

Affordable Housing in Florida

Housing costs may be poised to erupt as a contentious economic, social, and political issue in Florida. On the surface, the culprit is the statewide explosion in housing prices over the last five years or so. On a more basic level, the issue may pit "them that have" against "them that don't have but want" housing. Well intended, but misguided, policies to address this issue could, over time, have serious unintended consequences (as we have discussed before) for the state's economic health.

The data give an indication of the emerging problem. In the five years ending in June, 2006, housing prices in Florida more than doubled, rising almost 113 percent to a median value of roughly \$225,000. (Data on housing price increases from the Office of Federal Housing Enterprise Oversight.) During this period, Florida's economy – the country's most robust – experienced record economic growth. Population soared by some 1.8 million residents; more than one million new jobs were created; personal income advanced by more than 30 percent; and income per person jumped roughly 18 percent.

As a frame of reference, during this same period, housing prices nationwide accelerated only half as much as in Florida, or by about 56 percent. Just four other states (Hawaii, Maryland, California, and Nevada), plus the District of Columbia, witnessed triple-digit gains in housing prices. Indeed, of the twenty metropolitan areas nationwide experiencing the largest increases in housing prices in the past five years, eleven were in Florida.

Moreover, Florida's 113 percent increase in housing prices masks disparities around the state. Metropolitan areas, including Miami-Dade, Naples, Cape Coral, Fort Lauderdale, Port Saint Lucie, Sarasota, and West Palm Beach, have seen housing prices soar more than 135 percent. At the other end of the spectrum, housing prices in Tallahassee and Pensacola have moved up by 'merely' 75 percent. The National Association of Realtors reports that in June, 2006, the median sales price of a home ranged from a high of \$376,000 in the Miami–Ft. Lauderdale area to a low of \$170,000 in Ocala. Builders appear to have done their part in recent years to limit the jump in housing prices by building more houses and lots of them. They have constructed about 1.1 million new housing units and, in the process, have increased the number of housing units some 15 percent to a statewide total of approximately 8.3 million units.

Nonetheless, questions about the affordability of housing in Florida are becoming more pointed. For example, data from the Shimberg Center at the University of Florida suggest that in 2005 as many as 1.1 million households in Florida – some 17 percent of the total – confronted a serious problem with affordable housing. The Homebuyer Affordability Index constructed by the National Association of Realtors shows that, nationwide, housing affordability has plunged about 20 percent since 2003 alone. Renters are affected as well. Research by John Turcotte of Florida TaxWatch indicates that in 2004, 50.5% of Florida renter's spent at least 30 percent of household income on rent and utilities. This was the highest percent in the U.S., exceeding even California and New York. The accompanying map reveals the statewide scope and geographic distribution of the problem.

Productively addressing the issue of affordable housing, in this economist's humble view, should start from an understanding of the fundamental causes of the problem. There seem to be three basic but interrelated factors in this regard: (1) interest rates, (2) household income and wealth, and (3) housing prices.

Interest rates play a critical role in housing affordability as very few home buyers pay cash for a home, but instead finance the purchase over a period of years with a mortgage. Lower interest rates, other things equal, make housing more affordable and higher interest rates have the opposite effect. While Florida has been at the forefront of making lower cost interest programs available for first-time homebuyers, and innovations in housing finance have expanded the availability of mortgages to home buyers, at the end of the day, all interest rates – including mortgage rates – are set in the national, if not global, credit markets.

Many private and public sector forces affect the structure of and changes in interest rates and, thus, the affordability of housing. Among the most important are the national saving rate, the expected return on capital investments, and the expected inflation rate. National economic policies, both fiscal and monetary, play significant roles in either stimulating or retarding saving; in either boosting or diminishing expected returns on investments; and in maintaining a low and stable inflation rate. Florida must be a voice for sound national economic policies in order to address the issue of affordable housing.

Although state-level economic policies cannot alter the structure and course of interest rates, they nonetheless can substantially influence the allocation of national saving by making the state either a relatively more or less attractive location for investments, for businesses, and as a place to live. Florida's robust economic performance in recent years demonstrates the soundness of its economic policies. Undoubtedly, without sound economic policies, Florida's affordable housing challenges would be even more severe.

Household income and wealth are the second factor in determining the affordability of housing. Obviously, rising incomes and wealth for households make housing, other things equal, more affordable. The strong gains Floridians have enjoyed in jobs and incomes during recent years have lessened, but certainly not eliminated, the challenges in providing more affordable housing. Once again, a whole host of national and state policies that expand economic opportunities will contribute to rising incomes and wealth, and make housing more affordable.

In this respect, it is the expected household income over a long period of time, what economists call "permanent income" or wealth, that is especially important for housing affordability as housing is rarely financed from just one year's income. Measures of housing affordability that emphasize current incomes of prospective buyers, rather than their permanent incomes, may therefore be distorted. As the composition of Florida's population slowly evolves from a high concentration of retirees, who have already accumulated wealth, to a larger proportion of younger households, who are in the earlier stages of wealth accumulation, this potential distortion may make Florida's affordable housing challenges appear considerably more serious than they really are.

Housing prices themselves are the third key factor in the affordable housing mix. Certainly, a spiraling demand for housing has been a major contributing factor to the rapid escalation in Florida's housing prices. Perhaps of even greater importance, however, has been the often neglected supply side of the equation. Research by Harvard Professors Edward L. Glaeser and Raven E. Saks, and Professor Joseph Gyourko of the University of Pennsylvania, is illuminating in this regard. (Edward L. Glaeser, Joseph Gyourko, and Raven E. Saks. "Why Have Housing Prices Gone Up?" Harvard Institute of Economic Research, February, 2005.) They examined the supply of housing in 316 metropolitan areas from three perspectives: the costs of the physical structure, the cost of land, and the costs of obtaining regulatory approval for

building new homes. Their findings indicate that inflation-adjusted costs for new home construction, such as labor and materials, have actually been falling since about 1990. Construction costs do not seem to be the primary cause of soaring housing prices and the attendant affordable housing problems. Professors Glaeser, Gyourko, and Saks also find that rising land values cannot account for but a relatively small fraction of higher housing costs. Finally, their research indicates that the nationwide increase in housing prices largely reflects the increasing difficulty of obtaining regulatory approval for building new homes. Regulatory constraints may be the key reason why housing has become expensive relative to its fundamental costs of construction!

While the research of Professors Glaeser, Gyourko, and Saks is national in scope and their data do not extend to very recent years, particularly to the post-2004 hurricane related acceleration in construction and labor costs in Florida, it nonetheless strikes me as having potentially important applications to affordable housing. It is entirely understandable that households – especially urban and suburban ones – after having made substantial investments in their homes, want more and more vacant land in their areas used for parks, schools, playgrounds, nature preserves, open vistas, environmental enhancements, shopping centers, transportation corridors, and other amenities. It is entirely understandable that elected and appointed state and local government officials would be increasingly sensitive and responsive to organized efforts of local residents to discourage new residential projects and have land used instead for various amenities. Stories abound, not only in Florida of course, of such efforts on the parts of residents and government officials.

Few people would argue against the merits of somehow making housing more affordable. Market-based mechanisms appear to be working to lower construction costs. But, I wonder, how many of us want the solution to be in our own backyards? How many of us would be willing to sacrifice our amenities and potentially suffer more congestion so more housing could be built?

The good news is that the home ownership rate in Florida is about 73 percent and stands well above the national rate of about 69 percent. Even with the sharp escalation of housing prices in Florida in recent years, housing has been within the grasp of more Floridians due to low interest rates and our healthy state economy. Also, there is the hint that we Floridians may be more willing to sacrifice some amenities than citizens of other states. The bad news is that many Floridians who want a home may increasingly be shut out, not by rising property values and construction costs, but because we don't want them in our backyards.

Coming Next Month: The 2007 Economic Outlook for Florida

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