Rethinking U.S. Rental Housing Policy
Build on State & Local Innovations

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Summary

In recent years, housing has all but disappeared from national debate. But while federal policymakers focus their attention elsewhere, our country's housing challenges are changing in ways that not only affect an expanding segment of the population, but also undermine other top domestic priorities. If we are serious about commitments to grow the national economy, make work pay, leave no child behind, and protect the natural environment, we must more effectively tackle today's rental housing problems. The next President should reinvigorate national rental housing policy, building on the innovations being tested in various states and locales. Specifically, the President should promote a housing policy under which:

- the federal government assumes responsibility for boosting the purchasing power of low-income renters to cover the cost of decent quality housing, through a combination of an increased minimum wage, an expanded Earned Income Tax Credit, and targeted housing vouchers
- state and local governments could then take the lead in expanding the supply of moderately priced rental units, using a combination of regulatory tools and capital subsidies
- the federal government would deploy a combination of carrots and sticks to ensure that state and local governments reduce regulatory barriers that artificially constrain housing production and drive up costs, expand the stock of affordable rental housing in the locations where it is needed, and ensure

full and fair access to regionwide housing opportunities for low-income and minority households

This new blueprint for federal rental housing policy responds to the root causes of current challenges, respects the creativity and growing capacity of state and local governments, catalyzes private market forces, and creates new housing opportunities for many more low- and moderate-income Americans.

Context

One-third of all Americans—more than 36 million households—rent, and a growing share of renters cannot find homes or apartments they can reasonably afford. Moreover, as metropolitan areas sprawl outward and jobs become increasingly dispersed, fewer low-wage renters can find housing near their work. While employment growth is fastest in the low-density counties on the fringes of America's metropolitan areas, affordable housing—and affordable rental housing in particular—remains disproportionately located in inner-city and older suburban neighborhoods. In fact, in many metropolitan areas, a substantial share of the affordable rental stock is concentrated in distressed, high-poverty neighborhoods.

These challenges warrant more serious and sustained policy attention than they currently receive, both because they create hardship for low- and moderate-income families across the country and because they undermine other high-priority policy agendas. Specifically, the lack of affordable housing hinders economic productivity and undermines the premise that full-time workers should be able to achieve a decent standard of living. The concentration of affordable housing in distressed inner-city neighborhoods traps low-income children in dangerous places where public schools are failing. And the mismatch between employment and affordable housing locations contributes to environmentally and fiscally wasteful patterns of sprawl.

Today's rental housing market challenges reflect a confluence of demographic, economic, and social forces that the current array of federal housing programs can no longer effectively address.

Nationwide, rents are rising faster than incomes for a growing segment of the workforce. Specifically, gross rents (which include utility costs) have been growing faster than inflation, while the median renter's monthly income has declined 7.3 percent since 2000. As a result, average gross rents as a share of renter income have grown from 26.5 percent in 2000 to 30.3 percent today. This trend is primarily the result of widening income inequality—with incomes rising much more slowly for low- and moderate-wage workers than for those in high-skill, high-wage jobs.

Moreover, in ***prosperous metropolitan areas***, the supply of housing is not keeping pace with employment and population growth. Local zoning laws, land use controls, and other regulatory barriers limit total housing production, raise the costs of new units, and often prevent the production of low-cost units. As population expands in a market with constrained supply, the increased competition for units causes prices to rise, even for households that do not typically rely on new construction for their housing. In effect, the traditional "filtering" process—in which older housing units become more affordable over time while the most affluent households trade up to new units—cannot function properly when supply falls too far short of growing demand.

Within metropolitan areas, affordable rental housing is especially scarce in communities where job opportunities are expanding. Historically, both jobs and affordable rental housing were concentrated in central-city locations. But over the last few decades, employment growth has become increasingly dispersed, while exclusionary zoning laws have limited the development of rental housing in many suburban communities. Central cities, then, remain the primary source of affordable rental housing within most metropolitan regions. Nationally, 45 percent of all renters and two-thirds of poor renters live in central cities.

The clustering of affordable rental housing in ***central-city neighborhoods*** concentrates minority poverty and exacerbates distress. Although most poor Americans live in non-poor neighborhoods, 7.9 million poor people still lived in "extreme poverty" census tracts in 2000, and more than half of all high-poverty neighborhoods are predominantly black or Hispanic.[1] Residents of these distressed neighborhoods often fall victim to a host of undesirable outcomes: higher rates of crime, teenage pregnancy, and educational failure; poor health and mental health outcomes; reduced private-sector investment and higher prices for basic consumer goods; and greater dependence on overburdened local government.

The existing panoply of federal rental housing policies can claim credit for some important accomplishments, but now suffers from serious failures of scale, design, and implementation. Most significantly, the gap between housing needs and subsidy resources is steadily widening, with no resolution in sight. Since federal housing assistance is not an entitlement, only about one-third of eligible households receive assistance.[2] In essence, low-income renters participate in a national "housing lottery" that has ceased to be fair or rational in its distribution.

In addition, programs to produce more rental housing units continue to focus on inner-city neighborhoods—further concentrating poverty, rather than expanding access to opportunity. A recent analysis revealed that central cities received 58 percent of all metropolitan Low Income Housing Tax Credit units built during the 1990s, even though they are home to only 38 percent of metropolitan residents. And one out of every seven tax credit projects sited in a central city is located in a neighborhood of extreme poverty.

Finally, federal programs provide few incentives to states and localities to remove the regulatory barriers that raise production costs and distort the location of rental housing. Thus, scarce federal production resources do not go as far as they could, with

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[1] Note: this report defines "high-poverty neighborhoods" as those with poverty rates of above 30 percent, and "extreme-poverty neighborhoods" as those with poverty rates above 40 percent.
[2] This estimate is derived by dividing the total number of directly assisted rental units (4.9 million) by 13.7 million, which is the total number of extremely low-income (below 30 percent of U.S. average monthly income rates) and very low-income (below 50 percent), given that most direct federal assistance programs target these income levels.

per unit costs of production increased by burdensome local regulations and administrative procedures. And the federal government "looks the other way" when local jurisdictions implement policies that effectively disallow the construction and operation of affordable rental housing.

In the absence of federal leadership on rental housing policy, many local and state governments have stepped into the void, because *state and local leaders increasingly recognize the connection between the availability of affordable housing and future economic vitality.* As a consequence, they have begun to build effective coalitions in support of policies that

- boost incomes so that more working families can afford the cost of housing,
- re-orient the regulatory environment to encourage the production of new rental housing where it is needed most, and
- expand support for the production and preservation of moderately priced housing.

On the income side, 18 states plus the District of Columbia have enacted minimum wages higher than the federal standard; 21 states plus the District now have their own earned-income tax credit programs, which—like the federal program—supplement the incomes of workers who earn up to double the rate of poverty. On the regulatory side, more than 130 localities nationwide are boosting the production of affordable housing through inclusionary zoning ordinances, and a handful of states like Illinois and California have enacted anti-NIMBY ("Not In My Back Yard") statutes to expand supply, particularly in restricted communities. And on the production side, 37 states and more than 350 counties and cities have created housing trust funds and are collectively spending nearly $1 billion annually on the production and preservation of affordable housing.

Blueprint for Rental Housing Policy

The federal housing policy debate can and should be reinvigorated during the next presidential election and beyond, building on the imaginative new solutions arising from state and local governments and the vibrant state and local political coalitions that are successfully promoting meaningful housing reforms and initiatives. These coalitions are using fresh language, deploying new arguments, and involving powerful partners from the business community in their push for change—a potential model for building broader support for a reinvigorated housing policy at the federal level as well.

A New Division of Responsibilities

The reawakening of policy innovation at the state and local level is inspiring, but without a renewed commitment from the federal government, these efforts will never be sufficient to address the breadth and depth of the affordable housing challenges we face today. If the new President were committed to tackling the challenges outlined here, we would need a new division of responsibility. No single level of government can or should try to address today's complex rental housing challenges on its own. Federal, state, and local governments all have essential roles to play. Therefore, we propose a new division of responsibility—and accountability—between the federal government and states and localities.

Only the federal government has the fiscal capacity to address the consequences of stagnant wage growth and income inequality nationwide. As long as incomes for a substantial segment of the population fall short of what it takes to cover the costs of producing and operating adequate housing, state and local governments simply cannot afford to close the affordability gap for enough households. Therefore, federal policies should target the demand-side of the housing affordability equation, ensuring that all households have sufficient income (or a housing voucher) to make adequate housing affordable.

If the federal government addresses the demand side of today's housing affordability crisis, state and local jurisdictions can and should assume lead responsibility for the remaining, supply-side challenges. Using both regulatory policies and supply-side subsidies, states and localities should create incentives that induce private-market actors (both for-profit and non-profit) to produce and maintain rental housing that is affordable for people with moderate incomes.

Under this basic framework, the federal government would retain a strong interest in the impact of state and local supply-side policies, because federal efforts to boost incomes will come to naught in markets where the housing supply is artificially constrained. Therefore, the federal role with respect to supply-side policy must be to create strong incentives for states and local jurisdictions to reduce regulatory barriers that unnecessarily constrain supply and inflate costs. The goal is to produce affordable rental housing where it is needed most, as well as to ensure that families aren't excluded from opportunity-rich communities based on their race or ethnicity.

This proposed strategy goes beyond narrow housing goals to advance a broader set of national priorities that are currently being undermined by the failures of federal housing policy. Specifically, by expanding the availability of affordable housing in regions where jobs are plentiful and population is expanding, this strategy enhances the economic productivity and competitiveness of the nation as a whole. By raising after-tax wages to a level sufficient to cover the cost of decent housing, it lives up to the fundamental premise that people who work full-time should be able to provide their families a decent standard of living. And, by tackling the regulatory barriers that have concentrated affordable rental housing in distressed central-city neighborhoods, it expands opportunities for low-income families to raise their children in safe and healthy communities with well-performing public schools.

Boosting Families' Purchasing Power

Ensuring that people who work full-time earn enough to make decent housing affordable is the critical first step in a 21st century housing policy. The federal minimum wage standard and the Earned Income Tax Credit both represent powerful tools for accomplishing this goal. According to estimates from the National Low Income Housing Coalition, a full-time worker would need to earn close to $16 per hour (more than three times the federal minimum wage) in order to afford the average rent for a modest, two-bedroom house or apartment (that is, costing 30 percent of gross income). Clearly, a substantial increase in the federal minimum wage must be part of a strategy for ensuring that full-time workers can earn enough to make minimally adequate housing affordable.[3]

The minimum wage cannot fill the income gap alone. Currently, the federal Earned Income Tax Credit provides a substantial wage supplement for many working families. In fact, estimates indicate that the EITC already reduces the number of households with severe housing cost burdens by 18 percent. Increasing the EITC, extending it to childless workers, and expanding participation would substantially reduce the number of working families paying unaffordable housing costs, even at the current minimum wage. Combining a modest increase in the federal minimum wage with a substantial expansion of the EITC (or the refundable tax credit for renters proposed by John Quigley) offers an administratively efficient strategy for making housing more affordable for many working families.

One of the limitations of a national, income-based strategy is that it fails to reflect variations across markets in the cost of decent housing. In other words, the strategies above may be sufficient in some low-cost markets, but still leave working families in high-cost markets with unaffordable rent burdens. One option would be to adjust EITC payments to reflect local housing costs. However, the federal government's primary responsibility should be to bring working people's incomes up to a single, national standard, while creating incentives for state and local governments to reduce the costs of housing locally and to expand the availability of units affordable at the national standard.

For households headed by elderly or disabled people who cannot work and for families with children where adults are not working (or are not working full-time), targeted pools of housing vouchers could be linked to appropriate incentives and services. For example, one pool might be designed to provide a dignified safety net for those who

[3] At the time of this writing, both the House of Representatives and the Senate had passed legislation increasing the minimum wage to $7.25 per hour. The Senate bill, however, would make changes to tax and immigration laws that were not addressed in the House bill, and includes an $8.3 billion package of small business tax cuts.

cannot work and who lack the resources to obtain decent housing. Elderly and disabled families could use these vouchers to live in conventional rental housing or to move into supportive housing. Another pool of vouchers might be targeted to families leaving welfare, with a rent formula that encourages work and a requirement that families enter into a self-sufficiency contract, in order to make the best possible use of housing assistance. A third pool of vouchers might be targeted to families with young children living in severely distressed neighborhoods, providing support and help to relocate to communities with well-performing schools.

A potential strategy for encouraging states and localities to expand rental housing production and reduce market rent levels would be to set a single national payment standard for these new vouchers in conjunction with a supplemental fund that local authorities would be required to use to "top up" vouchers to a level sufficient to cover the costs of adequate housing in the local market area. As other state and local policies brought local housing costs down and expanded the stock of moderately priced units, money from this fund that was not needed to supplement federal voucher payments could be redirected to other, locally determined housing purposes.

The federally funded voucher program should be administered regionally, not by individual, local jurisdictions (as is the current Housing Choice Voucher Program). Administration by local public housing agencies fragments the metropolitan rental market, making it difficult for low-income families, particularly minority families living in central cities, to know about and act on the full range of housing options that a voucher makes affordable. Moreover, by automatically assigning responsibility to local public housing agencies, the current system prevents other capable public and private sector entities from administering the program, stifling the innovation that competition can bring. In non-metropolitan areas, the vouchers should be administered by a state-level entity.

Expanding the Affordable Housing Supply

If the federal government tackled the income side of the rental housing affordability challenge as outlined above, its supply-side intervention could focus on leveraging the full panoply of state and local powers and activities. More specifically, federal production resources should be designed to encourage state and local governments to be “affordable housing friendly” in the design and application of their regulatory regimes. In that way, federal programs will catalyze the production of substantially more affordable housing than is possible with current or even substantially higher funding levels. Federal production resources also should be allocated in a way that ensures that affordable housing is built in the right places—in communities of choice and opportunity that have good schools and quality jobs.

The federal government should deploy a combination of carrots and sticks to effectively guide state and local action. First, existing metropolitan planning organizations (MPOs) should receive federal funding (and technical assistance) to prepare regional housing strategies that complement the regional transportation plans already mandated by federal law. These housing strategies should ensure that all communities in a metropolitan area, including the prosperous ones, participate in the production of housing for families with a broad range of incomes. MPOs are a logical choice for the development of regional housing strategies, given that they are generally governed by elected representatives of city and county governments, have been responsible for metropolitan transportation decision-making since the early 1990s, and increasingly are staffed with professionals with planning expertise.

To complement the metropolitan focus of the MPOs, new federal resources should be made available to support and nurture the creation of non-profit regional housing corporations. These corporations would have the principal task of developing and preserving affordable rental housing in growing suburban areas. Some of these regional housing corporations would, by necessity, be new nonprofit entities; others would likely evolve from existing community development corporations.

Within this new regional planning framework, cities and urban counties would continue to receive funds from the Home Investment Partnerships (HOME) and Community Development Block Grant (CDBG) programs, but would be required to implement housing programs in ways that further and are consistent with regional housing strategies. MPOs would have the authority to certify compliance, and cities and counties that did not comply would be given a designated period in which to correct deficiencies or lose federal funding for either housing production or transportation.

In order to induce more affordable rental production in suburban communities—many of which do not currently qualify for HOME or CDBG funding—we propose a new federal incentive fund. Jurisdictions would be eligible to receive awards from this fund if they reduced regulatory barriers and expanded the supply of moderately priced rental housing within their borders.

States would continue to administer the Low Income Housing Tax Credit (LIHTC), but the formula for allocating credits would be recalibrated to increase the availability of credits in areas where new rental production is demonstrably needed. And LIHTC income limits and incentives should be adjusted so as to discourage the concentration of more affordable housing in distressed neighborhoods, but rather to support *both* housing developments serving a broad range of incomes within revitalizing communities *and* developments that expand the availability of rental housing for low and moderate income households in opportunity-rich communities.

Priority First Steps

Even if the basic thrust of this new housing policy framework gained wide acceptance, it would take time to transform federal programs and incentives and to build local, state, and regional capacity to perform more effectively. Moreover, the transition to a new system of federal responsibilities would have to include a responsible strategy for dealing with the existing stock of federally subsidized housing—public housing and privately-owned rental housing alike. These are the four short-term, high-priority next steps for the new President with respect to federal rental housing policy.

Require existing Metropolitan Planning Organizations (MPOs) to produce regional housing plans in conjunction with their already-mandated transportation plans. This requirement would begin the process of linking regional housing and transportation and could encourage some metropolitan regions to begin addressing regulatory barriers and other rental housing supply constraints. To support MPOs in this expanded mandate, the federal government should provide funding to enable hiring of qualified housing staff, as well as technical assistance.

Create new pools of federal housing vouchers, to be awarded competitively to local and regional entities able to implement innovative programs linking vouchers with effective support services. The new voucher pools would be explicitly intended to encourage and support work among welfare-leavers and to enable low-income families with children to relocate to communities with high-performing public schools.

Expand and retarget the Low Income Housing Tax Credit program (LIHTC). First, LIHTC resources should be reallocated to provide more credits to states where rental housing is in short supply and fewer credits to states with sufficient (or excess) supply. In addition, LIHTC income limits should be adjusted so that credits support two distinct types of housing developments: mixed-income housing in revitalizing communities (where the broadest possible mix of incomes is needed) *and* affordable housing in opportunity-rich communities (where more of the LIHTC units should be targeted to low- and moderate-income levels within mixed-income neighborhoods).

Preserve and transform the current inventory of public and federally assisted housing through new initiatives. These new initiatives include a reinvigorated HOPE VI program to demolish and replace severely distressed public housing; reliable federal funding for the renewal of Section 8 contracts; a new block grant program for acquisition and recapitalization of affordable housing by non-profits, guaranteeing their long-term affordability; and the elimination (or reduction) of tax liabilities for owners of federally assisted housing who sell to a nonprofit entity that commits to long-term affordability.

These four steps, all of which could be implemented immediately and at varying scales, offer the new President the opportunity to begin moving federal rental housing policy in a new direction—toward a framework that addresses the fundamental challenges facing the country today. How much would these steps cost? Although the scale of each of the proposals is flexible, a desirable five-year package would include:

- one million new incremental vouchers (phased in over ten years)
- a 20 percent expansion in the LIHTC
- restoration of the HOPE VI program to its original scale
- a comparable annual investment in preservation matching grants
- exit tax relief for the owners of older subsidized properties

The cost of this package totals about $2.6 billion in the first year, rising to $6.3 billion in year five. One potential source of funding could come from a modest adjustment to the homeowner capital gains tax exclusion (*not* the deductibility of mortgage interest or property taxes). This exclusion was expanded in the mid-1990s, in part to assist older owners of large, high-valued homes who wanted to downsize to smaller, lower-valued homes. The cost of this exclusion is estimated to climb from $35 billion in 2006 to $47 billion by 2012.

Concluding Observations

Ever since its inception in the 1930s, federal rental housing policy has been evolving—responding to market trends, changed political circumstances, and the shifting philosophies of the day. The pressing housing challenges facing the nation at the start of the 21st century require federal rental housing policy to renew itself once again, because—left unchecked—current trends threaten to undermine national economic, social, welfare, environmental, and even educational priorities.

These recommendations build on the energy and innovation that is emerging from state and local leaders across the country. In that spirit, they are meant to be federalist rather than federal and to fully acknowledge the preeminent role of state and local governments in setting the rules of housing production. The recommendations focus primarily on closing the growing gap between wages and rental prices in the country, one of a series of responses to globalization and our changing economic landscape. They also recognize that the federal role in producing affordable housing must catalyze markets, stimulate the overhaul of regulatory restrictions, promote mixed income housing, decommission federal enclaves of poverty, support city and suburban collaboration, and diminish the ill effects of balkanized, duplicative, and fiscally wasteful administration.

There are no doubt risks to pursuing this strategy, and many constituencies will find greater comfort in protecting their piece of a shrinking pie than in striking out for new, uncharted territory. Yet political risk and political leadership are essential if the current stalemate over housing policy is to be broken. The next President should forge a new national compact on housing and launch a period of meaningful policy debate, reform, and action.

About the Authors and the Project

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Bruce Katz is Brookings vice president and founding director of the Metropolitan Policy Program. His expertise includes major demographic, market, development and governance trends affecting cities and metropolitan areas. Katz was chief of staff to former U.S. Department of Housing and Urban Development Secretary Henry G. Cisneros, and staff director of the Senate Subcommittee on Housing and Urban Affairs.

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