Comment on Kathryn P. Nelson's "*Whose* Shortage of Affordable Housing?"

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Introduction

Programs to address housing needs in the United States have evolved considerably over the past 50 years, and that evolution has been accompanied by significant debate over what the best housing policy is. Much of that debate has focused on supply-side versus demand-side subsidies (see Apgar 1990). Within that debate, further questions have concerned the role of private market versus public sector provision of housing, the design of housing allowances, and the effects of different subsidy schemes on the supply and price of housing.

A second area of debate has been the targeting of limited resources for housing assistance. The appropriate target income level for eligibility and the amount of subsidy, which together dictate whether many eligible households receive a little assistance or fewer eligible households receive more assistance, are among the elements of this debate. In her article "*Whose* Shortage of Affordable Housing?" Kathryn Nelson adds to previous work by documenting the arithmetic shortages and surpluses of housing affordable at various income levels and the deficiencies of existing programs in attacking the severest shortages.

Recent housing efforts have moved away from deep subsidies and provide a rent level that is determined not by tenant income but by area median income. Nelson and Khadduri (1992, 3) discussed this trend:

> Moreover, Congress has also been experimenting with new program designs that use "flat rents" rather than rents set as a percentage of income. The flat rents for the Housing Development Grant (HoDAG) and low-income housing tax credit (LIHTC) programs were set at a level affordable to households with incomes around 50 percent of median, but not to most of the yet poorer households likely to qualify for federal preferences for Section 8 and public housing. Thus the design of these programs, in which rents are fixed at a

> specific dollar level, unlike that of Section 8 and public housing, in which rents vary with income, does not encourage participation by families with incomes well below the nominal income limit.

Nelson presents a compelling case that the current LIHTC and HOME programs do not target the income range where the severest shortages of affordable housing exist. The shortages are severest for extremely low income renters—those with incomes below 30 percent of area median. In fact, surpluses of units exist in a range affordable to those with incomes between 50 and 80 percent of area median, although these surpluses do not necessarily indicate an absence of housing needs in this income range.

Important contributions made by Nelson include a detailing of different definitions for low-income renters and affordable rents and the use of American Housing Survey (AHS) data to document shortages and surpluses of housing units affordable to households in different income ranges defined in relation to U.S. Department of Housing and Urban Development (HUD) adjusted area median family income (HAMFI). The evidence supports the view that the two major federal supply programs—the LIHTC and HOME—are targeted at income levels too high to produce directly the low-rent housing in shortest supply.

This comment focuses on the policy implications of Nelson's findings. It explores further issues in the targeting of supply programs, raises policy issues related to the design of federal housing programs from a state and local government perspective, and provides several other brief comments on the Nelson article. Primarily, the policy concerns relate to coordination between federal programs and state and local objectives and to the spatial targeting of assistance. This comment focuses on the LIHTC because it is older than HOME and so provides more evidence on outcomes. The HOME program is better designed to address the issues raised in this comment because of its greater flexibility, but experience with it is limited because of problems encountered by local and state governments in starting a new program and because of regulatory requirements that these governments viewed as excessive. Congress and HUD have attempted to rectify these problems.

Targeting the LIHTC: Evidence from Florida

Are rents in LIHTC projects at the maximum?

As discussed by Nelson, maximum rents in the LIHTC and HOME programs are based on HAMFI. However, the LIHTC has often been used in combination with other subsidy programs, including those created at the state and local levels (Stegman 1991). It is conceivable that efforts at the state and local levels bring rents below the maximum so that LIHTC projects are better targeted to needs, although evidence suggests that this has not been the case, as noted by Nelson. This section examines limited evidence on LIHTC implementation in Florida to determine whether actual rents equal or approach the maximum allowable, as expected. If providers of units through these programs can offer units at rents below the maximum threshold, the income-targeting issue is less important.[1]

In Florida, the State Apartment Incentive Loan (SAIL) program is a state subsidy program used in combination with the LIHTC. This program offers second mortgage loans with rates as low as 3 percent covering no more than 25 percent of project cost. Data on 20 completed family projects that have used both the LIHTC and SAIL programs were examined to determine the rent levels that have been achieved by combining subsidies.

The 20 projects are found in nine counties, of which six have high median incomes. In these high-income counties, 50 percent of median income, the very low income cutoff, is more than $19,000 for a family of four. In Palm Beach County, the county with the highest income of the nine, the very low income cutoff reaches $21,550.

Under the LIHTC program, projects can qualify for credits by providing a minimum of 20 percent of their units at a rent affordable to households with 50 percent of median income or less or by providing 40 percent of units at a rent affordable at 60 percent of median income or less. The SAIL program uses the same set-asides. Since most projects set aside more than the minimum percentage of units, they can qualify at the 60-percent-of-median standard. Of the 20 projects studied here, most set aside 100 percent of their units as LIHTC units; the minimum set-aside among the projects was 40 percent. In selecting

[1] However, as discussed later, the issue of inefficiencies associated with packaging multiple subsidies and financing sources with the LIHTC would remain.

projects to receive tax credits each year, the Florida Housing Finance Agency currently awards bonus points to projects that exceed the minimum set-aside or offer rents affordable at 40 or 45 percent of median income.

The 20 projects include a mix of unit types: Eleven have one-bedroom units, 19 have two-bedroom units, and 12 have three-bedroom units. Several of the projects quote a rent range for a given unit size. The rents in each case were compared with the maximum rent for that unit size based on the 50-percent-of-median-income standard.

For 4 of the 11 projects with one-bedroom units, all one-bedroom LIHTC units had rents above the level affordable to households at 50 percent of median income. The other 7 specified upper and lower bounds for the rent; for 3 the upper bound was below the 50 percent rent, while for the other 4 the lower bound was below the 50 percent standard but the upper bound was above the standard. For only 1 project did the upper bound fall below a rent set according to 45 percent of HAMFI; for 3 other projects the lower bound was below that threshold.

Of the 19 projects with two-bedroom units, 11 had at least some two-bedroom LIHTC units with rents affordable at 50 percent of median income. Five of those had all their two-bedroom LIHTC units affordable at or below 45 percent of median income. One had a lower rent bound below the 45 percent level. Among the 12 projects with three-bedroom units, 6 had all their three-bedroom LIHTC units renting at levels affordable at 50 percent of area median, and 4 of those had all LIHTC units affordable at 45 percent of median. Across all unit sizes, projects that offered rents affordable below the 45 percent standard did not offer rents affordable at or below 40 percent of area median income.

These findings can be interpreted in several ways. First, a number of SAIL/LIHTC projects have rents that are below the maximum allowable, which is based on 60 percent of area median income. This fact may be due both to the additional subsidy provided by SAIL and to the receipt of bonus points for providing units affordable at a 40 or 45 percent level. A number of projects also have rents close to the maximum allowable. Project location or whether the developer is for-profit or nonprofit does not appear to explain which projects have lower rents. Finally, rents do not reach levels affordable at or below the 40 percent standard, and many of the projects have been built in counties that have median incomes higher than the Florida median and so have high allowable maximum rents.

Other states and local governments use other programs to supplement the LIHTC, and it is possible that through multiple subsidy programs rents can be brought below the maximum allowable. However, it is unlikely that rents can be brought to the levels cited by Nelson as the areas of greatest need.

Do LIHTC units "skim" households?

New LIHTC units have the potential to attract, or "skim," the highest income renters that qualify for the program. If such skimming occurs, unsubsidized providers of low-rent housing may be hurt by losing their "best" tenants. Alternatively, LIHTC tenants with incomes below the maximum qualifying income for the units may improve their physical housing situation but pay more than 30 percent of their income for rent. Evidence from the Florida projects provides clues as to actual incomes of LIHTC renters.

Across all SAIL projects in Florida (including projects not reflected in the above analysis), the median income for tenants has been \$13,631, or 38 percent of the median income for the state. The average allowable tenant income for LIHTC units in these projects was \$19,548. Besides the 20 projects discussed above, these numbers include projects built for the elderly, farmworkers, and single-room occupancy.

Average household size and income data are available for 13 of the 20 projects included in the above analysis. Two have average incomes for LIHTC households below \$10,000, 4 have average incomes between \$10,000 and \$15,000, and 7 have average incomes over \$15,000. The highest average incomes for LIHTC renters were \$18,924 and \$18,730.

It appears that the SAIL/LIHTC projects in Florida have not uniformly skimmed the highest income tenants. In some cases, they have attracted tenants with incomes close to the levels that Nelson suggests have the greatest need. However, those tenants are likely paying more than 30 percent of income toward rent.

Spatial targeting and the LIHTC

The use of the LIHTC raises an additional targeting issue beyond those cited by Nelson. Spatial targeting of housing units built under this program is determined by incentives inherent in program design and by developers' decisions. Ling and Smith (1991) discussed the possibility that developers would have an incentive under the LIHTC program to target projects to areas that have the highest median incomes—and therefore the highest allowable rent. Their analysis of maximum allowable LIHTC rents in Florida counties verified their hypothesis. This phenomenon is particularly likely for projects that are not using any additional subsidy. In Florida, LIHTC units are now targeted so that they are distributed across three groups of counties classified by size. Because larger counties tend to be more affluent, this requirement limits but does not eliminate the bias toward locating LIHTC projects in higher income counties. Nevertheless, the LIHTC program by its nature lets the developer determine where units will be provided.

Relationship of federal programs to state and local government housing programs

Some state and local governments have in the past decade taken on a larger role in providing affordable housing. This greater involvement has been a response both to the federal environment and to an increased recognition of housing problems at the local level. Consistent with an increased state and local role has been the focus on the local nature of housing problems and the need to address those problems at the local level. This emphasis implies that housing issues have a spatial character that is not reflected in Nelson's analysis (as she notes) and that should be the subject of future inquiry. Policy prescriptions need to address issues at the local level that may not be identified in national, regional, or even metropolitan-level statistics.

The major problem facing state and local housing policy in many areas is the spatial concentration of extremely low income households and the lack of access to opportunities for these households. Examined in this way, housing policy addresses concerns beyond placing households in decent affordable units and includes using housing as a vehicle to address broader urban concerns.[2]

Two general approaches might be taken to attack the problems of extremely low income households concentrated in urban areas. One is to focus efforts on the areas currently occupied by these households through housing programs, infrastructure and service improvements, and efforts to attract jobs. The second approach is to locate housing and households to outlying areas

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[2] Discussions of housing policy goals include Downs (1991), Dreier and Atlas (1993), and Weicher (1990).

where jobs are located, implementing such approaches as fair-share housing, through which communities are required to provide for their share of regional housing needs, and requirements that low- and moderate-income housing be available within a certain distance of a site before an employer is allowed to locate there. To facilitate a range of programs to address these problems, the best policy may be to allow state and local governments, with federal support, to play the role of incubators of ideas. The LIHTC program, with location driven by developers, may not be flexible enough to allow this innovation and the implementation of local goals and objectives. Specifically, the spatial targeting of the program may limit its effectiveness in meeting state and regional entities' concerns about jobs-housing mismatch.

States and local governments may have objectives beyond the spatial targeting of affordable units. For example, they might want to achieve mixed-income developments. Toward this end, some local governments have created inclusionary housing programs in which a portion of the units in a development are reserved for moderate- or low-income households in exchange for a higher allowable density or other incentive.

While the LIHTC program allows mixed-income projects, the incentives favor projects in which 100 percent of the units are subsidized and occupied by households with incomes below 60 percent of HAMFI. As a parallel to local efforts to encourage income mixing through density bonuses and other incentives, it may be desirable to explore the possibility of providing the LIHTC to an entire project if, say, 20 percent of units are set aside for and affordable to households with incomes below 30 percent of HAMFI. While the cost to the Treasury per low-rent unit provided would be higher under such an approach, it would help address Nelson's findings about the areas of greatest need and would also permit income mixing within LIHTC projects.

Partnerships, multiple subsidies, and capacity building

Currently, there is an emphasis on the use of public-private partnerships and leveraging of resources to address housing and urban problems. Partnership participants include federal, state, and local governments; financial institutions; developers; nonprofits; builders; and others. The partnership process entails structuring financing, subsidies, incentives, and other components in a complicated package. LIHTC projects have involved as many as 15 different components (Stegman 1991). While the result may be affordable housing, and units that can be made available at a lower rent than if the tax credits alone were used, the complexity of the process may limit the range of participants and require expertise available only in large urban areas. Certainly the participation of a variety of players is important, but the downside is the inefficiency that results from both the complexity of working with multiple programs and participants and the lack of experience and sophistication in housing delivery among some participants. Further, the large number of parties involved raises the questions of who is in control of the process and what role local and state objectives play in influencing location and other characteristics.

Other issues

Nelson's analysis and conclusions raise several issues that have been discussed elsewhere or are beyond the scope of her article. In an earlier article, Nelson and Khadduri (1992) detailed caveats in the use of AHS data. These include the underreporting of income by survey respondents, which may result in an overcounting of households in extremely low income categories. Stegman (1992), in a comment on the Nelson and Khadduri article, also discussed the use of AHS data for policy analysis and suggested an enlarged data collection effort and expanded survey instrument.

The shortages and surpluses of housing units at various rents relative to households of different income ranges detailed by Nelson suggest that the filtering process does not work, since units do not move down in rent to meet the demand that exists at lower levels. Filtering might be a rationale for programs such as the LIHTC, which through the creation of more units at a given rent would be expected to start a filtering of existing units down to lower rents. Further analysis of the LIHTC's ability to spur filtering is needed. Other questions of interest include (1) whether LIHTC units represent increases in the housing inventory or replace other units that would have been built and (2) whether the 1986 tax law changes and their effect on rental markets contribute to the phenomenon Nelson observes through reduced construction, demolition, and conversion.

Another issue in housing policy is political reality. Support from a coalition of interests is necessary to pass legislation, and this reality may limit what can be done in designing a housing program. For example, there is evidence that the political climate may not be amenable to Nelson's call for deeper income targeting of housing assistance. Stegman (1992) pointed to growing local intolerance of the mentally ill homeless and recent state cutbacks in public assistance as evidence that it may not be politically feasible to focus more housing resources on the poorest of the poor.

Conclusion and policy considerations

Nelson's analysis indicates that a large number of households have incomes below the level likely to be served by "flat-rent" programs such as the LIHTC. The policy relevance of this finding depends on the goals of the LIHTC and similar programs. If the goals are to support the construction industry, the evidence suggests that the program has been successful, although the question of whether units would have been built anyway is an empirical issue yet to be investigated. In addition, if the filtering process works, then extremely low income households would be assisted indirectly through the expansion of the housing stock, and housing would be provided to them at a lower cost to the Treasury than would be required for deep subsidy programs.

However, if the primary goal of the LIHTC and other flat-rent programs is to directly assist households with the greatest housing needs, it appears that the programs are unable to do so without additional subsidy. Evidence from 20 Florida projects shows that even when the LIHTC is combined with other housing subsidy programs, it may produce units that are unaffordable to renters with incomes below 40 percent of area median. Furthermore, given the complexity of tying together various assistance programs and putting together LIHTC projects, the shallowness of the subsidy might involve efficiency costs and require complex partnerships. Many areas lack the capacity to develop such complex partnerships and project-financing packages and therefore are unable to use the LIHTC.

Yet it may be possible to redesign the LIHTC program to meet these criticisms and preserve a program that is politically popular and supply oriented, as is necessary in some locations. Such a redesign should consider the income-targeting issue, but it should also consider issues associated with state and local efforts to do more than provide decent, affordable housing. These issues include giving state and local officials greater control over the location of LIHTC projects rather than allowing the location to be decided primarily by developers. The issues also include providing sufficient program flexibility to support state and local planning goals, such as expanding the availability of affordable housing in locations near job growth, producing mixed-income communities, and expanding social and economic opportunities for lower income households.

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