The wheel of fortune: How to play the housing affordability game

by C. Theodore Koebel

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The housing game is one that most Americans know how to win. The United States is not only the best-housed country in the world, it is probably the best-housed country in history. After all, most of us are homeowners, and several of us have upgraded from the small cottage inside the white picket fence to the McMansion inside the gated community. The royalty of yore can't hold a candlestick to the average American homeowner—the castle might have had a great view from the tower, but most rooms were cold and dank, plus the chamber pot was more than a tad inconvenient, particularly without a chambermaid. For sheer luxury, give me any new house built in the U.S.A.

The housing industry in the United States has produced wonders. Consequently, articles about housing problems generally aren't given much credence. People tend to think, "If my house is bigger and better than my parents' house, and theirs was bigger and better than my grandparents', what could be wrong?" Are articles describing a housing "crisis" the hyperventilations of Chicken Littles announcing that the roof (if not the sky) is falling, or is there a housing crisis that most of us never notice?

To give Chicken Little his due, housing is expensive. But claims of an affordability crisis during the 1990s were largely overblown. For the United States as a whole, the median rent burden (gross rent as a percentage of household income) decreased between 1990 and 2000, from 26.4 percent to 25.5 percent. Renters in Virginia were even better off, with median rent burdens dropping from 25.8 percent to 24.5 percent. Rental housing affordability improved across most of the state, even in high-cost areas such as Fairfax County. Among the state's metropolitan areas, the median rent burden decreased in all but Charlottesville (which had the highest median rent burden in 2000) and Danville (where affordable housing is comparatively abundant).

If there was good news for renters, homeowners have fared even better. Homeowners have significantly lower cost burdens relative to incomes than do renters, and tax deductions for mortgage interest and real estate taxes further reduce their housing cost burdens. In Virginia, the before-tax median cost burden for owners with mortgages decreased from 21.9 percent in 1990 to 21.4 percent in 2000. Across the nation, median cost burdens for homeowners with mortgages did increase between 1990 and 2000, but only from 21 percent to 21.7 percent. In addition, homeowners without mortgages (which includes one of every three homeowners in Virginia) have a median cost burden around 10 percent.

Greenspan's contribution

After 2000, the Federal Reserve orchestrated a dramatic drop in interest rates, which made homeownership even more attractive. The average effective interest rate in Virginia on conventional mortgages was 8.18 percent in 2000. This dropped by more than 100 basis points (or one percentage point in interest) in 2001, another 50 basis points in 2002, and then by another 80 basis points in 2003, when the conventional mortgage rate averaged only 5.83 percent. During this span, low interest rates and a variety of incentives for first-time homeowners pushed the ranks of homeownership to new heights (and resulted in a generally soft rental market).

Higher median cost burdens for owners are not necessarily bad. Low interest rates and national efforts to promote home ownership, with some mortgage programs for first-time homebuyers allowing cost burdens as high as 35 percent, could contribute to an expansion of ownership among lower-income families and thus increase the median cost burden for owners.

If we're the best-housed nation in the world, what's the problem?

So with all this good news, one might wonder if claims about a crisis in affordable housing are totally without merit. However, interpreting statistics on housing affordability is not as simple as it might first appear, and to some extent, both the "best housed" and the "crisis" camps are right. The two views are as closely related as the two faces of Janus, one perpetually smiling and the other perpetually sad, without either being able to see the other. The smiling face is the one most of us see—in the mirror in our bathrooms and in Fannie Mae commercials. We live in good-quality housing in good neighborhoods, spend amazingly little for it, and get to deduct some of that cost from our taxes. And if owning one house is good, for some of us, owning two is even better—one near where we work and the other near where we play.

Those with good housing can't turn around fast enough to catch a glimpse of Janus' other, less fortunate face. First, that face is hard to find amid the multitude of prosperous faces. Second, we would need binoculars to see across the distance between the well-housed and the ill-housed. Over time, local planning has produced an exclusionary landscape that segregates the working poor and others of modest means from the expanding suburban economy. It has also produced the stealth privatization of public education, whereby the well-off locate themselves in suburban enclaves of privilege that provide public schools of the highest quality for those who can afford the high cost of entry: the price of a single-family home.

Despite the overblown claims of a housing crisis made during the 1990s, the trend since 2000 in housing prices relative to incomes is troubling. In Virginia, the median price of homes sold has been increasing at a double-digit pace, far outpacing the increase in incomes. From 2000 to 2003, median prices increased 40 percent, whereas median incomes increased only 10 percent. Overheated markets in Northern Virginia have resulted in bidding wars over homes. A March 7 Washington Post article reported people camping out "a full seven days before the developer was planning to accept contracts on the first, still-unbuilt units" in the hope of buying homes ranging from $560,000 to $1.1 million. If the person buying a half-million to million dollar home faces shortages, those of lesser means are forced to head for the urban fringe to find anything they can afford—a trip called "drive to qualify." With such frenzied competition, prices naturally shoot up quickly, causing worries about housing price bubbles similar to the stock market bubble during the "dot-com" boom of the 1990s.

The shock of higher prices has been softened significantly by low interest rates. The median price for houses sold in Virginia during 2003 (which is estimated at a little over $210,000) required a monthly payment equal to about 19 percent of the median family income, virtually the same as in 2000. However, if interest rates had been the same as in 2000, the monthly payment would have been over 24 percent of the median family income. We won't react with sticker shock until interest rates go up, which is highly probable.

Lately, concerns about affordable housing have accelerated along with prices and will likely become more widespread as interest rates increase. Recent national opinion polls sponsored by the Fannie Mae Foundation and by the National Association of Realtors (NAR) found that in high-cost metropolitan areas, housing affordability ranks with health care and jobs at the top of citizens' concerns. In the NAR poll, affordable housing was at the top of the list in five of the ten largest U.S. metropolitan markets, including Washington, D.C. In two other markets, it ranked second. Mounting concerns about affordable housing can also be found outside these fever-pitch housing markets in places as unlikely as Iowa City. Spillover development from the Washington metropolitan area now stretches past the Shenandoah Valley, and second-home and retirement development in the Northern Neck has escalated land prices beyond the reach of long-term residents.

Why should I care, as long as my house outperforms my 401k?

For professionals who benefit from Northern Virginia's high salaries, the housing market game is both challenging and rewarding. The game obviously has little to do with shelter—McMansions are well beyond the basic needs for hearth and home. It is, instead, about investment. If you already own a house in the area, you're probably happy to see prices push the value of your asset even higher since this adds directly to your own wealth. High prices also increase local tax revenues, making local government happy. For these winners, housing scarcity (also known as exclusivity) and affordability are not evils to be avoided, but are outcomes to be promoted.

Given that three-fourths of Virginia's households are homeowners, most of us are more concerned about protecting housing as an investment than about keeping prices down to promote affordability. At a recent national forum of government and industry leaders who share the goal of making new housing more affordable, I suggested that if we found a way to produce new housing for 30 percent less than current costs, we would never be let out of the room alive. We would be a direct threat to the housing wealth of the nation's 72 million homeowners.

And this notion recalls Janus' two faces—will those of us with good housing ever see the faces of those who cannot afford our fortune? Are we caught in a perpetual dilemma of either hypocritically ignoring our other face or avoiding it out of fear that it might somehow diminish our success? Many homeowners (and local governments) do more than ignore affordable housing; they actively oppose it whenever it is proposed where they live. This "not in my backyard" (or NIMBY) reaction is nearly as prevalent as homeowners.

NIMBY has several adverse impacts. It restricts the supply of affordable housing to locations farther away from many of the jobs our economy is creating in the suburbs. Some workers buy houses they can afford in nearby small towns and rural areas outside the high-cost housing markets. To witness this "drive to qualify," just look at the commuters going from Winchester and the West Virginia panhandle to jobs in Loudon and Fairfax counties, or at those driving over Afton Mountain to Charlottesville, or at the morning commute from the rural hinterland into Blacksburg by most of Virginia Tech's service employees.

Just as importantly, the reduced production of affordable housing due to NIMBY makes existing housing prices higher than necessary. The affordable housing solution for the drive-to-qualify commuters causes housing prices to escalate in rural towns and villages, as well as for suburban sprawl to extend well into the rural countryside. These communities are the least prepared to manage growth and often adapt their own NIMBY response to development. Those stuck in less desirable city neighborhoods find that commuting to a suburban job is expensive and difficult, particularly as these job locations are ill served—if at all—by public transportation, resulting in higher turnover. Many of these households already pay enough for housing to afford a suburban apartment, if one were available and not made unduly expensive by local regulations.

Should homeowners be afraid of affordable housing?

To some extent, fear about affordable housing is fear of the unknown. "Affordable housing" does not mean anything specific, and the term can readily trigger images of deteriorated and dysfunctional public housing. There are sufficient examples available to reinforce a negative image, and to some extent, affordable housing has been branded by the public housing stereotype. However, the affordable housing product being produced today is of a distinctly different brand. It is virtually indistinguishable from market-rate, multifamily housing and often includes a mix of rent levels and incomes.

Recently, researchers have addressed the main fear that homeowners have about affordable housing, which is its impact on their house values. Surprisingly, most studies on the impact of affordable housing on adjacent property values report neutral or positive effects, with only a few reporting negative effects. The results depend, in part, on the developer, the number of units, and the income mix of the tenants. Affordable housing developed with Low Income Housing Tax Credits, which are now the main production subsidy for affordable housing, has a neutral or positive impact at moderate density levels (e.g., below 500 units). Since most affordable housing developments are well below this size, few affordable housing proposals today are likely to raise legitimate fears about negative effects on adjacent property values.

What can be done to promote affordable housing?

There is no single approach to promoting affordable housing that is likely to be successful, but there are several steps that can increase the supply of affordable housing. These efforts include educational campaigns, state and local regulations to promote affordable housing, physical design improvements, management improvements, outreach and negotiation, and—usually as a last resort—litigation.

The Virginia Association of Realtors has helped start a campaign in Virginia to promote greater awareness and acceptance of affordable housing and soon will be testing the effectiveness of the campaign. Educational campaigns need to operate at the level of the general community and at the site-specific level of a particular development proposal. The general public and elected officials need to learn more about affordable housing, including both the demand for units from the workforce employed within the community and the characteristics of affordable housing being produced today. Ultimately, communications need to be specifically tailored to individual developments in individual neighborhoods.

Good design and professional management by experienced developers are important. Many affordable housing developments implement "New Urbanism" design principles that promote the image of a traditional American neighborhood. Others mimic the appearance of big single-family houses while incorporating several smaller units into the structure. Larger developments mix residential and retail land uses (typically, neighborhoods serving retail). Most include a range of targeted incomes. Experienced developers and managers are capable of proposing and delivering a housing product that will remain a community asset.

Good design and communication can be expected to work best where there is greater public commitment to affordable housing. State and local government mandates and incentives for affordable housing are the best evidence of that commitment. If government requires us to be inclusive, we accept inclusiveness. If government merely suggests or encourages it, we resort to our narrow interests and NIMBYism.

Some communities, most notably Montgomery County, Md., have adopted Affordable Dwelling Unit ordinances requiring developers to include affordable housing in new subdivisions, but a combination of state, regional, and local approaches is necessary. States should require localities and regions to prepare land-use plans and zoning ordinances that enable sufficient production of affordable housing throughout metropolitan areas. Unless we address the impact of land-use planning on the supply of affordable housing, the benefits of other affordable housing programs likely will be dwarfed by the larger system's contribution to exclusion.

Affordable housing in Virginia

The Virginia General Assembly took a step in the right direction in 2003, when it amended the requirements for comprehensive planning to include "the designation of areas and implementation of measures for the construction, rehabilitation, and maintenance of affordable housing, which is sufficient to meet the current and future needs of residents of all levels of income in the locality while considering the current and future needs of the planning district within which the locality is situated." Currently, the interpretation of this amendment is left to individual communities, but eventually, the General Assembly, the governor, or the courts will need to provide more guidance, which should, at a minimum, require the zoning of sufficient land to accommodate projected growth for single-family and multifamily housing.

Except for a few excesses, the housing market works very well. Significantly altering it in the name of affordable housing or some other slogan would be a mistake worthy of sackcloth and ashes. Rather than impeding the housing success of the middle class, we should set ourselves to the task of spreading the housing bounty to an even wider share of the population. This can only be done if land-use planning includes sufficient housing to meet the demand for housing among all Virginians.

Editor's note: A new national Association of Realtors report, Community Acceptance of Affordable Housing, by C. Theodore Koebel, Robert E. Lang and Karen A. Danielsen, is forthcoming.