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POLICY BRIEF

Opportunities for Better Federal Housing Policy: How the Biden Administration and Congress Can Improve Housing Affordability

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THE HOUSING AFFORDABILITY CRISIS

For decades, some of the US cities where demand for housing has been highest have been experiencing rapidly rising house prices. Local restrictions on new housing supply, including minimum-lot-size requirements, single-family zoning, parking requirements, and historic preservation rules, all limit the supply of housing allowed within localities and drive up the cost of housing that is permitted. Federal policymakers have an interest in local zoning reform that improves housing affordability and opportunities for people to live in the location where their best job opportunities are located, and President Biden's campaign released a housing plan to this end. The current administration has an opportunity to provide leadership on housing policy reforms that benefit the lowest-income households while encouraging the liberalization of local zoning rules to open up cities to more housing at more affordable prices for all.

Because of local zoning rules in the country's most productive regions, the populations of regions including Boston, New York City, the San Francisco Bay Area, and Washington, DC, are constrained. High housing costs deter workers from pursuing their best job opportunities and push them into lower-paying jobs in regions where housing is more attainable. As a result, workers miss out on their best career opportunities and earn less than they would if more people could live where the best job opportunities are located.[1]

Land use regulations have nationwide effects on migration patterns and economic output.[2] But some of their most painful effects are felt by the low-income residents of high-cost regions. In Los

Angeles, for example, a household earning the region's median income has to spend more than the recommended 30 percent of its income on rent. Across California, the majority of households earning 80 percent or less of their region's median income are rent burdened.[3] Research indicates that tight housing markets are even contributing to increasing homelessness rates.[4]

This policy brief examines the most promising pieces of the Biden housing plan and explores options available to federal policymakers interested in improving housing affordability for US households. The next section summarizes the Biden housing plan. After that, the brief analyzes the plan's proposed expansion of the Section 8 housing choice voucher program. The brief then offers a plan to pay for this expansion, followed by a section that outlines some principles for effectively encouraging local zoning reform through federal policy. Most important, new subsidies for housing can support broad-based affordability only if they are paired with the local land use reform that is needed to permit more people to live in the location of their choice.

THE BIDEN HOUSING PLAN

Like many of the Democratic presidential primary candidates,[5] Biden released a proposal for improving housing affordability.[6] The plan calls for a litany of new programs to improve enforcement of the Fair Housing Act, build new public housing, and subsidize renters and homebuyers. Analysts have estimated that the plan could reduce child poverty by one-third.[7] In this brief, I focus on two key aspects of the plan.

First, for low-income renters, the plan would transform the Section 8 housing choice voucher program into an entitlement program that all households earning less than 50 percent of their area's median income would receive. Today, only about one in four households with incomes eligible to live in housing subsidized through Section 8 project-based rental assistance or to receive Section 8 housing choice vouchers actually receive these benefits. The programs are currently funded at a level determined by Congress, and they serve as many households as that funding level permits.

Second, the plan endorses Senator Cory Booker and House Majority Whip Jim Clyburn's bill that would make receiving Community Development Block Grants (CDBGs) and Surface Transportation Block Grants contingent upon local governments developing strategies to reduce local regulatory barriers to new housing construction, particularly low-cost multifamily housing. Low-income tenants struggle with housing affordability across the country, but in places with restrictive zoning rules and high demand for housing, affordability challenges extend up the income ladder. It is impossible for the federal government to spend its way out of local constraints on housing supply. In places with high and rising housing costs, the fundamental problem is a constrained housing supply that cannot be addressed without regulatory reform. The Booker-Clyburn bill is one of several congressional proposals for encouraging local land use reform, but so far, none have been designed for maximum success.

FEDERAL FUNDS TO IMPROVE HOUSING AFFORDABILITY FOR LOW-INCOME TENANTS

Low-income households bear the brunt of the country's housing affordability problem. The increase in the cost of housing caused by land use regulations' constraint on housing supply disproportionately burdens low-income households that typically spend a larger portion of their income on housing.[8]

The Section 8 voucher program improves important outcomes for the households that receive them. Of all low-income renter households with children, 80 percent spend more than 30 percent of their income on rent.[9] Compared to eligible households that do not receive vouchers, those that do suffer less food insecurity, less domestic violence, fewer child separations, and much less housing instability.[10]

While expanding the Section 8 voucher program for very-low-income households will do a lot to help the country's lowest-income residents, it will also exacerbate affordability challenges for others in supply-constrained markets. In housing markets where land use regulations cause inelastic housing supply, additional funding for housing will lead to an increase in demand and, in turn, higher market-rate prices for the households that do not receive vouchers. Many households that earn more than 50 percent of their area's median income are currently struggling to afford housing in the country's most expensive housing markets. If not paired with substantial reforms to local land use restrictions, expanding vouchers for low-income households risks increasing affordability problems for plenty of households that are already struggling.

In a housing market with liberal zoning, in which home builders can easily respond to new demand with new housing construction, a new infusion of money through Section 8 vouchers will lead to new construction—new construction of housing generally, and in particular, housing that serves voucher recipients. But in some of the most expensive housing markets, where very little construction is allowed, additional funding for housing will lead to little or no construction. In this case, new vouchers will benefit high-cost cities' lowest-income residents, who are suffering the most under the current conditions, but the housing market will continue to be a game of musical chairs in which not everyone who wants to live in a supply-constrained metro will get a seat.

The negative effects of expanding Section 8 for households that do not qualify for vouchers could be fully or partially ameliorated with local reform that makes housing easier and less costly to build. Expanding Section 8 makes it even more important for federal efforts to encourage local zoning reform to be optimally designed for success.

THE BEST DELIVERY FOR SECTION 8 BENEFITS

Section 8 is one of the most important housing subsidy programs in the country, but it is not without problems. One of the biggest is that some landlords do not like to accept vouchers, in part because of the requirement that landlords who accept vouchers complete a bureaucratic inspection process.

Under President Obama's administration, policymakers also raised concerns that voucher recipients could not use the voucher in the highest-opportunity areas of their region. Voucher rates are generally determined by the median rent of a region and may be too small to cover rents in localities that are more expensive than the regional average. To address this issue, in 2016 the US Department of Housing and Urban Development passed a rule requiring some regions to use vouchers that are calculated using median rents at the ZIP code level. These vouchers use small area fair market rents (SAFMRs). The rule change followed a demonstration of SAFMR-based vouchers in five localities.

I propose a new demonstration assigning some voucher recipients a cash transfer in lieu of a housing voucher. Cash benefits would likely reduce landlord discrimination toward voucher holders. Additionally, they would offer beneficiaries more freedom in how they use their benefit. Some may choose to spend more on housing than their voucher would cover in order to live in a location that offers amenities that are important to them. Others may choose to live with roommates or extended family members to save on rent, arrangements that would not be permitted under housing voucher rules but that allow recipients to spend more money on other priorities. Research on cash transfers has identified important benefits for recipients, and Section 8 vouchers should continue in their current form only if a pilot program finds that recipients' lives are improved more by vouchers than by cash transfers.[11]

PAYING FOR NEW HOUSING PROGRAMS

In addition to new funding for housing subsidies, a successful program to encourage local zoning reform will require new federal spending. Currently, the federal government runs several programs that are at odds with housing affordability. Repealing these programs would provide more than enough funding to cover both new housing subsidies and a grant program intended to encourage local zoning reform.

The mortgage interest tax deduction (MITD) subsidizes households proportionately to the amount that they borrow for a house. This subsidy is regressive. In 2017, the Tax Cut and Jobs Act (TCJA) sharply reduced the size of the MITD by reducing the cap on the amount of loans for which interest can be deducted from $1,000,000 to $750,000. Additionally, the TCJA increased the size of the standard deduction from $6,500 to $12,000 for individual filers, reducing the number of people for whom itemizing tax deductions makes sense. Both changes expire in 2025 under current law.

Supporters promote the MITD as a tool to encourage homeownership, but research finds that it does not increase homeownership rates; rather, it leads homebuyers to spend more on larger, fancier houses.[12]

Two additional tax policies subsidize homeowners in rough proportion to the amount that they spend on housing: the deductibility of state and local property taxes on owner-occupied homes and the capital gains exclusion on home sales. Combined, these two policies and the MITD are projected to cost on average $150 billion annually from 2019 to 2028.[13]

Policies that subsidize homeownership, boosting home prices and, thus, homeowners' net worth, encourage Americans to view homeownership as a wealth-building strategy. Policies intended to support homeownership as a wealth-building tool are inherently at odds with policies intended to support housing affordability for renters and new buyers.[14] Subsidizing homeownership also increases the number of homeowners who support constraints on new housing construction in order to increase their own property values through zoning-induced scarcity.[15]

Now is the time to repeal homeownership tax subsidies entirely, before the expiration of the TCJA cap. Always regressive, the MITD's benefits under the TCJA are accruing almost entirely to households earning more than the median income. In 2018, 80 percent of MITD benefits went to households in the top 20 percent of the income distribution.[16] The MITD not only fails to increase the rate of homeownership, but also does so at the expense of those in the bottom four income quintiles.

Rather than reckoning with the tension between current housing policies that purport to support both wealth-building through homeownership and housing affordability, the Biden plan would introduce further contradictions. The plan supports new programs for a tax credit and down payment assistance for homebuyers.

Homeownership is the right path for some households but not others. Homeownership offers some predictability of housing costs, a forced-savings mechanism, and an opportunity to invest with leverage. But homeownership has several downsides as an investment vehicle. A home is an undiversified investment, and it is expensive to buy and sell. For some, the costs of homeownership outweigh the benefits. Policymakers should not try to tip the scales with subsidies, particularly when a higher rate of homeownership makes reforms intended to improve affordability for the least-well-off households more politically difficult.

Turning the Section 8 voucher into an income-based entitlement would require increasing spending on the program about fourfold, to about $100 billion annually. Eliminating tax subsidies to homeowners would raise sufficient revenue to fund this entitlement and a program to encourage local zoning reform, outlined next.

ENCOURAGING ZONING REFORM AT THE FEDERAL LEVEL

Increasingly, policymakers at the federal level acknowledge the severe problems that land use restrictions cause. Since the 1960s, secretaries of Housing and Urban Development have recognized local zoning restrictions as an impediment to achieving the agency's affordability goals.[17] Democrats and Republicans in Congress have introduced bills intended to encourage localities to liberalize their land use regulations.[18] These bills are welcome efforts to improve housing affordability and increase housing supply in the places many people would like to live; however, all of these proposals could be structured as more effective incentives for local policymakers to permit more, lower-cost housing.

It is easy for federal policymakers to recognize the problems that land use regulations—repeated in locality after locality—are causing for housing affordability, mobility, and economic growth. But the politics of reform at the local level are difficult. The costs of land use regulations are dispersed widely, felt by people who struggle to afford housing, people who cannot live in the location of their choice, and firms that struggle to attract workers to high-cost areas.

All of the congressional proposals for encouraging zoning reform rely on attaching strings to federal funds to encourage localities to reform their land use restrictions. Under the US system of federalism, this is one of the few tools available to federal policymakers who wish to encourage localities to reform their zoning rules. In particular, multiple policy proposals have homed in on withholding CDBG money—one of a small number of federally funded programs that go to localities directly—from some of the worst exclusionary zoning offenders.

Although federal funding is the primary tool available to federal policymakers who want to encourage local reform, an inherent challenge of this approach is that the localities where exclusionary zoning is causing the biggest affordability problems tend to have very high-income residents. In these localities, with their high tax bases, the threat of losing federal funds may not be an effective incentive to reform. The importance of federal funds to localities' ability to fund public services is roughly inversely proportional to the benefits of local zoning reform.

In light of these limitations, any federal program intended to encourage local zoning reform must be carefully designed for maximum effectiveness to make progress toward the intended goal. The following principles should be incorporated in a federal grant program intended to encourage local zoning reform:

- Federal incentives should be based on local housing market outcomes. Past federal proposals have focused on localities creating plans to improve housing affordability and integration without requiring reforms to be implemented.[19] Other proposals have focused on local policymakers selecting reforms of their choice, such as reducing parking requirements or adopting inclusionary zoning in order to receive federal funds. This approach gets closer to requiring real reform but may allow policymakers to make reforms on paper that fail to make more housing construction feasible. My colleagues and I have developed a formula for comparing housing market outcomes across localities that could be used to identify the localities that the federal government should reward for providing a policy environment supportive of low-cost housing construction.[20] The formula also identifies the most exclusionary jurisdictions, from which funding should be withheld.

- The grants should be targeted to permitting jurisdictions. One limitation of CDBGs as a zoning reform tool is that not all jurisdictions that execute land use planning and issue building permits receive funding, and some receive CDBG funds through their states or counties rather than directly. Federal funding intended to encourage land use regulation reform should be available to permitting jurisdictions and only those jurisdictions.
- Funds should be allocated through a race-to-the-top approach. Once an amount of money is allocated to the grant program, localities should be awarded points based on their housing market outcome ranking. Those that are doing the most to permit more, low-cost housing should receive the most funding, encouraging all localities to improve their relative performance over time.
- CDBGs have few strings attached, offering local policymakers wide latitude to spend the funding they receive on their own political priorities, contributing to CDBGs' enormous popularity among mayors and other local elected officials who have the authority to reform or influence land use regulations.[21] In order to make the grant program a strong incentive to reform local barriers to housing construction, proposals to encourage local zoning reform should use a grant program that offers CDBGs' flexibility.
- The Biden housing plan and other past federal efforts to encourage local zoning reform have suggested providing localities funding to study the policies that constrain housing supply, increase housing costs, and cause segregation. But the land use regulations that cause these problems are well known. Furthermore, a ranking of localities' housing markets will provide local policymakers with new information about how their regulatory environment affects housing market outcomes compared to other jurisdictions and compared to their own results over time. Any funds dedicated to helping local policymakers identify barriers to housing construction would be better spent rewarding jurisdictions that are doing the most to support housing construction and affordability.

Beyond encouraging localities to reform their land use regulations through federal funding, the president has a powerful platform to encourage reform by promoting the benefits of liberally zoned housing markets. Publishing a list of localities' openness to new, low-cost housing—and naming and shaming the worst performers—could be a powerful tool to convince residents and policymakers in poorly performing jurisdictions of the need for reform.

CONCLUSION

Housing affordability is a serious, growing problem for many US households. Local land use restrictions limit the number of people who can live in some of the locations where the country's highest-paying jobs are located and contribute to high prices. Regulations that limit the supply of housing and increase the cost of housing that is permitted have regressive effects, making life more difficult for low-income households in particular.

The federal government has an important interest in reducing the problems local land use restrictions cause, but the options available to federal policymakers for encouraging reform are limited. Therefore, a successful reform program must be carefully designed to create the strongest possible incentive for the most exclusionary jurisdictions to reform. Expanding housing vouchers is a sure way to improve housing affordability and stability for the lowest-income Americans, but ultimately solving the housing scarcity problem requires localities to permit more housing supply in the locations where demand is high.

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