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The Lack of Affordable Housing in New England: How Big a Problem? Why Is It Growing? What Are We Doing About It?

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(with an overview by Robert Tannenwald)

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Abstract

Although housing costs in greater Boston and elsewhere around the region have leveled off, affordable housing is still high on the public policy agenda in every New England state. A growing chorus of employers and policymakers are warning that the region's high cost of housing is now undermining its ability to attract and retain workers and businesses. This paper presents a thorough, region-wide analysis of the housing affordability problem in New England. We construct three affordability indicators to examine differences in the cost of housing across socioeconomic, demographic, and occupational groups, for every New England state and for the region's principal metropolitan areas.

We find that owner-occupied housing is often not affordable, particularly in southern New England, and the problem is getting worse over time. In contrast, New England's rental housing is expensive relative to the rest of the nation, but incomes are high enough that rentals are still affordable to most New Englanders. However, the lack of affordable owner-occupied housing is a problem for both middle-income and very low-income households. Households headed by young professionals can afford to purchase median homes in New England, but not as easily as they used to, and not as easily as in most rival metropolitan areas. At the same time, the very low-income are being squeezed by falling household incomes coupled with rapidly appreciating prices for houses at the lower end of the price distribution. Finally, fewer rental and owner-occupied units are actually available to the very low-income than in the past because households with higher incomes are moving down the housing distribution in order to secure shelter.



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We also draw on the existing literature to analyze what might have caused the region's affordability problem to worsen over the last decade. While many factors may have contributed in small ways, easier access to mortgage credit and strict regulations on building are likely to be the two most important reasons behind the increase.

Finally, we summarize the strategies New England governments have adopted to address the problem. These policies attempt either to increase the ability of households to rent or purchase a home or to increase the supply of affordable units. Supply-side strategies are likely to be particularly critical in improving housing affordability given the sluggish growth in the region's housing stock over the past decade.

Keywords: housing policy, New England, affordable housing, house prices

JEL Classifications: F10, I29, R11

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Executive overview

By Robert Tannenwald

For several decades, policymakers at all levels of government have tried to expand access to affordable housing. Policies designed to this end have generally targeted low-income households, those least able to secure adequate shelter. However, in recent years competitiveness as well as compassion has catapulted affordable housing to the top of the public policy agenda in every New England state—even as housing prices have leveled off. A growing chorus of policymakers and employers is warning that expensive housing may be undermining the region’s ability to attract and retain workers, especially those with skills in high demand. More and more households, spanning a wide swath of the income distribution, find that they can get more “bang for their buck” outside New England, particularly the region’s major metropolitan areas. As a result, the cost of housing may be driving away households and repelling potential migrants, slowing growth in the region’s workforce. Thus, concern about affordable housing has intensified with housing policy focused not only on the least fortunate members of their community but also on the region’s ability to compete economically with other parts of the country.

This report provides, to our knowledge, the most thorough *region-wide* analysis of this problem ever undertaken. The authors analyze differences in housing affordability among specific socioeconomic, demographic, and occupational groups, for every New England state and for the region's principal metropolitan areas. These detailed breakdowns provide unique insights into the incidence and severity of New England's housing problems and their implications for the region's competitiveness. The report also synthesizes what we know (and do not know) about why housing in many parts of New England is so unaffordable and why it has become increasingly so. Finally, the report discusses the larger public policy initiatives undertaken by state and local governments within the region that attempt to ameliorate the problem.

A. Changes in New England's housing market over the past decade

The authors provide a comprehensive overview of changes in the region's housing market over the past decade, discussing both the rapid increase in prices and rents as well as sluggish growth in housing supply. Notable findings include:

- **Owner-occupied housing has become increasingly expensive in New England.**

The gap in owner-occupied house prices between New England and most other parts of the country has grown substantially over the past decade. Between 1995 and 2005, real house prices increased by 85 percent in New England versus 56 percent nationwide. House price appreciation was even greater in some of the region's larger metropolitan areas within the region, with prices almost doubling in the Boston area during this period.

- **As a result, house prices are relatively high throughout most of New England compared to the rest of the U.S.** As of 2005, the median price of a single-family house exceeded the nation's in eight of the region's nine largest metropolitan areas. Among these, both the Bridgeport-Stamford-Norwalk CT and Boston-Cambridge-Quincy MA metro areas ranked among the 13 priciest metro areas in the nation. Even in the region's less expensive metro areas, house prices were often higher than those in rival metro areas such as Phoenix AZ and Raleigh NC.
- **In contrast to owner-occupied housing, the gap in rents is not as great, nor has it grown as fast, as the gap in owner-occupied house prices.** As a result, the median gross monthly rent in New England, at \$831, was only 14 percent higher than the national median of \$728. Moreover, in the greater Boston area, the growth in rents slowed in 2002, was constant between 2003 and 2004, and actually declined in 2005.
- **Over the past decade, most of New England has been characterized by sluggish growth in its housing stock.** Every state in the region except New Hampshire ranked among the bottom 10 states in the rate of growth in housing starts between 2000 and 2005. Housing production has been especially slow in the region's largest metropolitan areas.

B. The lack of affordable housing in New England: How big is the problem?

The authors use several indicators to compare the affordability of housing inside and outside of New England and how it has changed over time. These indicators take into account rent levels and house prices as well as the financing, taxes, and insurance costs

associated with purchasing a home. Moreover, their measures take into consideration the role of household income in determining affordability. If households facing high housing costs also enjoy high incomes, housing burdens may not be out of line. With these concerns in mind, the authors have assembled data for three distinct indicators to measure various aspects of affordability in New England for both the rental and homeowner markets:

- **Housing burden ratio:** the ratio of the costs of owning or renting a home to household income. Typically, households spending more than 30 percent of their income on housing are considered to be moderately cost-burdened while those spending more than 50 percent are considered to be severely cost-burdened.
- **Housing income adequacy ratio:** the ratio of median household income to the minimum income needed by a household to afford the median-priced rental or owner-occupied unit. Places where the housing income adequacy ratio was 1.0 or higher indicate that households earn incomes that are equal to or greater than the income needed to secure housing and so are considered to be affordable.
- **Housing availability ratio:** the ratio of the number of affordable units available to the number of households within a given income range. The number of units available is the number of housing units that are both affordable to these households and not occupied by households in a higher income range. Places where the housing availability ratio was 1.0 or higher indicate that the number of units was equal to or greater than the number of households and as such are considered to have an adequate supply of affordable housing.

The authors compare these indicators across a variety of socioeconomic and demographic groups, examining both the current level of each indicator as well as the trend

over the past decade for various parts of the region. Within each group and geographic area, they compare indicators for both homeowners and renters. The authors find:

- **Although housing burdens are high for many low-income households, rental housing in New England is relatively affordable compared to other parts of the U.S.** All three of the affordability indicators used in this study show that while rental housing in New England is expensive, incomes in the region are high enough to compensate. When household income is taken into consideration, rental housing in every New England state is as affordable as, or even more affordable than, rental housing in the nation as a whole.
- **Yet owner-occupied housing is not affordable in some parts of the region, especially in southern New England.** Access to affordable owner-occupied housing is a relatively severe problem in several (though not all) New England states and metropolitan areas. Owner-occupied units appear to be especially unaffordable in southern New England—Connecticut, Massachusetts, and Rhode Island—where the gap between median household income and the income needed to purchase the median priced house was considerably larger than that for the U.S. as a whole. In particular, housing burdens were significantly higher in Massachusetts and Rhode Island versus nationwide with the number of available units in these states being in short supply.
- **The lack of affordable owner-occupied housing is getting worse.** Most indicators show access to affordable owner-occupied units falling faster in every New England state than in the nation as a whole in recent years. This is true for almost all

socioeconomic and demographic groups, whether categorized by age, education, or select service occupations (e.g. teaching, nursing, police work).

- **Owner-occupied housing is not affordable for middle-income as well as low-income households in many parts of New England.** The lack of affordable owner-occupied housing is not limited to low-income households. In 2005, 29 percent of middle income homeowners in Massachusetts and 32 percent in Rhode Island bore moderate or severe housing burdens as compared to 21 percent of homeowners nationwide.
- **Owner-occupied housing is often more affordable in competitor metro areas.** The authors find that even after taking into account the relatively high household incomes in southern New England, owner-occupied homes in some of the region's southern metro areas were much less affordable than those in competitor metro areas. In 2005, the median household earned only 65 to 80 percent of the income needed to purchase the median-priced house in Boston-Quincy MA; Bridgeport-Stamford-Norwalk CT, Providence RI, and Cambridge-Newton-Framingham MA. But in rival metro areas—places like Phoenix AZ and Raleigh NC—the median household earned just enough or even in excess of the income needed to purchase the median-priced house. Smaller metro areas in New England, however, compared more favorably, with median households earning at least enough to afford the median home in Hartford CT; Springfield MA; Worcester MA; Manchester-Nashua NH; and Burlington VT.
- **Young professionals can afford the median home in New England, but not as easily as they used to, and not as easily as in other regions.** As of 2000,

households headed by young professionals—college graduates in the first-time homebuyer age bracket (25 to 39 years old)—were able to afford the median-priced house in every New England metro area. However, for young professionals, the gap between median household income and the income needed to purchase the median-priced house was greater in many of the region’s metro areas compared to rival metro areas such as Chicago IL, Philadelphia PA, Phoenix AZ, and Raleigh NC. Moreover, between 1995 and 2000, affordability decreased sharply for young professional households in each of the New England metro areas. These households, often looking to purchase their first home, are more mobile than other groups, making them especially sensitive to the burden of housing in general and of owner-occupied housing in particular. Given that college graduates possess valuable skills that are in high demand, rising house prices may make it difficult for employers within the region to recruit these workers if these workers can buy more house for their money elsewhere. Moreover, firms may also choose to relocate if compensation is being driven by higher housing costs rather than greater worker productivity.

- **The very low-income are being squeezed by falling household incomes coupled with rapidly appreciating prices for houses at the lower end of the price distribution.** Over the past five years, very low-income households at the bottom of the income distribution have experienced a double-whammy when it comes to housing affordability. According to detailed house price data for Connecticut, the least expensive houses have appreciated more rapidly than those higher up in the housing distribution. At the same time, the median household income for this group has actually fallen in real terms. As a result, a significantly higher share of very low-

income homeowners spend more than 30 percent of their household incomes on housing in New England than elsewhere; indeed, on average very low-income homeowners in New England spend 67 percent of their income on housing.

- **Very low-income households are being crowded out of affordable rental units as higher income households move down the housing price distribution to obtain shelter.** As of 2005, there was roughly one affordable apartment for every two households in this group. Excluding those apartments occupied by higher-income households, there was only one affordable apartment that was *available* for every *three* households in this group.

C. Why has housing become so unaffordable in parts of New England?

Why has owner-occupied housing become so unaffordable in parts of New England, and why has this affordability gap widened in recent years? The authors search for answers to these questions by analyzing previously conducted research and its implications for housing prices and affordability in New England. They explore several possible explanations on both the demand side and the supply side of the markets.

On the demand side, the authors discuss five factors that may have fueled housing demand within the region, thereby exacerbating affordability problems: 1) rising incomes, 2) increasing income inequality, 3) changes in the age distribution of households, 4) easier access to mortgage credit, and 5) high and rising expectations regarding future price appreciation. The first three factors listed above are rather slow-moving and therefore

unlikely to have caused such a rapid increase in housing demand over such a relatively short period of time.

However, the two remaining factors—easier access to mortgage credit and accelerating expectations of house price appreciation—have the potential to affect rapid change in housing markets and may have stimulated demand beyond equilibrium levels. Although the latter can change quickly, survey evidence indicates that New Englanders were no more likely than homebuyers in other regions to engage in speculation. However, easier access to mortgage credit—in particular falling real interest rates, the growth of adjustable rate mortgages, and the use of non-traditional loans—appear to have played an important role in increasing the demand for housing. These changes in financing reduced income constraints for borrowers, making housing appear more affordable and possibly luring more buyers into the market. The resulting surge in demand may have spurred houses prices beyond equilibrium (“normal”) levels.

On the supply side, the authors discuss three factors that may have limited the supply of housing: 1) rising costs of physical construction, 2) increasing land prices, and 3) greater regulatory barriers to new construction. While scarce land and high construction costs may be partially responsible, the single most important factor appears to be the region’s strict land-use regulations. Recent research indicates that such regulations can raise prices from 17 to 50 percent, depending on the type of restriction and geographic area studied. While land-use regulations have been in place for many decades, it appears that some regulations—particularly sub-division regulations—have become a greater impediment to builders over time. Moreover, it may be the case that land-use regulations

may have become more binding over the past decade as easier access to mortgage credit has fueled demand beyond “normal” levels.

D. Affordable housing in New England: What are we doing about it?

Governments at all levels are engaged in a wide variety of efforts throughout New England to promote access to affordable housing. While these policy initiatives address different segments of the population, they all take one of two approaches: 1) increasing the ability of households to rent or purchase a home or 2) increasing the supply of affordable units.

The former consist of demand-side strategies that seek to increase the purchasing power of low- and moderate-income households by providing subsidies to renters or reducing wealth and income constraints for buyers. The latter consist of supply-side strategies that seek to maintain or increase the supply of affordable housing by increasing investment in new construction and rehabilitation, removing regulatory and procedural barriers for developers, or preserving the affordability of existing units.

Recent research and experience suggest that supply-side strategies are likely to be critical to increasing the supply of housing given the sluggish growth in the region’s housing stock over the past decade. In particular, the most innovative policy solutions have occurred in southern New England where state governments have either constrained the ability of local governments to restrict land use in ways that curtail the production of affordable units or reduced the incentives to engage in such constraint. Furthermore because many communities have concerns that increasing their stock of affordable housing will result in

higher municipal costs, particularly for education, Massachusetts passed a new law this year to provide funding for any net education costs associated with affordable units developed within a smart growth district. However it remains to be seen whether local communities will find this to be a sufficient incentive to create enough affordable units to alleviate the upward pressure on prices.

Should state governments restrict municipal regulatory discretion? The answer is not clear-cut. The reluctance of many communities to allow the production of affordable housing within their borders is understandable. Moreover, local control is one of New England's distinguishing traits. More so than communities in other regions, New England's cities and towns have the power to shape their own environment with minimal interference from higher levels of government. However, this aversion to hosting affordable housing may be near-sighted. As each community vigorously defends its right to shape its own character, the region's collective interest in attracting and retaining workers suffers. And, as housing prices remain high, low-income households, already squeezed, have increasing difficulty finding affordable shelter.

New Englanders face unavoidably difficult tradeoffs as they confront the troublesome issue of affordable housing. The lack of affordable housing has the potential to affect not only individual households in the region, but also the region's economy itself. A successful solution will require coordination across cities and towns, metropolitan areas, and even states to create policies that will have a measurable effect on prices throughout the region. We hope that those who read this report will understand the issue better and will have better empirical tools at their disposal.