

Rethinking Affordable Housing in the United States and Israel

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The authors of this article compare and contrast what is happening in the United States and Israel in the area of affordable housing.

What comes to mind when you hear the words “affordable housing”? “It means housing that I can afford based on my income,” responded one participant at a recent housing conference at the Gazit-Globe Real Estate Institute at IDC University in Israel. “It is where poor people live,” responded another. “It is a place I would not want to go after dark,” responded a third.

We suspect that if we asked an American audience the same question, we would get similar responses ranging from moderately positive to strongly negative. The three of us were in Israel to share ideas about housing issues and especially the lack of affordable housing with participants from the government, academia, community organizations and the private sector. Some of the housing issues in Israel are unique: absentee owners of ‘ghost’ condominiums; government mandates for housing immigrants; and politically powerful religious groups who do not work. Other important factors include a difficult topography and government ownership of 93% of the land. However, many of the issues, like the high cost of housing in the metropolitan areas with the best job opportuni-

ties are the same in both countries. By comparing and contrasting what is happening in the United States and Israel some useful insights emerged.

Segmenting the Market

As the comments from participants cited at the beginning of this article clearly indicate, “affordable housing” is a catchall phrase that encompasses a broad range of people with different incomes, needs and aspirations. In both Israel and the United States, replacing this catchall with four distinct categories might be a useful starting point. What are the housing needs of each segment? What incentives can the government offer to get the best results?

Public or Social Housing

In Israel and in the United States, for the poorest of the poor, those earning less than 30% of median income, the residents cannot pay even the basic operating costs or any money toward a mortgage. The stark choice is either the government provides all the capital costs for building this housing or, es-

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pecially in the United States, these people end up being homeless.

Some portion of the people in public housing may never be able to work due to physical or mental disabilities. But a substantial portion could work. In developing housing for this group, we believe that decent, safe housing is only part of the answer. Unless we also provide counseling, job training and other services, we are simply treading water.

Subsidized Housing

The next group, the working poor, consists of households making roughly 30 to 60% of median income. Most 'affordable housing' programs in the United States target this group. A typical household in the U.S. might have an income of \$25,000 per year and be able to afford rent of \$625 per month (30% of their income). The \$625 will cover ongoing operating costs, but only leaves a couple of hundred dollars to service the mortgage. To bridge the gap between what this household can afford and what it costs to build and maintain housing, one can: subsidize the capital cost, subsidize the financing and/or supplement the rent. In the United States we do all three. The Low Income Housing Tax Credit generally provides 30 to 40% of the capital costs in the form of equity. Tax exempt financing reduces the cost of the mortgage. And Section 8 and other rent subsidy programs supplement the amount that this household pays each month to the owner of the property.

Workforce Housing

The next category of affordable housing is for working families that earn about 60 to 100% of median income. In the United States, this family might earn \$40,000 per year and be able to afford monthly mortgage payments

or rent of \$1,000 per month. The average cost of renting a house is now \$1,350 and the average cost of renting an apartment is \$1,041. In high cost markets like New York City the average apartment rental is \$2,935. So even in this category, where the private market used to provide an adequate supply of rental and even some ownership housing, developers are unable to meet the demand at a price people can afford. In Israel the situation for this group is even worse because housing costs are almost as high as in the U.S. and incomes are less than half. In the U.S. these working families generally earn too much money to qualify for rental assistance or most of the other subsidies described above. However, some localities are using tools like inclusionary zoning to help. The other option for working families is to move far out from the city to exurbia where the land is cheap. But then they must deal with the time and cost of long distance commuting.

Middle Class Housing

In both Israel and the United States, in the cities where young people want to live and where they can find the best jobs, the private market no longer seems able to provide decent housing that people earning 100% or even 150% of median income can afford. In many ways, it is an income problem more than a housing problem. In Tel Aviv, the ratio between annual median incomes and median house prices is 12 to one. In other words someone earning about \$18,550 is faced with trying to buy a condominium for \$222,600. In the United States, housing prices have come down considerably from their peak in 2006, but the bigger problem is that salaries have been flat and actually decreased in real, inflation adjusted terms during the last 10 years. In desirable cities

like New York and Seattle, housing prices are still more than young people earning median salaries can afford. In addition, mortgage underwriting has tightened to the point where lenders require a \$20,000 to \$40,000 down payment in order to buy a median priced house. In Israel the down payment requirement is 30%.

In an earlier time, we assumed that people making the median income did not need housing subsidies. That is no longer true. Young people graduating from college in the United States and young people who have served in the military in Israel are increasingly forced to move back in with their parents. We are seeing increasing pressure on the U.S. and Israeli government to use levers like selling land at discounted prices or allowing greater density in order to create rental housing for middle class households. Even with record low interest rates, another lever the governments may need to utilize is subsidized mortgages for developers of rental housing. In defining the middle class, we used to think that it included owning a home. In the current environment, homeownership may be out of reach for most people in their 20s and 30s.

Three Things The United States Is Getting Better At

In comparing the affordable housing programs in the United States with those in Israel, we were reminded of some of the progress the United States has made. As Israel tries to develop its own systems, we think it can benefit from the experience in the United States in areas such as: the relationship between the central and local government, the role of community organizations, and the development of mixed income housing.

The Relationship Between the Federal and Local Government

In the United States it has taken decades for the different government entities to work out appropriate roles and responsibilities. While affordable housing experts in the United States can find lots of flaws in this relationship, compared to the situation in Israel, the United States might offer some guidance. The U.S. federal government provides most of the resources for affordable housing in the form of Low Income Housing Tax Credits, HOME funds, Community Development Block Grants and rental assistance. Each of these programs comes with criteria and restrictions. However, it is up to the States and local governments to determine which projects in which locations receive this funding. In Israel these roles have not been worked out. As a result, the central government tends to develop "one size fits all programs" because they do not trust local governments to utilize resources in ways that most effectively meet the local needs.

Community Organizations and Intermediaries

Israeli government officials were particularly interested in the role played by community development corporations. As Israel tries to create more affordable housing and revitalize buildings and neighborhoods, they believe that trusted local organizations can play an important role. In most urban neighborhoods in the United States, these organizations exist. Some are more effective than others, but after the devastation caused by urban renewal in the 1950s and 1960s, community development corporations have played a significant role in ensuring that residents' concerns are heard and neighborhood revitalization is done in a thoughtful and productive way. The combination of com-

munity development corporations with deep roots in the neighborhood and intermediaries like LISC, Enterprise Community Partners and Housing Vermont, who possess great financial and project management expertise, is something Israeli officials believe they need. The challenge is that it took decades for these organizations to emerge and grow in the United States, and Israel needs them now.

Mixed Income Housing

Segregating poor people into isolated projects rarely works out well. We shared the example of Pruitt Igoe which housed 10,000 people in 33, 11 story buildings on the outskirts of St. Louis. Conditions got so bad that 20 years after it was built, all 33 buildings were demolished. In contrast, in 200 communities across the United States local governments have established inclusionary zoning provisions. These provisions often require developers of large private apartments to set aside some percentage of their apartments (13% in the case of Boston) at below market rates for lower income households. Montgomery County, Maryland was among the first places to implement inclusionary zoning. Montgomery County is “the sixth wealthiest county in the United States, yet it has built more than 10,000 units of affordable housing since 1974, many units door-to-door with market-rate housing.” As an incentive to build mixed income housing, local governments sometimes provide a density bonus and/or favorable tax-exempt financing. For Israel, finding a way to build greater density in high cost, desirable markets like Tel Aviv is something they very much want to do. Replacing deteriorating public housing with mixed income projects seems like an idea worth considering.

Mistakes to Avoid

As Israel studies affordable housing practices in the United States, it can learn as much from our mistakes as from our successes. As pointed out above, Israel does not want to repeat the kind of urban renewal programs that devastated neighborhoods or build large scale public housing projects like Pruitt Igoe and Cabrini Green. Two other broad areas where they can learn from our mistakes are: “expiring use” and “financial complexity.”

Expiring Use

A number of U.S. affordable housing programs allow the developer to pay off the mortgage or otherwise free itself from affordability requirements after a certain number of years. From 1970 to 1974, private developers created 250,000 affordable housing units utilizing a program called Section 236 housing. Developers could finance these projects with mortgages as low as one percent in exchange for charging below market rate rents for 20 years. In the 1990s, many of these properties were worth many times their original development cost. Owners had a big incentive to pay off the mortgages and turn these properties into market rate units with much higher rents. Or if the government wanted to keep this 236 housing affordable, it had to make substantial cash payments. Some of us believe that affordable housing should have legal restrictions so that it remains permanently affordable. Others think that “permanent” is too long and that a mechanism needs to be in place so there is flexibility as neighborhoods and cities change. What the U.S. experience in this area has taught us, however, is that with all the work and effort involved in creating quality, affordable housing, 20 years is too short.

Financial Complexity

If the U.S. affordable housing program has an Achilles heel it is the number of different funders required to finance most projects. We recently reviewed a 40 unit affordable housing project in Burlington, Vermont. In order to finance the project, the developers cobbled together 16 distinct “sources of funds.” These included: \$70,000 from the Burlington Housing Trust Fund, \$380,000 in a bank loan, \$110,000 in State Tax credits, \$312,000 in weatherization funds as well as substantial federal funding from Low Income Housing Tax Credits and HOME funds. A colossal amount of time, money and brain-power is required to pull together all of this financing. And then there are the complications when the different sources of funding have requirements that are contradictory. As Israel develops its affordable housing system, it needs to ensure that funding programs have clear and consistent rules and that financing from each source is large enough so that only a limited number of lenders and investors are involved in each transaction.

Current Challenges

Section 2 of the Housing Act of 1949 set forth the following national housing objectives which read like goals that the United States and Israeli government might set today:

The general welfare and security of the Nation and the health and living standards of its people require housing production and related community development sufficient to remedy the serious housing shortage, the elimination of substandard and other inadequate housing through the clearance of slums and blighted areas, and the realization as soon as feasible of the goal of *a decent home and a suitable living environment for every American family*, thus contributing to the development and redevelopment of communities and to the advancement of the growth, wealth, and security of the Nation.¹

Sixty-four years later, we are no closer to these goals than we were in 1949. We have improved the quality of our housing stock, but it has become less affordable. As Alan Mallach, a Senior Fellow at the Brookings Institute put it: “the cost of producing and maintaining housing to modern standards has outstripped the ability of much of the population to afford that housing.”²

Housing preferences and demographics have also changed. In 1950, the dominant household configuration was married couples with children who occupied 43% of American housing units. Another 35% of U.S. housing was occupied by married couples without children. Thus, 78% of U.S. households fit the profile of families who might want to live in the emerging suburbs with its inexpensive land. Fast forward to today. Only 20% of U.S. households include children. The cheap land is now in exurbia far from jobs and far from the lifestyle that most households, especially younger households, are seeking.³ These changing demographics and housing preferences also mean we need to rethink the proper balance between homeownership and rental housing. In this context, hybrid forms of ownership, like limited equity cooperatives and land trusts might have a larger role to play.

To drive down the cost of housing in desirable cities where young people in Israel and the United States want to live requires creativity. In selling land for development, the Israeli government often seems to focus solely on maximizing revenue. Efrat Tolkovsky, General Director of the Gazit Globes Institute for Real Estate Studies, tracked the sales of commercial real estate in the Tel Aviv metropolitan area. She discovered that the price the government charged for land zoned for residential development cost twice as

much as the land it sold for office building development. To make housing more affordable, the government of Israel may need to sell public land at discounted prices and/or allow greater density which reduces the per unit land cost.

Private developers remain the engine with the capacity to build (and overbuild) vast amounts of housing. To deal with the current affordable housing challenges, the governments in Israel and the United States need to decide which segments of the population they want to address, which kind of resources are most appropriate and how much land, money and other incentives they are willing to invest. With the right package of incentives, they should be able to attract strong interest from private developers and community organizations. In structuring these packages it is worth keeping in mind a few key lessons from the experience in the United States:

- The neighborhood must be at the table and have a voice as the plans are developed.
- The government must establish clear public policy goals with specific, quantifiable targets.
- Think long term. Property management

and reserves are critical. A key measure of success will be that the housing continues to be a desirable place to live 20 years from now.

- Consistency is essential. Developers can work with a wide range of goals and incentives as long as they are confident that the rules will not change.
- Experiment and Pilot. Try a lot of things on a small scale and see which ones work best.

NOTES:

¹In language that again reflects current thinking, The Housing Act of 1949 goes on to say that “private housing enterprise shall be encouraged to serve as large a part of the total need as it can” and that “local public bodies shall be encouraged to undertake positive programs to assist the development of well-planned, residential neighborhoods.”

²“Creating Affordable Housing: The Conditions for Success and the Need for Public Subsidy,” by Alan Mallach, a short paper delivered at the Gazit-Globe Real Estate Institute conference on affordable housing at IDC University in Herzliya, Israel.

³“Housing: An irresistible force meets an immovable object,” Robert Steuteville, New Urban Network, <http://bettercities.net/news-opinion/blogs/robert-steuteville/14629/housing-irresistible-force-meets-immovable-object>. “Forty-seven percent of households want urbane living; (according to the) National Association of Realtors . . . 70% wants to walk to discernible destinations, from transit to grocery stores . . . The generation that is currently moving into the housing market—Millennials—is the most urban-oriented cohort since at least before World War II. A whopping 88% of this generation wants to live in an urban setting, according to a survey by RCLCo.”