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EITC Housing Supplement Fails to Address State's Underlying Problem

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KEY TAKEAWAYS

- The proposed housing supplement would equal the difference between 30 percent of household income, including the EITC, and local fair market rent. Although under this proposal no household would be "cost-burdened," the proposal would significantly increase EITC program costs.
- The supplement would not address California's underlying problem: a severe housing shortage. Putting more money into people's pockets without boosting production of housing, particularly affordable units, would only drive up costs further.
- Policymakers' proposal to expand "by right" approval for multi-family housing projects with set-asides for affordable housing is a good first step in streamlining development and getting affordable housing on the market more quickly.
- Compared with market rate housing production, building subsidized housing is more than twice as effective in protecting low-income households from displacement. While seeking to streamline production, policymakers should expand subsidized housing solutions, such as the Low Income Housing Tax Credit, housing vouchers, and new initiatives like the bond under consideration to fund supportive housing programs for homeless people with mental health needs.

Case Study Abstract

Nationally, housing affordability is a growing problem, with falling homeownership rates and an increasing number of cost-burdened renters. In California, housing is particularly expensive. Dr. Peter Dreier of Occidental College proposes adding a housing subsidy to the federal Earned Income Tax Credit (EITC). This housing supplement would equal the difference between 30 percent of household income, including the EITC, and local fair market rent. Although the proposal directly addresses the definition of "cost-burdened," the housing supplement's simplicity makes it a rough method of addressing needs. There are administrative questions, in part concerning possible over-subsidization for certain household types. The proposed housing supplement would also significantly increase the cost of the EITC program. Most important to California's context, though, is that the proposal would not address the state's underlying problem: a severe housing shortage.

Case Presentation

The national homeownership rate has fallen back to where it was two decades ago, helping to drive up rental demand. Rents grew faster than inflation in 2012, 2013, and 2014, and in 2013, the number of cost-burdened renters reached a new high of 20.8 million—just under half of all renters nationwide. The U.S. Department of Housing and Urban Development (HUD) considers households paying more than 30 percent of income in housing costs to be cost burdened.

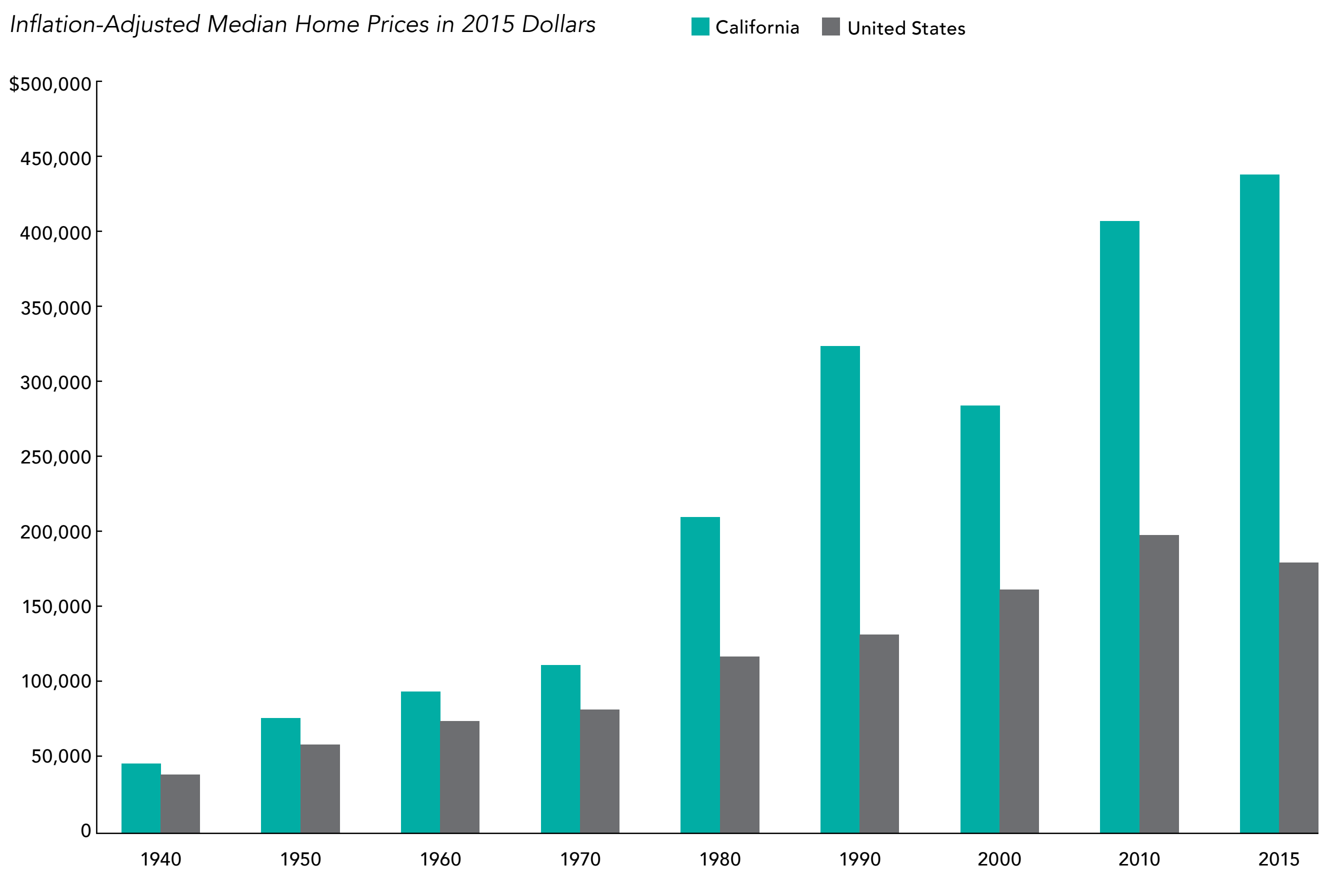
Californians face a particularly challenging housing market. The average cost of a home here has grown to two-and-a-half times the national average, and the average monthly rent in California is now 50 percent higher than the national average. At the same time, inflation-adjusted hourly wages for low- and middle-wage earners in California are below where they were in 1979.

To help address the problem of housing affordability, Peter Dreier, Chair of the Urban & Environmental Policy Department at Occidental College, proposes that a supplemental housing subsidy be added to the existing federal Earned Income Tax Credit (EITC). This housing supplement would be equal to the difference between 30 percent of household income, including the EITC, and the local fair market rent (FMR).[1] This way, no household receiving the EITC would pay more than 30 percent of its income for housing costs, at least relative to the FMR where they live.

Because it would vary according to local FMR, the housing supplement would be responsive to differences in regional housing markets. Housing

CALIFORNIA HOME PRICES HAVE GROWN MUCH FASTER THAN U.S. PRICES

Inflation-Adjusted Median Home Prices in 2015 Dollars



Source: Legislative Analyst's Office

[1] FMR is generally the 40th percentile rent for apartments in an area, defined separately for units with different numbers of bedrooms.

is far more expensive in coastal cities, such as San Francisco and Los Angeles, than in inland cities like Bakersfield and Fresno. In 2013, the average monthly rent in both Bakersfield and Fresno was just below the U.S. average of $840, while in Los Angeles and San Francisco the average was $1,390 and $2,000, respectively.

Dreier's proposal does raise some administrative questions when considering its implementation. Currently, the EITC does not distinguish between homeowners and renters, so his proposal would help EITC recipients regardless of whether or not they were paying rent or mortgage payments, or already owned their home. Also, beneficiaries could be over-subsidized if, for example, someone lived alone in a two-bedroom apartment or two individuals who filed taxes separately shared an apartment. Because of its simplicity, the proposal is a rough method of addressing housing needs.

One challenge to using the EITC as a mechanism for housing assistance is that the credit arrives in a lump sum at the end of the tax year, after a household has filed its return. This is poorly structured to help a family pay rent or other ongoing expenses. Dreier highlights a Brookings Institution paper on existing advanced and periodic payment systems in other countries, which are being studied in the U.S. These might be more complicated than providing a lump sum payment at the end of the year, but they provide the benefit of increasing availability of funds throughout the year and helping families avoid taking out loans.

Another consideration is that the EITC only reaches working households. Other policies to help jobless households would still be necessary. The existing housing voucher program helps families regardless of job status. California's renter's credit only provides a very small dollar amount, and because it is a nonrefundable credit – it only benefits households earning enough to owe California income tax – it does not help those most in need.

Perhaps of more immediate political concern, however, is that the proposed housing supplement would significantly increase the cost of the EITC program. Consider, for example, a single parent with two children in Los Angeles working full-time and earning the 25th percentile annual wage of $24,211. The housing supplement would more than triple the cash benefit they receive, from about $4,300 for the EITC alone to about $13,600 once the roughly $9,300 gap between 30 percent of income (including the EITC) and FMR is fillled.[2] A married couple in Los Angeles with each spouse working full-time at the 25th percentile wage with two children would receive a boost smaller in dollar amount due to their higher combined income, but a much larger increase as a proportion. This is because filling in the roughly $3,300 gap between FMR and 30 percent of work income plus EITC benefit increases the total benefit received to $3,600—almost 11 times the nearly $330 of their federal EITC alone.

Certainly, in cities with lower housing costs than in Los Angeles, the gap to fill would be smaller, making for a lower cost for the housing supplement. Also, there is much variation in workers' situations, as not everyone works full-time or at the same wage, so the amount of subsidy needed to reach FMR would vary widely among households. But the way the proposal is structured means the value of the EITC plus housing supplement essentially starts at a region's FMR and declines as the household's earnings rise to replace the supplement.

This raises a related political consideration: The proposal weakens the work incentives underlying the EITC. Currently, EITC benefits increase as income rises, up to a plateau before decreasing again. In contrast, the *combined* benefit of EITC and the housing supplement would *only decline* as income rises.[3] Although, overall income would still rise with every dollar earned as the benefits phased out. The strong political support for the EITC is due in part to the work-incenting aspect of the EITC. While some may welcome Dreier's formulation, which would directly cover housing cost burden

[2] I produced my estimates using the most recent wage data, updated to the first quarter of 2015, from the California Employment Development Department, and FY2016 FMR data from HUD. EITC estimates are for tax year 2015.

[3] That is, starting after the first dollar earned, since the EITC only serves families with at least one job-holder.

for any working family, others would likely view the proposal as dis-incentivizing work.

Most important to California's context, though, is that the proposed housing supplement would not address the underlying problem in the state: a severe shortage of housing. The need for additional housing in California far outstrips annual production. Between 1980 and 2010, California would have had to add around 210,000 housing units each year to keep housing costs from growing faster than the national average. This is 90,000 units more than the 120,000 that California actually added each year on average. Putting more money into people's pockets without boosting production of housing, particularly affordable units, would only drive up costs further. As long as housing supply continues to fall far short of demand, housing costs in California will remain high—and unaffordable to many.

The governor and legislature's proposal to expand "by right" approval for multi-family housing proposals with set-asides for affordable housing is a good first step in streamlining the development process and getting more affordable housing on the market more quickly. Under this change to state law, housing developments that meet certain baseline requirements, including setting aside units to be affordable to low-income households, may be permitted by city or county planning staff without further approval from elected officials or discretionary approval processes.

The affordable housing criterion is important. Focusing on expanding housing supply without regard for affordability will not necessarily help lower-income families. As a recent University of California, Berkeley study found, market-rate housing construction may "eventually help lower rents decades later, [but] these units may still not be affordable to low-income households." Instead, the study found that subsidized units built with Low Income Housing Tax Credits and other federal and state subsidies had more than double the protective effect against displacement of low-income households as did market-rate housing production.

In addition to continuing to explore how the state and localities can streamline housing development, policymakers should support subsidized housing solutions, such as the Low Income Housing Tax Credit, housing vouchers, and new initiatives like the $2 billion bond under consideration to fund supportive housing programs for homeless people who need mental-health assistance. ■

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