homeward *bound*

Housing markets work just fine for most people. But certain markets in the Fifth District aren't producing homes and apartments that working families can afford

BY CHARLES GERENA

Washington, D.C., radio stations reach far beyond the borders of the nation's capital. Their traffic reports provide vital guidance to drivers commuting from the outskirts of the metro area, from Charles County in southern Maryland (28 miles from downtown Washington), to Fredericksburg in central Virginia (52 miles away), to Jefferson County in the Eastern Panhandle of West Virginia (73 miles).

Most Washington workers live outside of the city, driving half an hour, on average, each way. Other suburbanites and rural residents throughout the Fifth District are well acquainted with interstate travel, working in one place and living somewhere else miles away in order to earn a better salary, benefit from a lower cost of living, or both. In the U.S. Census Bureau's 2003 population survey, about 2.6 million of the 40 million people who relocated did it because they were looking for a cheaper place to live.

There certainly isn't a lack of residential development — housing construction has been rising for years in both metro and nonmetro areas. The problem is the type of development that has occurred in certain housing markets. These markets emphasize larger, pricier homes for purchase over smaller homes and multifamily rental units that are less expensive to build and sell.

"In most places, the new construction is going for the high end of the market," says C. Theodore Koebel, director of the Center for Housing Research at Virginia Tech. "We're not building for the middle of the market, and we're certainly not building anything for below the middle." As a result, people at or near the median

PHOTOGRAPHY: MEL CURTIS/GETTY IMAGES

income cannot afford the median-priced home or apartment in a growing number of communities, while those further down the income scale are feeling the squeeze even more. "Home prices have moved closer to the median, whereas their incomes have not moved up toward the median," adds Koebel. "If anything, they have moved further away from the median."

Housing affordability has long been an issue for the poor and those on fixed incomes. People at the bottom are the least able to respond to price increases or relocate, and they have so few financial resources that it's hard to build shelter cheap enough for them to afford. Now, mounting housing costs are outrunning the earnings of working families as well, taking bigger bites from the paychecks of retail store employees, teachers, nurses, and other low- to moderate-income workers. Not adjusting for inflation, data from the Office of Federal Housing Enterprise Oversight and the National Association of Home Builders shows that house prices appreciated 78 percent from 1994 to 2004. National personal income increased only 64 percent during the same period.

In other words, affordable housing is a concern for wider segments of the U.S. population. The number of middle-income families devoting more than 30 percent of their income to housing grew from 3.2 million in 1997 to 4.5 million in 2001. This 41 percent increase exceeds the population growth in this income group.

What is behind the growing divide between what people can pay and what housing sells for? The leading candidate on the supply side of the market equation is the collision of rapid population growth with constrained residential development in regions like Northern Virginia. "The region is pretty heavily regulated in terms of land use, and that's true of the Washington metropolitan area in general," says Richard Green, director of George Washington University's Center for Real Estate and Urban Analysis. "When you have limits on supply, it means that increases in demand will show up in prices rather than in quantity."

Opening the door to more development wouldn't necessarily provide affordable options for all — it doesn't address demand-side factors that put housing outside of people's grasp — but it might reduce the number of people in need. Then, government agencies and nonprofit organizations could tackle housing affordability in a more targeted manner.

Where's the Problem?

When reporters and researchers examine housing affordability in a community, they often refer to the share of income that residents spend on putting a roof over their heads. The U.S. Department of Housing and Urban Development (HUD) considers an apartment or home to be unaffordable when expenses like rent, mortgage payments, and property taxes exceed 30 percent of earnings, since that leaves an inadequate amount of money to pay for other necessities like food, clothing, and health care.

For example, the median annual salary of a kindergarten teacher in the Washington, D.C., metro region is $48,396, according to surveys conducted by Salary.com. Thirty percent of that income would be $14,519, or $1,210 a month. Thus, teachers earning at the median could qualify for a $155,000 house, assuming they can get a 30-year loan at a 5.75 percent fixed interest rate and put down 10 percent of the price toward the down payment and closing costs. However, the D.C. region's median home price was $340,000 in the fourth quarter of 2004, and it hasn't been near the $155,000 mark since 1998.

Using income-cost ratios to gauge a neighborhood's housing affordability doesn't take into account individual preferences, though. "Some households may consider their housing a good deal even if they spend more than 30 percent of their income on it," noted Ron Feldman, an assistant vice president at the Federal Reserve Bank of Minneapolis, in an August 2002 working paper. "[They] may prefer to live in amenity-rich locations, with nice weather, for example. In such locations, the greater demand for housing would boost its cost."

Moreover, low-income people may make short-term sacrifices in their budgets so that their children can grow up in safer neighborhoods with better schools. Others, especially young people, may initially tolerate high housing costs relative to income if they expect their incomes to rise over their lifetimes. Economists say that such smoothing of consumption is common — people plan their present consumption based upon what they observe today and what they expect for the future.

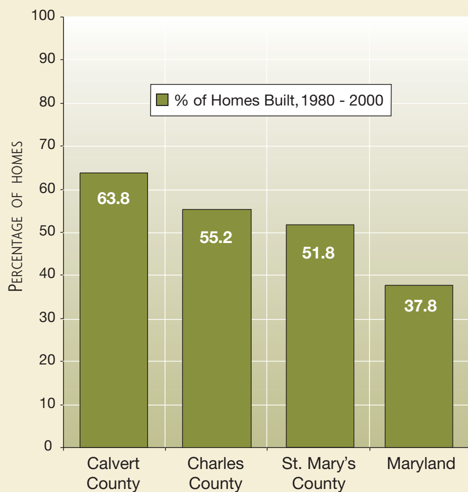
Using income-cost ratios also doesn't take into account the availability of credit. That's why Howard Savage, a researcher at the Housing and Household Economic Statistics Division of the U.S. Census Bureau, includes household assets in his reports on home affordability. "If they had to, people could sell some of their financial assets to buy a house," he says, or they can borrow against them. Therefore, when the cost of credit is cheaper, "people can afford to pay more. When interest rates get higher, which they will someday, they will be able to pay less than what they can now."

No matter how it is measured, housing affordability isn't a problem confined to notoriously expensive cities like New York or San Francisco. "People with critical housing needs [those who pay more than 50 percent of income on shelter] are more likely to be found in the Northeast and the West, but it's a growing problem in the South and the Midwest," notes Barbara Lipman, research director at the Center for Housing Policy in Washington, D.C.

Affordability can become an issue in any community where economic prosperity and residential development aren't in sync. For example, parts of the Baltimore region have done well economically, but housing development hasn't occurred in the same places, according to John Kortecamp,

Moving Up

In southern Maryland, there isn't a large supply of older housing stock to redevelop into affordable homes. More than half of the region's owner-occupied units were built in the last two decades in response to population growth.



SOURCE: U.S. Census Bureau

executive vice president and CEO of the Home Builders Association of Maryland. "The demand is not being met where the jobs are being created."

The city has thousands of vacant homes that could be redeveloped or torn down to make room for affordable housing. Yet crime and under-performing schools have resulted in population losses in these deteriorating neighborhoods, leaving behind lower-income residents who don't earn enough to pay even the most modest housing costs.

Meanwhile, smaller homes and multi-family units aren't being built outside of the city, where higher-income people have moved, because of community pressure to reduce density. As a result, "Every time a new project opens up, the prices get bid up substantially," says Kortecamp. Waterfront communities like Fells Point and Locust Point are being redeveloped for high-end buyers to take advantage of unmet market demand.

The Charlotte, N.C., metro area has experienced broader economic and residential development than Baltimore has. John Byers, president of the Charlotte Regional Realtor Association, describes a flurry of new housing in the city's downtown, especially condominiums, and redevelopment of older neighborhoods near downtown in response to the influx of new residents.

This rising demand has driven up prices. "If you are looking for the most bang for your buck, you may not live downtown," notes Byers. But more affordable options are available within a short drive from Charlotte's employment centers. He knows of several builders producing smaller, simpler homes for working families.

On the opposite end of the affordable housing spectrum is Washington, D.C. The metro region's economic growth has been strong, but the cost of residential development is so high in Virginia counties like Loudoun and Fairfax and Maryland counties like Charles and Calvert that only expensive projects go forward. The result is people driving an hour or more to West Virginia or central Virginia to find more affordable options.

The Supply Side: What Sellers Can Build

What has driven up the cost of residential development in these counties and in other communities, pushing housing costs beyond the financial means of some working-class families? Joseph Gyourko, a professor of real estate and finance at the University of Pennsylvania, believes that land is the culprit. "Construction costs have gone down over the last 20 years," while land costs have climbed in certain places.

One would expect that in areas with strong demand for housing, the marginal cost of acquiring land for development would increase as available space becomes scarcer. In recent papers, Gyourko and economist Edward Glaeser at Harvard University have argued that man-made scarcity — namely zoning rules, building codes and other regulatory constraints on residential development — is a bigger factor.

"If demand is going up in areas where you have restricted the ability to develop, you're going to get very high land prices," explains Gyourko. This makes it harder to build less expensive housing. "[Builders and developers] want to spread the fixed costs of those restrictions over a bigger base, so [markets] end up tilting toward a higher-value product."

Although most methods of regulating residential development add to housing prices, they have been utilized since the early 20th century to meet legitimate policy goals. For example, the outcry over poor families living in crowded, substandard tenements prompted lawmakers in New York and other cities to require that residential buildings have larger rooms, indoor plumbing, external windows, and separate hallways.

"The market would create some serious problems without some level of land-use planning," argues Virginia Tech's Theodore Koebel. "You might not have efficient use of certain locations."

Regulation of residential development also stems from a community's desire to discourage the construction of smaller homes, multifamily rental properties, and manufactured housing like mobile homes. Neighbors fear that these less expensive options will lower property values, even though numerous studies have cast doubt on this claim.

For instance, Charles County changed its land-use regulations in the late 1990s and early 2000s to address concerns over the type of housing being built to meet demand, according to the county's community development housing plan drafted in 2004. Officials increased the minimum size of townhouses and single-family, detached homes to 1,650 square feet, and imposed architectural standards such as requiring the use of brick exteriors. "The idea was to 'upscale' the housing styles," says Robert Tourigny, housing division administrator of an anti-poverty group called the Southern Maryland Tri-County Community Action Committee (SMTCAC). In the process, the new

rules also upped development costs.

Communities also oppose dense development out of concern for crowded roadways and schools. Once a community is built out with relatively sparse, single-family development, it is difficult to rezone it to meet rising demand. SMTCAC lobbied Calvert County officials to change the zoning in its town centers to allow mixed-use development with housing above storefronts. "The county commissioners looked at us like we had two heads and were from Mars," says Tourigny.

With no land available to meet demand, development often spills into neighboring communities. "Those areas get hit with a lot of major development all of a sudden and are completely unprepared for it," notes Koebel. In turn, local officials may impose their own land-use restrictions.

This scenario has played out in the Washington, D.C., area — restrictions in Fairfax County pushed demand westward to Loudoun County, which implemented slow-growth measures in 1999 that pushed development farther west into Jefferson County, W.Va. (In March, the Virginia Supreme Court overturned Loudoun's slow-growth regulations, much to the satisfaction of the numerous property owners and developers who had protested the measures.)

Regardless of the motives, "land-use planning has to reasonably anticipate what future growth is going to be, and plan for that growth," says Koebel. When it leaves a lot of demand for housing unmet, prices can skyrocket and affordable options can evaporate.

The Demand Side: What Buyers Can Pay

Of course, supply-side factors aren't alone responsible for driving up the cost of residential development. Things also have been happening on the demand side. As long as some buyers and renters in a community are willing and able to pay higher prices, the market as a whole will bear those prices, even if some people can't.

Often, newcomers that aren't economically tied to a community distort housing prices. For example, workers from flourishing suburbs may migrate to urban and rural communities where their incomes are relatively high and the cost of living is relatively low so they can get the amenities they want. As a result, housing prices will rise, since newcomers will still consider them relative bargains. Meanwhile, many natives may be unable to keep up with rising prices and property taxes because there are few job opportunities around.

Back in southern Maryland, population growth has come from workers migrating from the District and

The Push to Homeownership

Enlarging the ranks of homeowners has been viewed as a way to bring stability to the finances of communities and individuals. At the same time, though, the push toward homeownership may be contributing to affordability problems in various housing markets.

First, the mortgage interest deduction and the exclusion of home price appreciation from capital gains taxes are only available to those who earn enough income to itemize deductions on their tax returns. Moreover, both tax breaks increase with the size of the house. Therefore, the people who benefit the most have higher incomes and own larger homes, thus orientating housing markets away from lower-income buyers looking for smaller properties.

Second, local officials and communities usually view converting multifamily rental units into for-sale condominiums or replacing them with single-family homes as supporting entry-level homeownership and higher property values. But conversions also reduce the supply of rental units. This helps apartment markets avoid a period of oversupply that requires owners to reduce their rents to attract tenants, which is good for apartment owners and developers. It's not so good for tenants because they never see prices fall and they are left with fewer affordable options.

So what if there is less rental housing available? In general, homeownership may not be appropriate for everyone. "With mortgage delinquencies and foreclosures at record levels ... millions of poor families might have been better off today had they not chosen to purchase a home," noted an article in the January/February 2003 issue of *Shelterforce*, a publication of the National Housing Institute. "Lower-income families are more likely to borrow against the equity in their home, often at high rates, diminishing any accumulated wealth." And, they are more vulnerable to downturns in the real estate market since more of their wealth is tied up in their homes.

At one time, renting an apartment was something young couples did while saving money to buy a house or to avoid dealing with the overhead of homeownership. Now, there is a bias against renters. They are perceived as people with financial difficulties who could bring trouble. As a result, communities often oppose the approval of rental housing.

Meanwhile, developers seem less interested in serving renters on the low end of the income scale. For example, Gumenick Properties decided that three of its rental properties in Henrico County, Va., were "worn out" and "nearing the end of its useful economic life," according to spokesman Edward Crews. So, the Richmond-based firm has been demolishing the properties and replacing them with higher-quality apartments and townhomes, most of which are priced much higher than the original rental units were. In addition, it has built high-end for-sale units on these properties.

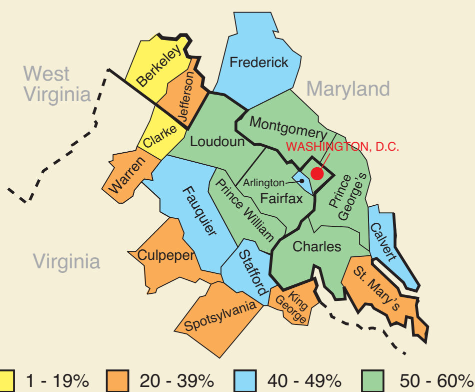
Gumenick's strategic plan reveals why the company chose this course. "The costs of servicing conventional construction loans and paying for normal operations, coupled with the extremely low profit margins for low-income houses, would force the company either to produce substandard structures or to lose money on the project. Neither alternative is acceptable." — Charles Gerena

Northern Virginia, as well as military and civilian workers transferred to Patuxent River Naval Air Station in St. Mary's County as part of the Pentagon's recent base realignments and closures. Contract workers with defense firms have also moved to the region. All of these people have brought their higher wages with them, along with a demand for higher-quality housing. "It really tightened the market to the point where local service workers just couldn't find housing," Tourigny says.

Jefferson County is in the same predicament. Out-of-towners have transformed a traditionally agrarian community with some light industry into a middle-class refuge that stands in stark contrast with the majority of West Virginia. "There are more young families with larger incomes and college educations moving into the Eastern Panhandle," says Topper Sherwood, a consultant for the regional office of Habitat for Humanity. "The bad news is that they are, by and large, linked to jobs in and around Washington." Today, 50 percent of Jefferson's residents commute outside of the county's borders.

In Search of Cheaper Housing

Housing affordability isn't just a problem for the poor. Middle-income workers have had to move miles away from the central core of the Washington, D.C., metropolitan area to find housing that doesn't overwhelm their budgets.



Percentage of Middle-Income Households That Pay More Than 30% of Earnings on House-Related Costs

NOTE: Middle-income households were those earning between $35,000 and $49,999 a year.
SOURCE: U.S. Census Bureau, 1999

Well-heeled retirees, investors in seasonal housing, and second-home buyers can have a similar effect when they enter housing markets. Residents in Charleston, S.C., complain about the impact of "drive-by neighbors," wealthy people who have been renovating historic properties into coastal retreats. Their demand has worked hand in hand with local restrictions on new development to drive up property values beyond the reach of longtime residents.

This contributes to a lack of "filtering." Housing experts expect people to move up to better homes in more desirable communities as their financial status improves, leaving behind older homes in less desirable areas or rental units that others with lower incomes can move into. However, refugees from hot housing markets can rapidly bid up prices as they compete for these latter properties.

Filtering may fail to occur for other reasons. Some homeowners may not want to upgrade. They may live in a nice place and have no mortgage to pay. Or, they may be unable to afford a move, even if they sell their home for a tidy profit, because housing prices are rising sharply.

Another demand-side factor that has supported higher housing costs is the wider availability of cheap credit. "Prices have gone up very dramatically in many areas [but] low interest rates have significantly dampened the effect of those increases," says Virginia Tech's Koebel. Also, "we've got a tremendous amount of new mortgage products" that give borrowers more flexibility and allow them to have a higher loan-to-value ratio.

Still, not everyone qualifies for favorable mortgages, if any. And credit won't be cheap forever. Real estate economists expect mortgage rates to rise from 45-year lows later in 2005, affecting housing affordability in the future.

Finally, while median earnings have kept up with housing costs in the aggregate, not everyone in a community earns the median. Lower-skilled, lower-income workers have experienced slower wage growth than those who are at the median and above, excluding noncash government benefits. Also, certain occupations have suffered from stagnant wage growth at various times, including nursing, teaching, and social work.

Below the Median

For most of American history, markets met the demands of lower-income people seeking housing, although not always in ways that everyone considered socially acceptable. In cities, boarding houses, low-rent apartment buildings, and single-room occupancy hotels were available for people climbing from the bottom rungs of the economic ladder. Owners of commercial buildings would add apartments on their upper floors, while immigrant families would build simple homes like the brick bungalows of Chicago or the Polish flats of Milwaukee.

Many of these options disappeared in the 20th century when local officials, with the help of federal funding, tore down blighted areas as part of broad urban renewal projects. To fill the need for low-cost housing, governments began building their own.

The construction of federal public housing began in the 1930s and continued through the '70s. But by the 1990s, this model was widely considered a failure because it removed the incentive for private parties to come up with affordable alternatives. It also concentrated poorer people into high-rise buildings and sprawling low-rise complexes, many of which were mismanaged and riddled with criminal activity. Now, governments on all levels have shifted gears by spurring others to develop and operate affordable housing for those people whose incomes fall below the median.

Some localities and states offer property tax breaks to developers, usually nonprofit groups, in exchange for building affordable projects and maintaining their pricing for a minimum number of years. (HUD offers Low Income Housing Tax Credits that provide a 10-year reprieve from federal taxes for investors in affordable hous-

ing.) Others create housing trust funds to finance affordable housing, using development fees and other taxes as sources of revenue, or provide below-market construction loans to reduce development costs. Banks also provide such loans to fulfill their legal obligation to meet the credit needs of all areas from which they draw deposits.

But such efforts to subsidize housing development carry risks. "Any financing that distorts the market creates some problems," says Moises Loza, executive director of the Housing Assistance Council, a Washington-based nonprofit group that examines affordable housing issues in rural areas. Some economists say that subsidized development can discourage private investment in building new housing or keeping existing units in the market.

Another approach is to impose inclusionary zoning on a community. Pioneered in Montgomery County, Md., 30 years ago and used throughout the Washington, D.C., metro region, this regulation requires a new residential project to include units that are affordable to people at a particular income level (usually a percentage of median income) for a specified period (often 10 years or more).

To help prevent the developer from raising the prices of the other units to make the project's numbers work, Montgomery and other municipalities provide "density bonuses" that allow more units to be built than the project's zoning normally permits. Developers may also get fast-track permitting, fee waivers, or exemptions from growth controls.

A commuter bus carries Charles County, Md., residents from this Park and Ride to their jobs in Washington, D.C., every morning.

Inclusionary zoning has succeeded in creating additional supply in some areas — more than 10,000 affordable units were produced in Montgomery County between 1974 and 2001. However, if the factors that are driving up home prices aren't dealt with separately, even the affordable units that the builder was required to construct will go up in value, says Howard Savage at the Census Bureau. When the units are open for purchase by any buyer, they will likely be sold at market prices, eroding the supply of affordable housing. "It doesn't get turned over to other people who are poor. It gets renovated and the people who have high incomes buy it," Savage says.

Ultimately, lowering the bar for residential development will likely be the most effective way to increase the supply of housing to include units for low- and moderate-income households. That would require a slowing or reversal of policies meant to curb sprawl and guard property values. Then, some form of rent subsidization, like HUD's Housing Choice vouchers, could be provided for the lowest income families who still couldn't afford housing. Also, if the real concern is with people devoting too much of their incomes to housing, the Minneapolis Fed's Ron Feldman suggests that governments provide direct assistance to help cover other basic needs.

Meanwhile, working families are finding ways to cope. For one thing, they may decide to spend more on housing at the expense of other things in the household budget. In extreme cases, this could mean paying the phone bill late or skimping on a grocery trip. Usually, it means foregoing some things in the short term in order to meet their long-term housing needs.

Others have saved money by purchasing manufactured homes. Once epitomized by a flimsy trailer parked on cinderblocks, this category of housing has vastly improved in quality while remaining cheaper to produce and purchase than site-built homes. As a result, many rural residents have used this route to homeownership — North Carolina, South Carolina, and West Virginia are among the five states in the nation with the highest share of housing units that are built off-site.

For those who are prepared to give up their neighborhood ties and shoulder the costs of relocating, families can search for affordable housing elsewhere. "People [who] are paying large amounts of their income for housing ... reach a point where they can't do that anymore and they move," says Savage. It is this migration that has shaken up so many housing markets across the country. **RF**

PHOTOGRAPHY: CHARLES GERENA

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