“Housing Equity in a Time of Crisis”

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Spring 2021 Ackman Lecture in Real Estate Leadership and Ethics
Schack Institute of Real Estate
New York University
April 28, 2021

I am the CEO of an equity REIT that invests to create social equity. How do we do that? We invest, in partnership with strong nonprofit housing providers, names you may know like Mercy Housing out of Denver, Eden Housing out of San Francisco and Hispanic Housing out of Chicago, to acquire and maintain the affordability of rental apartment communities that serve families of modest means. We know that our approach changes lives and that it strengthens communities.

How do we know? Well, let me tell you about the people we serve essential workers. People we need in our community. People we all rely on.

Who did you miss during the pandemic? The retired teacher who used to come to your house to tutor your son for AP chemistry; the regulars – workers and customers – at the corner café; the staff at the seniors’ exercise program your mother-in-law used to take at the county’s parks and rec center; the guys at the local hardware store who could help you figure out how to fix anything.

Who were you grateful for during the pandemic? The nurses, lab-techs and orderlies who kept the hospitals, doctors offices and health clinics going; the delivery drivers who delivered all those things you used to go out to get so you could stay safe at home; the home healthcare aides who continued taking care of your dad well before anyone even had good masks or vaccines; the teachers who figured out how to juggle in-person and remote learning on an on-again/off-again schedule; the folks at the bagel shop who figured out the new logistics of interrupted supply chains, varying staff needs, and outdoor pickup windows.

In case of a natural disaster, who do you need first? Emergency personnel, healthcare professionals, public safety officers and fire fighters, transportation, food, and construction workers.

These are the residents who my company serves because we know that if we are going to have a vital community, that delivers the things we all want and need, we need housing that meets their needs.

But why this? Why focus on housing instead of jobs or healthcare or education? Because, to quote Michael Stegman, housing is economic destiny**.** Your home and your neighborhood play a critical life role for every member of your household. In Chicago, average life expectancy for those born at the same time but in different neighborhoods can differ by as much as 30 years. Poor-quality housing is directly tied to childhood emotional and behavioral problems and early developmental delays. Housing Indoor air quality is responsible for up to 40 percent of children's asthma episodes, and research indicates that moving an asthmatic child from poor-quality housing into a healthier home reduces asthma-related doctor visits by 66 percent.[1]

Growing up in high-crime, poor communities can impact earning potential. In 2015 academic researchers[2] looked at income data on more than five million children whose families moved across counties between 1996 and 2012 and found that low income boys who stayed in high-crime poor neighborhoods, made about 35 percent less on average than low-income children who grew up in the best areas for mobility. For girls, the gap is closer to 25 percent. Children in Seattle whose lower-income families used federal housing vouchers to switch neighborhoods were found to be on track to earn an extra $210,000 in the course of their lives. Such moves also produced significant health benefits for poor parents, including lower prevalence of the conditions that have contributed to the higher Covid death rates among minorities, such as diabetes and obesity.

Where you live also affects the education you receive. High-quality schools can be a great economic equalizer, but access to good schools – including good public schools – is expensive. In the 100 largest metropolitan areas, a household must spend $11,000 more per year in housing costs to live in a high-scoring school district.

Housing matters to individuals and families and to our overall economic health.

But we have a shortage of housing overall and particularly of affordable housing. As a result, we have an affordability crisis that started well before Covid-19 and has accelerated with the pandemic.

You are in the housing business, so, you know the stats: Households are cost-burdened when they spend more than 30% of their incomes on rent or mortgage and utilities and severely cost-burdened when they spend more than 50%.

[1] Michael Stegman, To Rebuild America's Post-pandemic Economy, We Need to Rethink Housing, LinkedIn, July 1, 2020

[2] Raj Chetty, Nathaniel Hendren, and Lawrence Katz, The Effects of Exposure to Better Neighborhoods on Children: New Evidence from the Moving to Opportunity Experiment, American Economic Policy Review, Vol. 106, No. 4, April 2016.

For households making 30% of area median income -- we only have 37 available and affordable homes per 100 households. At 50% of area median income, we have 60 available and affordable homes per 100 households. At 80% of area median income, we have 94 homes per 100 households.[3]

Households are forced into the worst game of musical chairs to have security and stability with the losers in this brutal game, paying more, sometimes much more, than they can afford.

Homeowners are not exempt from the affordability challenge. In 2019, before the pandemic, 30% of all households paid more than 30% of their income on housing.[4] With the job and work hour losses from the pandemic, the number of cost burdened households has only climbed.

We also know how issues of racial equity are deeply involved. A higher percentage of black and brown households rent, a higher percentage of black and brown renters are cost burdened, and a higher percentage of black and brown renters suffered income losses during the pandemic. While 42% of all white renters are cost-burdened, 52% of Latino renters and 54% of Black renters are cost-burdened. More than 30% of Black renters spend more than half of their income on housing. [5]

As the pandemic took hold in April of 2020, Freddie Mac surveyed consumers to see where they were on housing issues and found that:

- Sixty-seven percent of renters had made spending changes or had moved to afford their monthly housing payment. Eighty-two percent of renters in the "essential workforce" had made cuts.
- Half of all renters were finding it difficult to find affordable housing close to work. This includes 57% of essential workers.

Households who pay too much for rent do not have the funds to cover the necessities, much less to thrive. So, let's look at a family of four with two full-time working adults making minimum wage. You know even before we get started that the math isn't going to work, right? A full-time job at the federal minimum wage yields $1,256.67 in monthly gross wages. Then let's assume a few deductions for local, state, and federal taxes.

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[3] National Low Income Housing Coalition, The Gap: A Shortage of Affordable Homes. March 2021.

[4] Joint Center for Housing Studies of Harvard University, The State of the Nation's Housing. 2020. (SONH)

[5]NLIHC, The GAP

And let's assume a little hourly stability in working hours to get to a net monthly income of $2,008 for two working adults. An average two-bedroom apartment at fair market rent costs $1,246 a month (although good luck finding that apartment). And I don't know what you are paying for groceries, but the Department of Agriculture's thrifty food budget for a family of four (two adults and two school- aged children) is $671 per month. When you deduct for rent and food, this working family only has $91 a month for transportation, childcare, and all other basics for four people. It just doesn't add up. [6]

Let's look at the problem another way. What does someone need to make to afford a modest place to live? The National Low Income Housing Coalition says you need to make $19.56 an hour (more than twice the federal minimum wage) to afford a one- bedroom or $23.96 to afford a two-bedroom apartment.[6] Twelve of the 20 largest occupations in the country, including home health aides, janitors, and food servers, provide a median wage lower than what is needed for a full-time worker to afford modest rental housing (NLIHC, The Gap). When you factor in the furloughs or reductions in hours and job cuts, we have seen over the past year, renters may be left with debts they can never. (NLIHC, The Gap)

The job sectors that lost the most jobs and have yet to recover because of the pandemic were the sectors that rely on people gathering in close proximity. For example, according to Fannie Mae, as of the end of January 2021, there were still an estimated 23% fewer jobs in leisure and hospitality than there were at the start of 2020, representing a 3.8 million job loss in this sector alone.[7]

More importantly, these are the workers most likely to rent. As recently as 2018, an estimated 57% of workers in leisure and hospitality were renters, according to the Fannie Mae study.

A key component of the affordability challenge has been stagnation and decline in incomes for lower and middle-income working households.

Prior to the pandemic, according to research by the National Multifamily Housing Council, falling incomes for low-income households and stagnant incomes for middle-income households, were a critical factor in causing rapid growth in affordability challenges**.** Since 2000, real household incomes have fallen for the bottom 40% of American households, while the middle 20% experienced almost no real household income growth.[8] Median renter

[6] NLIHC, The Gap

[7] Tanya Zahalak, Fannie Mae, Covid 19 Exacerbates the Affordability Crisis. February 18, 2021.

[8] National Multifamily Housing Council, Housing Affordability Toolkit. https://housingtoolkit.nmhc. (NMHC Affordability Toolkit)

Median renter household income declined more than 5% between 2000 and 2016.[9] Thus, even more middle-income households were struggling to afford housing than we had seen in the past.[10]

New research by Freddie Mac shows that more than half of surveyed renters spent last year worried about their ability to pay the rent. 27% of surveyed homeowners and 35% of renters had asked for a housing payment postponement.

In 2019, less that 2% of all renter households were threatened with eviction within the previous three months,[11] while In January, even with a federal eviction moratorium in place, almost 10% of renters reported they were behind on rent --- and thought it was likely they would be evicted within the next two months.[12]

The inability to pay rent over this past year has affected every apartment class. Real Page Analytics has reported that rent payments across asset classes were down approximately 3% in 2020 from 2019.

Estimates of back-due rent range from $1740 to $6039 per household as of January 2021, depending on whether you consider all the renter households, including those who were struggling before the pandemic, or just those who had lost their jobs due to Covid.

The eviction moratoria and prohibitions on late fees have had an impact in keeping residents housed, with the stimulus payments directly to households, unemployment insurance, and new federal, state, and local short-term rental assistance have had a significant impact in limiting the ballooning back-due rent deficit. But it's certainly not been enough.

But it's not just income. We have an overall crisis in housing supply that has been building for decades.

In 2018, Freddie Mac estimated that the U.S. had about 2.5 million fewer homes than was needed to meet long-term demand. Research by the National Multifamily Housing Council in 2019, found that, on average, the U.S, needs to product approximately 328,000 new apartment homes every year to keep up with total demand. But the U.S. has only produced that many apartments in one year three times in the past 30 years. Between 2000 and 2016, 6.3 million net new low- and middle-income households (those earning less than $75,000) entered the rental market. But only 3.2 million rental units affordable to them were added.

[9] NMHC Affordability Toolkit
[10] NMHC Affordability Toolkit
[11] SONH
[12] NLIHC The GAP (Census Bureau, 2021b)

One factor in the overall housing shortfall --- and particularly in the affordable shortage --- has been the loss of existing affordable housing inventory. Let's start with single family homes. If you live in the suburbs, how many of the modest 3-bedroom ramblers in your neighborhood --- could house a county government worker and his family or a family with a parent who has a good, blue collar job --- have been replaced with 3- and 4-story, 5-bedroom homes that are priced for law firm partners (and REIT CEOs)? In my neighborhood, it's about 90% of them. When we look at the apartment supply, about half the rental apartment stock was built before 1980. In any given year between 120,000 and 240,000 units of affordable rental housing are lost to the affordable housing inventory through upgrading of the housing to serve higher income residents, or through decay and demolition. As I will discuss further below, since new apartment production generally falls into two categories – higher rental cost, higher amenity properties designed to serve renters by choice and, at a much smaller rate, properties subsidized by Low Income Housing Tax Credits and designed to serve households below 60% of area median income, but often targeted at much lower incomes. As a result, the loss of rental housing serving households making 50 to 70% of area median income is particularly damaging.

A key driver of the housing shortfall has been the long-term decline in the construction of entry-level single-family homes and of lower cost rental apartments. In the late 1970s, nearly half a million new entry-level homes were being built per year. That number has declined every decade so that by 2020, Freddie Mac estimates that only 65,000 new entry-level homes were completed.

At the same time, more than two million households bought their first home in 2020, despite all the economic uncertainty. What does this all mean? Clearly, not every renter looking to buy their first home wants a so-called "starter" home, but the large gap between the type of available housing and the demand puts pressure up and down the income chain. Renters can't buy houses that don't exist, creating more pressure on rental affordability.

Larger demographics also have an impact on our housing crisis. You've all seen the headlines this week on population growth reminding us that growth isn't distributed evenly across the country. According to Freddie Mac, between 2017 and 2019 The South and West grew seven times faster than the Northeast and Midwest and the pandemic has likely increased this trend. In the South, population growth was mainly driven by domestic migration, while in the West, growth was mostly driven by natural increase (more births than deaths).

Before the pandemic, a majority of metros experienced more growth in the suburbs than in cities, a trend that accelerated through the pandemic. Population in some of the smaller and medium-sized metros was growing faster in percent terms than the larger metros, another trend that was reinforced by the pandemic. As a matter of fact, over the past ten years, the top three MSA with the fastest growth are The Villages, FL, Myrtle Beach, SC, and Austin, TX.

Of the top ten fastest growing metros, only the Washington, DC area grew more because of natural increase (more births than deaths). The rest grew due to net migration. [13]

Why do we care? Because if your town is growing because people are moving there, you need to think about what happens when they stop. Because people quit moving when there is no place to move to. And as a result, employers struggle to attract talent, and businesses are challenged, and community vitality and resilience is constrained. In many other metropolitan areas, before COVID, housing growth was not keeping pace with job growth. The Washington, D.C. area is forecasted to add approximately 413,000 new jobs to its employment base between 2020 and 2030, but just over half that many new homes.

Using standard metrics for balancing households and jobs, that means the region needs more than 75,000 additional homes to meet the demand, above the housing growth that was already expected. This housing shortage means that before the pandemic more than 325,000 workers were commuting to jobs in the DC region each day from communities located beyond its footprint. The shortage affects affordability and potentially undercuts the area's attractiveness to new companies and talent, strains the transportation system, and impacts the environment and quality of life for the regions residents.

For some this means long commutes to work, and difficult choices between paying rent or affording other necessities.[14] And even a bigger commitment to ongoing remote working, won't take the pressure off this housing need.

While the pandemic has increased moves to suburbs and smaller cities, it has also caused a slowdown in household formation. As a result, according to Zillow there are 5.7 million "missing" households -- representing people who historically would have moved into their own home but were either unable or unwilling to do that during the pandemic.

The demographic with the greatest number of missing households during the pandemic were white 25- to 29-year-olds, while the group with the largest fall since 2006 in forming new households were African Americans 25-to-29-year-olds.

The labor market still needs to add 8.4 million jobs to get back to the pre-pandemic level. [15]

But when the economy recovers, there could be 6.4 million more households in 2025 because all those people who did not move out from their parents and their roommates, particularly the millennials who are aging into their late thirties, may set up their own households. That is, if they can find a place they can afford to live.

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[13] Freddie Mac, Housing Market Data, January 2021
[14] Metropolitan Washington Council of Governments, THE FUTURE OF HOUSING IN GREATER WASHINGTON, September 2019
[15] Freddie Mac, April 2021 Economic Report

How can we build more housing? There is no single, magic solution. We need local, regional, and national efforts by the public and private sectors.

Four things limit supply: 1) labor; 2) cost of materials; 3) cost of land (which is largely impacted by the fourth thing), and 4) rules for building or not building. And of those, our rules are the thing that all of us in this virtual room can have an impact on.

The cost of construction materials and labor grew 57% from 2000 to 2016 --- and continues to climb. Last year saw record high in lumber prices. They've more than doubled since 2020. Land costs, meanwhile, almost doubled between 2000 and 2019.

Perhaps more importantly, state, local and neighborhood barriers add to the cost of development and, for apartment properties. Those increased costs create a barbell effect, where the market only produces high-end, high-rent apartments whose rents can cover the development costs and rent restricted properties whose unit costs are subsidized by the government. Units targeted to moderate-income renters – like those my REIT serves -- are rarely financially feasible because it costs more to build those units than moderate-income renters can afford to pay.[16]

State and local governments have substantial control over development costs. Zoning policies, land use regulations and other state and local policies add delay and additional costs to new development.

Delay costs money. In our largest cities, the time from when a developer starts thinking of a new apartment project to when the first tenants move in can be ten years. The children of a family that could use a decent apartment come of age waiting for that apartment.

According to research by ULI, apartment developers estimate that a two-year approval process can add $2 million to $2.5 million in costs before fees and developer contributions regardless of whether a project is 60 or 600 units. And those costs must be covered by rent or by subsidies.

So, we need to look long and hard at whether we collectively believe that all the good things that our requirements and regulations designed to create, offset the terrible costs they are cumulatively imposing on American households.

Speaking of supply, I haven't talked about the impact of climate, but it looms large in any consideration of our built environment. In the first eight months of 2020, the United States experienced 16 distinct billion-dollar natural disasters, making last year one of the three worst on record. [17] Climate change has added to the number of low-income households facing energy and housing insecurity as record heatwaves and cold spells have driven energy usage sky high. And the challenge didn't end in September.

[16] NMHC Affordability Toolkit
[17] SONH

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All of us watched in horror as record cold overwhelmed the capacity of the Texas power grid to meet life and death needs for electricity and heat. As we focus on supply, we must focus on making our buildings more climate resilient and finding ways to reduce energy and natural resource consumption.

Now everyone is talking about infrastructure. And often when you talk about infrastructure you talk about sewers and bridges and roads. But the nation's supply of housing represents a significant share of investments made in physical infrastructure. In 2020 total capital investment in housing was estimated at $36.2 trillion, comprising nearly 140 million homes. Housing is also a vital component of the country's economy, contributing nearly one fifth of the nation's GDP.

The Biden administration's American Jobs Plan represents an historic acknowledgement that housing is a critical part of the nation's infrastructure. It proposes $213 billion for housing, for modernizing and rehabilitating public housing; homeownership in underserved communities, and; for the construction and rehabilitation of affordable homes. This $213 billion is the biggest promised outlay in affordable housing supply since the Great Depression. [18]

So, how should we invest this money and our other housing dollars? The Aspen Institute has recommended a five-part approach:
1. Affirmatively address racial and ethnic inequality—and other forms of discrimination—in housing and promote neighborhood integration,
2. Make it easier to build all types of housing,
3. Preserve the availability and physical quality of lower-cost, private-market housing, and subsidized affordable housing,
4. Support households directly to close the gap between their resources and the cost of securing and maintaining stable, adequate, and affordable housing, and
5. Support renters' wellbeing and access to resources to resolve housing challenges. [19]

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But increased funding alone won't solve the problem. As the Terner Center has noted, we need to reform our existing housing programs and rethink how we deliver housing assistance directly to families and change the broader land use landscape. [20]

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[18] Ben Metcalf and Barry Zigas, Terner Center for Housing Innovation, UC Berkeley, Addressing Housing's Critical Role as Infrastructure. April 23, 2021 (Terner Center)

[19] Aspen Institute Financial Security Program, Strong Foundations: Housing Security Solutions Framework at p. 68. January 2021

[20] Terner Center.

We have the opportunity to align this infrastructure investment with broader housing policy reforms, to have a larger impact and to create a more equitable future. And we can't waste this opportunity.

What reforms are needed? First, we need to rethink how we get more housing built, including what types of housing we build and where. This goes to regulatory reform.

Second, we need to directly support households in affording housing. Today, only one in four families that are eligible for Housing Choice Vouchers from the federal government actually receive them. And not all that receive them can find places to use them. We need to fill this gap.

Third, and perhaps most importantly, we need to change our zoning practices. Today's housing landscape is the direct result of a long history of policies that have prevented the development of new, denser, and more cost-effective homes. But if we want more equitable and resilient communities, we need to quit funding approaches that compel economic and racial segregation.

If we do the work to do this right, this time, we have a real chance to use the economic recovery to build housing stability and household wealth for everyone in our community.

So let me move away from research and theory to the actions my company and others have been taking on the ground to address this challenge.

My company, Housing Partnership Equity Trust, takes one approach to the housing crisis – preservation -- we invest in maintaining rental affordability in neighborhoods that have the necessary elements for household success. In the research by Chetty, Hendren and Katz that I referenced, the researchers found that there were five characteristics of areas that improve upward mobility: they have less segregation by income and race, lower levels of income inequality, better schools, lower rates of violent crime, and a larger share of two-parent households. Therefore, we should target those locations affordable and where new demand and new recognition of all the neighborhood has to offer makes the properties in that community unaffordable to a preservation buyer like us.

It’s a challenge, because you are trying to catch a property and a neighborhood at a point of inflection, between the point where age and neglect and changing consumer demand had made the neighborhood relatively affordable. We buy older properties – typically 1980s vintage garden apartments in inner-ring suburbs that with targeted investment are generally Class B properties.

Our residents typically make 50 – 60% of area median income. While many were essential workers through the pandemic, others who work in hospitality and service jobs lost hours or lost their jobs altogether. A typical resident for us is a home healthcare aide, divorced with two children. In any ordinary year, her life works, and her children thrive --- if she has reasonable rent for a decent and safe home, access to a bus line to work, to full-service grocery stores, and to good schools. For the past year, she has needed a bigger hand up. Our nonprofit partners provided that.

We partner with strong nonprofit housing providers who know their markets and have decades of experience in serving economically vulnerable households. They often serve as the property manager for our investments. Through the pandemic, effective property management often looked like social work case management --- surveying residents to understand their needs and then responding by getting pop-up foodbanks to come to the community, helping residents apply for rental assistance and other community benefits. They have tapped philanthropy to fill gaps, identified resources for parents forced to provide homeschooling, and developed payment plans for residents who needed them.

In the pandemic, physical occupancy remained very high, while rent payments lagged later and later into the month. our residents are as savvy as any other – with the prohibitions on late fees and penalties in place in most jurisdictions, our residents had the option to take an interest free loan by paying on the 25th of the month instead of on the 1st and still stay current.

Overall, our rent payment levels averaged about 90% from April of 2020 through March of this year. This aligned with what the rest of our sector was seeing.

Our properties are what is typically called “NOAH” – naturally occurring affordable housing – rental properties that do not benefit from deep, ongoing public subsidies. So how do we make the math work between what it costs to acquire a property, what working households can afford to pay, what it costs to maintain a property as a healthy community and what investors need in return? First, we are very disciplined about our numbers. We know we can’t absorb the cost of overpayment by charging our residents significantly more, without driving our current residents from their homes. In some jurisdictions, particularly California, we seek tax abatements that are available for affordable housing provided by nonprofit providers. We also often seek local subsidies when available, in the form of forgivable second mortgages or low-cost energy improvement financing. And we always accept Section 8 rental vouchers from residents who have them.

We create meaningful operating reserves at acquisition, because our residents can't afford to shoulder the cost of an unexpected expense and our investors are fair in expecting a reasonable and consistent return.

The properties we buy often are tired and have experienced significant deferred maintenance when we take them over. When our partners survey residents as part of the acquisition, the number one thing residents note is that they want to have their repair tickets responded to – no more waiting six months for a leaking water faucet to be repaired, no more months without a working stove. Our primary real estate focus is on addressing the things that drive savings and make an economic difference. We "green up" the properties that we acquire and reduce energy and resource consumption. We also focus on improving quality of life – trading out that broken tennis court for a dog park and a children's playground. Our primary resident focus is to treat residents with dignity, because some participants in this market segment use tenant abuse and property neglect as a business strategy. The combined approach of modest rent growth and focused and respectful property management means that our unit turn-over is well below the industry average of 50% a year, thus saving us money on marketing and turnover costs.

But in the line-up of policy concerns and considerations I've discussed, where does this approach fit in? We are delivering affordable housing, largely to residents of color, providing housing security and stability, and assuring that residents have access to tools they need to succeed. But we still must work through a complex array of public programs and requirements, even though our properties don't generally have deep subsidy. Many of the properties we acquire previously benefited from Low Income Housing Tax Credits or other long-gone subsidy programs. The subsidies are no longer flowing yet the properties have use restrictions that continue. We also accept housing choice vouchers and project-based rental assistance, so our properties must meet federal requirements. This year, our nonprofit partners helped residents access emergency rental assistance that has carried different requirements. Each of the light subsidies we access, from tax abatements to lower cost subordinate financing, carries their own additional restrictions. If we seek to sever excess land and make that available for development, we face all the local zoning and permitting, and entitlement requirements associated with that. And, of course, the properties are subject to all the ordinary rules governing rental apartments in any community. Then we have the requirements from our investors. CRA-motivated bank investors need use restrictions for their regulators. Foundations who have made program related investments need our investments to meet their tax exemption rules.

And, because we are a REIT, we are subject to the tax and compliance regimes applicable to all REITs. Most of these rules are designed with good intent to address very particular problems. But the cost of compliance is daunting and reduces the amount of funds available to meeting the needs of the residents we serve. For me personally, there may be some karma at work – I'm both a former HUD official and Fannie Mae executive, so I may be paying for my earlier hubris about the value, on balance, of the rules I imposed.

As we navigate through this year and get beyond the pandemic, the affordable housing shortage may be one of our largest obstacles to the nation's overall economic growth. We know there isn't a one size fits all solution to the housing crisis we are facing. There doesn't need to be. But we do need is a commitment – by all of us -- to fight for housing that provides a foundation for inclusive growth, resilience and well-being for our neighbors, or communities and ourselves.

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