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# Fixing the Housing Crisis: Subsidized Housing Is a Slice of the Solution

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All corners of the country have been hit by an historic housing crisis that has been percolating for years. Rents in many urban areas have trended dramatically upward in recent years, fueled by pandemic-related shifts in demand and a chronic undersupply of new construction.

Although the pandemic is largely over, the housing crisis shows no signs of relenting. And this crisis is worsening as real estate developers seem unable to increase the supply of new housing in amounts needed to meet demand, forcing rents ever higher.

## A Sobering Shortfall of Housing

Estimates of the new housing shortage (defined as the amount of new housing supply necessary to meet demand without increasing rents) vary, but reports consistently reflect this chronic undersupply. Up For Growth, a policy and research group focused on addressing the housing shortage and affordability crisis, recently reported that national housing underproduction doubled from 2012 to 2019, rising from a shortage of 1.65 million units to a shortage of 3.79 million units.

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Likewise, a Freddie Mac report released last year estimated the housing deficit was 3.8 million units in 2020, up from 2.5 million units in 2018. And according to Moody's Analytics, the country is facing the largest housing deficit in nearly a half century, with the annual supply of new housing approximately 100,000 units below new housing demand at current rents.

Pressure on the housing market increased during the pandemic due to several factors boosting overall demand, including the mass move to remote work and robust household growth, particularly among millennials. Institutional investors added to the booming demand as they bought up a significant share of single-family homes nationwide.

While the overheated housing market has started to cool down, rents remain high amid severe constraints on the supply

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of much-needed housing. At the state and local level, outdated zoning restrictions, prohibitive development fees and burdensome tax policies, particularly property tax hikes, have long restricted the overall supply of housing—including middle- and upper-income housing. This has created a challenging dynamic in the rental sector, with middle- and upper-income households swooping up units that otherwise would be available to lower-income households.

Furthermore, the Federal Reserve has raised interest rates at a record pace this year, and in response, mortgage rates have increased in kind. Skyrocketing costs have dampened demand for homeownership, all the while deepening demand for rentals and putting more upward pressure on rental rates.

According to the National Low Income Housing Coalition, there is a deficit of approximately seven million rental homes that are affordable and available to extremely low-income renter households. As the current crisis continues to deplete the inventory of affordable rentals, state and local authorities are under increasing pressure to produce government-subsidized housing. Political will is also growing, particularly in big cities, to address the economic and social fallout of insufficient affordable housing—such as crime, homelessness, inadequate job opportunities, and disparities in education and health care.

What has emerged is a greater focus on income-restricted subsidized housing, and notably, a heavy concentration on the construction of 100-percent income-restricted affordable housing projects utilizing tax-exempt bonds and federal "low-income housing tax credits." Real estate developers have taken notice.

> Only the targeted construction of both more rent-restricted subsidized affordable housing and more market-rate housing will be able to finally end this crisis.

Facing climbing costs in land development and falling profit margins, traditional market-rate developers have had little incentive to pursue market-grade housing projects without some form of subsidy. And as capital budgets have channeled more funding toward income-restricted subsidized housing projects across the country, developers are increasingly exploring investments in the affordable housing space.

Developers are also looking on as federal, state and local policymakers are mulling legislative and administrative shifts that could open the door to more subsidized housing projects. As one example, President Biden's administration in May 2022 unveiled an action plan to help close the country's housing supply shortfall over the next five years.

Many are also eyeing a potential change to the bond financing threshold for accessing 4 percent low-income housing tax credits, otherwise known as the "50 percent test"—if the amount of tax-exempt bonds required for each affordable housing project is lowered from 50 percent to 25 percent, an influx of tax credits would be available to facilitate more deals.

While income-restricted subsidized housing, by addressing the renters in greatest need, is part of the broader solution to the housing crisis, the enhanced emphasis on 100-percent affordable housing projects will not be the panacea. The reason is that it does not address the fundamental problem of the lack of market-rate housing.

As rents rise, more and more lower-income properties (which though not income-restricted, have historically served lower-income tenants) gentrify and become unaffordable to lower-income tenants. This lack of affordability forces more and more people onto waitlists for income-restricted units and adds strains to the system. Rent control and eviction protection offer only "band-aid" fixes to the problem.

Only the targeted construction of *both* more rent-restricted subsidized affordable housing and more market-rate housing will be able to finally end this crisis. Ultimately, addressing the problem will require revamping national and state policies and programs to improve housing accessibility and affordability for households in all income tiers.

## Current Considerations

In the meantime, as conditions continue to stymie demand for market-rate housing, the affordable housing industry will remain a fertile ground of business investment opportunities for real estate developers. Facing a labyrinth of legislation, regulations and processes for affordable and mixed-income housing projects, developers should tread carefully.

Market-rate developers venturing into the affordable housing industry are finding that there is a learning curve on how to maneuver through the regulatory and financing complexities of affordable and mixed-income housing, and ultimately, how to efficiently get deals done. And with states and cities eagerly searching for strategies to troubleshoot the housing deficits, coordination and communication among all the stakeholders has become even more imperative to develop deals.

In this complex housing landscape, developers must consider several factors when entering the affordable housing market. Seeking guidance will be essential to understanding the relevant policies and processes, connecting with the right agencies and institutions, and crafting creative and efficient solutions to help drive deals. A snapshot of some critical considerations includes the following:

- To get in front of the subsidy line, developers need to speak early and often with agency approvers and be shovel ready.
- To be shovel ready, developers need to understand what sources of financing exist and how to comply simultaneously with different regulations.
- With limited sources there will be gaps—consider closing gaps with sustainability and clean energy funds from local, state and federal programs (NYC C-PACE, NYS Clean Energy Initiative Funding and the soon to be launched federal Greenhouse Gas Reduction Fund). The construction upgrades can be benchmarked to show savings in maintenance and operating budgets.
- Consider the cost of mortgage recording and transfer tax and what structures might help mitigate the cost.
- Establish relationships with professional advisors (attorneys, accountants and consultants) and tax-credit syndicators before embarking on the development process with specific affordable housing sites.

Affordable and mixed-income housing projects involve a wide range of disciplines—such as real estate, financing, tax, mergers and acquisitions, and government relations and regulations—and developers can easily become mired in the complexities and lose valuable time by exploring unworkable approaches to various issues. Knowing what will work, and how to get it done, is key to efficiently closing deals. Ultimately, cross-discipline collaborations, innovative problem-solving, and consensus-building among all stakeholders will streamline deals and grease the pipeline of projects that are coming.