# The Renter's Dilemma

**STEPHEN HESTER, CFA**
VP OF INVESTMENTS



# Abstract

The National Low Income Housing Coalition (NLIHC) estimates there is a shortage of at least 7 million affordable housing units in the U.S. today. There is no single definition for affordable housing, but a rule of thumb in law and practice is affordable housing must have rents at no more than 60% of area medium income ("AMI"). Families or individuals that earn income below the relevant threshold are most likely to qualify for housing assistance. The lack of affordable housing compounds other social challenges in predictable and unforeseen ways.

Considerable evidence exists that makes the problem of providing affordable housing for the several million families without it worth solving. A sufficient supply of affordable housing has demonstrated measurable improvements to schools, students, communities, homelessness, and local economies. At the national level, NLIHC research indicates a $2 trillion reduction in annual Gross Domestic Product (GDP) due to the deficit. Business owners and employees alike understand why: workers' inability to find economical housing limits where they can work and live. A business that might otherwise thrive does not survive if only higher cost labor is available. A motivated worker may pass on a great opportunity for personal and income growth because they cannot afford nearby housing. Wages are not optimized and productivity declines.

Various regimes are in place to mitigate the challenge, including state tax credits, Section 8 vouchers, and housing authorities at the local level. No matter the mechanism, one component of this complex system is unchanged: the need for human and capital investment to build and manage the affordable housing units these systems and people rely on.

The quality of the property management, from increasing tenant connectivity to existing public resources to improving the livability and energy efficiency of the property, is often as impactful to tenants as the cost. A family's ability to remain in an area they prefer for years, much less the same home, also accrues measurable benefits to children's school performance and overall development. Affordable housing has the capacity to alleviate many social challenges, but it requires a multifaceted solution society has yet to perfect.

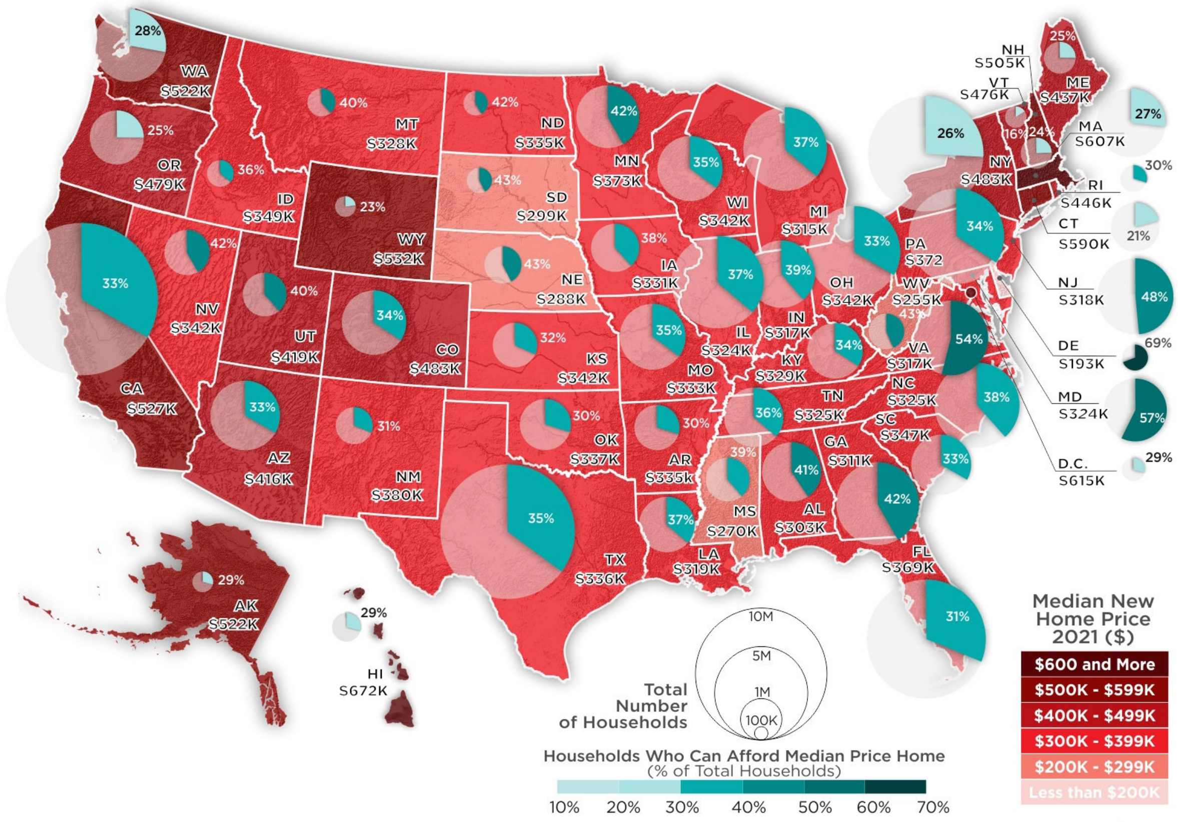
Improving and expanding affordable and workforce housing is one of CommonGood Capital's core pillars. We believe it's one of the most effective areas to deploy capital to generate social good and attractive risk-adjusted returns. This has included low-cost manufactured housing solutions, developments in Africa, and funds solely focused on keeping affordable housing affordable in the U.S.

# Scale of the Problem

There are numerous human and financial factors pertaining to affordable housing. As of the most recent data from the U.S. Census Bureau, over 30 U.S. states, including Florida, California, and Texas – the three largest by population - have at least 5% of adults reporting "Housing Insecurity." They are not current on rent or mortgage payments and have "slight to no confidence" they'll be able to pay next month's rent or mortgage on time.

## Home Affordability in the U.S.

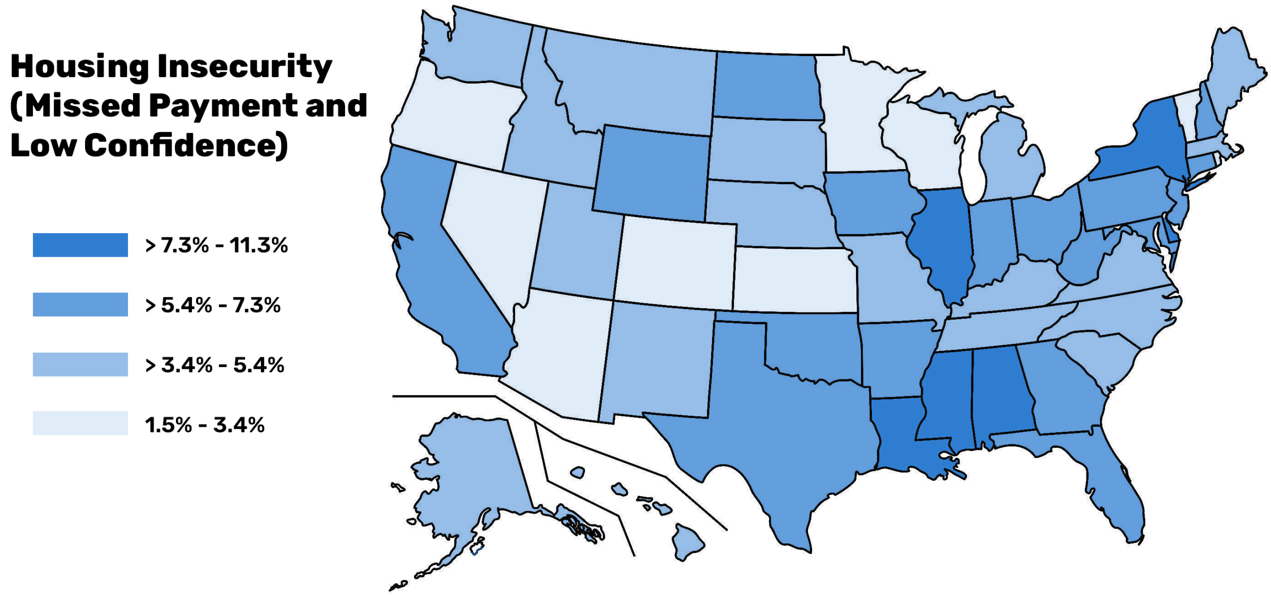
### Median New Home Price & Percentage of Households Who Can Afford It




https://howmuch.net/articles/home-affordability-in-the-US

If we expand this definition to those who believe eviction or foreclosure in the next two months is either very likely or somewhat likely, more than 10 states have adults facing Housing Insecurity exceeding 50% of their populations. The national average is 38.3%. More than one in three adults in the U.S. is not current on rent or mortgage and considers eviction or foreclosure in the next two months likely.

That statistic has increased by 2-3% annually at the national level since the onset of the pandemic and, simultaneously, the [extraordinary rise] in the cost of all types of residential real estate, whether single-family homes or apartments. Existing demand for lower cost housing is already high, and if these statistics are any indication, it may be even higher soon.




https://www.census.gov/data-tools/demo/hhp/#/?periodSelector=45&measures=HINSEC

The concerning housing insecurity statistics are in the context of [an official] unemployment rate of 3.5% as of June 2022. Although that figure fluctuates by state and community, and unlike some past periods, employment status is unlikely to be the driving force behind the housing affordability challenge that has accelerated in recent years. A natural improvement in the economy will not rectify this situation, nor will deficit spending aimed at other problems.

Whether we view sufficient affordable housing as a human right, a commonsense community goal, crime reduction tactic, or a statistically valid instrument for improving tax collections and economies, the solutions are similar: upzoning, lowering barriers to new residential construction, and financial incentives.

# Drivers & Solutions

Approximately 43 million renter households in the U.S. are classified as cost burdened, meaning over 30% of their income is spent on housing. As one would expect, this decreases the propensity for savings and investment at the very least and reduces the ability to obtain essential healthcare and educational expenses at worst.

While a lack of inventory is most frequently cited as the driver of insufficient affordable housing, the reality on the ground is more complex. A sustainable policy fix requires a thorough understanding of the problem. The Minneapolis Federal Reserve Bank, for example, examined the data and regulations associated with the Twin Cities.

Their conclusion was low incomes were the root of affordability issues. As a result, their recommendation was local governments needed to provide these households with funding to spend on housing rather than using those same dollars on new construction or the conversion of the existing supply to become affordable. Per the same institution, a substantial portion of Twin Cities low-income households would still pay over 30% of their income on rent *even if rents were reduced by 50%*.

No amount of additional supply can be expected to reduce rents to that extent. In other areas, such as dense urban environments in New York and California, they decided that land use and zoning regulation, not low incomes, were the primary drivers of untenable rents. In yet other areas, they determined that cash or federal subsidies on nonhousing necessities were most effective to mitigating onerous housing costs. No matter the form, the very existence of a subsidy that can only be applied to housing increases demand and is likely to contribute to higher housing costs, all other things being equal.

The Minneapolis Federal Reserve's array of conclusions, alongside those from the Brookings Institute, National League of Cities, and Environmental Protection Agency (EPA), coalesces into one: drivers of local affordable housing challenges must be individually identified and the appropriate scope and scale prudently applied.

# Up and "out"-zoning

Upzoning customarily describes increasing population density with reducing housing costs as one of several positive externalities. The cost of land, real estate taxes, and construction are split between more units and generates an inherent cost advantage versus suburban sprawl. Upzoning allows more families and workers to live closer to school and employers, thereby decreasing the need and cost of transportation. Cities tend to benefit through increased tax collections as many of these families would otherwise relocate outside of city limits where housing is less expensive. "Out"-zoning encourages the construction of new housing supplies outside of congested areas.

Entire states, such as Oregon, California, and Virginia, as well as cities, like Minneapolis and Seattle, have incorporated influential upzoning regulations into their building and development codes. Although most associated legislation has passed since 2018, New York City enacted the first comprehensive municipal zoning code in 1916. Although over 100 years ago, the concerns New Yorkers had then are not altogether different than today's.

Then and now, critics of upzoning cite negative environmental impacts, speculative real estate development, and little statistical improvement to rents. Those with the strictest upzoning requirements, like Austin, Texas and Seattle, Washington have seen no relief in rents compared to similar cities without them. These policies normally involve the ban of single-family home development and instead require the construction of multifamily buildings. Some believe this has also inadvertently widened the socioeconomic divide in these cities. Existing owners of single-family properties experience rapid appreciation while those without membership to the now restricted club fall farther behind.

The unintended consequences of upzoning include disproportionate short and long-term gains in wealth to existing landowners, and that goes well beyond single-family homeowners. As upzoning legislation permits the construction of taller buildings, institutional developers further monetize land holdings through the construction and leasing of 50 to 100 units where only 10 or 20 were previously allowed. This naturally increases the supply of housing, but it does not guarantee reduction in rents. Worse, the correlation is positive in most areas that it has been applied. Statistically, greater upzoning corresponds to greater rent growth and that's true even when compared to cities with similar demographic and economic trends.

The demand for the limited land permitting upzoning rises due to natural market forces. Cities have an incentive to create higher property values and earn greater taxes, and this creates a vicious cycle of higher property values necessitating higher rents.

Certain large-scale upzoning projects, such as Chicago's, have not yielded any increase in housing supply or decrease in rents compared to similar areas that were not upzoned. In some cases, upzoning immediately generated the opposite response due to a rapid rise in property prices. Upzoning can alleviate certain elements of the affordable housing challenge, but it requires careful planning and execution by closely aligned members of the business community and government officials over a long period of time.

# Financial Incentives

The common way governments provide more affordable housing is financial incentives. Section 8 housing vouchers are provided directly to qualifying individuals to reduce their housing burden. Operating subsidies are payments made to owners of affordable housing developments. This is designed to reduce the gap between the rents collected at market rates versus those deemed affordable by local officials.

Some communities provide property tax abatements for rental properties meeting certain affordable housing guidelines. These financial incentives may be derived from the HOME Program or Community Development Block Grand Programs known as CDBG funds.

Subsidies may be integrated with other forms of financial assistance, such as Low Income Housing Tax Credits. As the owner or potential acquirer of a property dedicated to affordable housing, extensive knowledge and experience is required to navigate this landscape.

# Encouraging New Construction

Conventional incentives to build more affordable housing include fee waivers or reductions by local officials, expedited permitting, and density bonuses.

Governments do not pay density bonuses directly, rather they permit the construction of additional units above what is normally allowed provided it includes a minimum number of affordable units. This has several potential upsides, including no direct cost to taxpayers and assurance that any qualifying project produces additional affordable housing units to the housing stock. This policy must be carefully crafted to ensure affordable housing stays affordable long-term and that tenants receive similar management quality as other types of developments.

Expedited permitting can be a major motivating factor in some jurisdictions. Developers in the Seattle area, for example, have increased their attention and operations toward Tacoma, Washington due in large part to the latter's much simpler and faster permitting process. Seattle's permitting process is described by The Urbanist as a "byzantine system" and "grueling marathon." Tacoma's permitting and corrections process is done in one-third the time compared to Seattle. By giving developers of affordable housing the fast track, the comparative economics and hassle of that project type improve significantly in many markets. Given housing constrained areas like Austin and Seattle tend to have the longest permitting times. Expedited permitting for affordable housing can be a powerful tool.

Fee waivers and reductions follow similar logic as expedited permitting in that it bolsters the economics of building affordable housing relative to other types of real estate.

# A Practical Answer

Lobbying local and federal politicians to increase the amount and efficacy of affordable housing financial incentives is always a worthwhile undertaking. Historically, financial incentives are the most successful tools to reduce the cost of housing burden on lower income families. Simultaneously, it's clear they are not enough.

There are paths separate from the legislative route for those seeking a direct impact on the availability and quality of affordable housing in the U.S. There are a variety of impact-oriented investment funds specializing in this exact cause. As a concrete example, CommonGood Capital is partnered with a real estate firm led by a management team of socially conscious, multifamily veterans averaging over 25 years of experience.

Each investment must pass strict underwriting criteria seeking to not only preserve the diminishing supply of affordable housing, but materially improve tenants' lives. Acquisitions are focused on projects that keep affordable housing affordable rather than transitioning to market rents. The investment thesis includes upgrades to enhance the asset and quality of life for residents. These range from simple ways to meaningfully improve tenant credit scores to improving engagement with local public services and charities.

The firm obtains the necessary government program approvals and permits prior to finalizing any acquisition and conducts a full assessment of the property's energy efficiency through a best-in-class technology partner. That is done at their expense but they know it'll pay social and financial dividends long-term. Their specialty is affordable housing and they've been working on behalf of bank and individual investors since 1997.

CommonGood's mission begins by identifying the investment areas we can have the most social and financial impact. The next step is the selection of the best investment management partners through institutional grade initial and on-going due diligence.

# Conclusion

Upzoning has the potential to improve densification, public transport utilization, and city finances, but its track record of improving affordability housing shortages is mixed. Cities implementing this strategy must make difficult decisions surrounding priorities and which of their constituents are truly likely to benefit long-term. Financial incentives from a range of government actors have been and remain the mainstay lever to help ease the burden of low-income residents. If not carefully designed around local dynamics, the cost-effectiveness of this vital capital may be limited. A ten-fold increase in housing subsidies will not necessarily help families if there aren't enough quality homes for them to live in because additional residential construction isn't feasible.

As a firm with a solutions-oriented mindset first and foremost, we believe that one viable solution is to partner and invest alongside those acquiring affordable housing, maintaining their affordable nature, improving their safety and efficiency, and providing truly great service to their tenants. One building staying affordable in Cleveland, Ohio or Ft. Worth, Texas because of our investments may not solve the nationwide dilemma, but we hope it will feel that way for the families living there.

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CommonGood Capital

824 Highland Ave, Suite 207
Orlando, FL 32803

(407) 476-5453
info@commongoodcap.com