How to strengthen housing safety nets

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U.S. homeowners and renters need stronger safety nets than existing social insurance programs provide to prevent housing insecurity during economic downturns, according to a new paper based on a study by Wharton real estate professor Benjamin Keys and co-authors at the University of Notre Dame and New York University.

In their paper "Bolstering the Housing Safety Net: The Promise of Automatic Stabilizers," the authors propose policy reforms that could help people stay in their homes during times of economic distress and support affordable housing construction and rehabilitation. Those reforms would complement and fill gaps in existing social insurance programs.

The authors have designed their proposals to incorporate three features: automatic mechanisms that respond to triggers such as increased joblessness; flexibility to adjust the degree of assistance to granular variations in local unemployment trends; and counter-cyclicality, where the size of programs expand or contract in sync with economic cycles and the degree of hardships households face.

"Many elements of existing safety nets are incomplete or insufficient to prevent people from facing housing instability like eviction or foreclosure," says Keys. "Programs for unemployment insurance and food and nutrition programs correspond very sharply to downturns because of the eligibility rules; when more people are eligible, more people qualify for those benefits. We don't have that same flexibility and counter-cyclicality built in the system for housing-related assistance."

The proposals called for the creation of three programs:

- New emergency rental assistance accounts for low-income households to buffet income and financial shocks that can trigger housing instability;
- An automatic homeownership stabilization program with a three-month forbearance period for vulnerable mortgage borrowers facing unemployment; and,
- A permanent tax credit exchange program where the government could exchange tax credits at fiscally neutral prices for direct subsidies when demand from tax credit investors falls. In other

words, the government could pick up any slack in the demand for tax credits by buying them, and thereby avoid curtailing housing subsidies.

Those programs are ideally run by the federal government, according to the paper. "When those programs are funded federally, it allows for another layer of insurance and regional stability to be built into the system," said Keys. By contrast, if states were responsible for funding a program, they might curtail that if their specific economies suffer a downturn, he explained.

Why the Reforms are Needed

The COVID-19 pandemic and the resulting economic hardships households face set the immediate context for justifying the proposals, but the study covered housing insecurities in earlier periods as well. Here are some stark facts the study highlighted:

- Nearly half of all renters and a quarter of homeowners in the U.S. are housing cost-burdened, spending more than 30% of their income on housing in any given month (the standard measure of housing cost burden), and that is "far higher than they were in the past century." For instance, in 1960, just one in four renters and one in 50 homeowners in the U.S. paid more than 30% of their income on housing costs. Today, housing cost burdens run high in not just high-cost cities like New York or San Francisco but in every one of the 50 metropolitan areas studied.
- As of December 2020, nearly a fifth of renters and more than a tenth of homeowners were behind on their rent and mortgage payments, Census surveys showed. Blacks and Hispanics faced threats of evictions and foreclosures more than other races.
- Government relief programs in the aftermath of the pandemic have helped lower the unemployment rate from its April 2020

peak of 14.3% to 6% as of March 2021, but it is still the highest since September 2014. Not surprisingly, low-income households face more hardships with income declines.
- Evictions and foreclosures make it more difficult for people to find new homes or even jobs in pandemic times when they ought to be sheltering in place. Housing instability can also depress earnings, undermine health, and worsen credit scores.
- In a 2019 Federal Reserve survey, nearly 30% of U.S. households said they would be unable to meet even three months of household expenses by using their savings, borrowing and selling assets. "With such limited resources, even small shocks to income or expenses can put households at risk of eviction, foreclosure, or other involuntary moves," the paper stated.

Where Existing Programs Fall Short

"Unemployment insurance and other social insurance programs fail to cover everyone and fail to protect against many common shocks such as lost hours at work, the dissolution of a relationship, or an emergency expense, which are often triggers to housing instability," the paper stated. While households can cut back on much of their consumption during times of economic distress, they are "not able to quickly adjust housing consumption," the authors pointed out. Rent leases typically require a one-year commitment, while homeowners face lengthy and costly processes in selling and buying homes, they added.

Citing research by others, the paper stated: "Although eviction is preceded by a variety of markers of economic distress—including falling earnings and employment and rising unpaid bills—eviction itself also contributes to lower earnings, reduced access to credit, increased hospital visits, and a spike in homeless shelter use in the two years following a case." For homeowners, "foreclosure increases divorces, financial strain, and moves to lower-income neighborhoods; [it may also] contribute to adverse health events and undermine children's educational progress," the authors added. More research found that "concentrated foreclosure increases neighborhood crime and lowers the value of nearby property."

For low-income renters, much of federal housing support is in the form of long-term subsidy programs such as housing choice vouchers, public housing, and project-based rental assistance. "These programs serve only a small fraction of the eligible households—typically around one in four—and are massively oversubscribed," the paper stated. In fact, individuals and families facing acute needs often must wait years to get an offer of federal housing assistance, it noted.

Some federal programs do help on this front, such as the Emergency Solutions Grant (ESG) program. However, those grants are relatively small and local communities must divide them across several important uses such as operating emergency shelters and preventing homelessness. Those constraints reduce their effectiveness, the paper pointed out.

Homeowners facing financial hardships can count on existing safety nets such as the 2009 Home Affordable Modification Program and the more recent pandemic relief of preventing foreclosures with a forbearance program for federally backed loans that paused payments and froze foreclosure proceedings.

However, the paper pointed out that such relief has been incomplete because it helps only those borrowers with federally backed loans; it also requires action on the part of the mortgage borrower, who must actively request forbearance from their servicer. Many borrowers are confused about both eligibility requirements and the benefits of forbearance, which represents "a substantial barrier to take-up for many struggling homeowners," the paper noted.

Current affordable housing programs, too, fall short in that they "provide less support for the production and renovation of affordable housing during downturns," the paper stated. Private lenders tighten underwriting and cut back on lending during downturns, and the Low-Income Housing Tax Credit (LIHTC) program "tends to be pro-cyclical," or contracts during downturns, it noted.

"Unfortunately, during downturns, when corporate investors anticipate less taxable income and therefore less ability to use tax credits, demand for tax credits falls," the paper stated. Although Congress has taken some steps to help ensure that the tax credit continues to be attractive during downturns, "the LIHTC is still vulnerable to reductions in both credit supply and investor demand."

How the Proposed Programs Would Work

Emergency rental assistance accounts: These would be automatically triggered when the unemployment rate rises by 0.5 percentage points above the past 12-month minimum. While that level has been shown to be "strongly predictive of subsequent distress at a macroeconomic level," it may not sufficiently capture local unemployment levels, the authors stated. They advised policymakers to consider raising that threshold selectively to 0.75 percentage points and look for "high-quality and high-frequency granular unemployment data" to determine the automatic triggers.

The plan calls for the Internal Revenue Service to automatically create rental assistance accounts for those with income less than 80% of the area median income, or AMI. The tenant would control the amount and timing of the payments, after which the IRS would mail a check to the landlord.

Households would not have to provide a reason for drawing from the account. This feature would "provide greater administrative simplicity and ensure that vulnerable households can receive immediate assistance before their financial woes compound." A savings incentive in the program would aim to discourage tenants from aggressively drawing down the entirety of the account unrelated to an urgent need.

Automatic homeownership stabilization program: Eligibility would cover all mortgages for low- and moderate-income borrowers with household incomes below 100% of AMI at origination or before they encounter economic distress. It would build on COVID-related housing relief and earlier programs to overcome limitations such as the lack of universality and standardized guidelines, and the need for active participation by both lenders and borrowers. The program's design would address those shortcomings with its feature of an automatic three-month forbearance period for eligible mortgages "in response to a triggering event of elevated local unemployment."

Permanent tax credit exchange program: Here, the proposal is to first make the Low-Income Housing Tax Credit Exchange Program automatic and permanent; the program was enacted through the American Recovery and Reinvestment Act (ARRA) of 2009. This would allow states and other agencies to exchange up to half of their allocated tax credits, up from 40% in the ARRA program.

The proposal also addresses the debt side of the market, since developers need both equity support and reasonably priced loans to produce housing at affordable rents. The plan is to automatically raise caps on Fannie Mae and Freddie Mac purchases of affordable, multifamily loans during downturns "when the rest of the commercial real estate industry cuts back on lending activity."

In order to maximize the counter-cyclicality of those automatic policy tools, the authors proposed tying their activation to increases in local unemployment.

Weighing the Risks

For sure, the proposals are not silver bullets and the paper's authors have raised several questions around them. First, they deliberated on how expensive their proposal on rental accounts could get. They noted that the proposal would require "a large upfront outlay because the [rental] accounts are created for every eligible household before they might experience a need for assistance."

The 2017 American Housing Survey estimated that 27 million renter households in the U.S. earned less than 80% of AMI. Limiting the incentive to the 21 million households that are already receiving federal rental assistance would mean a 10-year cost of $141 billion; lowering the threshold to 50% of AMI would lower that cost to $88 billion. The authors resolved the question by pointing to the net gain: "While this expenditure is significant, the social costs associated with acute housing instability are also sizable—meaning the net cost of the intervention is likely to be much lower."

Unlike with unemployment insurance, which is a direct transfer of funds, it would be helpful to earmark rental assistance for households as "a rainy-day savings fund to keep them safely housed" during times of distress, said Keys. One extreme would be to make those funds completely hands-off on the part of the tenant and maintain the rental account elsewhere, but that would then be difficult to access, he said. "One of the lessons we've learned from the COVID crisis is that making housing support more automatic and reducing barriers to access can make a big difference."

Next, they asked if four months of rent subsidy would be sufficient to prevent "acute housing instability for a substantial number of low-income renters." They cited research that showed that the typical tenant fighting eviction in a court owes roughly two months in back rent. Other research showed that even one or two months of emergency rental assistance can be effective in preventing homelessness.

Another risk is that the rental accounts would not be well targeted, and that some of these funds may go to people who don't "need it as much as some other people," said Keys. "That's why we are proposing some household income threshold."

The authors also explored the potential for abuse: Will households exhaust their accounts immediately to build their cash savings? They listed three reasons why that is unlikely to be a common occurrence. First, the accounts will have a competitive rate of return on unused funds, which will encourage households to keep funds unspent unless they are faced with an urgent need. Second, they cited "compelling evidence" that low-income households do not treat in-kind benefits as fungible with cash. Third, since the payment must be initiated each month by the tenant, the program will have an implicit default of not making payments.

That said, "some households might arrange prepayment with their landlords and accrue cash savings from redirecting spending on rent," they wrote. "[However], these households would still be potentially accumulating savings, however, and those savings could be used to prevent future housing instability."

The proposed permanent tax credit program could potentially crowd out private investors, according to Keys. "If you let the government exchange these tax credits for subsidies, depending on the price that you set, that may crowd out the private sector's ability to purchase these tax credits," he said. "And so it has to be designed a bit carefully."

While demand from businesses for such tax credits will fluctuate between good and bad times for the economy, the government could help even out demand dips by stepping in as a buyer at a "fiscally neutral" price. But therein lies a risk. "The pitfall is, if the price was set incorrectly, then all of the tax credits would be scooped up by the government and private sector firms would no longer have the ability to use them to offset their tax bills," said Keys. "That might dampen the overall interest or demand for these types of tax credits, which fund a significant amount of preservation and production of low-income housing."

Why the Paper

Keys explained why he and his authors set out to do the study for their paper. "With all these programs the question is, are you targeting the right people? Are the right people receiving the benefit that they need at the right time? We were coming at this from a reflection of the fact that housing assistance is rarely targeted at the right time, and it's often not targeted to the right people," he noted.

"Keeping people in place when they've suffered an income shock will be self-reinforcing in a bunch of dimensions," said Keys. "Being able to stay in the same place means that you're going to be able to continue to look for work in the same place. That means that your kids aren't going to be pulled out of school as you move around trying to find another place to live." There are "enough knock-on effects" in redesigning the programs to make them counter-cyclical, and activate them automatically in response to pre-defined triggers and with flexibility, he added.

More information: Bolstering the housing safety net: The promise of automatic stabilizers. www.brookings.edu/research/bol … tomatic-stabilizers/