LIHTC MONTHLY REPORT

A MONTHLY PUBLICATION OFFERING NEWS, OPINION, FEATURES AND COMMENTARY ON THE LOW-INCOME HOUSING TAX CREDIT INDUSTRY

January 2004, Volume XV, Issue I, Published By Novogradac & Company LLP

The Housing Bubble: Hot Air or Pending Doom?

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As it is with most things in life that beg for agreement, accord on the existence of a housing bubble is hard to come by. Some residential real estate professionals are convinced that the bubble theory is a bunch of hot air and that when the economy regains momentum the housing industry is well-positioned for another solid decade of growth. Others are warning that home prices are unsustainable and those homebuyers who are heavily leveraged because of low interest rates and government assistance are headed for inevitable disaster.

Federal Reserve Board Chairman Alan Greenspan's testimony before Congress in mid-July refuted, once and for all, the existence of an alleged housing market "bubble," according to chief economists of the National Association of Realtors® and the National Association of Home Builders, two trade groups that collectively represent more than 1 million professionals from all walks of the housing industry.

Asked about the issue during his testimony, Greenspan said, "We've looked at the bubble question and we've concluded that it is most unlikely." He attributed recent "sizeable gains" in home prices to "the effects on demand of low mortgage rates, immigration and shortages of buildable land."

"The time has come to put this issue to rest," said NAHB Chief Economist David Seiders. "The nation's home builders have said it, the Realtors have said it, and now Alan Greenspan has said it once again, in no uncertain terms: there is no such thing as a current or impending house price bubble."

According a recent Joint Center for Housing Studies of Harvard University study, "The State of the Nation's Housing," fears about housing market bubbles "seem overblown." The study is resolute in its belief that in locations where home prices have moved up relative to income, land is scarce and regulation keeps supply in check, the likelihood of falling prices is minimal. "It takes concentrated job losses - the likes of which have not been seen during this business cycle - to drive down home prices," say the study's authors.

While the Harvard study takes the more optimistic view, a paper from the Center for Economic and Policy Research (CEPR) paints a gloomier picture. The paper, entitled "Homeownership in a Bubble: The Fast Path to Poverty," notes the extraordinary run-up in home sale prices since 1995 and predicts that efforts by the government or not-for profit organizations to promote homeownership in today market could prove counter-productive. That is because bubble prices are unsustainable and may mean that home buyers, especially low- and moderate-income buyers in bubble affected markets, are putting their economic security at serious risk, much as they did in the early 1990s.

Rental Property

Since the homeownership boom began in 1993, growth in rental demand has been contained to about half a million households, according to the Harvard study. Although the number of renters has changed little during this time, the composition of renter households has undergone dramatic change. Strong household growth pushed the number of minority renters up by 2.7 million between 1993 and 2001, even though their rentership rates dropped. The number of white renters is down by 2.1 million and the minority share of renter households has increased from 34 percent to 42 percent.

The supply of smaller, less costly housing is shrinking, with especially sharp losses among two- to four-unit apartment buildings. Regulatory and natural constraints on land are driving up land costs in and

(continued on page two)

The Housing Bubble

(continued from page one)

around many of the nation's metropolitan areas, restricting development of affordable housing.

Rising rental property valuations, together with climbing vacancy rates and rent concessions in several markets, have also led to worries that recent rental transactions are overvalued. But because lower interest rates support solid leveraged returns on these acquisitions, they are financially viable, say the Harvard study authors. They estimate that absent further weakening rental markets, they should remain so.

Immigration and rental housing

Perhaps the most worrisome subject on multifamily developers' minds is the growing affordability of single-family homes. With the recent plunge in interest rates, many renters took advantage of the opportunity to become first-time home buyers. The effect on the multifamily housing sector has been significant, especially with government policies favoring home ownership and state governments looking for ways to fill their empty coffers with increased property tax revenue.

According to the National Association of Home Builders (NAHB), immigrants play a vital role, providing an initial stimulus to rental markets for their first few years in the country. NAHB forecasts a net flow of as many as 1.7 million foreign-born people coming to the United States every year between 2002 and 2012. Data from the 2000 Census verify the importance of immigration to the rental apartment market, figures show that the government systematically underestimated immigration levels during the late 1990s - a fact that NAHB says largely explains why multifamily starts and absorption rates were stronger than virtually all experts had predicted.

Immigration has added substantially to the demand for rental units, according to the Harvard study. Foreign born households now account for nearly one in five renters. Moreover, foreign-born households now account for 73 percent of the growth in Hispanic renters since 1997 and are expected to have an even larger presence in rental markets in the coming years.

The housing problem: a case for the LIHTC program

Harvard researchers point out that a staggering three in 10 U.S. households have housing affordability problems. Even without a housing bubble, fully 14.3 million households are severely cost-burdened (spend more than 50 percent of their incomes on housing) and another 17.3 million are moderately cost-burdened (spend 30-50 percent of their incomes on housing).

The fact is, notes the Harvard study, the cost of supplying even the most modest housing far exceeds the amount many lower-income households can pay. Based on HUD's fair market rent measure, households with one full-

(continued on page three)

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The Housing Bubble

(continued from page two)

time minimum wage earner cannot afford to rent even a one-bedroom apartment anywhere in the country.

In total, 6.3 million renter households receive subsidies that do not cap the recipient's contribution to housing payments at 30 percent of income. As a result, say the Harvard study's authors, 24 percent of these subsidized renters report severe cost burdens and another 23 percent report moderate cost burdens. Additionally, some recipients of housing assistance live in poor quality units -- approximately 705,000 subsidized tenants are housed in units with at least moderate structural deficiencies.

The inventory of directly subsidized rental properties is also under pressure, the Harvard researchers say. Working in partnership with local and state agencies, the federal government is replacing severely distressed public housing through the HOPE VI program but while the nation is gaining far better housing and restoring communities, replacement is not one for one. About 150,000 units of privately owned but publicly assisted housing have been lost since 1997 as owners opt out of their contracts, At a time of rising demand, the remaining federal production programs - the LIHTC, HOME and CDBG - are vital to forestall net reductions from the low-cost housing stock.

Conclusion

It was reported last month that typically optimistic Realtor groups have acknowledged that the pace of the housing market is about to cool. Home sales declined in October for the first time in four months, according to a National Association of Realtors' report.

With or without a housing bubble, however, the shortage of affordable market rate rentals is dire, according to the Harvard study. In 2001, the 9.9 million renters in the bottom income quintile outnumbered the supply of the lowest-cost units by fully 2 million. Reducing the pool even further, higher-income households occupied 2.7 million of the 7.9 million lowest-cost units.

The CEPR paper points to "an enormous glut of [market rate and high-end rental units] putting downward pressure on rental prices. It goes on to say that in the last year and a half, the rate of rental inflation has slowed sharply, with rental prices actually falling in real terms in the last year. "This decline in rental prices can be readily explained by the fact that the nationwide rental vacancy rate is currently at a record high," says the author economist and CEPR co-director Dean Banker. "This is entirely consistent with the housing bubble scenario." It also portends opportunity for those in subsidized housing to move into market-rate apartments.

The Harvard study reports that over the longer term rental housing

(continued on page four)

The Housing Bubble

(continued from page three)

demand should grow, whether or not the national homeownership rate continues its ascent. The number of renter households is currently expected to increase by about 1 million in each of the next two decades. But if conditions turn unfavorable for owning a home, or a housing bubble bursts, the number of renters could easily grow by five to six million. In any case, the renter share should hover near three in 10 households for the next 20 years.

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