Policy Proposals to Increase Housing Affordability

Lee E. Ohanian[1]

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Chair Wyden, Ranking Member Crapo, and members of the Senate Finance Committee, thank you for inviting me to testify at this hearing on "The Role of Tax Incentives in Affordable Housing".

America's housing crisis is nearly 100 years old, dating back to the 1920s when the average home price in Manhattan was over $1.2 million in inflation-adjusted dollars[2]. In the last century, dozens, and perhaps hundreds of federal, state, and local agencies have been created to deliver affordable housing, but affordability remains elusive, particularly for low and middle-income households. National Association of Realtor data show that affordability has plummeted in the last year, particularly in the Western United States where the median-priced home now requires over $100,000 of liquid assets for a down payment and closing costs, and a household income exceeding $100,000 annually to qualify for a conventional mortgage[3].

Increasing housing affordability requires addressing two related issues. We must expand housing supply and we must build new housing at a much lower cost. There are key policy reforms that would make considerable progress in advancing these goals. I focus on two areas for policy responses: (1) increasing the use of manufactured housing, which is much more cost efficient than traditionally built housing, and (2) reforming the process of building affordable housing, as this has become inordinately expensive in some states.

Increase Adoption of Manufactured Housing to Lower Building Costs

Summary: Manufactured housing is 60 percent less expensive to build per square than traditionally built housing, but regulations and financing difficulties have significantly hampered adoption of these homes. Tax incentives and regulatory reforms can significantly increase affordability by expanding the use of manufactured housing to increase U.S. housing supply.

The development of modern factory production made it possible for virtually all Americans, not just those with high incomes, to buy automobiles and other mass-produced durable goods. But modern production methods are notably absent from our residential construction industry, which builds homes in much the same way as they have always been built, as described in an important recent study of

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[1] Distinguished Professor of Economics, UCLA, and Senior Fellow, Hoover Institution, Stanford University.

[2] Nicholas, Tom and Anna Scherbina, 2013, "Real Estate Prices During the Roaring Twenties and the Great Depression" *Real Estate Economics*, 41, no. 2, pp 278-309.

[3] National Association of Realtors, "Housing Affordability index", https://www.nar.realtor/research-and-statistics/housing-statistics/housing-affordability-index.

manufactured housing by James A. Schmitz, an economist at the Federal Reserve Bank of Minneapolis[4]. This means that residential construction costs are much higher than they could be.

The Bureau of Labor Statistics[5] reports that worker productivity (inflation-adjusted output per worker) rose by only 11 percent between 1987 and 2016 in single-family home construction. By comparison, BLS data show that worker productivity in durable goods manufacturing industries rose by about 150 percent over the same period. The cost savings enjoyed by consumers of manufactured durable goods have evaded residential home building because building practices have not adopted cost-savings technological advances prevalent in manufacturing.

The high cost of traditional home building has been documented since at least 1937. A.C. Shire, the chief engineer of the Federal Housing Administration, wrote at that time that "In an age of large-scale financing, power, and mass production, we have the anachronism that the oldest and one of the largest of our industries…follows practices developed in the early days of handiwork .... is bogged down by waste and inefficiency, [and] is unable to benefit by advancing productive techniques in other fields."[6]

Manufactured homes are a much lower cost alternative to traditionally built homes. Census data show that production costs are about 60 percent lower than traditionally built homes[7]. Because of substantially lower costs, manufactured housing production grew significantly, rising from 103,700 units built in 1960 (10 percent of total single-family units) to 575,900 units in 1972 (60 percent of total single-family units)[8]. This growth led the Commerce Department to predict about 800,000 manufactured units by 1980, but only about 220,000 units were built that year.

One factor depressing manufactured housing since that time of rapid growth is a HUD requirement that manufactured homes be placed permanently on a chassis[9]. This requirement imposes a negative aesthetic on the home, leading them to be known as "mobile homes" or "trailers". The negative aesthetic of a home placed on a chassis has often led local zoning ordinances to exclude manufacturing housing from many neighborhoods. Manufactured homes typically are placed in "mobile home parks" that are locally zoned for that purpose. This in turn limits financing options, since the homes on chassis are considered "mobile", which means they are financed by personal loans or chattel loans which do not provide the homeowner with interest tax interest tax deductibility. [10]

Increasing manufactured housing would substantially improve affordability, given their construction costs are 60 percent less per square foot. Removing the HUD requirement that manufactured homes be placed on a permanent chassis would considerably change the landscape for

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[4] Schmitz, James A. Jr., 2020, "Solving the Housing Crisis will Require Fighting Monopolies in Construction", Federal Reserve Bank of Minneapolis Working Paper No. 773.
[5] Bureau of Labor Statistics, "Measuring Productivity Growth in Construction", *Monthly Labor Review,* January, 2018, pp. 1-15, https://www.bls.gov/opub/mlr/2018/article/measuring-productivity-growth-in-construction.htm.
[6] Schmitz, 2020, op. cit.
[7] Bureau of the Census, "Cost Comparisons: New Manufactured Homes and New Single Family Site-Built Homes", https://www2.census.gov/programs-surveys/mhs/tables/2017/sitebuiltvsmh.xls
[8] Schmitz, 2020, op. cit.
[9] U.S. Department of Housing and Urban Development, "Frequently Asked Questions About Manufactured Housing", https://www.hud.gov/program_offices/housing/rmra/mhs/faqs
[10] Schmitz, 2020, op. cit.

these homes by making them aesthetically acceptable and broadening the options available to finance these homes, including mortgage financing with interest deductibility.

A 2011 report by economists at the Center for Housing Research at Virginia Polytechnic University, which was commissioned by HUD, provides considerable detail on understanding the regulatory hurdles facing this low-cost alternative to traditional housing, including the permanent chassis requirement[11]. This report's recommendations are also very similar to those from President Reagan's Commission on Housing, which produced a 1982 report documenting the cost advantages of manufactured housing and the importance of removing regulatory impediments so that manufactured homes were accessible in more neighborhoods and could be eligible for traditional mortgage financing.[12]

The substantial cost advantages of leveraging modern production techniques to produce housing are well-known and have been discussed within the federal government for at least 85 years. Expanding the use of modern technologies to build housing is also consistent with President Biden's recent housing proposals, which focus on rewarding jurisdictions that reform land-use policies, deploying new financing mechanisms, and working with the private sector to improve building techniques and build more efficiently. Modifying local zoning rules will be needed but reducing the chassis requirement should make a significant difference in the acceptability of these homes [13]. Creating specific programs that incentivize state and local agencies to implement manufactured housing in the production of affordable housing developments could significantly reduce costs and improve affordability.

Reducing the Cost of Building Affordable (Subsidized) Housing

Summary: Affordable housing, which usually involves the use of the Low Income Housing Tax Credit (LIHTC), and sometimes other subsidies, has become more expensive to build than market-rate housing in at least some states. Studies show that high costs reflect both above market-rate construction costs, and high indirect (soft) costs that are related to regulatory and other requirements involved with subsidies. Expanded collection of cost data, identifying best practices that can be levered by all allocation agencies, and Incentivizing jurisdictions to become more efficient can make better use of taxpayer subsidies and expand affordable housing supply.

Construction costs of affordable (subsidized) housing have increased considerably, particularly in the Western United States[14]. In San Francisco, one affordable housing project is being renovated at a cost of $1.226 million per unit. There are a total of 608 units across seven projects in Northern California

[11] Koebel, Theodore C. et. al., 2011, "Regulatory Barriers to Manufactured Housing Placement in Urban Communities", https://www.huduser.gov/portal/publications/affhsg/rb_mhpuc.html
[12] McKenna, William, 1982, "The Report the President's Commission on Housing", Washington, D.C. USGPO, https://www.huduser.gov/Publications/pdf/HUD-2460.pdf
[13] The White House, May 16, 2022, Statements and Releases, "President Biden Announces New Actions to Ease the Burden of Housing Costs", https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/16/president-biden-announces-new-actions-to-ease-the-burden-of-housing-costs
[14] California Tax Credit Allocation Committee et. al., "Construction Costs of Affordable Housing", https://www.treasurer.ca.gov/ctcac/multistate-housing-costs.pdf

identified in a recent Los Angeles Times article costing over $1 million per unit[15]. These cost statistics are challenging to reconcile with the fact that the median single-family California home, which includes a parcel of land and more finished living space, can be purchased for about $325,000 less[16]. While these statistics are from California, similar issues may be impacting affordable housing construction in other states, and thus California's experience of escalating costs may be more broadly informative.

A 2018 GAO study found extremely large cost disparities in affordable housing construction across states, ranging from a minimum of below $100,000 per unit in Texas to a maximum of $750,000 per unit in California evaluating data from 2011-2015. They concluded that better data collection to understand these cost differences is needed, and that improved oversight of the use of subsidy funds should be implemented.[17]

The study found that only a few allocating agencies have requirements to guard against misrepresentation of contractor costs, which is a fraud risk. Although high-level cost certifications are required from developers for LIHTC policies, the cost of multiple contractors are combined in the certifications, but the IRS does not require detailed certifications. Weaknesses in data quality were also found by the GAO and some included inconsistencies in cost-related variables and not including the full extent of indirect costs associated with fees paid to syndicators acting as intermediaries between project developers and investors that IRS requires be collected.

The GAO made some recommendations for the issues described above, including designating a federal agency to analyze LIHTC cost data, having the IRS require contractor cost certificates, having the IRS and other allocating agencies create more standardized cost data, and having the IRS communicate to credit allocating agencies on how to collect certain information.

The GAO also noted that "Even without a designated federal entity, opportunities exist to advance oversight of development costs. In particular, greater standardization of cost data would lay a foundation for allocating agencies to enhance evaluation of cost drivers and cost-management practices."

The GAO also found financing inefficiencies, particularly related to the fact that there are typically many lenders involved in these projects, an average of six per project. UC Berkeley's Terner Center for Housing Innovation estimates that each additional lender adds an additional $6,400 in cost per unit[18]. The Terner Center found other cost drivers, including paying prevailing wage requirements, which they found increased costs above market labor rates by $53,000 per unit, a lack of government staff which delays approval, more stringent environmental requirements and sustainability regulations that add $17,000 per unit. They also found delays in approvals that increase costs.

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[15] Los Angeles Times, 2022, "Affordable Housing in California Now Routinely Tops $1 Million per Apartment", https://www.latimes.com/homeless-housing/story/2022-06-20/california-affordable-housing-cost-1-million-apartment.

[16] California Association of Realtors, 2022, "May Home Sales and Price Report", https://www.car.org/en/aboutus/mediacenter/newsreleases/2022releases/may2022sales

[17] General Accounting Office, 2018, "Low Income Housing Tax Credit: Improved Data and Oversight Would Strengthen Cost Assessment and Fraud Risk Management", https://www.gao.gov/products/gao-18-637

[18] Reid, Carolina, 2020, "The Costs of Affordable Housing Production: Insights from California's 9% Low Income Housing Tax Credit Program, https://ternercenter.berkeley.edu/research-and-policy/development-costs-lihtc-9-percent-california/

Reducing reliance on prevailing wage requirements would not only reduce costs, but one study found that such requirements limit employment opportunities for minority workers[19].

Lawsuits also delay affordable developments in California, particularly lawsuits filed under the California Environmental Quality Act[20]. States should study the incidence of litigation against development to identify any reforms that may be enacted to reduce such lawsuits and/or speed up their resolutions. My previous research identifies a large development in California in which plans were submitted for approval in 1994, and lawsuits were not resolved until around 2017, including lawsuits that were filed after the project had been approved in 2012. Most of these lawsuits were filed under the California Environmental Quality Act. To date, no homes have been completed in this project, making it 28 years since the proposal was first received by local government agencies.

I recommend that Congress revisit the GAO recommendations, including standardization of cost data from agencies that are collected and analyzed by a single federal entity. Creating funding opportunities that do not require so many funders can reduce costs and speed the development and approval timeline. Best practices regarding approval and funding sources should be identified and provided to all allocating agencies. Providing incentives to do this would be consistent with President Biden's recent guidelines to make housing more affordable. Senate Bill 1136 and House Resolution 2573 is an important expansion of the LHITC. Coupling S. 1136/H.R. 2573 with collecting and analyzing cost data and incentivizing allocating agencies to improve efficiency could have a significant impact on increasing affordability.

Restrictive zoning rules and other land-use regulations also impede the development of new housing. Incentivizing state and local agencies to expand the use of higher density housing would reduce building costs and place housing where it is most demanded. Reforming regulations that limit urban boundaries, which are present in California, would also expand housing where it is in most demand. My research identifies one example in which it took about 40 years for a California city to purchase undeveloped county land to expand its urban footprint. Homes remain to be built[21].

From this perspective, Senate Bill 1416, would be an important step in collecting and analyzing data on how state and local agencies manage their land use. S. 1416 would help these agencies identify and adopt best practices that can increase housing supply where it is most demanded, while at the same time maintain neighborhood qualities so that agencies can address the concerns of those who oppose development.

Thank you for this opportunity to testify to the Committee on such an important issue. American home affordability can be increased substantially by incentivizing the adoption of low-cost production techniques, improving efficiency in the building of subsidized housing, and helping state and local agencies create building development opportunities in areas that are in high demand. I welcome questions and comments.

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[19] Yurlov, Vlad, 2021, "Why is "Affordable Housing So Expensive", Cascade Policy Organization, https://cascadepolicy.org/land-use/why-is-affordable-housing-so-expensive

[20] Ohanian op. cit.

[21] Ohanian op. cit.