Leveraging More-Precise Governmental Support To Ensure the Middle Doesn't Go Missing

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Housing stability is a key driver of economic stability and mobility. More than ever before, millions of middle-income Americans living in high-cost regions are struggling to access homes they can afford. Ineligible for the Housing Choice Voucher (HCV) or Low-Income Housing Tax Credit (LIHTC) Programs because they earn too much, and with market-rate rent and home prices increasingly out of reach, this population—consisting largely of firefighters, nurses, teachers, and other members of the workforce—is falling through the cracks.

In search of more affordable options, middle-income families are forced to move farther and farther outside of cities, disrupting their home stability, disconnecting them from the communities they serve, extending their commute times, and shrinking their connections to jobs and economic opportunity. Beyond having consequences for family well-being, the high cost of housing has serious implications for the environment, as longer commutes contribute to greenhouse gas emissions, and for the economy, as housing instability has been linked to lower economic productivity as measured by gross domestic product (Furman, 2015).

Until and unless the market can better serve these middle-income families, governmental intervention is absolutely necessary to secure the middle class, and I oppose the idea that those families making between 80 and 120 percent of Area Median Income (AMI) should be excluded from all public subsidies. The question becomes, however, "What form *should* government interventions take, and how can we ensure they have their intended effect?"

Existing Government Subsidy for Middle-Income Families

In reality, a number of forms of public subsidy for families in the middle-income bracket are already applied at the local, state, and national levels. Some programs are effectively reaching those cost-burdened families who need support to bridge the gap between their incomes and housing costs. Other programs are administered without sensitivity to local economic contexts and have resulted in disproportionate support for those who may not really need it.

At the local and state levels, public subsidy in the form of downpayment assistance programs and inclusionary zoning policies help to bridge the gap between what a middle-income household can

afford and the increasing cost of living in already high-cost regions. These programs often have resale restrictions, shared appreciation mortgages, or both to keep homes affordable for a defined period of time and can be calibrated to the true size of the gap between income and cost in a particular region.

Meanwhile, less-calibrated efforts to reach middle-income families are conducted through the tax code. State and federal governments provide support to homeowners in at least three ways—(1) the mortgage interest deduction, (2) property tax deductions, and (3) capital gains exclusions.

These combined tax expenditures are estimated to have diverted more than $140 billion of revenue back to homeowners in 2016 alone (Tax Policy Center, 2016). They benefit only those households that itemize deductions and skew heavily toward wealthy homeowners; approximately 85 percent of the mortgage interest deduction, for example, goes to families earning more than $100,000 annually (Tax Policy Center, 2016). Furthermore, the amounts are not adjusted for AMI, and many states have duplicate tax expenditures. In California, for example, tax expenditures mirror the federal expenditures, and the mortgage interest deduction costs nearly $5 billion annually.

The federal housing finance system also provides important channels of implicit and explicit support to middle-income earners, with a wide variation in who benefits from them depending on the economic context in which they are operating.

San Francisco, California, for example, is one of most expensive real estate markets in the country. The median list price of a house for sale in San Francisco is $1,146,800 (Zillow, 2017b), and the AMI for a family of four is $107,700 (HUD, 2016). A median-income family with no other debt and $20,000 available for a downpayment would be eligible to purchase a home worth approximately $516,500 (Zillow, n.d.). The lending limit for both Fannie Mae and Freddie Mac (conforming loans) and for the Federal Housing Administration (FHA) is $636,150 (Fannie Mae, 2017) because San Francisco is a high-cost area. However, nearly no homes are available for purchase for this price; a search on Zillow.com in October 2016 found exactly one two-or-more-bedroom single-family home for less than $500,000 in San Francisco (exhibit 1).[1]

Exhibit 1

Regional Income, Mortgage Eligibility, and Home Price Comparison

	Area Median Income ($)	Median Home List Price ($)	Conforming Lending Limits ($)	FHA Lending Limit ($)	Home Price the Average Family Can Afford ($)	Homes Available at or Below That Price
San Francisco County, CA	107,700	1,146,800	636,150	636,150	516,500	1
Marion County, IN	66,700	111,300	424,100	299,900	316,700	2,600+

FHA = Federal Housing Administration.

[1] If studio and one-bedroom units are included, the number goes up to three. If condominiums, townhomes, and foreclosures are included, the number goes up to seven, including a deed-restricted, income-restricted home.

On the other hand, Marion County, Indiana (which includes Indianapolis), is one of the most affordable counties in the country, with a median list price of $111,300 (Zillow, 2017a). The AMI for Marion County is $66,700 (HUD, 2016); both list prices and income are substantially less than in San Francisco. The maximum FHA loan limit, which enables lower downpayment requirements and easier qualifying, is $299,900, and the conforming loan limit is $424,100, the national limit for a non-high-cost area. The average family, with no debt and one-half the downpayment amount available ($10,000), can afford a home that costs $316,700 (Zillow, n.d.)—in excess of the FHA limit and well within the conforming limit. A search on Zillow.com in October 2016 found more than 2,600 two-or-more-bedroom single-family homes available for less than $300,000.

The family earning AMI in Marion County is well-positioned to take advantage of federally backed lending programs, whereas the family earning AMI in San Francisco is not. Adjustments for local economic context are clearly a much-needed improvement to the current administration of programs targeted toward this income group.

What Should Future Subsidy Look Like?

The basic theory behind public subsidies is that government has a role to play in ensuring that housing stability and homeownership—essential components of economic well-being—are viable options. In practice, some of the forms of support reach those who might have faced chronic instability or who would never otherwise have accessed homeownership, but some skew heavily to wealthier families well above the income bracket of those making 80 to 120 percent of AMI without being balanced out with similar levels of subsidy for those on the other end of the spectrum.

That current inequities in the structure and administration of government intervention should be rectified does not invalidate the need for appropriate public support for those earning middle incomes. Again the question becomes, "What is the ideal form of support, and how can we ensure it is administered to have its intended effect?"

At the local level, governments should certainly retain the ability to provide assistance through programs that are responsive to local market conditions and the real needs of those in the middle-income bracket. Ideally, local subsidy could also be paired with legislative action that reduces barriers to production to add much-needed supply, relieve price pressure, and bring down costs. State governments could incentivize local governments to take such actions by allocating funds for housing assistance and rewarding communities with larger allocations as they make progress in reducing production barriers (such as faster processing times, fewer conditions on developments, and so on). This approach aligns policy and subsidy in a way that allows for a more scaled solution.

Meanwhile, at the federal level, assisting households in the 80- to 120-percent-of-AMI range should be done in a manner that is explicit and targeted, rather than embedded and hidden or left to chance, as in the current system. Solutions could include a first-time homebuyer tax credit for households earning, for example, less than 120 percent of AMI. Governments could also support tax-advantaged savings accounts (like those that exist for educational expenses) for downpayment savings for targeted income groups.

These types of interventions could secure viable pathways to homeownership for millions of families who are currently excluded from an important source of economic opportunity.

Taking the position that public subsidy is sometimes merited for the income bracket between 80 and 120 of AMI does *not* mean it should happen at the expense of lower-income households; we cannot afford to play a zero-sum game. With only one in four eligible households able to obtain support from the HCV Program and other housing assistance programs (CBO, 2015), public subsidy for this segment of the population absolutely deserves attention and expansion, as well.

To that end, serious consideration should be given to using the tax code (at both the federal and state levels) to provide for a direct rental assistance credit to renters who earn up to 80 percent of AMI. In addition to meeting the needs of lower-income populations, this credit would also serve those making between 60 and 80 percent of AMI—a segment of the population that is often overlooked. For several years running, the Obama administration proposed that the LIHTC Program be revised to enable any given housing project to serve, on *average*, those making 60 percent of AMI, which would then include renters earning anywhere between 30 and 80 percent of AMI.

Ultimately, in a market environment like the one we have today, government assistance is crucial both for those lower-income families who have long been undeserved by the market *and* the millions whose incomes may be considered "middle class" but who are increasingly being priced out of the current housing market in high-cost communities. We need to find federal, state, and local solutions that leverage the limited public dollars available in maximally efficient ways and that complement other policy initiatives to improve the efficacy of the market. Until then, state and local governments with high-cost housing markets should have the discretion with their own state and local funding mechanisms to serve this segment of the population. Federal programs should also be calibrated to be more sensitive to the diversity of localized markets and middle-income needs.

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