

Innovations in Housing Policy

The Evolving Role of Local Government

By Larry A. Rosenthal, JD PhD

Executive Director, Berkeley Program on Housing and Urban Policy

Lecturer, Goldman School of Public Policy, UC Berkeley

The US housing affordability crisis afflicting our highest-cost metropolitan areas is a dilemma of national dimension. But dreams of a national housing safety net—akin to the socialized programs familiar in Europe and elsewhere—have long since faded away. In the face of perennial shortfalls in federal subsidy and oversight, local government's role in the promotion of affordable housing has evolved considerably, both in terms of leadership and policy innovation. Indeed, local initiative is increasingly making the difference between areas making real progress on their housing problems and those just treading water.

... local initiative is increasingly making the difference between areas making real progress on their housing problems and those just treading water.

A number of local functions in housing are organic in nature, part of the customary ambit of city and county governance within federal-state civics. Beyond their role as administrators of supply- and demand-side subsidies, local authorities engage in a variety of everyday policymaking affecting housing markets and household welfare, including rent control, property taxes, land use plans and zoning regulations, and infrastructure provision, to name just a few.

Augmenting these traditional areas of local policy, additional responsibilities once managed in Washington have been devolved to the states. For more than a generation, the political vanguard has championed shrinking of the federal role in addressing social needs, arguing that local authorities are more able to shepherd resources, assess need, and finesse political obstacles. Local prerogative dictates outcomes for the Low-Income Housing Tax Credit, HUD's HOME, CDBG, homeless-aid and other federal funding.

In this decentralized context, the downside is that there is great variation in energy and vision among jurisdictions, with some localities underperforming on measures of service delivery or housing stock enhancement. But with the emphasis on the local role, there is room for the cultivation of a thousand flowers blooming, and there are numerous examples of creative, progressive local initiatives in housing. The balance of this article surveys some interesting mechanisms in the field: 1) private activity bonds, 2) community land trusts, 3) down payment assistance, and 4) promotion of infill development. Each features opportunities for municipal leadership in addressing urgent housing need.

Private activity bonds, mortgage revenue bonds, and mortgage credit certificates. States and local jurisdictions can raise funds through the sale of tax-exempt Private Activity Bonds (PABs), which may be used to finance affordable multifamily developments or provide funds for low- and moderate-income homebuyer assistance. PAB funds can also be used for other public needs such as airports, sewers, industrial parks, and student-loan programs. States are allotted a debt limit for such bond issuances; the limit set in 2002 for all purposes under this mechanism was the larger of \$225 million or \$75 per state resident, and these amounts have since been adjusted for inflation annually.

PABs comprise an important funding stream for local community development. During the 1990s, housing accounted for nearly half of all PAB issuances by dollar value. PABs help lower interest costs relative to those offered through private commercial financing. Developers often receive funds through a competitive application process, and PAB proceeds are typically used in conjunction with other public and private housing financing programs such as Low Income Housing Tax Credits.

Two additional ways of spending PAB debt allocations offer alternatives to traditional project funding. Mortgage revenue bonds support local programs providing below-market-rate mortgages to qualifying households. Mortgage credit certificates (MCCs) allow low-income homeowners to claim tax credits against their mortgage interest payments.

Unlike the mortgage-interest deduction, which reduces the amount of income on which the homeowner pays taxes, MCCs reduce the homeowner's federal tax bill directly, generally by around 15 percent.

In California, MCCs represent one of the largest state housing subsidy programs in terms of dollar value, with \$4.1 billion allocated during the 1990s. Localities apply to participate in the program, receiving allocations of awardable credits from the state and then granting those credits to qualifying households. By law every dollar of PAB proceeds utilized in this fashion must be granted in the form of issued MCCs; program administration must be financed through fees collected from applicants and participating mortgage lenders. Successful MCC programs depend in large part on the initiative and foresight of local agencies, which advertise them both to homebuyers and the networks of private lenders needed to package the subsidy within complex affordable-mortgage transactions.

Nationally only about 75 percent of the potential dollar-value for housing and other purposes is placed in eligible bonds at the state level under the pertinent provisions of federal tax law. Given the bond capacity that is left on the table, local government initiative is needed toward increasing the portion of debt limit used for multifamily development and mortgage assistance programs.

Down payment assistance programs. Local governments are also increasingly providing down payment assistance to first-time homebuyers, which can be particularly important in areas where median house values place ownership out of reach for many families. In addition, the benefits of down payment assistance policy often are concentrated among minorities, thereby helping to close the homeownership gap. While several localities have provided down payment assistance for years, the concept received a substantial boost with the enactment of the American Dream Downpayment Assistance Act of 2003. The Act authorized \$200 million annually to be administered via the states and other participants in HUD's HOME Investment Partnerships Program.

Several different models of down payment assistance exist. Funds are provided to qualifying households either as loans or grants, or both: hybrid programs gradually forgive loaned amounts over time so long as the borrower avoids default. The lender's security interest may even be allowed to dissolve entirely, once a five- or ten-year "recapture" period expires. In San Diego, for example, families earning below 80 percent of the area median income can receive grants of up to \$15,000 toward a down payment or closing costs. The grant is "recoverable," meaning that if the buyer sells within six years, it needs to be repaid. Localities may also target down payment assistance funds toward specific groups within the moderate-income workforce, such as local workers, teachers, nurses, and public-safety personnel.

State housing finance agencies are also important down



payment assistance providers. The California Housing Finance Agency, for example, operates several such programs, from those requiring junior loans funded by local agencies (sometimes including redevelopment agencies) to those directly funding 100 percent of needed home-purchase finance. The City of Honolulu offers a fifteen-year, zero-interest loan that will fund up to \$25,000 of the purchase price for first-time homebuyers.

Community land trusts. Housing units and the land parcels bearing them are actually separate financial assets, even though they are typically bought and sold as if indivisible. "Community land trusts" (CLTs) purchase and hold the land asset in trust for the benefit of low- and moderate-income households. Such trusts can be public, private or nonprofit entities. By removing land cost from sales and rental transactions, CLTs reduce rent and home prices.

A key issue in operating CLTs lies in characterizing the ownership interest of the occupying household. That interest can comprise absolute fee-simple title to the structure, but need not. Ownership can be framed as a "life estate" enduring for as long as the household-head lives, or as a series of renewable long-term lease arrangements. The right to occupy the CLT's land is conferred through separate lease instruments. Even though the land asset cannot be deployed as collateral by the "owner"-occupant, the value of the collateral can still secure the loan, with the trust serving as co-mortgagor or guarantor, barring state law impediments.

As the land's owner, the trust benefits most directly from any appreciation in land value. CLTs are structured to provide a fair, but only modest, return on homeowners' investments. Therefore, CLTs cannot quite reproduce all the asset-building benefits of traditional homeownership models. But

this private sacrifice contributes to the long-run benefit of later occupants and, more generally, the public's interest in maintaining affordable inventory at sufficient levels. In that respect, CLTs echo the public-trust justifications for conservation and farmland trusts familiar in the environmental field.

The California Community Foundation has recently established the Community Foundation Land Trust (CFLT) in Los Angeles, where in many areas high land costs and speculative investment are driving up home prices. CFLT aims to acquire sites for development to be placed in trust, and will add two features to the standard community land trust model. First, the foundation will serve as private custodian of the land, providing long-term stability relatively unaffected by the changing local political climate. The second element involves a wealth-creation mechanism for buyers through accelerated debt reduction. Land cost often approaches 40 percent of the total construction cost in Los Angeles; in removing such costs from the equation by financing the land through a ground lease, homeowners can pay off in fifteen years what would have taken thirty had they purchased the land as well. The accelerated debt reduction schedule also allows homeowners to build equity more quickly than under standard mortgage terms. CFLT is the first land trust in the nation to incorporate this kind of wealth creation-mechanism within its land trust model.

Promoting infill development. Local government acts as the gatekeeper for development generally, exercising considerable discretion over the grant and denial of applications for residential building permits. Expensive and delayed approval processes eventually contribute toward the runaway prices observed in the highest-cost metropolitan areas. But city planning agencies can work aggressively to leverage costs and delays in permit approvals as a means to increase affordable housing in already developed neighborhoods, or to promote economic development within enterprise zones.

Such "infill promotion" policies offer expedited permit review, reduced permit fees, and other preferences for affordable housing built in specified, distressed neighborhoods. Additionally, height restrictions, density limits, parking requirements, minimum setbacks and sidewalks, and impact fees can all be negotiated—or even forgiven entirely—as a means of encouraging the production of affordable housing units. In turn, more efficient use of land and densification of existing neighborhoods effectively eases price pressures in high-cost areas and can increase housing options near transit centers and encourage community revitalization.

The City of Phoenix, Arizona established its "Infill Housing Program" by ordinance in 1995. An inventory showed

that approximately 121 square miles of vacant land suitable for residential development existed within the urban area. Building on this vacant land would accommodate nearly 500,000 new residents and would help to control sprawl, traffic congestion, and air pollution. The program focuses on encouraging single-family construction for homeownership on vacant or underutilized parcels. To qualify, parcels must be located within 1,000 feet of existing housing and within 500 feet of buildings with median ages over 20 years. By meeting these and other criteria, developers get certain water and sewer fees waived, are considered for city contributions toward needed off-site improvements, and receive expedited staff attention, including support at hearings before appeals boards and the city council.

... it will only become more critical for local governments – as well as advocates and builders in private and nonprofit housing industries – to be as efficient and creative as possible in addressing dire problems of affordability in high-cost areas.

The federal government has reduced its spending on housing and urban development substantially since the 1970s. HUD's budget has rebounded somewhat since reaching its modern nadir during the Reagan Administration, but its overall spending authority is still less than half what it was thirty years ago. If national resources can simply be maintained at current levels over the next decade or so, that outcome would be a substantial political achievement.

Under these circumstances, it will only become more critical for local governments – as well as advocates and builders in private and nonprofit housing industries – to be as efficient and creative as possible in addressing dire problems of affordability in high-cost areas. The approaches described in this article are parts of a diverse and growing policy toolkit used by local and state leaders. Perhaps most important in this effort is the full exploitation of off-budget resources provided by the capital markets via tax-credit and tax-expenditure incentives. No less imperative is the appropriate reform of local regulatory and political barriers standing in the way of proposed construction. ■