

## Comment on William Apgar's, "Which Housing Policy is Best?"

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William Apgar's presentation confronts the most contentious issue in contemporary housing policy. Often, one's position on the question of supply-side subsidies versus vouchers is taken as the litmus test of being a housing "conservative" or "liberal." This is indeed unfortunate since many analysts and policy makers recognize that some mix of project-based and tenant-based subsidies is appropriate nationally, and that in a country as diverse as the United States, housing policy must vary with local market conditions. The real issue is under what *local* market conditions are the more costly per unit project-based subsidies essential.

Apgar's paper presents arguments to support the proposition that, in general, housing market conditions have changed significantly since the 1970s, when much of the empirical work on which current policy rests was developed. He also argues that even though project-based subsidies remain more costly on a per-unit monthly basis, the direct and indirect effects of subsidized new construction of housing for lower income families will dominate the direct and indirect benefits of tenant-based subsidies. In particular, he argues that constructing new units will relieve price pressures in the market segment serving low-income renters and will produce a more general improvement than tenant-based subsidies.

I read the available evidence differently than did Apgar. While I fully agree that, in certain metropolitan areas, some construction subsidies are needed, I arrive at this conclusion by a different route. And my conclusion is much less sweeping than Apgar's.

The balance of this comment consists of three sections. The first reviews four facts about contemporary rental housing markets and draws some conclusions germane to this discussion. The second section explicitly addresses Apgar's argument about the anticipated salutary price effects on other low-rent units from subsidizing new housing construction targeted on households with income eligible

for assistance under programs administered by the Department of Housing and Urban Development (HUD). The third section draws a general conclusion.

### **Four facts about rental housing**

Apgar appropriately notes the alarming combination of the reduced number of private, unassisted units affordable to lower income families and the increased number of families in this group. Surprisingly perhaps, the severe affordability problems exist simultaneously with conditions that indicate that there are plenty of units for rent in most housing markets. This section attempts to clarify some of these facts.

#### *Better housing*

The first half of the 1980s continued to witness a steady improvement in the quality of the housing stock occupied by very low income households.<sup>1</sup> The general pattern continues to be that the worst units leave the stock. Moreover, until very recently there has been little inflation in rents compared with the Consumer Price Index (CPI). In constant 1988 dollars, gross rents in 1982 were about the same as they were in 1967; between 1982 and 1988, they rose about 11 percent faster than the CPI.<sup>2</sup> Thus, while poor households are spending more for housing, they are purchasing more housing. Many of the poor would prefer to spend less on housing, but the smaller units with fewer amenities that were common in the 1960s have largely disappeared: the fate of single room occupancy (SRO) units is a vivid example. One can think of the affordability problem of the poor resulting from the combination of successful policies for improving housing quality and the failed policies for promoting adequate income growth among those in the lower third of the income distribution.

In short, the greater share of household incomes devoted by the poor to housing in recent years is a result of incomes rising slower than inflation, rents increasing somewhat faster than inflation, and the poor purchasing the larger and better units generally being offered in the market. As Apgar described, purchasing these bigger "housing bundles" clearly contributes to the increased housing allowance payments used to purchase housing services in recent years, compared with 1979.

### *Soft markets*

A second important fact about the rental housing stock since 1983 has been the high overall vacancy rate — consistently about 6 percent and as high as 8.1 percent on an annual basis. Table 1 presents some data on rental vacancy rates in 1988 and in the third quarter of 1989. As late as the fall of 1989, the vacancy rate was at 6.9 percent or higher in all regions except the Northeast, where it was at 4.8 percent. Among the 26 metropolitan areas for which data are compiled, in 1988 only two (New York and San Francisco) had rates under 4 percent, and only four more had rates under 5 percent. Many Sun Belt areas — not just those affected by the problems of the oil industry — had high vacancy rates; examples include the California cities of Oakland (7.8), Anaheim (7.3), San Diego (8.5), and San Bernardino (10.1).<sup>3</sup> In short, many areas are characterized as fairly soft rental markets, mostly because of overbuilding in the early 1980s.

*Table 1. Rental Vacancy Rate Data*

#### **A. Vacancy Rates by Rent Level - 1988\***

| Rent        | Vacancy Rate |
|-------------|--------------|
| Under \$100 | 2.2          |
| \$100 – 149 | 3.9          |
| \$150 – 199 | 6.3          |
| \$200 – 249 | 7.8          |
| \$250 – 299 | 8.8          |
| \$300 – 399 | 7.9          |
| \$400 – 499 | 8.6          |
| \$500 +     | 13.1         |
| All units   | 7.7          |

#### **B. Vacancy Rates by Region - 1988 and 3Q1989**

| Region    | 1988 | 3Q1989 |
|-----------|------|--------|
| Northeast | 4.8  | 4.8    |
| Midwest   | 6.9  | 6.9    |
| South     | 10.1 | 9.2    |
| West      | 7.7  | 7.3:   |

\* Rents are contract rents.

Source: Bureau of Census, *Housing Vacancies and Homeownership*.

C. Casey, in his 1989 study, presents a more comprehensive analysis of current rental market conditions. Casey (1989) shows that (a) out of 59 markets analyzed, only seven could be classified as “balanced to tight” and only one as “tight” and (b) there had been a very large year-to-year shift in the degree of tightness within individual markets, i.e., markets classified as tight only a few years ago are now balanced or even somewhat overbuilt.<sup>4</sup> Casey attributes this unusual pattern to several conditions, particularly the changes in the relevant tax laws in 1981 and 1986. Overall, the patterns of recent years suggest that a “snapshot” low vacancy rate can provide a poor measure of market tightness; at a minimum, such patterns should be sustained for several years before they are acted upon by developing additional housing with public assistance.

The market segment serving impoverished households is definitely tighter, but vacancy rates still are surprisingly high. In 1987 (the latest year for which data are available), the vacancy rate for units renting for less than the fair market rent (FMR) of the Section 8 Certificate Program was *at least* 7 percent, up from a comparable figure of 5.6 percent in 1985, according to American Housing Survey (AHS) data. These vacancy rate estimates differ from those quoted elsewhere because, in order to be compared with the FMR, which is a gross rent figure (i.e., rent plus utilities), these vacancy rates are computed as the ratio of vacant units defined by their imputed *gross* rent to occupied units in the same gross rent category.<sup>5</sup> The rates computed this way very likely are low compared with those normally computed because vacancy rates by rent range are usually computed with contract rents and because at contract rent levels around the FMR, vacancy rates are higher at higher rent levels.

Vacancy rates as conventionally computed tell a similar story. Even for rents in the \$150 to \$199 range the vacancy rate is 6.3 percent. This is a rent affordable by even impoverished families. To illustrate: a family with annual income of \$7,000 per year and using 30 percent of its income could afford a unit renting for \$175 per month. A \$300 rental could be occupied by a family with \$11,880 with 30 percent of its income. (The poverty line in 1988 for a family of three was about \$9,435; for a family of four, it was about \$12,092.) Reasonable vacancy rates do not always mean that the right units are available: vacant units may not be in the unit sizes needed nor be located in areas where the poor live.

Overall, however, the picture is one where unit availability is less desperate than sometimes portrayed. Such soft markets must raise questions about a *general* argument favoring subsidized new construction over assistance for renting existing units.

### *A dynamic market for low cost housing*

A third key fact about the stock of housing occupied by lower income families is its dynamism. Of the units occupied in 1974 by households in the lowest 25 percent of the income distribution, 20 percent had been destroyed or were vacant by 1983, and 38 percent were occupied by higher income families. On the other hand, 41 percent of the units occupied by the lowest income households in 1983 had been occupied by higher income groups in 1974. The estimate of the number of units filtering down to lower income groups is very conservative because it excludes any units built over the period for initial occupancy for higher income households that later filtered down.<sup>6</sup>

In numbers, 6.7 million units occupied by the lower income households in 1974 had “filtered up” and 3.4 million had left the stock or were vacant (some on their way to retirement); but 8.5 million units had “filtered down” to households in the lowest income quartile.<sup>7</sup> As noted earlier, however, the “replacement units” occupied by the poor are often more expensive than the originals because the replacements are larger and better equipped.

### *Market segmentation*

There is convincing empirical evidence that urban housing markets are not constantly well unified in the sense that the dwellings do not shift quickly and easily to the market portion where there is greater demand (in part because dwellings are fixed in space and costly to modify to serve another income group) or that households do not readily search for housing outside of their preferred areas, styles, or price range. The result is at least temporary differences in the price per unit of housing service in different segments of the market.<sup>8</sup> These segments can be defined by location or rent ranges, or both. The existence of market segmentation in part makes possible the severe shortages in some markets, while there are simultaneously high vacancy rates elsewhere. However, the dynamism of the market described above indicates that such segmentation will typically be a temporary phenomenon.

### *Implications*

The foregoing facts carry two policy implications. First, with the vacancy data indicating a combination of volatile and balanced-to-

soft market conditions for units renting below the FMR on a wide-spread basis, any proposal to add more units for low-income families (and thereby compete directly with those already existing) must be very carefully scrutinized. In many markets, adding more units renting for about the FMR will simply cause additional units to leave the stock. Targeting to sustained tight markets is essential. (Units being built with assistance through the Low Income Housing Tax Credit (LIHTC) must pass no test of market tightness.)

Second, substantial policy attention must focus on retaining serviceable low-rent units in the housing stock, rather than seeing them drop out because of inadequate rent rolls to cover operating costs and occasional major repairs. This implies policies that increase net revenues, including property tax abatement or reduced charges for water and sewerage services, and that assist with essential repairs and replacements. These are tasks primarily for local government, but federal funding under the Community Development Block Grant and Rental Rehabilitation Programs can be used effectively.<sup>9</sup>

### **Market-wide effects of housing assistance**

Perhaps the most critical part of Apgar's argument is that subsidized new construction can be counted on to reduce rents generally paid by lower income families. I am frankly skeptical of this argument, except in markets where the vacancy rate for units renting below the FMR has been at a low rate — under 4 percent — for several years.

I want to make three different points about the “rent effects” argument. The first point addresses Apgar's reference to Michael Murray's econometric work, which shows that construction of public housing substitutes only to a limited degree for housing that otherwise would have been built. I think the key to Murray's results is the type of housing public housing authorities built during the 1961-77 period analyzed. This was an era when public housing was characterized by huge projects, often located in inner-city neighborhoods. To be blunt, many projects are occupied only because they are subsidized. They did not displace other new construction because they occupy a unique market segment.

In contrast, consider the type of projects whose assisted development is preferred today. The monolithic projects built in the previous era are gone. Many authorities prefer to develop garden apartments similar to those developed privately and marketed without

subsidies. In some PHAs, even lower density scattered-site housing is preferred. Obviously, these are superior housing solutions. However, it seems likely that these units are much more likely to be substitutes for nonsubsidized units than were their predecessors.

My second point is that housing allowances will generally have the same kind of effects on rents as development of new subsidized projects. Meaningful reductions in rents from a modest amount of new constructions require that some housing market segmentation be present. The differential vacancy rates by rent range reviewed earlier certainly appear to support the current existence of such segmentation.

The logic of rent reductions resulting from new construction is that, if there are more housing units meeting the housing demands of a fixed number of households, competition will force rents down, i.e., supply is increased relative to demand in the low-rent market segment.

The same effect is achieved, however, if there is a reduced number of households competing for a fixed number of units. The reduction in households is exactly what occurs under tenant-based subsidies: households that were competing for units renting from \$150 to \$300 per month are now housed in units renting from \$400 to \$500 per month. Demand pressure on the under \$300-per-month segment of the market is relieved. Data from the 1986 evaluation of the voucher and Section 8 Certificate Programs support this example. Among households becoming Section 8 beneficiaries who moved to qualify their unit, rents increased from \$229 to \$460. Moreover, 63 percent of those becoming participants did so by moving.<sup>10</sup> Thus, housing allowances should afford considerable demand relief in the lowest rent ranges.

Naturally, the units must be available at these higher rent levels; the evidence on vacancy rates presented above states that this is indeed the case today. Given the high vacancy rates, it is very doubtful that there will be much upward pressure on rents from additional households using housing vouchers, even if the income elasticity of demand for housing by voucher recipients has shifted from .3 to about 1.0, as suggested by the figures in table 3 of Apgar's paper.

My third point is that the type of price effects illustrated with hypothetical examples in Apgar's paper may never materialize. Apgar presents data on the modest increase in rents above overall inflation experienced during the 1980s and correctly contrasts this

to stable or even declining rents in the previous decade. These are trends across the whole rental market. How do we interpret these data in light of the very high volume of new construction that was stimulated in the mid-1980s by the 1981 tax reform legislation?

As shown in Table 2, production levels were high and production for rental use was an unusually high share of all production in the mid-1980s. If one uses the average rental new construction levels of 1975-80 of about 370,000 units per year (which include a substantial volume of units built under the Section 8 and Section 202 programs) as a bench mark, the increase in volume over the 1983-87 period is 435,000 units (computed as the average number of units over the six-year 1975-80 period for five years to be equivalent to the five years of the 1983-87 period). This is about as large as Apgar's hypothetical program. But rents on average went up, not down. Of course, this is all speculative: one does not know what would have happened to rents without the high volume of new construction. The information here suggests, however, that property owners are adjusting to oversupply by losing revenue through greater numbers of vacancies rather than cutting rents. There is no obvious reason why this pattern would change if a greater share of new construction were subsidized.

*Table 2. Privately Owned Housing Units Completed  
1975-88*

| Year | Total Units<br>(In Thousands) | Rental<br>(In Thousands) | Rental as<br>Percent of Total |
|------|-------------------------------|--------------------------|-------------------------------|
| 1975 | 1317                          | 332                      | 25.2                          |
| 1976 | 1377                          | 269                      | 19.5                          |
| 1977 | 1657                          | 338                      | 20.3                          |
| 1978 | 1868                          | 424                      | 22.6                          |
| 1979 | 1871                          | 462                      | 24.7                          |
| 1980 | 1502                          | 400                      | 26.6                          |
| 1981 | 1266                          | 306                      | 24.2                          |
| 1982 | 1006                          | 244                      | 24.4                          |
| 1983 | 1390                          | 341                      | 24.5                          |
| 1984 | 1652                          | 468                      | 28.3                          |
| 1985 | 1703                          | 490                      | 28.8                          |
| 1986 | 1756                          | 537                      | 30.5                          |
| 1987 | 1669                          | 449                      | 26.9                          |
| 1988 | 1530                          | 363                      | 23.7                          |

Source: U.S. Bureau of the Census, *Characteristics of New Housing: 1987*, Washington, DC: Current Construction Reports - Series C25, table 2, and similar publications for other years. (U.S. Government Printing Office, Washington, DC, 1988).

## Conclusion

I conclude from the foregoing that there is no clear reason to change the overall orientation of current federal housing policy, which gives relative emphasis to tenant-based subsidies. However, there are adjustments I would make.

As I have argued elsewhere,<sup>11</sup> there are strong efficiency and administrative arguments for shifting the subsidies to develop low-income housing from the LIHTC to a direct appropriation. If support were through appropriations, the assistance could be allocated with other rental assistance in a way which permitted local governments to determine the mix of project-based and tenant-based subsidies. The process for allocating funds could be akin to the Housing Assistance Plan—Section 213 system in effect during the second half of the 1970s.<sup>12</sup> There would be, however, stronger limits on where new construction could be supported with federal funds. My suggestion, consistent with Casey's findings, would be that the vacancy rate for units renting for less than the FMR would have to be sustained at 4 percent or less for three years as a condition for developing new projects.

In addition, some new construction for special needs — such as for the frail elderly or the chronically mentally ill — could be considered outside this overall market limit. But, again, I would favor similar strong tests on tightness in the particular segment of the market, stronger than have been in effect. There are several metropolitan areas, for example, where there is a surplus of public housing for the elderly because of competition from Section 202 projects.

In sum, I favor a system of federal housing assistance that includes both project-based and tenant-based subsidies. To the maximum degree feasible, the system should concentrate on preserving existing low-income housing by using rehabilitation grants, property tax abatement, and tenant-based subsidies. Constructing new subsidized units for low-income families is a critical element in the overall system, but, because of its greater expense per unit, it should be employed only where the need meets fairly stringent federal guidelines.

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## Endnotes

1. National Association of Home Builders, *Low- and Moderate-Income Housing: Progress, Problems and Prospects* (Washington, DC: 1986) table 2 - 1. See also William C. Apgar, "Preservation of Existing Housing: A Key Element in a Revitalized National Housing Policy" (Paper presented at the Fannie Mae Annual Housing Conference, Washington, DC, 1990) exhibit 4.
2. Figures from William C. Apgar, D. DiPasquale, N. McArdle, and J. Olson, *The State of the Nation's Housing, 1989*, (Cambridge: Harvard University, Joint Center for Housing Studies, 1989) app. table 1.
3. U.S. Bureau of the Census, *Housing Vacancies and Homeownership: Annual Statistics:1988*, (H-111-88-51 and *Third Quarter 1989* (H-11-89Q3) (Washington, DC: U.S. Government Printing Office, 1989), table 23.
4. C. Casey, (1989) "Trends in Rental Market Indicators in Selected Metropolitan Areas, 1984-1988" (Washington, DC: Office of Economic Affairs, Office of Policy Development and Research, U.S. Department of Housing and Urban Development, 1989).
5. The vacancy rates for units with gross rents under the FMR were estimated by Kathryn P. Nelson at HUD's Policy of Division of Policy Development. Utilities payments were imputed for up to six different utilities for different types of units, where the types were defined by structure type and six climate zones.
6. Data are from the National Association of Home Builders, 1986, table 3.2.
7. For a rigorous analysis of filtering in the urban housing stock, see J. C. Weicher and T. Thibodeau, "Filtering and Housing Markets: An Empirical Analysis," *Journal of Urban Economics* 23 (1988): 21-40.
8. For systematic evidence on this point, see A. C. Goodman, "Housing Submarkets within Urban Areas: Definitions and Evidence," *Journal of Regional Science* 21, no. 2 (1981): 175-85; A.B. Schnare and R. Struyk, "Segmentation in Urban Housing Markets," *Journal of Urban Economics* 3 (1976): 146-66.
9. For more discussion of these kinds of initiatives, see R. Struyk, "Housing Preservation in Perspective" (Paper presented at the Fannie Mae Annual Housing Conference, Washington, DC, 1990).
10. Data from M.L. Leger and S. D. Kennedy, *Draft Final Report of the Freestanding Housing Voucher Report* (Cambridge: Abt Associates, Inc., 1989).
11. R. Struyk, "Housing Preservation," 1990.
12. R. Struyk, *Saving the Housing Assistance Plan: Improving the Incentives to Local Governments* (Washington, DC: The Urban Institute, 1979).

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