Rhode Island Policy Reporter

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Nor a roof against the rain

"CRISIS" IS AN OFTEN-USED WORD in public policy debates, but its meaning isn't always clear. Sometimes a crisis leaps up and slaps you in the face. The pain is the price of clarity, and you don't have to ask any questions. Other times, especially when a crisis sneaks up on you, it can be hard to tell the point at which insignificant symptoms blossom into a full-blown disaster. For example, the earth is warming, and it's been clear for many years that humans are the primary reason. But when will this become a crisis? Will it be when coastal communities flood and the low-lying nation of Maldives becomes uninhabitable? Or is it already a crisis, since the changes ahead are so momentous? Or do we have to wait until next year?

For another example, proponents of the 1996 welfare reform regularly assert that there hasn't been a crisis in response to those changes in federal laws. But they usually do so without specifying what a crisis would look like. Would it involve an increase in kids who qualify for free or discounted school lunches? An increase in children living in poverty? An increase in domestic abuse?[1]

Crises take all different forms: some are violent, but some are quiet. Some involve flames, while others happen behind closed doors. Without responsible people asking the right questions, terrible events can go entirely unnoticed.

So here are some questions that need asking: Why has the number of homeless children in Rhode Island almost doubled since 1998?[2] Why are Rhode Island's emergency shelters filled with families who have jobs?[3] And why is it so darn hard to find a decent affordable place to live?

The bare facts of our housing crisis have been reported thoroughly elsewhere. Briefly, the issue is the tremendous run-up in prices over the past five years, though the previous two decades were no picnic in this department, either. The median rent for any apartment in Rhode Island went up from slightly under $700 per month in 2001 (adjusted to include utilities) to over $1000 in 2004, an increase of over 45%. The median price of a house went from $156,000 to $264,700 over the same period.

Numbers The median prices of houses and median rents are widely reported, and these are the numbers people familiar with the debate throw around. But the median is simply the price of the property in the middle when you line them all up by price. Like any average, the median sometimes hides as much as it tells. In Rhode Island, rental data is collected by RI Housing, who was kind enough to share the data behind the medians with **RIPR**, and another view of it is shown in Figure 1. The height of each point on the curves roughly corresponds to the proportion of apartments whose rent is near that amount. It's a slightly unorthodox presentation, but it can be a useful illustration of some important points. The median for each year is close to the peak of each curve. The 2004 curve is shorter and wider than the 2001 curve: not only has the median rent moved up, but there are also fewer properties right at the median than in 2001.

When a curve like this shifts, it can move because all the prices are multiplied by some factor, or it can shift because some number is added to all the prices. A curve moved by adding, though, retains its basic shape, while a curve moved by multiplication tends to widen and broaden in the beam. And it turns out that adding nothing, but simply multiplying all the prices from 2001 by 1.45 brings a curve very much like the 2004 curve.

So what? Well, one thing this can tell you is that increases in fixed costs—permitting costs, inspections, insurance, labor costs, heat—have little or nothing to do with the price increases we've seen. These effects, because they're comparable or identical for many different apartments (permitting or heat is roughly as expensive

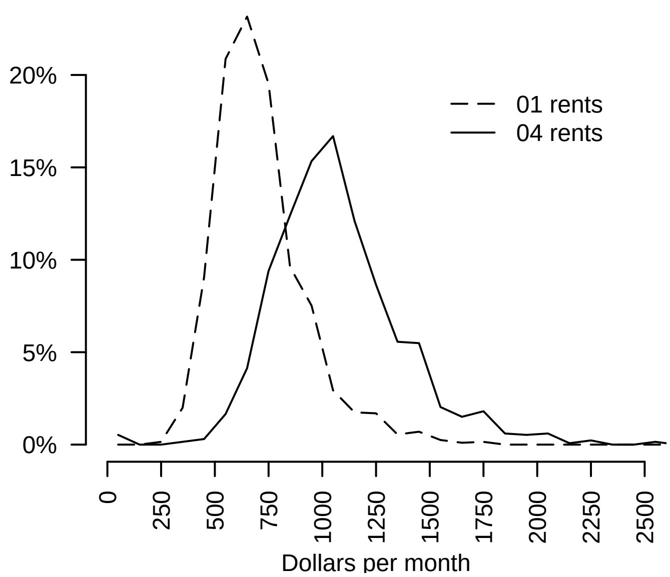

Figure 1: The percentage of Rhode Island apartments renting at a given price. For example, the peak of the dotted curve, at a monthly rent of $650, is around .23, which means that 23% of apartments in 2001 rented between $600 and $700. The dotted curve shows rents, statewide, in 2001, while the solid line is the corresponding curve for 2004. Rental data is from RI Housing's survey of classified ads.

[1] We've had all three of these. Nationally, reduced price lunch use is up 8.5% 1996-2003, according to a 2003 report from the House Ways and Means Committee. Child poverty in Rhode Island is up from 14% to 17% 1990-2000, according to the US Census, and domestic abuse complaints are up from 6628 in 1998 to 8389 in 2003, according to the RI Coalition against Domestic Violence.

[2] Up from 722 to 1325 (RI Kids Count, 2005 Factbook).

[3] Over 20% according to *housingworksri.org*.

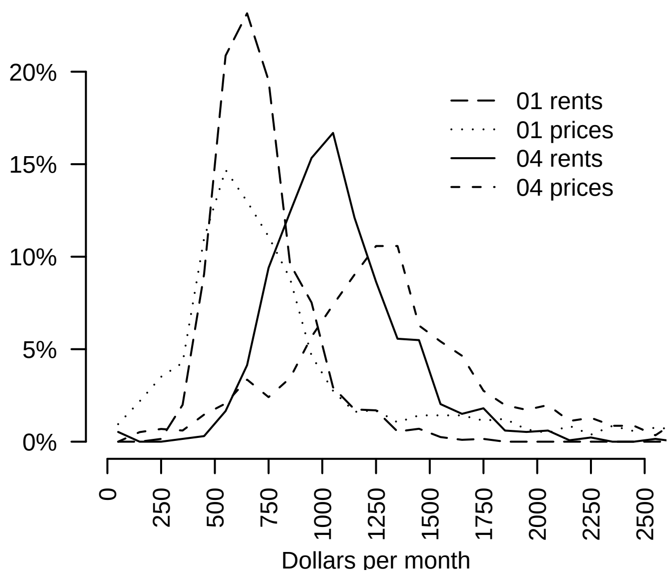

Figure 2: The curves from Figure 1 are shown next to curves corresponding to sales data in Providence. The sales data has been converted to a monthly cost, so it can be shown on the same graph, using estimated averages for down payments, interest rates, and property taxes. The sales data is from the Warren Information Group, provided courtesy of the Providence Plan.

for a cheap apartment as for an expensive one of the same size) wouldn't change the shape of the curve, they'd simply move it over.

There aren't many costs to a landlord that would have a multiplying effect rather than an adding effect. These would have to be costs that were proportional to the value of the property. The big one here is the property tax, but there isn't much else. Property tax increases over the past few years have been quite dramatic in many towns, but (apart from the effects of revaluations, which aren't across the board) they haven't added up to 45%.

Which is all to say that when you get to the bottom of the reasons behind the rise in rents, you learn that landlords raise rents largely because they can.

There will be more to say about demand shortly, but in the meantime, look at Figure 2, which compares the rent data from Figure 1 with sales data from the city of Providence. The sales data curves show the same relationship, lowering and widening between 2001 and 2004, and the same conclusions are possible: the price rise might be partly related to the property tax, but is mostly a reaction to demand.

But now look at the relation between the rental and the sales curves. In 2001, the curves were roughly on top of one another. Which means that the cost of renting an apartment would be roughly comparable to the financing costs of purchasing it (disregarding the down payment). This is only surprising until one remembers that of course this is how landlords earn money. If the rents can't cover the carrying costs of a building, then the only way to earn money from owning the building is to sell it.

Then look at the two 2004 curves to the right. The sales curve has moved much further to the right than the rents curve.[4] For example, you can read from the graph that around 5% of new or recently purchased residential properties have carrying costs of around \$1600, but less than 2% of rentals are that high. This implies that there are a substantial number of properties where rents cannot cover the carrying costs. Another way to say this is that the only people making money in those parts of the real estate market have owned for a long time, or are the ones who rely on the price appreciation of their property: speculators.

The last exercise with graphs involves a look at incomes. In Figure 3 you can see the 2004 rental and sales data superimposed on a graph of Rhode Island's income distribution. The first thing to notice is that 30% of the median family's income (\$1064) is not so terribly far from the median rent (\$1015). But the second thing to notice is how utterly irrelevant that is. The income distribution isn't anywhere near the same shape as the rent or price curves. For example, around 7.5% of families can only afford a monthly rent of around \$250. Those families are not well served by the available options.[5] There also seem to be families at the other end of the spectrum who are not in line with what's available. These are the people in the fortunate situation of being able to afford more than is available. (The figure makes it seem like a sliver, but it extends far to the right of the graph area shown.)

Few families fit comfortably under the rent curve. In fact, only about a third of families fall under the high parts of the rental curve that cover 90% of the available apartments. A little less than a third of families fall below, and the remainder are above. The unserved market,

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[4]In reality, the effect is probably slightly greater than shown. The rent data used in this analysis is the advertised asking price, and the sales data is from records of the actual selling price. Since landlords don't always get the asking price, the curve is probably biased slightly. Furthermore, the sales data is single-family houses and condos. But the price appreciation of multi-family buildings has been greater over the same period.

[5]The Census definition of income does not include "in-kind" public assistance like rent vouchers or food stamps, though it does include welfare payments. 5,083 RI households received Section 8 housing assistance in 2004, about 1.5% of the state's households.

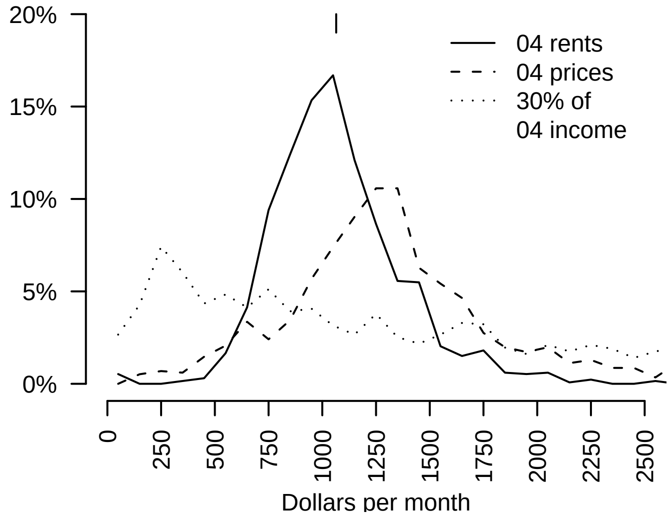

Figure 3: The 2004 curves from Figure 2 are shown next to a curve representing 30% of the monthly incomes of Rhode Island families. The tick mark above the graph shows the median family income. (Income data from the US Census, 2005 Current Population Survey)

then, is huge. But it's huge both higher and lower than existing properties and apartments. For many properties, the addition of some new paint and carpet can allow a landlord to pursue tenants from the unserved market to the right in Figure 3, rather than the unserved families to the left. Unsurprisingly, many landlords make just such a choice, pushing up prices. The mismatch between the income and price distributions is how we can have a housing crisis in the midst of plenty.

The big picture The data also show it has become more difficult than ever to make money renting apartments. Real estate investors, ranging from large investment companies to duplex-owning families, must speculate in property rather than manage it in order to make their money. People who have owned their property a long time don't face this problem, but they do face the temptation of rising prices. Presumably rental units are lost in the process, as property is sold off. Anecdotal evidence suggests this is happening. For example, Jefferson Place, the big development just off I-95 in downtown Providence, has been bought by Joseph Paolino, who is planning to sell off its 330 units as condominiums.

Now that we know this, what policy options might be suggested? For one thing, policies that favor income from rentals over income from property speculation might be a good place to start. The free choices of property owners have gotten us into this mess. Changing the incentives that create those choices may be the only practical way out. The box below shows one example, from Vermont. Tax credits or cuts for residential rental income might be another possibility. Other policy options might include restrictions on taking rental units off the market for sale, or restrictions on rent increases.

It's also possible to look at existing housing policy in light of the above. In a nutshell, the state's housing policy is essentially to contribute $7.5 million in borrowed money each year to construct low-income housing (and to demand that the towns come up with plans of their own, see page 4).[6] Between rentals and sales of property, residential housing in Rhode Island is a $5 billion a year market, almost 700 times as large. If one thinks that market opportunities and demands are driving the price increase, then the only way a policy like this could have any useful effect on prices is by constituting a significant fraction of the new housing produced. But at one part in 700, it's obviously not addressing the larger problem, even while it provides a few homes to a few families.

The real estate market is doing what markets do: efficiently allocating resources among the people who can pay for them. The problem may be an insufficient supply, but the profound mismatch between the price distribution of the goods for sale and the income distribution of the people who want to buy guarantee that the outcome won't serve the majority.

[6]This oversimplifies, but not by much. There are encouraging signs of change, though. The Governor recently hired Noreen Shawcross, the former director of the Coalition for the Homeless to be his housing policy director, and her plans involve developing a much more comprehensive approach.

Land Gains Tax

One example of a policy to discourage speculation can be found in Vermont. Since the 1970's, Vermont has had a tax on capital gains from the sale of property that is progressive in time. That is, the money made from properties held for a very short time are taxed at a very high rate, while properties held for longer are taxed at a lower rate. Properties held more than six years are not taxed at all, and there are other exemptions.

There are around $4.3 billion in residential real estate sales in Rhode Island each year. At current rates of inflation, a large amount of that is capital gains. Were such a tax enacted here, and sales continued to soar, the tax could raise tens of millions. But the point of the tax would be to change patterns of speculation, so a better, and more likely, result is that it would raise little, but reduce speculation. It would still raise some, though—Vermont's tax raised about $4.3 million in 2004, in a land market roughly the same size as ours.

A tax like this could be a sensible source of money for the as-yet-unfunded Open Space and Affordable Housing Trust Fund. This fund was established by the legislature in the early 1990's to make open space and affordable housing grants to cities and towns, but the state has never appropriated money to put in it.

In the early 1980's, the Reagan administration pressured Japanese car companies to limit their imports. In order to maintain their profits when faced with these limits, Toyota started importing more of the expensive-and-profitable Camrys and fewer Corollas, and suddenly there were fewer cheap cars available. But supply problems aren't even a necessary cause. A 1995 paper in the journal *Econometrica* pointed out that in a market where the goods are all very different, with consumers who have idiosyncratic tastes, the prices will rise well beyond the classically predicted equilibrium because each consumer only considers a small fraction of the goods for sale, and because the high profits lure too many firms to the market.[7] Which is to say that both the experience of the 1980's auto market and economic theory (at least according to some theorists) predict that under the current circumstances, the market will only make things worse.

Adding a few units of housing at the low edge of those price curves will only have a tiny effect: good for a few lucky families, but useless for the rest of us. If we want the housing market to serve everyone we must find a way to alter the structure of rewards and penalties that make up the real estate market. ■

Fair Share: Rhode Island's Low and Moderate Income Housing Act

Michael Lozano

It is no secret that, like much of the nation, the state of Rhode Island is in the throes of a housing boom. Perhaps riding the coattails of the red-hot Boston market, or experiencing the real effects of a Providence "Renaissance," housing costs have skyrocketed. If you are a single mom, a blue-collar dad supporting a family, or even a single professional hoping to strike out on your own, you face a struggle to keep a roof over your head. And if you actually want a piece of the "American Dream," to own your home, well, let's just say it's getting a whole lot harder without a winning lottery ticket. Perhaps the most innovative and controversial effort by the state to address the housing issue is the innocuously named Low and Moderate Income Housing Act (LMIH). The law, misunderstood in town halls and neighborhoods across the state, is actually both well intentioned and well written.

The LMIH Act (Chapter 45-53 of the RI General Laws) is a supply-side tool meant to increase production of affordable housing units by coupling their production with for-profit units—it is a trade between the state and developers that allows the developer to bypass local laws like zoning in exchange for affordable units. This type of tool has been used in states like Massachusetts and New Jersey to force more exclusive suburban communities to produce their "fair share" of housing opportunities and take some of the burden off of the urban cores, where most affordable housing has traditionally been located. The Rhode Island law improves the model by making a direct connection to planning legislation to create an equitable distribution of housing units across the state and to give communities the ability and tools to comply with the statute and get affordable housing on their own terms.[8] Unfortunately, most communities in Rhode Island did not act on their mandate until it was too late, creating a quagmire of bickering in the General Assembly and communities scrambling to head off a tremendous increase in development pressures.

The zoning override provided by the LMIH Act was written in language that directly relates it to both the mandated local comprehensive plan and zoning, with common goals set at both the local and state levels, allowing both the plan and the zoning legislation to work in concert, not in conflict. Specifically, the LMIH Act contains language that does not allow for a comprehensive permit or appeal of the local zoning board decision if the housing proposal does not meet needs outlined in the comprehensive plan, is in conflict with the plan, or if the community has met or has plans to meet the standard of ten percent affordable units. Effectively, the state has enabled local governments to retain their mandate to govern their land as they see fit, but provides guidance to ensure the welfare of the region and the state are accounted for in the local plan as it is drafted, not as an afterthought. Unfortunately, local communities long ignored their mandate and failed to plan adequately for affordable housing.

Recent changes In 1998, changes were made to the law that significantly increased the number of communities exempt from development proposals filed under the LMIH Act. The bill modified the state formula used to calculate the amount of affordable housing a community must have from a single figure of ten percent subsidized housing to a more complicated system creating two new categories dictated by the type of housing.[9] Before the

[7] "Oligopolistic Competition and the Optimal Provision of Products," Anderson, et al. v.63, no.6, pp. 1281-1301.

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[8] As written, the Comprehensive Planning and Land Use Regulation Act requires all 39 individual municipalities in the state to draft a "Comp Plan" that addresses nine elements: goals and policies; land use; housing (including affordable housing); economic development; natural and cultural resources; services and facilities; open space and recreation; transportation; and implementation.

[9] For communities where rental properties account for at least 25 percent of housing stock, 15 percent of the rental stock must be deemed affordable. For cities and towns where less than 25 percent of housing is rental stock, 10 percent of the total housing units—both rental and owner-occupied—must be deemed affordable.

change, only five communities—Central Falls, East Providence, Newport, Providence, and Woonsocket—had met the ten percent threshold. The change doubled that figure to include Cranston, North Providence, Pawtucket, Warwick and West Warwick. Even with the relaxed standards, the exempt communities are still largely urban in character. Suburban and rural communities still fail to reach the threshold.

More recently, a subtle revision to the law was quietly passed that, coupled with a booming housing market in Rhode Island, has thrust the debate back into the spotlight. In an effort to boost the construction of affordable housing and stem skyrocketing housing costs, the General Assembly modified 45-53 in 2002 to allow for-profit corporations to take advantage of the statute's "builder's appeal" provision with units for sale (single-family or condominium) as well as rental projects. This aspect of the law was previously reserved solely for non-profit developers. This seemingly tiny change has brought big controversy, with Rhode Island cities and towns crying foul as the LMIH Act opened a loophole for private developers to bypass local zoning control and led to massive new project proposals all over the state.

Under pressure from towns facing a huge influx of development proposals, the legislature has continued to make revisions to the law. In July 2004, a one-year moratorium was placed on for-profit projects trying to use the law, the mandatory percentage of housing included in a project was increased from 20% to 25%, and a completely new provision that states that municipalities with state-approved affordable housing plans may limit annual total number of units in comprehensive permit applications from for-profit developers to an aggregate of 1% of total year-round units in the town.

Naturally, town officials and residents across the state feel pressured by the new developments. They believe that more housing means more children flooding the school system, additional traffic, and additional burden on town services, all with total disregard to their current land-use guidelines. Interestingly, many of the same communities that are most under pressure from the new affordable housing developments are also lax in their mandate to implement the housing component of their Comp Plans. As late as 2003, well over a decade since the requirement was enacted, the Office of Statewide Planning could not name a single community that had even drafted an affordable housing plan.[10] With the increased pressure of the for-profit builder's appeals, the situation has changed. Currently, 26 of the 29 communities not meeting their 10% threshold and required to submit affordable housing plans as part of the housing element to their Comp Plans have met this requirement, with the exceptions being Barrington, Foster, and Richmond.

[10]This was noted in a Providence Journal article, May 4, 2003, "Towns take on R.I. housing law," by Randal Edgar. Note that there are no specified requirements for *how* a community reaches the 10 percent goal, as long as a plan is in place.

A Challenge

One of the first proposals to take advantage of the recently relaxed guidelines of the law was a project in Cumberland to develop 343 condominium units, 85 of which (voluntarily higher than the 69 required under the strict provisions of the law) are to be affordable to moderate income families and individuals, with the remainder selling at market rates, currently ranging upwards of $250,000. "Highland Hills," as the project is to be known, is currently being developed by Kirkbrae Development Corporation of Lincoln, RI, and The Peregrine Group LLC, of East Providence, and will consist of a mix of two- and three-story buildings clustered on a 98 acre site in the northwest corner of town.

Abutters fiercely challenged the project in Superior Court on several points, primarily that the entire LMIH Act was unconstitutional. Under pressure from the affordable housing law, the Cumberland zoning board initially approved the project with several conditions, primarily that the project be scaled back to 160 units. The abutter's main argument was that the local zoning board approval of a mixed-income affordable housing project in this manner was in effect a zoning change, power that is reserved exclusively for the town's legislative body. This was a particularly important argument, as a ruling in the abutter's favor would essentially deem the law unconstitutional, seriously placing the state's prime affordable housing policy in jeopardy. Recently, the Superior Court ruled against this argument, leaving the law intact as written. But the abutters did prevail in blocking the project under a technicality in the original zoning board's ruling (the condition related to reducing the unit count to 160 was deemed arbitrary and not based in relevant fact by the court, a major blunder by an unprepared zoning board). The case continues with the developer considering a further appeal of the ruling. Meanwhile, affordable housing is not being built.[a] -ML

[a]Kaveny et. al. *v.* Cumberland Zoning Board of Review.

Lessons Communities like Cumberland are now crying that they are being unfairly burdened with development pressure, but do they really have an argument? They had ample time to draft a comprehensive plan element to guide development of housing, both market and affordable, and failed to do it. Now, with the threat of hundreds of units of new housing units, completely unregulated from a land-use standpoint with the mere provision of a relatively small amount of affordability built into the project, the town scrambled to put together a plan that should have been in place years ago, a plan that would have prevented, or at least provided an additional level of local control, over projects exactly like this.

In fact, it seems as if the LMIH Act, right when it is coming under fire and may be abolished or substantially modified, is working much as it was intended. Builder's appeals laws were meant to shift the burden of affordable housing to the private sector, from the public sector. This acknowledged the reality of public housing that for decades was often substandard and almost entirely segregated from the surrounding market-rate neighborhood, creating "public ghettos" that were dangerous and contributed to concentrated areas of poverty and urban decline. In theory, the builder's appeal laws are one tool to get the private sector to tackle some of the affordable housing production by enabling increased density and numbers of market-rate units to offset the cost of providing below-market units.

In the late 80's and early 90's, the early years of the Comp Plan statute, communities did not meet their mandate to create a housing element specific to affordable housing for several reasons. First, they simply weren't required to, or at least there was no measurable punishment for communities that failed to draft housing elements. Even though technically required to draft housing plans, most towns had little or no dedicated planning staff, and saw little need to hire outside consultants to draft plans specific to affordable housing when they didn't need to. The second reason is directly related to the housing market. While the introduction of comprehensive planning in Rhode Island coincided with the housing boom of the late 80's, the boom quickly subsided, leading to a period of relaxed development throughout much of the 90's. At the same time, towns started to introduce stricter land use controls to combat sprawl and protect open space and wetlands. While it may have been wise to create effective affordable housing plans concurrent with new land use plans, for whatever reason, towns failed to do so.

As the housing market heated up in the late 90's with limited supply, spillover demand from Massachusetts, and an increase in local net household formation, the pressure for builders to produce more units increased greatly. The explosive response of private developers to take advantage of the newly modified LMIH Act was entirely predictable:Massachusetts had been dealing with an increasing number of comprehensive permit applications for years. Still, towns were slow to react and use the built-in overrides for the statute that they had available, with most communities only recently meeting the statutory requirement to implement affordable housing plans as part of their larger comprehensive plan. Because of the stick provided by the LMIH Act, these towns are now much more actively working toward meeting their share of the affordable housing need. In this respect, the Act must be considered a policy success.[11]

In 2004 and 2005, there was talk within the Assembly for a complete reworking of the affordable housing system in the state, but after particularly heated debate from both sides of the issue, the act has so far been left mostly intact. This is the right tack. While a seemingly overwhelming number of new housing units have been proposed since the modification of the law, this has been more a function of market forces than the opening of a gaping loophole. The Rhode Island law, with its direct link to the Comp Plan legislation, provides clearer and easier means by which towns can control their growth and acceptance of these types of development proposals. Rather than bickering and complaining, a concerted effort by local communities can continue to make significant inroads into the state's affordable housing problem. ■

[11] Interestingly, Providence, which has by far the largest affordable housing problem in the state, is not required to have an affordable housing plan filed with the state because it meets the 10% threshold. As the city continues on its "Renaissance" and housing costs in the city continue to rise at breakneck speed, an affordable housing plan most definitely needs to be enacted, state-level mandate or not.

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