

July 19, 2023

Rethinking Middle-Income Housing Subsidies

In a Nutshell

- Policymakers are contemplating changes to allow the Housing and Community Development Fund, a program traditionally targeting low-income households, to finance projects for middle-income households.
- A large majority of Michigan’s extremely low-income renters are severely cost-burdened.
- State housing policy should be focused on the housing needs of the lowest-income households rather than expanding the scope of existing housing programs.

Michigan has invested historic funding amounts to increase the supply of affordable housing. Building off the work of the last several months, the Legislature is considering changes to allow the Housing and Community Development Fund to finance projects for middle-income households. While middle-income households may find homeownership out of reach in some parts of the state, state resources should be allocated where they are needed most. Currently, the shortage of affordable rental units for extremely low-income households is estimated at 190,000 units and state policy attention should be focused on the housing needs of those at the bottom-end of the income ladder.

Actions to Increase Middle Income Housing Production

The Legislature has taken action to increase the supply of housing for middle-income households, defined as households earning up to 120 percent of the area median income (AMI), including authorizing tax abatement tools for local governments and providing funding for housing production grants to reduce the construction costs of middle-income housing.

In addition, changes have been proposed to allow the Michigan State Housing Development Authority (MSH-DA) to use the Housing and Community Development Fund (HCDF) to make financing available for the needs of households making up to 120 percent AMI. Under existing law, the HCDF makes financing available to meet the housing needs of low-income, very low-income, and extremely low-income households and to finance projects in downtown areas or adjacent neighborhoods. The contemplated changes are intended to provide MSH-DA with more flexibility to use recently dedicated business tax revenues and other HCDF monies to address a wider range of housing scarcity.

For Sale Housing Affordability is Slowly Improving

The National Association of Home Builders tracks housing affordability using the Housing Opportunity Index (HOI). The HOI for a geographic area (Metropolitan Statistical Area) is the share of homes sold in that area that would have been affordable to a family earning the family median income, based on standard mortgage underwriting criteria.

Generally speaking, housing in Michigan MSAs is more affordable than in many other states, although housing affordability in the Mitten State has declined in recent years. For example, the Lansing-East Lansing MSA was ranked fourth most affordable in the nation, as 87.5 percent of all homes sold in the first quarter of 2023 were considered affordable to middle-income families. Affordability in the Ann Arbor and Grand Rapids-Kentwood

MSAs has slightly improved since reaching a low in 2022. In Ann Arbor, 62 percent of all homes sold in the first quarter of 2023 were deemed affordable, up from 53.8 percent during the fourth quarter of 2022, but down compared to the first quarter of 2022, when 76.6 percent of homes were affordable. In Grand Rapids-Kentwood, 69.2 percent of all homes sold in the first quarter of 2023 were affordable, up from 56.7 percent during the fourth quarter of 2022, but down from 83 percent in the first quarter of 2022.

While housing affordability may be improving, there remains considerable unmet needs for the lowest income groups. Housing shortages for these groups should be the primary concern for state policymakers going forward rather than prioritizing middle-income housing needs.

Shortage of Affordable Housing for Lowest Income Households is a Bigger Concern

Housing is generally affordable and available for middle-income groups in Michigan. A recent analysis by the National Association of Realtors and Realtor.com suggests that metro areas in the Midwest have relatively balanced middle-income housing markets (meaning the supply of housing units on the market deemed affordable to middle-income groups is roughly equal to the proportion of middle-income households in an area) or even a surplus of affordable middle-income housing compared to states like California, Texas, and Florida. In the Detroit metro area, the for-sale middle-income housing market is only slightly off balance.

Although the Detroit market has a small shortage of affordable middle-income listings, housing affordability for extremely low-income renters is a much bigger issue. Michigan has over 300,000 renter households with extremely low incomes, defined as household income at or below 30 percent of the area's median income. Over 70 percent of those renters are severely cost burdened, paying more than 50 percent of their income on housing costs. Severely cost burdened households are more likely than other renters to sacrifice food, healthcare, and other necessities to pay for rent and are more likely to experience evictions. The National Low Income Housing Coalition has estimated that the affordable, available housing gap for extremely low-income renters in Michigan is about 190,000 units.

Michigan policymakers point to federal programs that target low-income households as a justification for allocating resources away from low-income households and towards middle-income households. However, existing federal housing production programs are not producing enough affordable housing units and housing subsidies are chronically underfunded, only serving approximately one in five eligible households. Federal programs are not meeting the needs of low-income households and state assistance remains a priority.

Some also argue that building more middle-income housing will free-up units that are affordable to low-income families (called filtering). Indeed, filtering has been the primary producer of affordable housing for low-income households, but filtering as a strategy to achieve housing affordability has its limits. It takes decades for a unit to filter down to low-income households and the location of housing may unintentionally reduce economic opportunity, lengthen commutes, and concentrate poverty. Further, many families may still experience a cost burden in these units because the average operating cost of a rental unit is higher than many low-income families can afford to pay in rent.

Local Government Resources vs. State Resources

Local governments were recently provided several tools to subsidize the development of middle-income housing in their communities, including offering tax abatements and allowing payment in lieu of tax (PILT) agreements for residential development or rehabilitation.

Local governments have a clear interest in attracting middle-income households. For one, middle-income households often perform jobs that are essential to a community, like teachers, police officers, firefighters, and public service workers. Additionally, middle-income households spur economic growth because they have more disposable income than lower-income households and spend a higher share of their income than wealthy households do. Lastly, because property taxes are typically the largest revenue source for local governments and property tax revenue growth is largely driven by new development, local governments have an incentive to attract new development that will maximize property tax collections without raising tax rates.

Thus, it makes sense for state officials to equip local governments with the flexibility to use their own resources to incentivize the development of middle-income housing. Local governments have immense power to control the course of development in their boundaries through zoning and land use. Often, housing prices reflect the policy choices of local governments to restrict “undesirable” housing production through regulatory barriers, such as minimum lot sizes, restrictions on multifamily housing, and onerous public hearings.

Sometimes, zoning restrictions and reviews are enacted with good intentions. For example, a requirement that new developments have solar panels or use certain building materials may help the local government achieve climate goals; a limit on building height might ensure residents have access to sufficient sunlight; and a requirement that developers contribute money towards parks or other services as a condition of permit approval may reflect the priorities of the community. These restrictions and required approvals, however, are folded into housing costs. The National Association of Homebuilders estimates that regulation can make up more than 30 percent of the cost of a multifamily development.

Historic and current exclusionary zoning practices contribute to the state’s affordable housing shortage and partly explain the sprawling development patterns in metro Detroit and other urban areas. A study by the EvictionLab at Princeton University concluded that zoning rules in metro Detroit are the eighth most restrictive in the nation. Similarly, the Urban Institute found that some municipalities surrounding Grand Rapids and Detroit have land-use regulations that limit more than 75 percent of residential land to only single-family homes, with three-or-more-unit buildings allowed on less than 25 percent of land. The zoning decisions of one local government in a metro region may seem inconsequential, but the cumulative effect of restrictive zoning decisions by all local governments is not. Housing becomes more expensive for everyone, and new development moves further away from the city center.

Allocating state resources to subsidize middle-income housing when local policy choices make it more difficult to build that type of housing is a poor use of state resources and serves to reward parochial local government decisions.

A Policy Alternative to State Subsidies for Middle-Income Housing

Before state officials allocate limited resources towards middle-income housing needs, more can be done at the local level. Local government reform to zoning and land use policies are critical to fostering more missing-middle housing. But, zoning and land use reform will only go so far to bring down prices in the most desirable neighborhoods. Researchers at the Federal Reserve Board studied the effect of adding housing supply and improving amenities on rents in high-priced neighborhoods. They found that marginal reductions in supply constraints alone are unlikely to meaningfully reduce rent burdens in high-cost neighborhoods because rents appear to be more closely determined by neighborhood amenities rather than housing supply. Instead, the authors argue that the more cost-effective way to reduce rents in high-cost neighborhoods is to improve amenities in low-priced neighborhoods so more households will substitute the high-priced neighborhoods for low-priced neighborhoods.

Improving existing low-cost neighborhoods (and municipalities) is an affordable housing strategy that could work in Michigan. Housing prices in metro areas vary widely across municipalities. Reforming the state’s economic development strategy to direct funding to truly distressed communities can help ease housing demand in high-cost areas while also having the added benefit of improving the economic conditions of low-cost neighborhoods. Still, even with targeted economic development, many middle-income households won’t pivot to low-cost neighborhoods because the basket of services offered in low-cost areas is often unappealing to them. This is one challenge of the finance system that Michigan has adopted for local governments, which limits the amount and type of taxes that can be generated. The state will need to contend with these limitations if it wishes to redirect housing demand to low-cost municipalities.

Conclusion

Achieving long-term housing affordability for all households will require a change in the way we live. Owning a single-family home with a yard in the suburbs has been the American dream for decades, in part because the

government made single-family homeownership attractive through subsidies, exclusionary zoning, and transportation policy. As we know now, the expected outcome of those policies is an affordable housing shortage and sprawling development pattern.

While middle-income households may find homeownership out of reach in some parts of the state, state resources should be allocated where they are needed most. As research shows, extremely low-income households have an estimated shortage of around 190,000 units and state policy attention should be focused on the housing needs of the lowest-income households.

ABOUT THE AUTHOR

Chelsea Dowler - Research Associate, Local Government Affairs



Chelsea Dowler joined the Research Council in 2023 as a Research Associate focusing on local affairs. Previously, Chelsea was a nonpartisan Research Analyst at the Michigan Legislative Service Bureau where she specialized in the policy areas of alcohol, cannabis, housing, public utilities, and transportation. Chelsea received her bachelor's degree in economics and master's of public policy from Michigan State University.

Founded in 1916, the Citizens Research Council of Michigan works to improve government in Michigan. The organization provides factual, unbiased, independent information concerning significant issues of state and local government organization, policy, and finance. By delivery of this information to policymakers and citizens, the Citizens Research Council aims to ensure sound and rational public policy formation in Michigan. For more information, visit www.crcmich.org.

Southeast Michigan

38777 Six Mile Rd. Suite 208, Livonia, MI 48152
(734) 542-8001

Mid Michigan

115 W Allegan St. Suite 480, Lansing, MI 48933
(517) 485-9444

Detroit (313) 572-1840

West Michigan (616) 294-8359

A Fact Tank Cannot Run on Fumes

Do you want to ensure better policy decisions and better government in Michigan? A donation to support our organization will help us to continue providing the trusted, unbiased, high-quality public policy research Michigan needs. We also accept charitable bequests. Click the gas tank to donate or learn more about planned giving.

