet, building and preserving affordable housing benefit financial investors through goodwill, shared risk, reduced lending costs, and adherence to legislative requirements. LMI households that have affordable rent payments experience an increased income and quality of life that reduce the risk of homelessness and are linked to improved health, safety, and school performance. Finally, Van Vliet notes, every dollar spent on affordable housing has both an investment leverage effect and a multiplier effect.

Implementing affordable housing has a significant, positive influence on local economies that provides jobs, stimulates business activity, and enhances the loss/gain ratio in revenue for local and state governments. In one example, NOAH helped finance a mixed-use housing project designed for seniors and disabled persons who earned 60 percent or less than the area median income.<sup>13</sup> The total project cost of \$11.6 million was calculated to have a positive impact of \$21.3 million on family incomes, business coffers, and government revenue; an employment impact of 168 jobs; and a statewide labor income impact of \$7.4 million.<sup>14</sup>

The Association of Oregon Community Development Organizations localized a model created by the National Association of Home Builders to calculate the

economic impact of affordable rental housing that member organizations developed between 1990 and 2002. After 12 years, the returns on investing \$94 million in 7,562 affordable housing units had helped generate 12,212 jobs, \$393 million in wages, and \$23 million in income taxes. In addition, the original investment leveraged a total of \$408 million from private and federal sources. The residents living in these units pay about \$267 less in rent each month than they would if they lived in apartments charging fair market rent, resulting in approximately \$24 million in savings for these households. The increased purchasing power of these families supported 833 ongoing jobs throughout the economy — jobs whose holders pay income tax and spend more on local goods and services.<sup>15</sup> In light of these outcomes, bank



Reach CDC; Traci Hill

An apartment building designed for the elderly or disabled that NOAH helped to finance reduces the financial burden for residents and improves their quality of life while also having a positive influence on the local economy.

consortia like NOAH, which stimulate the available supply of affordable rental housing with capital loans, are an integral part of safeguarding the future well-being of American communities and building community capacity for sustainable, long-term growth.<sup>16</sup> **EM**

(See “Outcomes of Affordable Housing” on page 14 for a further discussion of economic multiplier effects.)

<sup>1</sup> Federal Reserve Bank of San Francisco, “Community Development, Creation of the Consortia,” accessed 14 January 2011. For more on LIHTC, see U.S. Department of Housing and Urban Development, Office of Policy Development and Research, July 2010. “LIHTCs Boost Affordable Rental Housing Supply,” *Research Works*.

<sup>2</sup> The CRA required lending institutions to serve all segments of their communities, thus eliminating “redlining,” in which banks accepted deposits from low- and moderate-income populations but did not lend to them

at a commensurate rate. Federal Financial Institutions Examination Council. April 2006. “CRA 101: An Introduction to the Community Reinvestment Act.”

<sup>3</sup> United States Department of the Treasury, Community Development Financial Institutions Fund.

<sup>4</sup> Letty Ann Shapiro, “Similarities, Differences Between CRA and Public Welfare Investment Authority,” *Community Developments Investments*, Fall 2010.

<sup>5</sup> Interview with Joel Epstein, division manager of community lending and investment at Wells Fargo, February 14, 2011.

<sup>6</sup> U.S. Department of the Treasury, Comptroller of the Currency, October 2010. “Multibank Partnerships for Community Development Financing,” *Community Developments Fact Sheet*.

<sup>7</sup> Federal Reserve Bank of San Francisco, Community Development Department. December 2004. “Community Development Assessment for the State of Oregon: A Guide to Oregon’s Community Development Environment.”

<sup>8</sup> Oregon state-level renter statistics from the National Low Income Housing Coalition. May 2010. “Out of Reach 2010: Renters in the Great Recession, the Crisis Continues.”

<sup>9</sup> U.S. Department of Housing and Urban Development,

Multifamily Assistance and Section 8 Contracts Database, updated 20 December 2010.

<sup>10</sup> Oregon Housing and Community Services, “Manufactured Home Park Closures,” September 2010.

<sup>11</sup> Interview with Bill Van Vliet, NOAH’s executive director, January 14, 2011; internal documents provided by NOAH; NOAH’s website.

<sup>12</sup> Federal Reserve Bank of San Francisco, Community Development Department. 2006. “Financing Affordable Housing — Building Communities: The Story of Arch.”

<sup>13</sup> This housing complex opened in December 2007 in Portland, Oregon. According to the American Community Survey, Portland’s median household income was then \$47,143. For senior households (65 years and over), the median income was \$27,643.

<sup>14</sup> Oregon Housing and Community Services. 2008. “Housing as an Economic Stimulus: Exploring the Economic and Community Benefits of Affordable Housing Development,” 14–18.

<sup>15</sup> Molly Rogers and John Blatt. April 2003. “Economic Impact of Affordable Housing Development,” Association of Oregon Community Development Organizations.

<sup>16</sup> Interview with Van Vliet.

## Edward L. Glaeser

The home mortgage interest deduction is a decades-old mainstay of American housing policy that badly needs reform. The deduction is regressive and artificially distorts behavior, including pushing people toward single-family detached houses. Moreover, the deduction is poorly designed to actually promote homeownership. A reasonable path forward is to lower the upper limit on the deduction by \$100,000 per year over the next 7 years, and then perhaps replace the remaining deduction with a flat owner's tax credit that does not scale up with the size of the home or mortgage.

In the wake of a great national housing crisis, the federal government should not be encouraging ordinary Americans to leverage themselves as much as possible to gamble on the vicissitudes of the housing market. Yet the mortgage deduction does just that. The U.S. government should avoid any suggestion that it sees investing in housing as being particularly lucrative, for such beliefs have played an outsized role in creating past bubbles.

The mortgage deduction is also problematic because it encourages people to buy bigger homes; even the poorest quintile of American households live in homes that are twice the size of the French or British average. We should not induce people to live in larger homes that are typically associated with higher carbon emissions.

## Highlights

- Edward Glaeser finds that the mortgage interest deduction is poorly designed to encourage homeownership and incentivizes people to leave urban areas.
- David Crowe contests that the positive externalities of homeownership justify the mortgage interest deduction.
- Todd Sinai argues that broad reform of the tax code is necessary, but that changes to the mortgage interest deduction must take care not to disadvantage middle-class homeowners.

A strong link exists between housing tenure and structure type; multifamily units are typically rented and single-family units are typically owner occupied. Renting apartments avoids the problems of coordinating owners, and owner occupancy provides strong incentives for maintaining single-family homes. But the connection between ownership type and structure type means that encouraging people to own homes pushes them away from the multifamily dwellings that are more common in cities. We should not be bribing people to leave our economically productive urban cores.

According to research by James Poterba and Todd Sinai, the home mortgage interest deduction provides benefits that are 10 times larger for the average family earning more than \$250,000 than for the average family earning between \$40,000 and \$75,000.<sup>1</sup> Anyone who wants more equality in the tax code should favor reform.

Homeownership has often been pushed as a path to middle-class prosperity, but in the wake of the housing boom this argument seems quite dubious. Homeownership is also

correlated with a number of potentially desirable social outcomes, such as working to solve local problems. Yet the deduction is poorly designed to encourage homeownership because its benefits accrue mostly to the wealthy, who are likely to own their homes anyway. Many poorer households on the margin between owning and renting do not even itemize.

The housing market is still in distress, and eliminating the deduction overnight would be too extreme. But the upper limit on the deduction can be gradually decreased from \$1,000,000 to \$300,000 so that few households are immediately affected by the change. Eventually, policymakers could replace the deduction with a straight owner's credit that provided some incentive for ownership (if absolutely necessary) but did not encourage extra borrowing or larger homes.

<sup>1</sup> James Poterba and Todd Sinai. 2008. "Tax Expenditures for Owner-Occupied Housing: Deductions for Property Taxes and Mortgage Interest and the Exclusion of Imputed Rental Income," *American Economic Review* 98:2, 84–89.

*Edward Glaeser, Ph.D., is the Fred and Eleanor Glimp Professor of Economics at Harvard University. Glaeser recently authored [Triumph of the City: How Our Greatest Invention Makes Us Richer, Smarter, Greener, Healthier and Happier](#), which explores the benefits of urban living on cities, business, people, and the environment.*

## David Crowe

Homeownership plays a fundamental role in American society. A rich academic literature has consistently demonstrated the positive private and social benefits of homeownership, including improved educational outcomes for children, better health, reduced crime, and increased neighborhood concern and involvement. In the long run, homeownership is a path to wealth accumulation; the net worth of the average homeowner is more than 45 times that of the average renter.

For most homebuyers, homeownership is impossible without debt financing. The mortgage interest deduction (MID) provides parity with the tax treatment of interest expense associated with other forms of debt-financed investment, including financial assets and rental housing. The MID lowers the effective interest rate homebuyers pay, making homeownership accessible to more households. The MID is well justified as housing policy given the documented positive externalities associated with homeownership.

Critics often use misleading or incorrect arguments to attack the MID. One frequent claim is that few homeowners benefit from the MID because they take the standard deduction instead of itemizing their tax returns. In fact, 86 percent of all mortgage interest paid over the past decade is claimed as an itemized deduction.

The MID is often criticized as being “regressive.” Estimates from the Congressional Joint Committee on Taxation, however, indicate that approximately 70 percent of the tax benefits of the MID are collected by households earning less than \$200,000.<sup>1</sup> An analysis by the National Association of Home Builders (NAHB) also shows that these middle-class households earn the largest benefits from the MID, as measured as a share of income.<sup>2</sup>

Moreover, during the early years of a mortgage, interest charges make up the lion’s share of monthly payments. For younger, newly minted homebuyers, the MID offers significant benefits at a time when household budgets are at their tightest and wealth accumulation is just beginning.

Similar NAHB analysis indicates that families with children, who require larger homes, collect larger tax benefits.<sup>3</sup> In this sense, the claim that the MID causes homebuyers to buy a larger home is backward; in fact, the MID helps growing households finance a larger home as needed.

Finally, some commentators have cited the MID as a cause of recent turmoil in the housing market. This claim is without merit. The MID has been a feature of the tax code since 1913 and an important policy for the middle class since the 1940s, with no evidence of having created a housing bubble. During the most recent

recession, the homeownership rate in the United States began to decline more than a year before housing starts and prices fell, suggesting that speculation and poor underwriting were the leading causes of the crisis. If the MID were responsible, you would expect a positive relationship between the use of the MID and foreclosures, but none exists.

Homeownership remains the American dream, and the MID is a critical policy helping aspiring homeowners attain that dream. Homeownership confers social benefits to communities, including more than \$200 billion in state and local property tax revenue each year. Given the macroeconomic damage that weakening the MID would cause, the MID must retain its place as a cornerstone of U.S. housing policy.

<sup>1</sup> The Joint Committee on Taxation. 2010. “Estimates Of Federal Tax Expenditures For Fiscal Years 2010–2014.” Washington, DC: U.S. Government Printing Office.

<sup>2</sup> Robert Dietz. 2010. “Housing Tax Incentives: Age Distribution Analysis,” National Association of Home Builders, HousingEconomics.com. Accessed 1 April 2011.

<sup>3</sup> Robert Dietz and Natalia Siniavskaja. 2011. “Who Benefits from the Housing Tax Deductions?,” National Association of Home Builders, HousingEconomics.com. Accessed 1 April 2011.

*David Crowe, Ph.D., is Chief Economist and Senior Vice President at the National Association of Home Builders (NAHB), where he is responsible for forecasting housing and economic trends, survey research and analysis of the home building industry and consumer preferences, and microeconomic analysis of government policies that affect housing. Prior to joining NAHB, Crowe was Deputy Director of the Division of Housing and Demographic Analysis at HUD.*

# Viewpoints: The Mortgage Interest Deduction

## Todd Sinai

The current tax subsidy for owner-occupied housing offers little to like. Most academic research, including a 2010 paper by Christian Hilber and Tracy Turner, suggests that the subsidy has little to no actual effect on homeownership rates; instead, it induces those who already would have bought a home to spend even more on housing.<sup>1</sup> The subsidy is also a highly regressive component of the tax code whose benefits accrue overwhelmingly to high-income households in areas with high home prices.

In times of fiscal distress, then, talk often turns to eliminating the mortgage interest deduction. And it should; according to the Joint Committee on Taxation, the mortgage interest deduction, at an estimated annual cost of \$93.8 billion, constitutes nearly 9 percent of the 2011 budget deficit as projected by the Congressional Budget Office.

The mortgage interest deduction, however, is only one component of the total tax subsidy for owner-occupied housing. In an undistorted tax code, taxpayers would be allowed to deduct their expenses (mortgage interest) when they pay tax on their income (rent). Because the United States does not tax estimated rental income for owner-occupiers, the interest deduction should not be allowed. That the deduction is nonetheless available constitutes a subsidy. However, the tax code also does not permit many actions that could offset the effects of

untaxed rental income, such as taxing the estimated return to equity invested in owner-occupied houses.

In fact, James Poterba and I recently estimated that in 2004 the total tax subsidy for owner-occupied housing was \$330 billion, more than 4.5 times our \$72 billion estimate of the cost of the mortgage interest deduction alone. Not only is the mortgage interest deduction not the biggest tax subsidy to owner-occupied housing, it isn't even close.

Specifically, the mortgage interest deduction is just a subsidy that uses mortgage debt to finance home purchases. Curtailing it leaves behind a host of subsidies, the most important being a subsidy for using equity to buy a house.

Deterring housing leverage by making mortgage debt less subsidized than housing equity is not a bad thing. Many positive aspects of homeownership exist, but the inappropriate use of mortgage debt negated nearly all of them in the latest downturn.

However, one should not confuse eliminating the mortgage interest deduction with eliminating the tax subsidy for owner-occupied housing. Many high-income households have the financial wherewithal to substitute equity finance for debt, giving them the option to retain their housing subsidy. Older homeowners have little mortgage debt and would remain largely unaffected. In addition, most

low-income households do not itemize deductions on their tax returns and therefore do not benefit from the mortgage interest deduction. Curtailing the mortgage interest deduction would have the biggest impact on middle-class families — those who have the least choice about using mortgage debt — and would discourage wealthy households from using leverage. Is a partial reduction in the housing subsidy worth these distortions to household capital allocation and progressivity? Because the government can change other parts of the tax code to restore progressivity, the answer is likely yes.

Even so, much depends on the implementation. Reducing the mortgage interest deduction for existing middle-class homeowners would require a corresponding reduction in their income tax burden to avoid the risk of financial distress. In addition, any changes would need to be carefully phased in to mitigate any adverse effects on home prices.

<sup>1</sup> Christian A.L. Hilber and Tracy M. Turner. 2010. "The Mortgage Interest Deduction and Its Impact on Homeownership Decisions," Discussion Paper 55, Spatial Economics Research Center at the London School of Economics, U.K.

*Todd Sinai, Ph.D., is Associate Professor of Real Estate and Business and Public Policy at the University of Pennsylvania's Wharton School. Sinai is also Visiting Scholar at the Federal Reserve Bank of Philadelphia and Faculty Research Fellow at the National Bureau of Economic Research. Forthcoming research from Sinai explores the relationships between real estate and urban economics and risk, consumption, and the cost of consumption commitments. For a more detailed examination of the MID by Sinai and James Poterba, see "Revenue Costs and Incentive Effects of the Mortgage Interest Deduction for Owner-Occupied Housing."*

## Additional Resources

- “Housing Partnerships: The Work of Large-Scale Regional Nonprofits in Affordable Housing” (2007), by Neil Mayer and Kenneth Temkin, explores the productivity, models of business operation, and policy obstacles of these organizations. [www.urban.org](http://www.urban.org).
- “Assessing the Economic Benefits of Public Housing: Final Report” (2007), by Econsult Corporation, highlights the economic impact of public housing, its role in the housing market, and its contributions to local economies. [www.oakha.org](http://www.oakha.org).
- “Rental Housing Affordability — A Review of Current Research” (2010), from Center on Housing Policy, by Rebecca Cohen, Keith Wardrip, and Laura Williams. [www.nhc.org](http://www.nhc.org).
- “Childhood poverty, chronic stress, and adult working memory” (2009), from Gary W. Evans and Michelle A. Schamberg, examines how childhood poverty and resulting stress impacts the working memory of young adults. [www.pnas.org](http://www.pnas.org).
- “Rural Rental Housing Characteristics” (2009), from the Housing Assistance Council, discusses rural rental housing and renters, housing problems unique to this group, and federal assistance in rural areas. [www.ruralhome.org](http://www.ruralhome.org).
- *Worst Case Housing Needs 2009: Report to Congress* (2011), from HUD’s Office of Policy Development and Research, explores the incidence, causes, and trends of unassisted very low-income renters who pay more than 50 percent of their incomes toward rent, live in substandard housing, or both. [www.huduser.org](http://www.huduser.org).
- *Low-Income Housing Tax Credit Investment Survey* (2009), by Enterprise Community Partners, Inc., and Local Initiatives Support Corporation, reviews the LIHTC credit market and its history, current conditions and investor motivations, and responses to legislation designed to stimulate activity. [www.lisc.org](http://www.lisc.org) and [www.enterprisecommunity.org](http://www.enterprisecommunity.org).
- *Revisiting Rental Housing: Policies, Programs, and Priorities* (2008), Nicolas P. Retsinas and Erik S. Belsky, eds., includes chapters by experts who explore current rental housing policy challenges and solutions. [www.brookings.edu](http://www.brookings.edu).
- Affordable Rental Housing: State and Local Partnerships, from HUD’s Office of Policy Development and Research, is a new section on the HUD USER website that provides resources and strategies aimed at the preservation of affordable rental housing. [www.huduser.org](http://www.huduser.org).
- *Paycheck to Paycheck: Wages and the Cost of Housing in America* (2010), by the Center for Housing Policy. [www.nhc.org](http://www.nhc.org).
- “America’s Rental Housing: Meeting Challenges, Building on Opportunities” (2011), from the Joint Center for Housing Studies of Harvard University, describes the impact of the convergence of rising rent and utility costs, falling renter incomes, and the Great Recession on working and middle-class Americans. [www.jchs.harvard.edu](http://www.jchs.harvard.edu).

### UPCOMING: *Cityscape*

In the Summer 2011 issue of *Cityscape*, Editors Vicki Been and Ingrid Gould Ellen of New York University and six leading economists argue that although “Americans have long been in love with homeownership,” and U.S. housing policy is strongly biased in favor of homeownership, a robust rental housing market is vital to our economy. They analyze the costs to families and society of that bias, and suggest some alternative policy paths. [www.huduser.org](http://www.huduser.org).

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Discuss this issue on the *Evidence Matters* Forum at [www.huduser.org/forums](http://www.huduser.org/forums).



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