News

National Multifamily

Middle-Class Misery: Housing Crisis Hitting Cities, Working Americans Harder Than Ever Before

August 19, 2018 | Jon Banister and Miriam Hall

Ten years after the Great Recession roiled the global financial system and sent the American economy into a tailspin, the U.S. has roared back to boast an unemployment rate below 4% — a figure not seen since the 1960s. Yet, despite the influx of jobs, wage growth has remained stagnant, leaving millions of middle-class Americans without savings, living paycheck to paycheck as they continue to fight for what generations before have taken for granted: decent, affordable housing.

Unsplash/Raphael Biscaldi

Coast to coast, developers have heard the calls loudly and clearly.

But market forces in most cities are making it nearly impossible to build new housing that the middle class can afford — and the gap between subsidized low-income housing and high-end apartments is wider than ever.

Cities recognize that huge swaths of their workforce are heavily burdened by housing costs, but in the decade since the calamitous events of 2008, only a few minor steps have been taken to address the growing problem.

“We didn’t build anything during the recession — that’s biting us in the butt,’” said André Bueno, the founder of Los Angeles-based real estate investment firm Bueno Group. “If you are in the missing middle, you are shit out of luck.”

The Middle Disappears

From coastal economic hubs to Midwestern industrial towns, cities have experienced rising rents that have not been matched by wage increases. For middle-class renters who cannot qualify for subsidized housing, finding affordable apartments on the market has become more challenging by the year.

Renters need to earn $21.21 an hour to afford a modest, two-bedroom apartment in the U.S., according to the National Low Income Housing Council, significantly more than the average national hourly wage of $16.38. This leaves renters at the lowest income levels and in the middle class unable to afford a place to live in most U.S. cities.

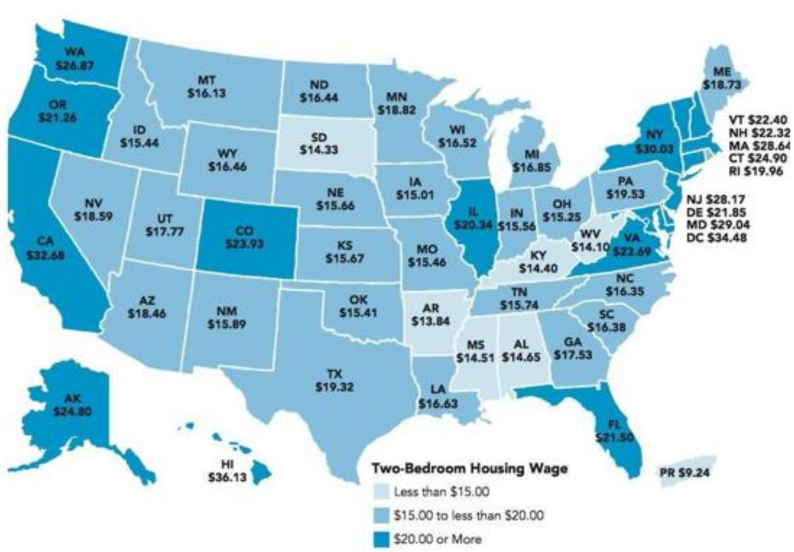
Housing costs have been a growing strain on workforce renters, which affordable housing development nonprofit Enterprise Community Partners defines as between 60% and 120% of an area’s median income.

More than a quarter of renters nationwide in this segment — out of 13 million total — are moderately cost-burdened, meaning they spend over 30% of their income on rent. And 3.5% are severely cost-burdened, spending over half their income on rent, an Enterprise Community study found.

“Wages have lagged rental inflation consistently for the past decade or more, even before the recession,” Enterprise Community Vice President of Policy Development Andrew Jakabovics said. “What you’re seeing is a rise in the number of moderately burdened households. That has gone up pretty dramatically over the course of the last two decades.”

The cities with the largest and fastest-growing shares of cost-burdened renters are not the expensive coastal cities typically associated with the housing crisis like San Francisco, New York and Boston. More often than not, they are smaller towns.

Among the metro areas with the highest cost burdens in 2016, according to Apartment List, were Laurel, Mississippi, and Laredo, Texas, with roughly two-thirds of renters spending more than 30% of their income on rent.



National Low Income Housing Coalition

This map shows the wages needed to not be cost-burdened over rent across in each U.S. state.

IN WASHINGTON

Seattle-based Spectrum has a plan to build around 1,000 units with rents set for ople earning between 60% and 120% of AMI, or around $40K to $80K per year, and who do not qualify for affordable housing.

Spectrum is partnering with Laird Norton Properties, which is leveraging $150M of its own money in the project to get more financing from other sources.

Cost burdens have grown the fastest in tertiary cities where incomes have stagnated or even declined, like Winston, North Carolina, and Chattanooga, Tennessee.

As a second-grade teacher in Allen, Texas, Alysha Huseman makes $50K a year, or roughly 78% of the Dallas area's median household income. When the recent college graduate began looking for apartments, her father told her she should be able to find a nice place for $700. But she soon found the apartment market was vastly different than it was when her parents were looking to rent.

Most of the one-bedrooms she looked at were out of her price range. The apartment she moved into costs $980/month. While she is just under the statistical threshold for being cost-burdened, Huseman said her rent bill puts a strain on her everyday life.

"Living on my own and being a teacher and having my rent and car payment and other bills, by the end of the month, it's tight," Huseman said.

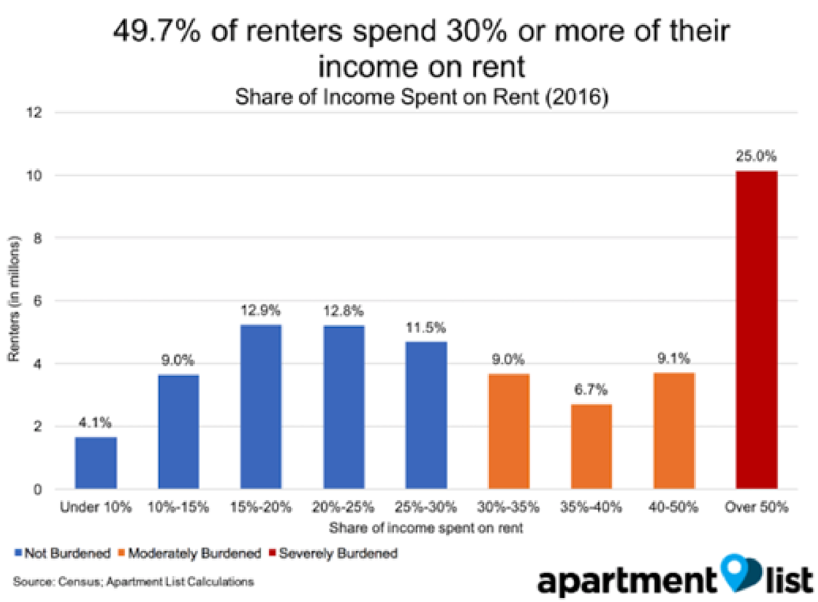
Spending too much on rent can have far-reaching implications on one's life that go well beyond end-of-the-month stress. Cost-burdened households across the U.S. spend 41% less on food and 74% less on healthcare, according to Apartment List.

While cost burdens for most renters have gone up, those with the means to splurge on an apartment have been presented with more options than ever. There has been a boom of high-end apartment construction this cycle, accompanied by a stagnant — and in some cases shrinking — supply of affordable, middle-class housing.

Since the recession, the number of Class-A multifamily units, those commanding the highest rents, has grown to 5 million nationwide, up from 3.9 million, while the stock of Class-B and C units has remained virtually unchanged at 5.7 million, according to Fannie Mae.

"The majority of people are struggling with their housing," Fannie Mae multifamily research head Kim Betancourt said. "There is not enough housing for the people at the cost level they should be at."

Growing demand from higher-income renters, who in previous economic cycles would have become homeowners, has fundamentally changed the apartment market.
The vast majority of new housing built this decade is occupied by people making over 120% of area median income, while those in lower income brackets are squeezed into a shrinking supply of older units.



Apartment List

The percentage of cost-burdened renters, broken down by age group

Just 4% of workforce-level renters live in units built since 2010, according to Enterprise Community, while over half of workforce renters live in units built before 1980.

The increase of higher-income renters has enticed developers to buy older properties and fix them up in order to raise rents, depleting the stock of naturally occurring affordable housing.

"If there aren't enough cheaper options, it becomes a chain, with a middle-class person living in an apartment a lower-income person might have occupied, and so on," Apartment List Senior Research Associate Sydney Bennet said.

"If you miss that gap in the middle for housing, it has a chain reaction."

What Builders Blame

Developers are often seen as a major cause of the problem, viewed as avaricious operators who only want to build luxury condominiums.

The reality, developers told Bisnow, is far more complex. Their ability to build housing is stymied by the price of land, rising construction costs, few tax incentives and, ultimately, a lending environment that simply does not support workforce housing.

When it comes to building housing, developers said, they don't set the rent. "The reality is, the bank is saying, 'If all else fails, we need to make sure we are not losing money,'" said Bueno, who is developing 17 buildings in Lansing, Michigan, that have both affordable and workforce units. "[They say] here's where your rents need to be, and here's the cap rate we are applying to the project."

Courtesy of André Bueno

André Bueno's workforce housing development in Lansing, Michigan

Bueno feels he and many of his colleagues are lumped into the "greedy developer bucket," but he is keenly aware of how many people have been squeezed by the housing crisis.

He developed an affordable housing project in East Wenatchee, Washington, and said it was painful to see people earning just above the average median wage have their applications denied, putting affordable housing just out of reach.

While development of affordable housing is supported by tax incentives like the Low Income Housing Tax Credit, developers said there are few policies that make building housing with middle-income rents viable.

"I'm the product of middle-class parents from Brooklyn ... I went to public schools in Flatbush. I would love to be able to produce housing for the next generation of people like me," said Slate Property Group principal David Schwartz, whose residential development firm has 10 projects under development in New York City.

"The challenge is the developer doesn't control it. We are one cog in the wheel … [but] people always think it's the developer's fault."

For a rental building to make a profit that a bank will lend to, Schwartz said, it needs to pull in a 6% or 7% return each year. At $362 per SF, New York City construction costs are the highest in the world, according to Turner & Townsend's 2018 International Construction Market Survey 2018. San Francisco at $347 and Seattle at $288 aren't far behind.

To figure out if a project will work, Schwartz uses a simple back-of-the-envelope calculation: building size multiplied by construction costs, adding in land costs, ongoing maintenance and taxes, divided by the rent needed for a 6% to 7% return.

For a 200-unit building with apartments averaging 600 SF, in a city with construction costs at $300 per SF, taking into account $100 per SF in soft costs like design and planning, the 150K SF building already costs $60M before a single resident moves in.

Then, Schwartz said, there are the running costs of around $12K per year for every apartment, or $2.4M for year in this hypothetical building. To hit a 6% return, without which a bank won't finance construction, this developer would need to make $6M in yearly rental income to cover expenses.

If the builder didn't have to buy the land and received a local tax abatement, Schwartz said, each unit would still cost an average of $2,500 per month.

For a renter to not be cost-burdened for such an apartment, he or she would need to earn more than $100K per year. But land is very rarely free, and tax abatements aren't guaranteed.

Pexels

The cost of building across the country has been steadily climbing for years. Rider Levett Bucknall’s national construction cost index was at 189.80 last quarter, 26% higher than it was during the same period five years ago.

Now, aggressive tariffs are heaping uncertainty on the cost of projects while the construction industry is plagued by a labor shortage only set to get worse with fewer and fewer young people taking jobs in the sector.

“It really is a perfect storm,” Bueno said. Not all developers think it is impossible. Spectrum Development principal Jake McKinstry said his firm has sought to create what he calls “creative partnerships” to build workforce housing.

Seattle-based Spectrum has a plan to build around 1,000 units with rents set for people earning between 60% and 120% of AMI, or around $40K to $80K per year, and who do not qualify for affordable housing.

The buildings, which will be in several locations across Seattle, are pegged at $500M and will include student housing.

The firm hopes to make the financials work by finding landowners to provide their land in exchange for a long-term ownership stake, and equity partners who are willing to fund it without the promise of immediate returns.

“Most development structures are set up where you build the project ... and develop it as fast you can,” McKinstry said. “Ours is the inverse. [We want to] let cash flow grow, [but] take a lower rate of return initially … It’s very different to most developments.”

Spectrum is partnering with Laird Norton Properties, which is leveraging $150M of its own money in the project to get more financing from other sources.

“Finding investors and other entities out there that are really willing to take that really long-term approach is not easy. It’s very difficult to find,” McKinstry said.

“There aren’t many … it took us a long time.”

Avanath Capital Management has successfully developed workforce housing by focusing on renovating Class-C units in cost-effective ways, founder Daryl Carter said.

The Southern California firm has properties in 16 states and targets higher-cost markets where there is strong demand for for quality workforce housing, like Denver, Dallas and Chicago.

inc.

Fannie Mae

The supply of Class-A apartment units has climbed since the recession, while the amount of more affordable units has stagnated.

“A safe strategy is to renew the property, but we are very value-oriented in what we renovate,” he said. “So we don’t remove the popcorn ceilings that are dated simply because it is expensive to do and may add $40 or $50 in additional rent.”

Carter said his national portfolio has a rental average of around $1,300 a month and occupancy is 98%; a far better rate, he noted, than buildings at the high end of the market.

While most new construction for workforce housing has not made any sense in the past, Carter said he is now considering whether to further develop properties that fall within the country’s new opportunity zone program.

“The fact is that our business model works. And there is considerable demand at the price points,” he said. “Our investors are generally large institutional investors. They like the returns but many of them also like the impact they make on the communities.”

In some cases, developers said the only real way to build something that middle-class renters can afford is to push into areas with lower land costs.

“We can go to a neighborhood where land prices aren’t too high,” said Hudson Cos. principal Alison Novak, a New York multifamily developer who recently built a project that has units set aside for renters earning up to 130% of AMI.

“But then you have people who say that’s gentrification.”

Bisnow: Jon Banister

The D.C. Council's Comprehensive Plan hearing drew hundreds of residents to testify.

Many developers told Bisnow that the public generally wants more housing for working families, but communities often don’t like what it takes to get it.

In Washington, D.C., groups opposing developments have brought over 15 projects to court in the last three years, delaying the construction of thousands of new housing units in a city already struggling with high rents.

"It is hard to understand what these NIMBYs think they have accomplished," former D.C. Director of Planning Ellen McCarthy, who now consults and teaches urban planning at Georgetown University, told Bisnow last year.

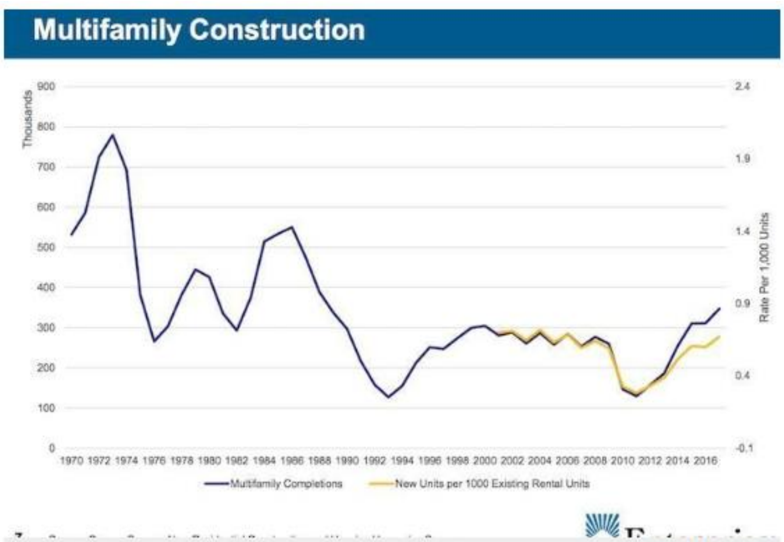
"They've reduced the total number of residential units being produced, making it harder for people to find places to live and keeping prices high, decreased the number of affordable units that are going to be produced, and reduced the amount of attractive public spaces created."

Cities Trying To Plug The Gap

Municipalities around the U.S. have for years put in place affordable housing policies targeting lower-income communities with the most need, but some cities are just beginning to widen their focus to help middle-income renters also struggling to afford housing.

Since the late 1980s, cities have used housing trust funds to dedicate resources to housing for low-income renters. Chicago's fund, established in 1989, assists those earning up to 30% of AMI, according to Enterprise Community. D.C. also set up a similar fund in 1988, Los Angeles established a fund in the early 2000s, and in 2016, Denver established a fund to support housing that serves those making up to 80% of AMI.

Many cities have also adopted inclusionary zoning programs that offer density bonuses and other incentives to developers who set aside a certain percentage of units for low-income renters. Some of these policies target low-income renters by setting a cap on those who can benefit from inclusionary zoning units, such as Chicago's program set for those making up to 60% AMI.



Enterprise Community

The historic trend of new apartments correlating with overall supply has reversed since 2012.

But relatively few cities have recently begun to target the middle class when they adopt zoning policies. An exception is Miami-Dade County's voluntary Workforce Housing Development Program, which offers density bonuses for projects that create units affordable to households earning between 60% and 140% of AMI.

The program was officially implemented last summer and two projects totaling over 1,000 units have already been approved with the density bonuses.

"We had programs at the affordable level that the county offered, but at the workforce level, there was very little," Miami-Dade Principal Planner Rosa Davis said. "Our households are very cost-burdened … this is one of the things in the county we consider something that's affecting not just our housing but our economy. If we don't provide housing that's affordable to the workforce, it makes it difficult to bring companies here."

Most cities have tended to focus their middle-class housing efforts on down-payment assistance programs to help those who would historically have owned homes, but are now stuck renting, to get back into the homeownership market, Jakobovics said.

"Middle-class households who — when the homeownership market was functioning properly — would go and buy homes, today they are still occupying rental units, and that's one of the sources of pressure on rents," Jakobovics said.

For middle-class renters like Huseman, their problem is the down payment, rather than the monthly mortgage costs. Her parents, who jointly make about three times her salary, pay roughly the same per month on their mortgage for a four-bedroom, single-family home as she does for her one-bedroom rental.

"It's frustrating, because if I did have enough money for a down payment, I might as well buy a house and be paying the same monthly, but I don't have enough saved up," Huseman said.

A 2017 Apartment List survey found that over 40% of millennials have no money saved for a down payment, and 68% have less than $1K saved.

Based on current savings trends, the study estimates that average millennials in most major metro areas will need at least a decade to save enough for a 20% down payment on a home, and in high-paying tech meccas like San Jose, Los Angeles and Austin, it could take 20 years or more.

Even for a smaller, 10% down payment, only about one-third of millennials nationwide could save enough in five years or less, the study found.

Reversing the decades of NIMBYism that has maintained low-density zoning in some urban areas could help boost housing construction.

Neighborhood opposition continues to be a significant barrier to producing housing, but a new crop of groups calling themselves YIMBYs has popped up in recent years to push cities to upzone areas to allow for more residential development.

A recent election in San Francisco, one of the nation's most expensive housing markets with historically tight development restrictions, appears to signal a shift in public attitudes.

The city elected a mayor who was the lone candidate to support a recent pro-density bill, was backed by the city's YIMBY group and made the need for new housing a central tenet of her campaign. But decades of development-hindering laws in San Francisco have helped make it, according to a recent study, the most expensive rental market in the world.

Cities can help spur construction of new apartments by loosening zoning restrictions and shortening approval processes, which experts say would take pressure off the rental market and make construction of affordable, market-rate projects more feasible.

Beyond zoning that restricts density, the length of cities' approval processes can have an effect on the type of housing that gets built.

The headache of getting a project approved in many cities makes developers more likely to only build high-rise projects with luxury units to maximize revenue, Jakobovics said.

"Developers are still pushing the bounds [on rents] rather than reverting back to low-amenity, simpler and faster construction," Jakobovics said. "If you go through the brain damage of the approval process, you go as big as possible. If you simplify and made it easier to do more moderate scale, if zoning were more flexible, you would relieve a lot of the pressure."

Easier zoning processes could lead to the construction of more mid-tier housing built with cheaper methods that workforce renters could afford. Massachusetts and Los Angeles have implemented policies to streamline the approval process for affordable housing.

In New Rochelle, a close-in suburb of New York, the city government introduced a 90-day approval process in 2015 in order to fast track development, a process that it says is "unrivaled" in the Tri-State area.

RXR Realty

Rendering of RXR's master development plan for downtown New Rochelle, N.Y.

The city launched a $4B revitalization plan, with the streamlined approval process as a catalyst, that is expected to allow for 12M SF of new construction, including 6,370 housing units. "You can't be pro-affordability and anti-density," said RXR Realty Executive Vice President Seth Pinsky, a former New York City economic development executive. "The only way to solve this problem over the long term is to produce more supply … Until supply and demand get back in balance, the problem will continue to get worse for most people."
New Rochelle selected RXR as its downtown master developer, and Pinsky believes the plan is a model solution for this conundrum: building in transportation hubs that are close to places like New York City.

But those types of initiatives, he said, have to be a partnership between developers, communities and the government.

Local governments can also spur new housing construction by disposing of vacant or underused public land and giving preferential deals to developers who commit to creating affordable projects.

New York, D.C., Los Angeles, Washington state and Chicago have all implemented policies for building housing on public land, according to Enterprise Community, and transit agencies in L.A. and Seattle have launched policies to create affordable housing on their underused lots. Private sector innovation could also help solve the problem, Jakobovics said, by finding more efficient and cheaper methods of building housing.

“Basic building technology and processes haven’t changed in 100 years,” he said. “The construction sector is ripe for disruption.”

A Deepening Hole

Left alone, the housing crisis has the potential to get much worse. A joint study by Harvard University and Enterprise Community estimated the number of severely cost-burdened households paying over half their income on rent will grow by at least 1.3 million from 2015 to 2025, an 11% increase.

The growing cost burden would affect seniors the most. The study projects the number of severely cost-burdened renters between 65 and 74 would rise by 42%, and by 39% for those 75 and above.

Hispanics would be the ethnic group hit hardest by the housing crisis. The number of severely burdened Hispanic households is projected to rise by 27% by 2025. Those projections, which the study calls the baseline scenario, assume rents and incomes will grow at roughly the same rate.

If rent growth outpaces income growth, the number of severely cost-burdened households could increase by 25%, forcing over 14 million renters to put at least half of their paycheck toward housing every month. “This is not going away,” Aurand said.

“It’s going to be a long-term problem unless we find a way to fix it.”