Center on Urban and Metropolitan Policy

Tax Policy as Housing Policy:

The EITC's Potential to Make Housing More Affordable for Working Families

Michael Stegman, Walter Davis, and Roberto Quercia[1]

"An expanded EITC could go far in helping lower-income workers meet the rising costs of safe, decent, affordable housing."

Findings

An analysis of how the federal Earned Income Tax Credit (EITC) could alleviate severe housing cost burdens—where housing consumes at least half of household income—finds that:

- **By any measure, severe housing cost burdens for low- and moderate-income households have risen in recent years.** Federal investment in vouchers and affordable housing production has not risen in tandem with increased need. In contrast, assistance provided to working families through the EITC has increased considerably.

- **If included as income, the EITC reduces by 18 percent the number of lower-income working households with severe housing cost burdens.** Including the effects of all federal taxes in measures of housing affordability significantly reduces the incidence of burden among families with children, but increases the incidence among childless workers.

- **Expanding the EITC for childless workers and larger families would eliminate severe housing costs for an additional 153,000 families.** A proposal along these lines introduced in the 107th Congress would also lift 228,000 families above the poverty line.

- **The authors' proposal to expand the EITC would relieve 510,000 families of severe housing-cost burdens.** Configuring EITC parameters to help renters afford typically priced units in most major metropolitan markets would assist working families with children most significantly.

Despite the economic prosperity of the late 1990s, housing became less affordable for millions of working families. Because current housing programs cannot fully close the affordability gap, policymakers should consider expanding support in the tax code for working families to help a greater number meet the high and rising costs of housing.

I. Introduction

The burden of high housing costs is a significant and growing fixture of the nation's housing landscape for low- and moderate-income families. To be considered "affordable" under commonly accepted standards, housing costs (rent or mortgage, plus utilities) should consume no more than 30 percent of income for low- and moderate-income families.[2] According to the Joint Center on Housing Studies, 14 million of the nation's 34 million renter households spend at least this amount on housing, and half of those households face "severe" housing cost burdens, where housing costs consume at least 50 percent of their incomes.[3] These cost burdens have overtaken substandard housing as America's principal housing problem.

As the housing affordability gap has grown, the federal government has failed to mount a sufficient response with dedicated housing programs. Today, all forms of Department of Housing and Urban Development (HUD) housing assistance serve fewer than one in four households that qualify for aid. At the same time, the stock of permanently affordable housing under HUD oversight continues to dwindle.[4]

This survey argues that the housing affordability problem has escalated to the point where housing programs alone can no longer remedy it. To make significant progress, we recommend incorporating housing assistance into a broader "working families agenda" so that it is embraced by a larger and more politically influential community of common interest than those focused solely on low-income housing policy.[5] We present our case for using the federal tax code—specifically, the Earned Income Tax Credit (EITC)—to address the steep and persistent rise in housing-cost burdens for millions of low- and moderate-income working families.

We begin by examining recent measures of the housing affordability problem, how government has responded, and why the EITC provides an attractive vehicle for addressing the problem. Second, we use data from the American Housing Survey to explore how our understanding of the problem would change if the significant dollars that the EITC provides to low-income working families were considered in measures of housing affordability. Third, we determine how the changes in a recent proposal to expand the EITC for childless workers and large families would affect housing-cost burdens. Fourth, we develop our own EITC-based proposal to make modestly priced rental units affordable to low-income working families in most U.S. metropolitan areas. The conclusion compares the relative merits of these proposals, and discussing the prospects for using the tax code to close the housing affordability gap for lower-income renters and homeowners.

II. Methodology

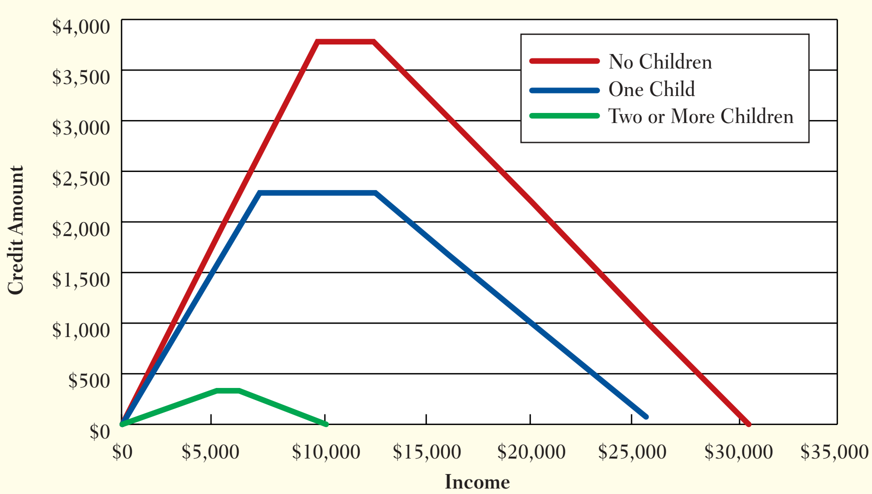
This survey is based primarily on analysis of the national files from the 1999 American Housing Survey (AHS).[6] We use these data to model EITC eligibility, benefit levels, housing-cost burdens, and related measures. The AHS is the foundation for most national housing policy research, including HUD's Worst Case Needs assessment, Harvard's Joint Center for Housing Studies' *The State of the Nation's Housing,* and the National Housing Conference's continuing analysis of the housing needs of America's working families.[7]

The EITC is a refundable tax credit for low- and moderate-income workers, particularly those with children.[8] Because it is intended to encourage and reward work, the EITC differs from many other safety net programs, including housing assistance, in that its benefits initially increase with earnings (Figure 1). Eligibility and the maximum credit differ according to family size. In particular, because the EITC is designed primarily to assist families with children, the maximum credit and the eligible income range are much smaller for childless workers than for families with children. In tax year 1999 (the year on which this study's analysis is based), the maximum EITC for a childless worker was \$347; for a working family with one child, it was \$2,312; and for a family with two or more children, it was \$3,816—more than ten times that of a childless worker. Although we use tax year 1999 parameters to model eligibility and receipt of the EITC, our analysis of policy proposals recognizes certain post-1999 changes in tax policy, such as the refundable portion of the child credit enacted in 2001.

One challenge in using the AHS to analyze the effects of the EITC is that it surveys dwelling units, or households, while the taxable unit for purposes of the individual income tax is the family. Because a household can contain more than one family, it may thus contain more than one tax unit, or EITC-eligible worker or family. Our AHS data contained 46,589 households, which in turn contained 60,104 families. We define an EITC-eligible household as one that contains at least one EITC-eligible tax unit—such as a single mother and her child. We estimate that in 1999, more than 40 percent of all EITC-eligible households lived in housing units containing more than one family—that is, they were "doubled up." Further, 6 percent of EITC-eligible households in the 1999 AHS contained more than one EITC-eligible family—roughly 900,000 households and more than 1.8 million families.[9]

Although we estimate that nearly 1 million households are eligible to receive more than one tax refund that includes the EITC, multi-tax-unit households are not necessarily large

Figure 1. Structure of EITC in 1999



families, and do not always receive large EITC benefits. In fact, the opposite is more often true. Single-tax-unit households have more than twice the average number of eligible children as multi-tax-unit households, given that the latter generally contain one or more EITC-eligible childless workers. Because tax credits for childless workers are much smaller than for families with children, average EITC benefits are generally higher for single-tax-unit households.

Although we do not propose to substitute an EITC-based program for housing vouchers or other dedicated housing assistance, it is helpful for policymakers and housing professionals to know the extent to which the two systems may overlap. Of the 14.6 million households that contained at least one EITC-eligible tax unit or family in 1999, about eight in ten reported incomes lower than 80 percent of their respective area median incomes, thus placing them squarely within HUD's program limits. More than one-quarter of all these EITC-eligible households were working adults without children.

III. Findings

A. By any measure, severe housing cost burdens for low- and moderate-income households have risen in recent years.

Affordability is the nation's most widespread housing challenge. This represents a departure from America's housing past, when overcrowding and substandard housing were viewed as the country's most pressing housing problems.

Today, 14 million of the nation's 34 million renter households face housing-cost burdens, as do 17.5 million of the nation's 72 million owner households. Among the cost-burdened are more than 4 million low- and moderate-income working families, defined as those with incomes of between $10,700 (the equivalent of a full-time worker earning the federal minimum wage of $5.15 an hour) and 120 percent of their metropolitan area's median income, who are severely cost-burdened.[10] These families work and "play by the rules," but still paid more than half their incomes for mortgage or rent in 2001.

The affordability problem has grown worse in recent years. The number of low- and moderate-income working families facing severe housing-cost (SHC) burdens rose an astounding 68 percent between 1997 and 2001.[11] The median amount that a family must earn per hour to afford a two-bedroom unit at the applicable HUD fair market rent in 2003 is $15.21—a 37 percent rise in just four years, and roughly three times the federal minimum wage.[12] Meanwhile, real median wages for workers have grown much more slowly, and actually declined between 2002 and 2003.[13]

In the face of the growing affordability gap, the federal government has failed to mount an adequate policy response. Funding for tenant-based rent assistance generally, and the Section 8 voucher program in particular, has fallen short of meeting market need.[14] Although independent evaluations have shown vouchers to be highly effective in markets with an ample supply of decent rental housing, Congress has, in its 30-year history, funded fewer than 2 million portable rental certificates and vouchers.[15] As of September 2000, there were fewer than 1.5 million families with vouchers. In addition, vouchers are still largely limited to very low-income renters at a time when nearly 60 percent (2.6 million) of severely cost-burdened low- and moderate-income working families are homeowners.[16]

Recent experience also suggests that the voucher delivery system is incapable of handling increased program activity that would be required to effectively deal with the recent decline in housing affordability. Although the situation is improving, HUD finds that about one-fourth of all voucher programs across the country have substandard lease-up rates (i.e., rates less than 95 percent).[17] Moreover, even when agencywide lease-up rates are high, many families with vouchers often cannot use them. Nationally in

2000, about 30 percent of families with vouchers in large metropolitan areas had to turn them back in because they could not find housing that both met their needs and met program standards in the time allotted to them. This is a marked increase from a decade ago, when the turn-back rate in large metropolitan areas was 19 percent.[18]

The declining willingness of property owners to rent to voucher households also acts to constrain the program.[19] One recent study found that approximately half of Chicago landlords "refused to rent to testers posing as apartment seekers when the 'renter' told them they would use a [Housing Choice] Voucher to pay rent, despite the fact that such behavior violates the city's fair housing laws."[20]

State and local agencies have recognized this problem in recent years. In 2002, Fairfax County, VA, decided not to ask HUD for additional vouchers "because there were not enough apartments for people already in the program."[21] In CA, the State Senate Judiciary Committee noted a "growing trend among landlords to flatly refuse to rent to anyone on Section 8 housing, or more blatantly, to evict an existing Section 8 tenant because the landlord no longer wants to accept Section 8 vouchers."[22] This practice led to a precipitous decline in housing access in Los Angeles. According to the director of the city's Section 8 program, the share of all voucher holders who are able to find landlords who accept vouchers has fallen by more than half—from 90 percent three years ago, to just 41 percent today.[23]

The sharp rise in the size and benefit levels of the EITC stands in stark contrast to the painfully slow growth of vouchers. Although the annual value of the average EITC is only about one-fourth that of the average Section 8 voucher—$1,500 versus $6,012—more than six times as many families receive the EITC as receive housing vouchers.[24] Average EITC benefits for families with children are somewhat larger, about $2,000 in tax year 2000.[25] In aggregate dollars, the EITC is two and a half times the size of total Section 8 rental assistance ($31 billion a year versus $13 billion).[26]

In some metropolitan areas, the disparity between receipt of the EITC and housing vouchers is dramatic (Table 1). In 2000, there were at least 15 times as many workers and families earning the EITC as households receiving Section 8 assistance in the Atlanta, Detroit, Miami, and Houston. In more expensive West Coast markets such as Oakland, San Jose, Seattle-Tacoma, and San Diego, the ratio of EITC filers to voucher holders ranged from between four to one and ten to one.

To be sure, any effort to expand the EITC explicitly to relieve housing-cost burdens must consider the timing of credit delivery. Almost since the inception of the program, EITC recipients have been able to receive at least a portion of their anticipated credit in every paycheck (the "advance payment" option). Yet more than 98 percent of families receive the credit as a lump sum along with their income tax refund.[27] Families paying half or more of their income in rent clearly cannot afford to wait until the end of the year to receive a subsidy intended to help them with their monthly housing costs. Thus, the proposals to expand the EITC described below should be coupled with new efforts by the Internal Revenue Service (IRS) to increase participation in the advance payment option, particularly in markets where significant portions of working families face housing-cost burdens.

Table 1. Earned Income Tax Credit Filers and Section 8 Voucher Households, Selected Metropolitan Areas, 2000

Metro Area	Number of Section 8 households	Number of EITC filers (families)	EITC families per Section 8 household
Atlanta, GA	18,900	278,972	14.8
Baltimore, MD	12,797	153,062	12.0
Boston, MA-NH	27,422	227,438	8.3
Chicago, IL	42,218	477,294	11.3
Dallas, TX	17,411	239,672	13.8
Detroit, MI	13,561	232,998	17.2
Houston, TX	13,039	332,244	25.5
Miami, FL	13,586	262,752	19.3
New York, NY	96,400	756,669	7.8
Oakland, CA	23,567	90,145	3.8
Philadelphia, PA-NJ	20,306	281,831	13.9
San Antonio, TX	12,702	154,185	12.1
San Diego, CA	17,548	160,350	9.1
San Jose, CA	10,688	47,878	4.5
Seattle-Tacoma, WA	11,787	88,632	7.5

Source: Brookings Institution Center on Urban and Metropolitan Policy unpublished data; U.S. Department of Housing and Urban Development, "The Housing Choice Voucher Program: Who is Served—A National Overview" (2003).

B. If included as income, the EITC reduces by 18 percent the number of lower-income working households with severe housing cost burdens.

Common measures of housing afford-

Table 2. Impact of the EITC on Incidence of Severe Housing Costs, by Number of Children in EITC-Eligible Households with Severe Housing Costs, 1999 (in Thousands)

	Before EITC		After EITC		After EITC, Full Participation	
	Number with SHC	Percent with SHC	Number with SHC	Percent with SHC	Number with SHC	Percent with SHC
No Children	1,408	28.3	1,394	28.0	1,380	27.7
One child	975	21.9	769	17.2	758	17.0
Two children	888	23.7	614	16.4	593	15.8
Three or more children	605	25.2	512	21.3	445	18.6
Total	**3,876**	**24.9**	**3,289**	**21.1**	**3,176**	**20.4**

An additional 7,000 ineligible families with no children no longer had severe housing costs due to living with an EITC-eligible family.

Source: 1999 AHS and authors' calculations

ability are calculated on a pre-tax basis. That is, they consider the percentage of gross household income, before taxes are taken into account, consumed by rent or mortgage, plus utilities. Because families claim the EITC through the federal tax code, the income subsidy the credit provides may ameliorate some portion of the SHC burdens documented in recent studies.

In this section, we estimate receipt of the EITC by families in 1999 using data from the American Housing Survey and information on the credit parameters for that tax year, and inquire to what extent the tax credit reduces the incidence of SHC burdens and other indicators of housing-cost problems.[28] We examine the impact of the EITC at current participation levels as estimated by the General Accounting Office (GAO), and at full participation—assuming all eligible workers and families claim the credit.[29]

Overall, about 3.9 million low- and moderate-income working families—one in four EITC-eligible families—lived in households with SHC burdens in 1999 (Table 2). When we factor the EITC into their household incomes, assuming GAO's less than full participation rates, the overall incidence of SHC burden declines by 15 percent, or by nearly 600,000 families. The incidence of these burdens drops from 25 percent to 21 percent of EITC-eligible families.

Our model shows that the EITC's differing benefit levels and participation rates across family types result in very different impacts of the credit on the incidence of SHC burden (columns 1 and 2). Among childless workers, the combination of low income limits and low benefit levels in the credit means that the EITC removes burdens for only 14,000. At the same time, significantly larger credits and participation rates for families with children reduce the incidence of SHC burden among EITC-eligible families with one child by 206,000 families (21 percent), and among EITC-eligible families with two children by 274,000 families (31 percent). Because GAO identified a lower EITC participation rate among families with three or more children, the credit removes SHC burdens for only 15 percent of these EITC-eligible families—less than half its impact for two-child families.[30] Nevertheless, our model estimates that the EITC reduces the incidence of SHC burden for all EITC-eligible families with children by an impressive 15 percent, or 587,000 families.

The EITC's impact on severe housing costs would be heightened at full participation—that is, if all eligible working families claimed the extra income they earn via the EITC. Because of the low participation rate GAO estimated for larger families, boosting participation to 100 percent for qualifying families with more than two children would have the single greatest incremental impact, reducing the incidence of SHC burden by an additional 67,000 families. We estimate that full participation in the credit across all family types would remove 700,000 families from the ranks of the severely cost-burdened, an additional 113,000 above its effect at current participation levels.

Although they do not appear on the SHC radar screen, families with gross housing costs between 40 and 50 percent of income also carry a heavy burden that the EITC could significantly reduce. If all eligible families were to claim the EITC, the number of lower-income working households with children paying this much of their income for housing would decrease by nearly 60 percent, or by 760,000 households (Table 3).

Although the EITC has the potential to reach a significant number of families with SHC burden, IRS-sponsored research suggests that a sizable portion of EITC-eligible families fail to file taxes and miss out on the credit altogether. According to the IRS, between 2.3 million and 3.4 million EITC-eligible individuals (13 to 18 percent of eligible recipients) did not file for the credit in tax year 1996, the most recent year for which data are available. As a result, these individuals failed to claim between $2.1 billion and $3.5 billion.[31]

The IRS further finds that the eligible families least likely to receive the credit are from populations at substantial risk of SHC burdens. According to the IRS, up to 40 percent of all EITC-eligible nonfilers were childless workers, who represent half of all SHC-burdened families. Compared with eligible families who received the EITC, nonfilers were more likely to be renters, had lower incomes, and were highly clustered, with 40 percent living in just four states—CA, TX, NY, and FL. Not unrelated to this, about one-quarter of all nonfilers were born in "Hispanic countries." Several high-cost housing markets had above average nonfiling rates, such as Los Angeles (28 percent), New York City (23 percent), and Washington-Baltimore (22 percent). The financial value of forgone EITC income averaged $1,025, or about $85 per month, but was higher in a number of high-cost markets—more than $1,400 in San Francisco ($119/mo.), and $1,334 in Los Angeles ($111/mo.).

In short, even without any new initiatives to expand the EITC, local efforts to increase filing rates among those already eligible could help moderate severe cost burdens for a significant number of working families. As we discuss below, efforts focused on families with two or more children, who are generally eligible for higher benefits, could make an even greater difference.

Consistent with most housing policy research, we have calculated measures of housing affordability—including the impacts of the EITC—on a before-tax basis. Because the EITC boosts after-tax income, however, it is also useful to examine how all federal taxes. including credits such as the EITC. affect housing-cost burdens for low-income working families.

As we explain more fully in related work, our model of after-tax housing costs is designed to capture the relevant federal tax provisions that affect lower-income families. These provisions include federal income taxes, including the EITC, and the employee share of federal payroll taxes.[32] The model also includes two relevant post–1999 changes in individual income taxes: a refundable credit of up to $600 per child; and a modest expansion in the EITC for married couples with children. To compute after-tax income, we deduct 7.5 percent of earnings (the employee share of federal payroll taxes), along with any federal incomes taxes due, from gross income. We then add, where applicable, the EITC and refundable child tax credit to arrive at after-tax income, and recalculate the percentage of income paid for housing costs.

The most important finding that emerges from this analysis is that the established practice of assessing housing costs on a pre-tax basis seriously understates cost burdens among low-income childless workers. For low-income childless households, federal taxes increase the incidence of SHC burden from 31 to 38 percent, or by about 250,000 households (Figure 2). Because only a small EITC is available to these workers, the credit offsets their after-tax burden only minimally, eliminating SHC burden for just 15,000 households.

In contrast, for households with children, we find that the EITC and child credit more than compensate for income and payroll taxes paid, and that after-tax housing-cost burdens are less severe than before-tax burdens. After taxes, 373,000 fewer low-income working families with children bear SHC than before taxes. The net effect of federal taxes and tax credits on all working families is therefore a modest reduction in the incidence of SHC burdens. About 3.7 million EITC-eligible households pay more than 50 percent of before-tax income on housing, and 3.6 million pay more than 50 percent of after-tax income on housing.

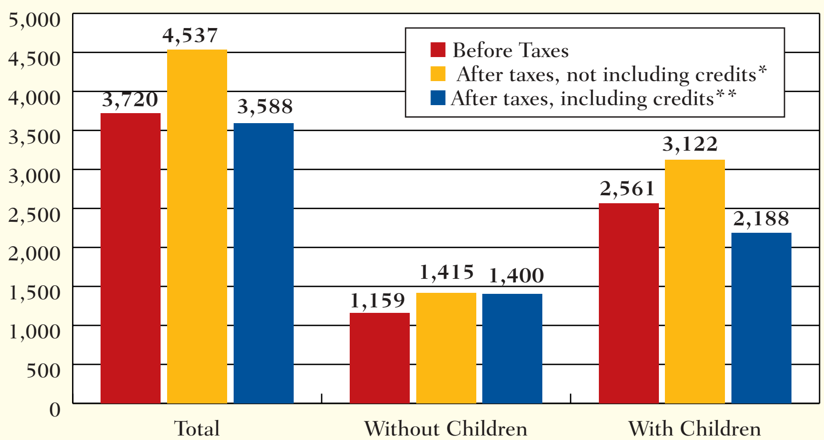
These findings confirm that, in the absence of the EITC and the refundable child credit, several hundred thousand additional low-income workers and families would spend more than half of their after-tax incomes for

Table 3. Impact of the EITC on Housing Cost Ratios, EITC-Eligible Households Only, Full Participation, 1999

	Before EITC Number of Households	After EITC Number of Households	Percent Reduction
Housing cost ratio category			
Households without children paying:			
30–40 percent of income	513,000	499,000	-2.7%
40–50 percent	272,000	251,000	-7.7%
Households with children paying:			
30–40 percent	1,969,000	1,229,000	-37.6%
40–50 percent	1,273,000	512,000	-59.8%

Source: 1999 AHS and authors' calculations

Figure 2. Effect of Federal Taxes on Severe Housing Cost Burdens, EITC-Eligible Households, 1999



* *Includes federal income and payroll taxes.*

** *Includes EITC with marriage plateau extension and refundable tax credit of up to $600 per child.*

housing. The findings also suggest that policymakers might more actively use the tax code to relieve housing-cost burdens—for childless workers, in particular—a topic we examine in greater detail in the next section.

C. Expanding the EITC for childless workers and larger families would eliminate severe housing costs for an additional 153,000 families.

The EITC was initially designed to relieve tax burdens for families with children. Only in 1993 was a small version of the credit enacted for childless workers, providing them with an effective rebate on the employee share of payroll taxes for the first few thousand dollars of earned income. In 1999, $700 million, or 2 percent of total EITC dollars, went to low-income workers without children.[33] That year, the maximum credit for a childless family was under $400, and eligibility for the credit ended at $10,000 earned income.

Greenstein has argued that no group of workers needs a tax cut more than low-income workers without children. He notes that, in addition to paying federal payroll and excise taxes, these workers begin paying federal income tax before their earnings reach the federal poverty line. In addition, Greenstein observes that childless workers are eligible for few if any other government benefits, such as cash, housing, or medical assistance.

Another argument in favor of increasing the EITC for this group is that it might encourage young fathers, especially minority fathers, who largely have been ignored by welfare reform efforts, to join the workforce. As Offner and Holzer note, encouraging marriage and family formation among welfare families will depend, in part, on the ability of young men to find jobs.[34] Yet today, only about half of the nation's 1 million young black high school dropouts are employed compared with more than 60 percent 20 years ago. Raising the return on low-wage labor by increasing the childless worker EITC could induce more young men without dependent children to join the labor force.

A bill sponsored by Congressman William Coyne in the 107th Congress (H.R. 3574) would increase EITC benefits for all families, particularly those without qualifying children and those with three or more qualifying children. The proposal contemplates four major changes to the structure of the EITC. First, for families with children, the bill would raise the maximum earnings used to calculate the credit to $10,710, the annual earnings for a full-time worker at minimum wage.[35] Second, the bill would extend the "phase-in" range for childless workers through the first $6,000 in wages, and extend the "plateau" for these workers through $10,710. Third, H.R. 3574 would double the credit's phase-in rate for childless workers to 15.3 percent, offsetting both the employer and employee share of the payroll tax.[36]

The fourth major change that the Coyne proposal makes recognizes that the poverty rate is "a stunning 29 percent for children in families with three or more children, which is more than double the poverty rate among children in smaller families."[37] The bill would create a new EITC benefit level for families with three or more children, including a credit percentage of 45 percent, which is higher than the 40 percent credit rate in the existing two-or-more-children category. Figure 3 shows how the Coyne proposal would expand eligibility and credit amounts for both childless workers and families with three or more children compared with current law.

We estimate that the Coyne proposal would nearly double the number of EITC-eligible childless workers, from 5 million to 9.7 million.[38] It would also more than double both the maximum credit (to $846) and the average credit (to $527) for these workers. For the 15 percent of EITC-eligible families with three or more children, the maximum benefit would rise by more than $600, and average benefits by nearly $400, to $2,549.

Overall, our model indicates that the Coyne proposal would eliminate SHC burden for 153,000 workers and families (Table 4). The bulk of this burden reduction occurs among childless workers, 93,000 of whom would escape the severe-cost category through this expansion of the EITC. The effects on poverty are even larger. The proposal would lift 132,000 childless workers above poverty, as well as nearly 100,000 families with children. The significant poverty reduction for families with and without children reflects the high incidence of poverty among the childless workers and large families that this proposed EITC expansion targets.

Figure 3. Structure of EITC in 1999 and under Coyne proposal (H.R. 3574)

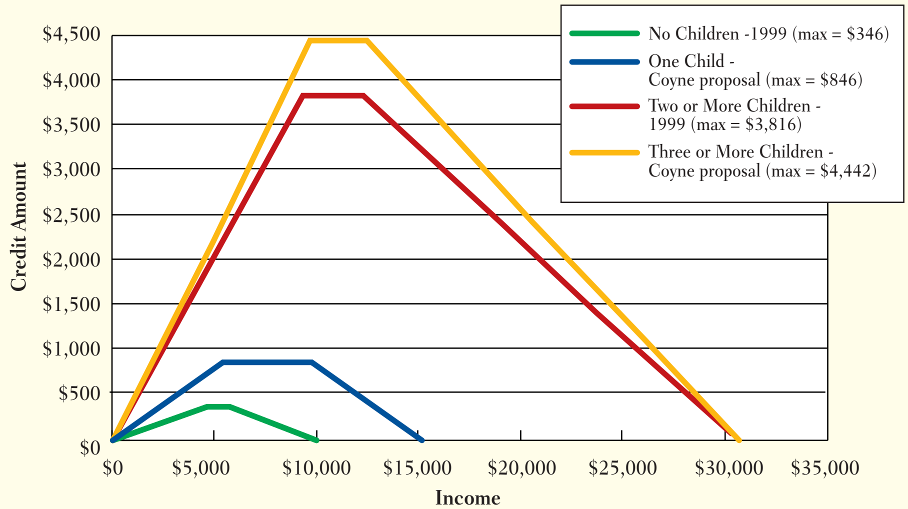


Table 4. Effects of Coyne (H.R. 3574) and a Median Housing Cost–Based Proposal on Severe Housing Cost Burdens and Poverty, 1999

	Coyne	MHC
Families with SHC burden:		
No-child families	-93,000	-234,000
One-child families	-37,000	-132,000
Two-child families	-2,000	-87,000
Three or more child families	-21,000	-58,000
Total	**-153,000**	**-510,000**
Poverty:		
Households without children	-132,000	-281,000
Households with children	-96,000	-447,000
Total	**-228,000**	**-728,000**

Source: 1999 AHS and authors' calculations

D. The authors' proposal to expand the EITC would relieve 510,000 families of severe housing-cost burdens. In contrast to Coyne, we set out to expand the EITC with the explicit goal of ensuring that significantly fewer working families, especially those with children, pay more than 50 percent of their gross household incomes for decent but modest housing. To get the most "bang for the buck" out of such a proposal, one might consider making an expanded EITC benefit available only to those families who currently bear such burdens.[39] But doing so would be enormously complex. The effectiveness of the EITC derives in no small part from the credit's administrative simplicity relative to most public benefit programs.

Rather than base the EITC on a family's individual income and housing circumstances, our proposal draws on what we refer to as a median housing-cost (MHC) standard. The MHC standard is based on a national distribution of local median housing costs. We set the standard such that most EITC-eligible families could afford a median-priced unit of the appropriate size in 25 to 75 percent of all local housing markets in the country. Under the proposal, EITC benefits for working families with earnings at the low end of the EITC plateau are pegged to median housing costs at the 25th percentile of the national distribution, while benefits for families with earnings at the high end of the EITC plateau are pegged to MHC at the 75th percentile.

Because the majority of EITC-eligible families with children and SHC burdens have incomes between $5,000 and $15,000 (not shown), we incorporate a steep "phase-in" rate and relatively slow "phase-out" rate into our EITC design, so that families across this income range would qualify for the largest benefits (see box for an example of how the proposal works).

The higher credit levels built into

Using the EITC to Help Families Meet Typical Housing Costs—An Example

To illustrate how our MHC proposal works, consider the proposed structure of the EITC for a one-child family:

- The median housing cost of a two-bedroom apartment in 1999 located at the 25th percentile along the national rent distribution (i.e., the price point that exceeds exactly one-fourth of all local median housing costs nationwide) was $485 per month, or $5,820 per year.

- For a family to spend no more than 50 percent of its income on rent, it would need to earn twice that amount, or $11,640.

- Therefore, we set the EITC phase-in rate (the amount of additional credit per dollar earned) and plateau starting point for one-child families such that the sum of earned income plus EITC benefits roughly equals the target income of $11,640.

- To achieve this, we raise the phase-in rate from 34 cents per dollar of earnings to 60 cents, and push out the starting point of the credit plateau from the 1999 level of $6,800 to $7,000. Thus, a family at the beginning of the plateau would receive $4,200, raising total income to $11,200, including the EITC. This is just a bit shy of our target income of $11,640.

- At the upper end of the plateau, we aim to make a two-bedroom unit at the 75th percentile price affordable. In 1999, that price was about $690 a month, or $8,280 a year.

- To meet the earnings target of double that amount ($16,560) at the end of the EITC plateau, we select the end point such that family income plus the EITC roughly equals the target income. Moving the maximum income on the plateau back from $12,460 to $12,200, coupled with the $4,200 maximum EITC, results in total family income of $16,400, again just shy of the target.

We set parameters for the no-child and two-or-more-children credits in the same way, using MHC for three-bedroom apartments for the latter, and half the MHC of a two-bedroom apartment for the former.

How would a credit tied to local MHCs be administered? Each year, the IRS publishes new inflation-adjusted parameters for the EITC. As part of that process, HUD would supply IRS with information on the distribution of local median housing costs so that the agency could set the corresponding EITC plateau points.

this MHC-based proposal give families an added measure of housing affordability regardless of whether they face SHC burdens (and regardless of whether they choose to spend their additional EITC dollars for housing). Table 5 displays parameters for the MHC-based credit for families of different sizes, and Figure 4 compares this proposal with the existing EITC (current credit in dashed lines, proposed credit in solid lines).[40]

By targeting families' high housing costs, the MHC-based proposal would increase the EITC for childless workers by a larger amount than the Coyne proposal, quadrupling the average credit to $917. It would also significantly increase benefits for families with two or more children, by 44 percent on average, to $3,104.

Table 5. Parameters for EITC based on Median Monthly Housing Costs

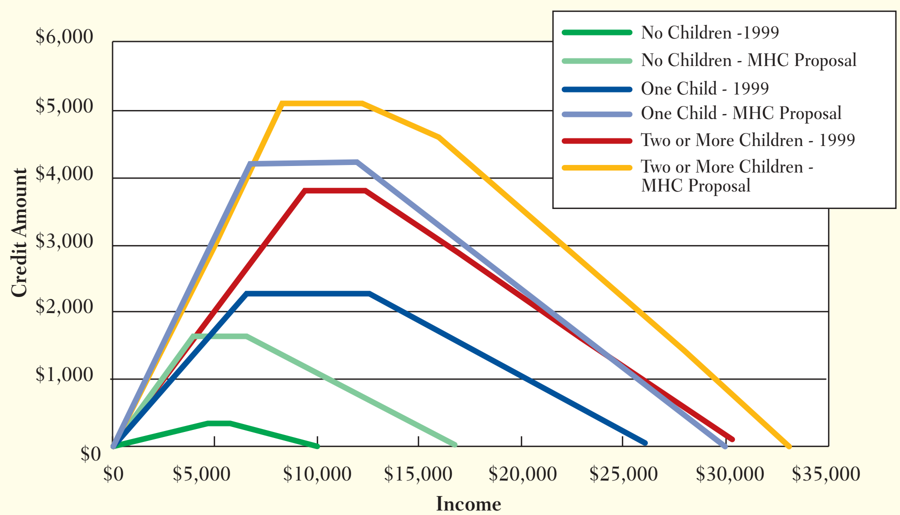
	No Children	One Child	Two or more Children
Phase-in rate	40%	60%	60%
Plateau begins	$4,000	$7,000	$8,500
Plateau ends	$6,600	$12,000	$12,200
Phase-out rate	15.3%	23.3%	13.5%, 27.0%[a]
Maximum earned income	$17,058	$30,026	$32,989
Maximum credit	$1,600	$4,200	$5,100
No. of eligible families	10,860	5,299	6,878
Average credit	$917	$2,467	$3,104

[a] *Declines at the rate of 13.5 percent from $12,201 to $16,000; declines at rate of 27 percent after that.*

Source: 1999 AHS and authors' calculations

In line with the significant increases in the EITC that the MHC proposal contemplates, its impacts on housing-cost burdens are even larger than those with the Coyne proposal. Expanding the EITC along these lines would eliminate SHC burden for more than 500,000 families, the majority with children (Table 4, right-hand column). Based on our calculation that roughly 3.3 million EITC-eligible families face SHC burdens under the credit's current structure, relieving SHC burden for an additional 510,000 workers and families would constitute a substantial impact. In addition, an MHC-based credit would lift an added 728,000 families above the poverty line, more than 60 percent of them families with children. This represents an additional 20 percent of EITC-eligible households.

Figure 4. Structure of EITC in 1999 and under MHC-based Proposal



IV. Discussion

The impact measures analyzed above for each proposal—their reduction of SHC burdens and poverty among EITC-eligible families—are not by any means the only criteria by which these proposals can be judged. This section compares the two proposals across a number of other factors (Table 6), and discusses their relative merits as methods of closing the housing affordability gap for working families.

Cost. The estimated cost of the MHC proposal ($25 billion per year) is roughly three times the estimated cost of the Coyne proposal ($7.7 billion). The MHC would increase the aggregate size of the EITC by roughly 81 percent; the Coyne proposal by 25 percent. Neither of these cost estimates includes any additional administrative costs. The three-to-one cost ratio is roughly in line with the proposals' respective reductions in SHC burdens (510,000 versus 153,000) and poverty (728,000 versus 228,000).

Targeting Efficiency and Impacts on Housing-Cost Ratios. We define "targeting efficiency" as the proportion of new EITC dollars that families with SHC burden would receive. The proposals are very similar in this respect, directing 22 to 23 percent of new dollars to families with extremely high housing costs. Although these figures reflect the fact that about three-quarters of additional EITC from each proposal would go to families who do not have SHC burdens, we argue that working families who spend 30 to 50 percent of income on housing costs can also benefit greatly from expanded income assistance.

Indeed, the benefits of the Coyne and MHC proposals for moderately cost-burdened households are quite significant. The MHC proposal would reduce the number of currently EITC-eligible households paying 40 to 50 percent of income on housing by 342,000, compared with 132,000 for the Coyne proposal. Reductions in the number of families spending 30 to 40 percent of income on housing are even larger. Per dollar expended, the Coyne proposal appears to have an advantage over the MHC proposal in reducing burdens for currently eligible workers and families without children.

Impact on SHC burden for working families. One area of particular policy concern is the high and growing concentration of SHC burden among low- and moderate-income working families, a group we define as earning between full-time minimum-wage income ($10,700) and 120 percent of area median income. The two proposals reduce the number of working families with SHC burdens by amounts roughly in line with their costs, with the MHC proposal having the largest impact (224,000 families). In addition, unlike housing vouchers, which target renters only, both measures would assist homeowners who face SHC burdens. The MHC proposal would have a greater per dollar impact on this group, reducing the incidence of SHC burden among homeowners by 169,000.

Table 6. The Impact and Efficiency of the Coyne and MHC Proposals

	Coyne	MHC
Revenue cost	$7.7billion	$25.0 billion
Targeting efficiency:		
Percent of new EITC spending on SHC families	21.6%	23.3%
Reduction in households by housing-cost ratio		
Currently eligible households without children paying:		
30-40 percent of income	-79,000	-154,000
40-50 percent	-46,000	-98,000
Currently eligible households with children paying:		
30-40 percent	-157,000	-406,000
40-50 percent	-86,000	-244,000
Newly eligible households without children paying:*		
30-40 percent	-39,000	-106,000
40-50 percent	-29,000	-66,000
50 percent and above	-36,000	-81,000
Reduction in SHC for working families		
LMI working households	-76,000	-224,000
LMI homeowners	-46,000	-169,000
Poverty reduction by race-ethnicity (EITC-eligible households only)		
White non-Hispanic households	-6.8%	-21.0%
African American households	-5.1%	-15.7%
Hispanic households	-6.9%	-23.1%
Other households	-5.4%	-19.2%
Total	**-6.2%**	**-19.8%**

Source: 1999 AHS and authors' calculations

**Both the Coyne and the MHC proposals greatly expand eligibility for childless workers; these figures represent reductions in housing-cost ratios among childless-worker households who would become eligible for the credit under these proposals. SHC = severe housing-cost burden.*

Impact on poverty. The impact of the two measures on overall poverty roughly tracks their dollar sizes. However, their effects vary by race and ethnicity because of differences in the demographic and economic composition of working families. In general, both proposals would serve to reduce poverty more among non-Hispanic whites and Hispanics than among other groups, with our MHC measure lifting nearly one-quarter of EITC-eligible Hispanic families above the poverty line.

V. Conclusion

There is a growing recognition among national housing policy observers that America's core housing problem stems not from a deficit in supply but from a deficit in income.[41]

Our experience during the 1990s—an almost decade-long period of unprecedented economic prosperity during which income inequality grew and housing affordability deteriorated—underscores this reality.[42] With unaffordable housing costs no longer confined to the nonworking poor, advocates and policymakers alike are searching for new strategies to help make housing affordable for working families.

In this survey, we argue that expanding the federal EITC can improve housing affordability for millions of working poor families. Our results indicate that, as currently structured, the EITC already substantially reduces SHC burdens for millions of lower-income working households, especially those with children. Because the purpose of this brief

"An expanded EITC would not, and should not, sound the death knell for housing assistance programs."

is to initiate a policy conversation among housing interests and those working on a broader "working families" agenda, we explored two ways that the EITC could be expanded to address growing housing costs among America's working families. Above and beyond the impacts of the existing credit, each proposal would alleviate SHC burden for hundreds of thousands of working families, and lift an even larger number of families above the poverty line, independent of their existing housing-cost burden.

We also recognize that there are complications to fully deploying the EITC as a policy tool to improve housing affordability. Most recipients choose to receive their payment in a lump sum once a year, making it difficult to meet monthly rent obligations, or in economic vernacular, making it difficult to "smooth" their spending. To effectively use the EITC to help families pay for housing, the IRS should improve and better publicize the credit's advance payment feature. In addition, the scale of the proposals considered would increase the size of the EITC significantly, a difficult proposition given the current state of the federal budget. Nonetheless, our results demonstrate that the federal individual income tax code already plays an important role in reducing the cost of housing for working families with children, and for that reason deserves further consideration as a vehicle for achieving housing policy goals.

In examining the potential of the EITC as an instrument of housing policy, we do not seek to diminish the role of dedicated housing and community development programs. Indeed, we cannot hope to eliminate altogether the incidence of SHC burdens through tax policy alone. Like Dolbeare, we seek ways to "remove from HUD's back some of the impossible burden of adequately addressing the nation's most critical housing affordability needs…[while leaving room]…for imaginative and creative use of vouchers and other measures."[43] An expanded EITC would not, and should not, sound the death knell for housing assistance programs.

The Section 8 voucher program, in particular, should complement income-based strategies, such as an expanded EITC. The congressionally appointed Bipartisan Millennial Housing Commission, for instance, recommended the Section 8 voucher program for additional funding "in substantial annual increments."[44] Because a demand-side strategy based only on the EITC would ignore too many families with SHC burdens—either because they are elderly or are disabled and cannot work, or because they are only marginally employed—it makes sense to use expanded Section 8 rental assistance largely for those individuals and families who would not benefit from an expanded EITC. In fact, according to HUD, almost two-thirds of current voucher holders have primary sources of income other than wages.

The problem of affordable housing is so great that our nation cannot deal through traditional housing programs alone. We therefore envision an important role for the tax code in helping families pay for housing.[46] The EITC provides a potential mechanism for increasing our commitment to affordable housing at a level commensurate with the growing needs of working families. Whether implemented at the federal, state, or local levels, an expanded EITC could go far in helping lower-income workers meet the rising costs of safe, decent, affordable housing for themselves and their children.

Endnotes

1. Michael A. Stegman is the McRae Professor of Public Policy and Business at the University of North Carolina at Chapel Hill. Walter R. Davis is research director of the Center for Community Capitalism at the University of North Carolina at Chapel Hill. Roberto Quercia is associate professor of city and regional planning at the University of North Carolina at Chapel Hill.
2. Jennifer Daskal, "In Search of Shelter: The Growing Shortage of Affordable Rental Housing" (Washington: Center on Budget and Policy Priorities, 1998).
3. Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing" (2003).
4. M.A. Stegman, R. Quercia, and G.W. McCarthy, "Housing America's Working Families," *New Century Housing* 1 (1) (2000).
5. I. Sawhill and A. Thomas, "A Tax Proposal for Working Families with Children" (Washington: Brookings Institution, 2001).
6. More detailed information on our research methods can be found in Michael Stegman, Walter Davis, and Roberto Quercia, "The Earned Income Tax Credit as an Instrument of Housing Policy" (Washington: Brookings Institution, 2003).
7. Stegman, Quercia, and McCarthy, "Housing America's Working Families." The tendency of the American Housing Survey to underestimate incomes and overestimate poverty when compared to the Current Population Survey suggests that we might overestimate EITC eligibility and benefit levels relative to CPS-based measures. See U.S. Department of Commerce and U.S. Department of Housing and Urban Development, "American Housing Survey for the United States: 2001." Despite this bias, we are comforted by the fact that our estimates of average EITC benefits by number of children are within 6 percent of official IRS statistics. This suggests that earned incomes reported in the AHS may be understated by the same order of magnitude.
8. Alan Berube, "Rewarding Work Through the Tax Code: The Power and Potential of the Earned Income Tax Credit in 27 Cities and Rural Areas" (Washington: Brookings Institution, 2003).
9. The distinction between families and households requires us to do some analysis using the former and some using the latter. The unit of analysis is clearly marked in each table.
10. For families in rural areas, up to 120 percent of state median income.
11. B. Lipman, "America's Working Families and the Housing Landscape 1997–2001," *New Century Housing* 3(2) (2002).
12. Winton Pitcoff and others, "Out of Reach 2003: America's Housing Wage Climbs" (Washington: National Low-Income Housing Coalition, 2003).
13. Jared Bernstein and Lawrence Mishel, "Labor Market Left Behind." EPI Briefing Paper #142 (Washington: Economic Policy Institute, 2003).
14. In this survey, we refer to tenant-based assistance generally as "vouchers," though such assistance occasionally takes other forms.
15. U.S. Department of Housing and Urban Development, "The Housing Choice Voucher Program: Who is Served—A National Overview" (2003).
16. Lipman, "America's Working Families."
17. U.S. Department of Housing and Urban Development, "Congressional Justifications for Fiscal Year 2003" (2002).
18. A. O' Hara, "Proposals to Improve the Housing Voucher Program," Hearing before the Senate Committee on Banking, Housing and Urban Affairs, 107 Cong. 2d. sess. (2002). Turn-back rates should not be confused with overall voucher use rates. Vouchers not used by the original recipients are available for use by other families; therefore housing authorities can simultaneously experience high use rates and high turn-back rates. Both rates are affected by factors such as program features, family demographics, management practices, and local housing market conditions. The most recent data indicate that overall voucher use rates approached 91 percent in fiscal year 2001, and the overall spending rate was about 95 percent (email correspondence with Will Fischer, Center on Budget and Policy Priorities, November 1, 2002).
19. B. Sard, "Housing Vouchers Should Be a Major Component of Future Housing Policy for the Lowest Income Families," *Cityscape: A Journal of Policy Development and Research* 5 (2) (2001): 89-110. A survey of members by the Council of Large Public Housing Authorities also identified landlord unwillingness to accept vouchers as a primary cause of lease-up problems in large housing authorities.
20. Vallerie Denney Communications, "Half of Landlords Tested Refuse Housing Vouchers, Additional 15%-25% Equivocate," Available at www.vdcom.com/articles/publish/article_143.shtml (January 3, 2003).
21. F. Kunkle, "Housing Vouchers No Magic Key," *Washington Post*, August 5, 2002, p. A1.
22. *Housing Law Bulletin*, "The Case for Applying California's Source of Income Anti-Discrimination Statute to Section 8 Tenants" (June 2001).
23. J. Stewart, "Being Forced Out by Low Incomes, Rising Rents," *Los Angeles Times*, September 29, 2001, p. 1.
24. U.S. Department of Housing and Urban Development, "Congressional Justifications."
25. D. Campbell and Michael Parisi, "Individual Income Tax Returns, 2000," SOI Bulletin (Fall 2002).
26. Berube, "Rewarding Work Through the Tax Code"; U.S. Department of Housing and Urban Development, "Congressional Justifications." Even if we expand our comparison to include the more than 4 million low-income households receiving any kind of low-income housing assistance, whether or not they have any earned income, the EITC remains a much larger program.
27. J. Romich and T. Weisner, "How Families View and Use the EITC: Advance Payment versus Lump Sum Delivery," *National Tax Journal* 53 (4) (2001), Part 2: 1245-1265. Under the advanced payment option, a family with children is eligible to receive up to 60 percent of their projected total credit. For a one-child family in 1999, this translated into up to $1,387 with their paychecks.
28. Before proceeding, it is important to note that our analyses pertain to EITC-eligible families and households, not to EITC recipients. Although we have used IRS data on EITC filers to calibrate our model, we have no way of determining whether each qualifying household in our AHS data actually received the EITC. Because there is no best way to adjust our empirical models to account for actual rather than full participation, our later assessments of how a modified EITC could impact housing-cost burdens consider full participation only. In this section, to give the reader a sense of how current participation in the EITC alters the credit's impacts on housing-cost burdens, we use the General Accounting Office reported participation rates to quantify those effects by family size. Thus, tables in this section portray the estimated actual impact of the EITC on severe housing-cost burdens in 1999 and the estimated hypothetical impact of the EITC on severe housing-cost burdens had all eligible earners claimed the EITC that year.
29. General Accounting Office, "Earned Income Tax Credit Participation." Report GAO-02-290R (2001).

30. See L.E. Burman and D. Kobes, "Analysis of GAO Study of EITC Eligibility and Participation" (Washington: Urban-Brookings Tax Policy Center, 2002) for a critique of the General Accounting Office methodology in estimating participation in the credit for families with three or more children.

31. Internal Revenue Service, "Participation in the Earned Income Tax Credit Program for Tax Year 1996" (2002).

32. For purposes of this analysis, we assume that all EITC eligible filers take the standard deduction. According to the Internal Revenue Service, in 1999, 90 percent of all tax returns from filers with incomes less than $30,000, and 94 percent with incomes less than $15,000, took the standard deduction. Our analysis does not take state taxes into account, which for some low-income families consume a greater share of income than federal taxes.

33. R. Greenstein, "Should the EITC for Workers Without Children be Abolished, Maintained, or Expanded?" (Washington: Center on Budget and Policy Priorities, 2000).

34. P. Offner and H. Holzer, "Left Behind in the Labor Market: Recent Employment Trends Among Young Black Men" (Washington: Brookings Institution, 2002).

35. In tax year 2002, the credit reaches its maximum at $7,370 in earnings for one-child families and $10,350 in earnings for families with two or more children.

36. Most economists believe that, in the long run, the full burden of the payroll tax—including the employer share—is borne by workers in the form of lower wages. Greenstein, "Should the EITC for Workers Without Children be Abolished, Maintained, or Expanded?"

37. R. Greenstein, "Should EITC Benefits Be Enlarged for Families with Three or More Children?" (Washington: Center on Budget and Policy Priorities, 2000).

38. H.R. 3574 was introduced in 2001. To properly compare to the tax year 1999 EITC, we adjusted the plateau and maximum earned income limits for inflation from those presented in the bill.

39. This type of proposal is contemplated in C.N. Dolbeare, "Housing Affordability: Challenge and Context," *Cityscape: A Journal of Policy Development and Research* 5 (2) (2001): 110-130.

40. Readers may note that for families with two or more children, we include a graduated phase-out rate. In addition to helping control the costs of this provision, this feature would also help many families with below-poverty incomes avoid a high marginal tax rate implicit in the EITC phase-out.

41. L. Winnick, "The Triumph of Housing Allowance Programs: How a Fundamental Policy Conflict was Resolved," *Cityscape: A Journal of Policy Development and Research* 1 (3) (1995): 97; R. Feldman, "The Affordable Housing Shortage: Considering the Problem, Causes, and Solutions." Banking and Policy Working Paper 02-2 (Minneapolis, MN: Federal Reserve Bank of Minneapolis, 2002).

42. M. Elliott, M.W. Grote, and O. Levin-Waldman, "Deepening Disparity: Income Inequality in New York City" (New York: Public/Private Ventures, 2001).

43. Dolbeare, "Housing Affordability."

44. Bipartisan Millennial Housing Commission, "Meeting Our Nation's Housing Challenges" (2002).

45. U.S. Department of Housing and Urban Development, "The Housing Choice Voucher Program."

46. J. Turnham and J. Khadduri, *Issues and Options for HUD's Tenant-Based Assistance Program: Prepared for the Millennial Housing Commission's Consumer Based Assistance Task Force* (Bethesda, MD: Abt Associates, 2001).

Acknowledgments
The Brookings Institution Center on Urban and Metropolitan Policy would like to thank the Annie E. Casey Foundation and the Fannie Mae Foundation for their generous support of our work on working-family investments and policies.

For More Information
Michael Stegman
Director, Center for Community Capitalism
University of North Carolina
stegman@email.unc.edu

Walter Davis
Project Director, Center for Community Capitalism
walter_davis@unc.edu

Roberto Quercia
Associate Professor, Department of City and Regional Planning
quercia@email.unc.edu

THE BROOKINGS INSTITUTION
1775 Massachusetts Avenue, NW • Washington D.C. 20036-2188
Tel: 202-797-6000 • Fax: 202-797-6004
www.brookings.edu

CENTER ON URBAN AND METROPOLITAN POLICY
DIRECT: 202-797-6139 • FAX/DIRECT: 202-797-2965