

COMMENTARY:

Not in *our* backyard. Plans, planners, regulators and others thwart affordable housing.

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Not since the collapse of the nation's savings and loan industry in the early 1980's has credit been so difficult to access, and not since the 1986 Tax Reform Act has the real estate industry faced such enormous loss in market value. Residential declines, in several markets, exceed the gains of the last few years.

As recently as last summer, even as leading indicators were suggesting housing demand had stalled, credit remained plentiful for prime and sub-prime residential borrowers. Blame for the market's failure lies everywhere. But in retrospect, free flowing mortgage dollars certainly contributed to once soaring residential prices which have zoomed into free fall. To protect certain classes of home buyers currently threatened with foreclosure, congress is now working to limit their losses by forcing *both* lenders *and* borrowers to share the total financial exposure. Through forbearance procedures, besieged homeowners may be able to keep their homes under more favorable terms. As borrowers are helped so are their lenders.

Good policy? Effectively, the strategy envisioned shores housing prices at an inferred level rather than allowing them to find their own value in an otherwise unregulated market. Approximately 1,000,000 existing borrowers, under the current congressional proposal, are assured a measure of relief while lenders avoid plummeting security for their loans. Communities, by retaining the solidarity of the housing stock, are insulated from suddenly abandoned neighborhoods and a litany of social ills. Free fall has been slowed by an opening parachute. The fix is an apparent economic win for the nation's middle class who have crawled to homeownership.

Others meanwhile may lose. Viscerally appealing, the proposed end strategies do not reconcile with policy goals intended to make housing more affordable to larger numbers of families. By intervention, the failures of the market are not given a chance to correct themselves leaving the impression that higher values are obviously the preferred public policy. Absent price supports, there is the premise that a larger inventory of housing units should become available to these populations needing cost effective shelter. Further, there is the premise that the apparent losses experienced in market values become societal gains as housing opportunities are broadened. Seen in terms of sum gains and losses, the effects of congressional action to sustain prices may be neutral.

Social activists should see reasons to avoid federal intervention. After all, federal housing assistance programs have never been a legislative favorite. HUD has all but gutted many programs and others will terminate unless renewed. If not for the ostensible national economic

impacts, federal resources might not be directed to housing. Almost ironically, the current state of the economy pushes congress and its agencies into an industry where their recent practices and priorities suggest they would rather not tread.

What federal intervention virtually assures is the continued policy of institutional practices or procedures which already constrain affordable housing initiatives in almost every market. Despite claims to the contrary, there is little in either practice or policy that works to enhance affordable housing. Almost without exception, the rhetoric proclaiming the need for affordable housing is not supported by the realities of regulatory controls, financial practices, lending policy, and in particular the expressed wishes of housing consumers themselves. The new call for a federal role only continues to disrupt opportunities in a way that precludes the market from reaching the appropriate level. In this case, that level would almost certainly mean lower home prices.

If housing affordability is a socially desirable end state, then programs, policies and capital should reinforce that goal. Instead, we have institutionalized a contemporary form of redlining with predictable consequences.

The social and economic influences that shape our housing preferences are not new phenomena and generally arise out of fear, expectations, and cultural norms. Approximately 65%-70% of America's housing stock is owner occupied, the balance renter occupied. This segmentation creates a dominant population of households prejudicial to maintaining and advancing their own economic self interest. In this simple calculus, policy decisions that promote or assure increasingly high value homeownership are materially more attractive than those which don't. By extension, there is an implicit aversion to smaller homes, attached homes, condominiums, rental housing and the people who live there.

Lest these observations be roundly offensive, they are of course broadly generalized. Still, whatever exceptions there are to these biases, they are rarely sufficient to induce major restructuring or redirection of policy which has social and political dimensions as well as economic and physical dimensions. Despite ostensible trends toward diversity, land use policy and personal preference celebrate sameness in housing delivery and choice.

Americans have a cozy sentimentality about their homes, confounding the apparent relationship between its value as *shelter* and *asset*. Americans nest in their homes. They eat in them, raise and entertain their children in them, occasionally smoke in them, often paint them outrageous colors and then sell them. Were a home but an automobile -- perhaps one costing thousands of dollars -- there would be an expectation of diminished value following years of use or neglect. A home is simply different. Americans expect to profit when they sell a home, *even after* years of use or neglect.

The institutional practices and personal preferences abiding in the residential market are not hard to understand. Unlike now discriminatory neighborhood redlining, they have little to do with perceived racial or income intolerances although these social factors may be indirectly or adversely reinforced. Instead, these practices and preferences stem from the value embedded in the residential homestead which, in the United States, is the principal source of accumulated equity and wealth, certainly for the nation's group of homeowners.

Think Goldilocks and the lessons of balance. Spend more than 25% of the family income for housing, and maybe that's *too much*. Spend less and maybe that's *not enough*. Spend 25%,

and somehow that seems *just about right*. Regardless of who's counting, it's a lot of money and it reflects on our capacity as a functioning household.

Studies have suggested that 40% of the average family's wealth is attributed to the homestead so asset preservation is a powerful force in shaping outlook as well as policy. Home equity has paid for college, new business startups, weddings, sabbaticals, and retirement. When directed into the existing homestead through a remodeling effort, equity offers the prospect of even greater future accumulated wealth. The homestead stands not just for the proposition of individual accomplishment. It is the single investment vehicle which has enabled almost every American household to achieve cross generational goals and social improvement.

Although new housing designs showcase the advantages of the smaller home, data collected over decades point to increasingly larger as well as increasingly more expensive homes which are no longer just basic shelter. In 1950, the average new home contained about 850 square feet (SF) and included two bedrooms and a single bath. Astonishingly, the average family of about four people managed to function in this space. Today, the average new home is more than 2,000 SF and usually has two or more bathrooms and three or more bedrooms. Astonishingly, this space supports a family of 2.25 people. How the added space gets used is something of a mystery...today's new house provides almost the same space per person occupied by an entire family in 1950! All things equal, a new home today would be more than twice as expensive as the basic single family home constructed a generation ago.

Personal choices drive personal demand. The content and scale of the house as a product is not a marketing ploy, foisted by the developer or builder, on an unwilling or unknowing buyer. Advertising is seductive and may speed access to information but this simple relationship ignores the consumer's steady *willingness* to upgrade. Consumers may be dupes but they are eager to buy. The current state of the residential market is ample evidence of America's housing appetite. In the United States, the single family suburban home remains the standard by which alternatives are evaluated. Despite swelling numbers of urban dwellers, buyers want larger single family homes because they see opportunities for equity growth and appreciation.

Anything which compromises the single family unit as a source of economic empowerment is grossly unappealing to America's homeowners. Few households are likely to surrender a belief system which has had generations to mature. Even if a home is only of modest price, it is a singular form of investment transaction. Though study after study works to dispel misplaced ideas regarding new residential forms, poorly executed examples are as painfully visible as the successful alternatives, and these failures are a reminder to exercise caution.

The regulated environment in which America's homesteads are rooted is largely a product of property ownership, homage to this nation's commitment to rights based on English common law. The individuals active in the electorate are largely the families occupying and protecting their homestead interests. When they mobilize to create or influence land use policy, their perspectives are disturbingly, but understandably, narrow. Toiling to create a vision of the community commensurate with their own expectations, they lobby for lower density single family neighborhoods where they preserve and enhance their homestead.

An inherent resistance then emerges to land development regulations and policies that encourage smaller lots, higher density, and smaller housing units. Together, these approaches can push housing costs down. Declining *costs*, however, cast a shadow on housing *values* which, conventional thinking suggests, will also decline.

Occasionally, extraordinary design and communication skills convey a richer and compelling landscape through mixed use, height and flexible forms. Where the changes occur, they are still not altogether without resistance. When the friction becomes intense, negotiated positions function to undermine the intent of desirable land use forms. Mixed use is defined as *specific* uses or activities without regard to the vagaries of the marketplace or the functional needs of the desired users. Height and bulk constraints impose envelopes which make it difficult to execute the concept physically or financially. Residential units intended for rental may be discouraged overtly or discreetly through minimum size standards. Whatever planning and design goals may be accomplished through regulatory controls, they rarely *induce* more affordable housing.

To the contrary, there are many examples that suggest regulations have forced cost increases well beyond the provided benefits of individual or community protection. In many cases, these controls can add literally thousands to the cost of basic home. As consumers, these costs are a barrier to homeownership. As residents, they reinforce a perceived community value that is realized in the pricing of the homestead.

A transfer of development rights (TDR) is often touted as one way that desired intensity or unit counts, sometimes of a specific configuration, can be achieved. The objective is conceptually intriguing in that it promotes the idea of encouraging specific building activity in targeted areas. These targeted areas have regulated maximum densities which can only be exceeded once rights from another area are acquired. Much oversimplified, the planning fiction associated with the TDR mechanic is that it allows lower cost units to be paired with higher value ones, ostensibly driving down costs over all, an apparent benefit to affordable housing. Viewed through this lens, it takes the appearance of an incentive. Only in the world of land use control can a series of tedious intermediate steps (identify neighborhood, negotiate transaction price for additional units, approve movements with regulators, reassign units to new area, price reallocated to units) be cast as an incentive.

If the goal of a specific policy is to promote density -- making housing production more efficient and distributing greater land costs over the available unit count, thus enabling lower overall prices -- why is the policy something else? The question, of course, is rhetorical but it focuses attention on the disconnects among stated objectives, community intentions, planning policies generally, zoning specifically, subdivision regulations, building codes, and fundamental economics dictated by personal expectations and demands imposed by the market.

The homebuilder is something of an outsider in this dialectic which yields repeated iterations of plans and concepts. The highly valued suburban builder is positioned to absorb a part of these costs. Without specific incentives to bolster his business model, the builder of affordable housing must balance the needs of marginally qualified buyers, neighbors, and regulators. Money can be made providing affordable housing, but the risk-reward quotient is painful and not compelling. Often viewed as a pariah within the community, the affordable builder is challenged along the entire continuum of the development process.

The financial dimensions of housing delivery present their own set of constraints to affordable housing. Like America's owner occupied households, mortgage capital also seeks a secure investment. Security takes the form of equity, mortgage insurance, and expectations about rapidly increasing value so that the combination of equity and insurance enhance the lender's position. While the sub-prime nightmare suggests these guidelines were violated, more often than not the escalating value aligned the motives of both lender and borrower. That is, the borrower acquired an appreciating asset and the lender received substantial security in the loan.

In the mortgage industry, loans can be retained by the lender but it is considered prudent to package these loans and sell them on the secondary market. When retained, the security interest is dictated by the lender and the requirements are usually different than those imposed by the secondary market. Again, security takes the form of equity, private mortgage insurance, and expectations about rapidly increasing value so that the combination of equity and insurance enhance the lender's position. Where the loan is held, the transaction costs will be high to reflect the risks involved. While these transactional costs are not central to the subject of affordable housing, this market segment is certainly not enhanced.

Condominiums, a source of much affordable housing, has proven especially vulnerable to the restrictions of the secondary market which avoids mortgages on such products. Some private insurers are no longer providing coverage for this form of housing. For example, beginning May, 1, 2008 United Guaranty will no longer insure condominiums in zip codes it has identified as having declining or unacceptable market conditions. Changes prompted by secondary lenders effectively label condominiums as undesirable home purchases. The combination then of transaction costs and standard underwriting behavior is to favor conventional single family loans. Because condominiums are usually constructed at higher densities consistent with allowable zoning, the financial markets complicity work in concert with single family homeowners to obviate affordable housing options.

Yes, the wheels are now falling off the mortgage wagon so the awkward relationships among lenders, borrowers and regulators may be revisited. This unexpected turn of events, however, is not the point of this financial allegory. A failure for either party to understand their obligations clouds the underlying motivation to become a homeowner. Clearly, the impetus for lenders and borrowers transacting in this context is to build wealth through the personal residential homestead. Affordable housing simply does not figure in this discussion.

HUD, FNMA, FHLMC and other functioning mortgage conduits share in steering people away from affordable housing conceptually, HUD through its historical lending and insuring processes, the latter groups because of the ways they package and evaluate loans suitable for the secondary markets. HUD has been implicated in and associated with redlining, suburban low density settlement patterns, and development standards in excess of otherwise accepted normal market requirements. While not to dispute the stability that HUD has injected in the market, the organization leaves a legacy which has contributed to expectations about the building industry and what consumers should demand in a housing product. Other than in benchmarking a specific mortgage limit deemed affordable, HUD's practices have not been that dissimilar to those of other lenders and individual consumers.

As For FNMA and FHLMC, they inject their own bias that drives housing costs upward and, like HUD, push consumers toward a large, conventional single family product. Their behavior in the secondary market may have fashioned the practices which have dragged the securitized market downward and which may now receive federal assistance. Specific to condominiums, both FNMA and FHLMC have initiated stricter due diligence procedures that address legal documentation, adequacy of operating budgets, the age of association receivables, and the percentage of units owned by non-residents. These changes, according to FNMA, will "protect borrowers and manage increased risk".

America's tax structure contributes to our housing excesses in other ways. Not only is an eligible household allowed deductions but a gain on sale up to \$500,000 has no tax liability! This gain may be exercised every twenty-four months under the current tax code. Clearly, the largest

and most expensive homes generate the greatest opportunity to realize these tax free gains. While available to all taxpayers, these tax provisions are just an additional inducement to construct larger and more expensive housing. Effectively, our tax code pushes buyers to maximize their purchases. Seen in terms of earnings, what other form of activity in the United States literally assures a household an average of \$250,000 per year tax in free income?

Newspaper headlines have not fully extinguished the confident visions of American homeowners. Financial return from property ownership remains an expectation. Unless actively selling a home in today's market, the typical homeowner is in a state of denial regarding the value of his or her homestead and the threats to equity. The congressional proposal to aid troubled borrowers steadies that confidence.

It is with some irony that excess housing production -- not price supports, interest rate modifications, controls, and lowered underwriting standards -- may have been the greatest opportunity in a decade to close the affordable housing gap. The housing market *may* be in need of price supports but the direction is an explicit decision to promote *less* affordable housing supply.

The distinction between *value* and *price* is all but misunderstood. In economic terms, home prices are *sticky*. That is, the prices rise quickly but slip slowly because of many interacting variables. Among others, these variables include the resolute determination of the homeowner to hold a price regardless of the implications. With values falling around them, many homeowners still perceive *their* investments as stable or improving. A combination of hope, regulations and policy, it seems, will continue to protect equity and blur the price/value distinction despite societal costs.

Are America's middle class households going to be helped by congress? The evidence seems mixed at best. So where then does that leave policy makers who fervently support more affordable housing?

The answer is extraordinarily complex -- players in the housing industry have had more than 50 years to codify and entrench their thinking -- but a direction might begin with a relatively simple premise. In this construct, shelter has a commodity value as well as an investment value but the former takes priority. In that rubric, individuals would be free to elect the housing product which serves a personal interest, real or perceived. Presumably, financial vehicles would be available as they are in varying ways now. These individuals would *never* have the right to resist alternative housing schemes which may be inconsistent with their personal value system. Regulators would universally adopt form based codes so structural configuration would be less dependent on content based standards. Minimum size standards for shelter would disappear. Development everywhere would be available by right to avoid manipulation at the local level. In effect, compatibility issues would cease to be a legislative function. Instead, they would be an administrative function with limited room to exercise discretion.

The federal government and the states can play a pivotal role in supporting these practices. The feds would act by producing fair housing policies which are virtually impossible to circumvent through zoning and similar regulations. The Community Reinvestment Act took a strong position against redlining but the practice has emerged in a new form, and its effects are now experienced in ways which the lending crisis should make us understand.

The states would comply with the lead of the feds but also commit transfer fees collected from real estate sales to affordable housing. These fees are, in most states, already intended for this purpose but, like in Florida, they remain in trust and are not released as a budget balancing measure. The outcry at these budgeting practices is only a murmur. This pool of dollars is especially attractive as a means of reducing housing costs through down payment or other direct assistance without addressing the widespread institutional barriers that preclude smaller, less costly units in specific neighborhoods or locations. With direct assistance, these issues are potentially avoided altogether.

Market corrections are painful and should be minimized if possible but loss, in and of itself, should not be the single subject debated by policy makers. All costs and benefits need to be considered in the mix of strategy. The condition of the market opens the door to spark these discussions as part of an initiative to boost the economy which needs every foundation poured to bring housing and financial stability. The door is likely to close as soon as housing values suddenly are released from the constraints of the current slowdown.

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