Community Foundation
FOR PALM BEACH AND MARTIN COUNTIES
Promoting philanthropy - Investing in communities

AFFORDABILITY **FORECLOSED:**

The Rental Housing Challenge

Executive Summary • January 2013
Palm Beach and Martin Counties

Dear Friends,

Improving the quality of life for Palm Beach and Martin counties residents is central to the Community Foundation's mission. To develop proactive solutions we must understand how residents and community leaders view important issues affecting our economy and our future. With that goal in mind, the Foundation updated the 2007 *Rental Housing Study of Palm Beach and Martin Counties,* which was prepared at the end of South Florida's "housing bubble."

Affordable rental housing was an issue before the "housing bubble" collapsed. The 2007 study revealed the impact of the 2003-2005 residential boom which resulted in rapid housing appreciation, a severe shortage of affordable housing and extreme affordability gaps for all housing types. The lack of affordable housing was exacerbated by speculative investment: the conversion of 16,000 rental units into condominiums and an explosive, overall trend of upscale housing development.

The 2012 report, *Affordability Foreclosed: The Rental Housing Challenge,* documents how the Great Recession and the devastating housing market collapse continues to impact thousands of individuals and families who have increasingly struggled with high under-employment, unemployment, stagnant wages, tight credit, minimal discretionary income, and rising costs. Foreclosures remain a serious threat to those caught in a financial crisis that, for many, has become the first step into an economic decline that could end in homelessness.

The Community Foundation's leadership on affordable rental housing issues is long standing. Utilizing resources provided through the Chicago-based John D. and Catherine T. MacArthur Foundation, the Community Foundation's MacArthur Foundation Fund, and the additional support of donors, we have supported the initiatives and operations of nonprofit housing and community development organizations throughout Palm Beach and Martin Counties. These organizations include nonprofit affordable housing developers, service providers offering housing assistance to low- and moderate-income residents, and agencies acting as "first responders" to homeless and near-homeless individuals and families.

The 2012 report emphasizes the critical need to increase and preserve the supply of safe, affordable rental housing for low- and moderate-income households in our communities. The Community Foundation does not claim to have all the answers but we share with many the urgency that solutions must be found. We hope the report will be a catalyst toward greater engagement and discussion of these issues by our communities' leadership in the public, nonprofit, and for-profit sectors. We believe by working together solutions can be found that affirm the importance of affordable rental housing to improve the lives of low- and moderate-income families and our region's overall economy.

Sincerely,

Deborah Dale Pucillo

Deborah Dale Pucillo, Chair
Board of Directors

Sincerely,

Leslie Lilly

Leslie Lilly
President & CEO

HOUSING WE CAN AFFORD: MEETING THE CHALLENGES AHEAD

Fueled by easy-to-get mortgages, an explosive three-year housing boom in Palm Beach and Martin counties brought rapidly escalating home prices and rampant speculation from 2003-2005. Seemingly everyone could buy a home of their dreams, sometimes two, if the first could be flipped to pay for the second. And in the frenzy of the times, some 16,000 rental apartments were converted to condominiums to keep up with the demands of would-be homeowners.

By 2009 the “housing bubble” had turned to “bust,” amid the collapse of Lehman Brothers and job losses of the Great Recession. The mortgage-foreclosure crisis that followed exacerbated the region’s “extreme affordability gap” in housing that today shows few signs of abating.

A new 2012 report, *Affordability Foreclosed: The Rental Housing Challenge*, commissioned by the Community Foundation for Palm Beach and Martin Counties, examines the current state of rental housing and strategies for reducing the growing affordability gap.

“Current and projected housing and economic market conditions indicate a serious shortfall of affordable rental housing in both counties,” the data-rich report warns adding, “the growing demand for affordable-rental housing in Palm Beach and Martin Counties will not be addressed by current subsidies and tools that are severely limited or no longer available.” It also issues a challenge: “The development of affordable multi-family housing will remain dependent upon innovative financing solutions.”

FACTORS IMPACTING AFFORDABLE RENTAL HOUSING

low housing production

low vacancy rate

continuing foreclosures

depressed household income

SO, WHAT IS AN “AFFORDABLE” RENT?

The traditional benchmark is 30 percent of income. The Department of Housing and Urban Development, however, defines “affordable” as rent that is 30 percent or less of the “area median income (AMI).” The AMI calculations include adjustments for a number of factors such as size of family or household, age, disability, Social Security benefits and whether an individual or family lives in an urban or rural area. The AMI is then used to determine eligibility for a variety of housing benefits, including rent discounts. Individuals and families are considered “cost burdened” if they are spending more than 30 percent of the “area median income” on rent and “severely cost burdened” if spending more than 50 percent. Government grants and loans for the construction and rehabilitation of rental housing often require that units be set aside for individuals and families with household incomes pegged to various levels of AMI.

The report was compiled by researchers at Florida International University’s Metropolitan Center led by Ned Murray, Ph.D., AICP. It updates a 2007 rental housing study by Dr. Murray that was also commissioned by the Community Foundation.

CONSTRUCTION OF RENTALS ISN’T KEEPING UP WITH DEMAND

An adequate supply of affordable rental housing is vital to the labor force and economies of Palm Beach and Martin counties. Yet, as difficult economic conditions continue to increase the number of renters, new construction of rental housing is not keeping pace with demand. In the last four years, only 1,633 rental-housing construction “starts” were recorded in the two counties despite the area’s population of 1.4 million people and growth rate of 4 to 5 percent annually.

People employed in professional, financial and manufacturing sectors of the local economy with incomes of $53,000 to $60,000 continue to have an array of housing choices. The vast preponderance of wage-earners in Palm Beach and Martin counties, however, are employed in service-sector

AVERAGE MONTHLY RENT IN PALM BEACH COUNTY SKYROCKETS

Two-Bedroom Apartment

$757
month in 2000

$1292
month in 2011

occupations, including retailing, leisure and hospitality, educational and health services and their incomes limit their housing choices.

Collectively, 90 percent of renters in Palm Beach and Martin counties have incomes of less than $35,000 and can't afford the monthly median rent of $1,103 in Palm Beach County or $887 in Martin County. Worse as vacancy rates continue to decline, rents are rising – by $29 to $52 a month annually according to Reinhold P. Wolff Economic Research. The Community Foundation study found affordability gaps at all income levels below the region's average annual wage: $49,879 in Palm Beach County, and $48,311 in Martin County.

According to Reinhold P. Wolff Economic Research, who specializes in tracking and marketing South Florida real estate, development of rental properties in the region has been sluggish for the last seven years it reports, but also projects an annual demand for an additional 5,216 units in Palm Beach County alone. A six-month inventory is considered reasonable, so the Palm Beach County market could fill 2,608 new units annually for the next two years without triggering fears of overbuilding.

Mortgage foreclosures have had the greatest impact on the area's homeowners, but a significant number of renters have also been displaced. According to the National Low Income Housing Coalition, renters accounted for as many as 40 percent of the households evicted in 2009 when lenders foreclosed on landlords. Moreover, homeowners who have gone through foreclosure are likely to remain renters for years while re-building their credit.

Hardest hit by foreclosures in Palm Beach County were homeowners in the region's "growth areas" – Wellington, Royal Palm Beach, the Acreage and newly developing neighborhoods of unincorporated Palm Beach County west of Military Trail and south from Boynton Beach Boulevard to the county line and east of the Florida Turnpike and north of Lake Worth Road. In a 2008 listing of "top 20" foreclosures, the Palm Beach Metropolitan Area was ranked 18th. Even today, courts in Palm Beach County report as many new foreclosures being filed as there are cases being closed. State officials currently count 377,272 pending cases in Florida's 20 judicial circuits and predict 220,000-240,000 new filings annually for the next two years.

AFFORDABLE HOUSING REQUIRES AFFORDABLE FINANCING

In Palm Beach County 89 percent of existing multi-family rental housing, and in Martin County 78 percent, is comprised of small five-to-49 unit apartment complexes. Most of that housing is located along the I-95 corridor. Typically the buildings are 40-years old, fully occupied with moderate levels of deferred maintenance and some health- or building-code violations. It costs between $50,000 to $60,000 per unit to restore or rehabilitate a building with six to nine apartments, but $25,000 to $30,000 per unit in complexes of 24 to 49 units. Per-unit costs are less in the larger complexes because on-site management and maintenance means they are in better shape when restoration begins.

RENTAL HOUSING NOT KEEPING PACE WITH GROWING DEMAND

1,633
new rental housing starts since 2008

1,504
rental housing completions since 2008

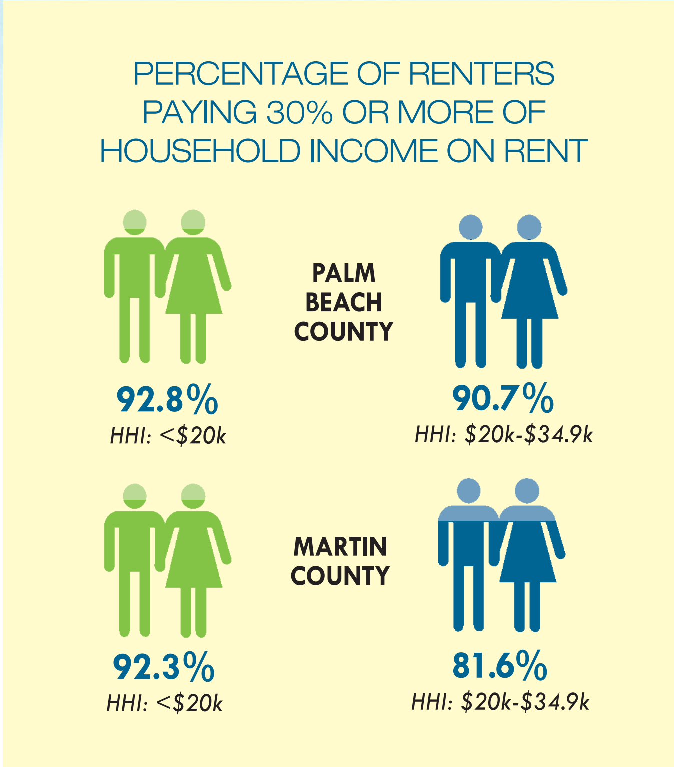
5,216
estimate annual demand for rental apartments in 2011-2015

The Community Foundation's study includes three investment pro formas that detail the costs to purchase and rehabilitate a nine-unit, a 24-unit, and a 49-unit building and calculate the size of the financing shortfall that would have to be covered by grants and loans. Government loans and grants usually require a negotiated number of rental units be "set aside" and offered to renters at "affordable rates" that are pegged to 50, 80, and 120 percent of the renter's AMI.

But if investors, who were assumed to be putting in $25,000 worth of equity, are limited to collecting monthly rents of $407 (50 percent of the region's AMI) none of the buildings written up could generate sufficient income to cover operating and capital investment costs. For example, the purchase price of the nine-unit building was $375,000, but it also needed $520,000 in repairs. The gross rental income of $39,960 generated by rents wouldn't be enough to cover $49,795 in operating costs and leaves an unsupportable $870,000 financial shortfall. If rents were raised to $651 (80 percent of AMI), the shortfall decreased to $787,903 and could be covered by a loan of $82,097 and grants. When rents were raised to $977 (120 percent of AMI), the $508,420 shortfall could be financed with grants and a loan of $361,580.

The larger 24 and 49-units buildings required capital investments of $1.8 million and $5.6 million respectively and both showed substantial financing/grant shortfalls. With monthly rents set at $651, the 24-unit building could qualify for a $321,718 loan but would also need $1.5 million in grants. The 49-unit building required a $5.6 million capital investment. If rents were $977 a month, the financing shortfall could be covered with a $2.2 million loan and $3.4 million in grants. You can find complete comparisons and details in the study on the Community Foundation's website: www.yourcommuityfoundation.org.

Finding appropriate investment strategies to preserve small, multi-family rental properties and to expand affordability is a challenge. Many of the programs communities, developers and investors have relied upon are running out of money or expiring. HUD is closing out the Neighborhood Stabilization Program, which has provided substantial grants to local governments and consortiums of nonprofits to buy or redevelop rental housing in the area. That program got a boost in 2009 from stimulus dollars of the American Recovery Act and in 2010 from the Dodd-Frank Wall Street Reform and Consumer Protection Act, but there is no new money being put into its pipeline.



The Florida Housing Finance Corporation (FHFC), specifically established to stimulate private investment and increase the supply of affordable housing in the state, suspended its State Apartment Incentive Loan (SAIL) program after the Legislature diverted the documentary-stamp taxes that financed the program into balancing recent state budgets. Also, FHFC has ceased issuing new guarantees on mortgages of bond-financed affordable housing. The corporation does continue to allocate about $40 million a year of federal Low Income Housing Tax Credits, which provide a dollar-for-dollar reduction in federal tax liability to developers/investors building or rehabilitating affordable-rental housing. That program commonly caps tenant eligibility at 60 percent of AMI despite the rapid growth of cost-burdened and severely cost-burdened renters with household incomes well above that threshold.

Given current constraints, affordable rental housing will become increasingly dependent on innovative financing brought forward by local government and private and non-profit community-investment lenders. Community investment institutions have a track record of developing consortiums and partnering with local government, nonprofit organizations, foundations and private investors, which package loans, grants, tax credits and similar incentives to buy, rehabilitate and build affordable-rental housing.

RATHER RENT THAN OWN? **YOU'RE NOT ALONE**

Affordable rental housing is essential to maintaining a spectrum of housing choices to accommodate people's needs and preferences. Because rental housing imposes no maintenance obligations, it costs less, and people of all income levels in urban centers like its convenience. Here's more reasons people rent:

- Young people value the independence of establishing their own household and the opportunity to build up their savings and credit rating.
- Seniors are re-locating or ridding themselves of homeownership's obligations
- In urban and rural areas, the "mobile workforce" willing to travel and quickly re-locate for a job is the new "norm."
- Individuals and families are recovering from job losses, foreclosures or other dislocations and want to rebuild their capital.
- People simply don't have the household income required to qualify for a mortgage to buy and maintain a single-family home or condominium.

Bridging the gap between what low-income renters can afford to pay and the rents necessary to cover maintenance, management and construction is a goal that dovetails with the public interest in maintaining strong economies and livable communities.

WHAT CAN LOCAL GOVERNMENT DO TO HELP?

Local governments in Palm Beach and Martin counties will face increasing pressure to play an active role in meeting the need for affordable housing by participating and facilitating the packaging of grants and loans.

A critical finding of the 2007 Rental Housing Study was the fragmentation and lack of coordination between local government policy and regulatory systems that raise costs and ultimately the price of housing and rents. The Comprehensive Growth Management planning process can be used to identify, coordinate and integrate systems for managing housing development among county, municipal, and community-redevelopment agencies.

Both counties have updated their comprehensive plans to address affordable-housing needs, set goals and identified incentives to encourage construction and preservation of affordable housing and to make it easier to tap what funds are available. Martin County established an Affordable Housing Land Bank and Housing Trust Fund; Palm Beach County developed a Work Force Housing program that requires developers to set aside units to be sold or rented at a price based on the income of the buyer or renter.

Local government exerts its most important impact when it effectively uses its control over land-use and construction standards. The restrictions placed on the location and density of rental housing are the greatest regulatory barriers to increasing the amount and to assuring the affordability of rental housing. Given the scale of demand for such housing, Palm Beach and Martin counties will each need to create new or expand existing multi-family districts.

Slow regulatory processes can significantly increase construction costs. By establishing internal-performance standards that streamline development approvals and inject predictability into development, counties and cities can make it easier for residents, developers and contractors alike to schedule work. The cost savings of such efficiencies can then be leveraged to obtain additional affordable units. The first step to be taken is to conduct a "self-assessment" to determine how current policies, regulations and programs encourage and discourage the preservation of existing affordable rental housing and the construction of new rental housing.

In the coming years, persistent unemployment and stagnant growth of household income may well continue to impact local housing and neighborhoods. Local policymakers will have to find ways to do more and with less money, but they are not without tools to address the problems and assure affordable housing, sound local economies and livable communities.

WHERE DOES THE MONEY GO?

For years parents warned adult children about renting their first apartment, "Don't spend more than 30 percent of your income." Today that benchmark of affordability is etched in public policy, and the U.S. Department of Housing and Urban Development describes anyone spending more as "cost burdened," or "severely cost burdened" if spending more than 50 percent.

Yet two startling facts emerged in the Community Foundation's study assessing the local need for affordable rental housing: In Palm Beach and Martin counties **90 percent** of renters with household incomes of less than $35,000 spend more than 30 percent on rent. Sixty-two percent of households with incomes between $35,000 and $49,000 are also spending more than 30 percent.

The impact is easier to understand if "annual income" is translated into wages: $35,000 is equivalent to an hourly wage of $16.83 for a year of 40-hour work weeks; $49,000 is the equivalent of $23.56 an hour. When people spend almost a third of what they earn on housing, how much is left to spend on other essentials?

The Center for Responsible Lending offers some insight with its "Financial Snapshot of a Typical American Household." The snapshot presumes an after-tax income of $41,516 and housing costs, which are based on national statistics, are slightly less than the 30-percent benchmark.

$11,455
Housing

$7,160
Transportation

$5,596
Food

$3,603
Utilities

$3,068
Health care

$594
Education (including reading)

$2,658
Debt payments (excluding mortgage and auto)

$6,175
Other (excluding alcohol, tobacco, entertainment)

What's left in "discretionary" income to be saved or spent is $1,207 – about $100 a month.

That's not much of a cushion. If housing costs were to rise to 35 percent of income – to $1,211 a month from $955 – the cushion would be wiped out and the "typical American household" would be "in the red" $1,865 at the end of the year.

The Center is a nonpartisan financial research organization based in Durham, NC. Its snapshot appears in a just released report, "The State of Lending in America & its Impact on U.S. Households," that covers housing, auto, credit card and student loans.

You can construct your personal fiscal "snapshot" using CredAbility's budget calculators found on that organization's website: www.credability.org. Formerly known as the Consumer Counseling Credit Service, it is based in Atlanta, GA, and has a West Palm Beach office.

You may download the *Affordability Foreclosed: The Rental Housing Challenge* full report and executive summary at www.yourcommunityfoundation.org/Publications-And-Reports.

For more information, contact info@cfpbmc.org
or visit www.yourcommunityfoundation.org

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