Community and Economic Development in North Carolina and Beyond Blog: Report: The Unintended Consequences of Housing Finance

By CED Program Interns & Students

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The Unintended Consequences of Housing Finance is a recent report by the Regional Plan Association that addresses the negative externalities of certain federal housing finance rules, and myriad methods to address these externalities through rule changes and amendments. Perhaps it is not immediately apparent how financing rules can have dramatic impacts on the physical form of our cities, but this report demonstrates the way in which these rules encourage certain types of development (single-family housing and large multifamily projects) and discourage others (mid-rise, mixed-use multifamily projects).

What Programs?

The report focuses on HUD Section 220 and 221(d)(4), as well as Fannie and Freddie Mac's securitized loan efforts. The sum of these program is a bit too exhaustive for this post, but in general, Section 220/221 provide loan guarantees for targeted residential projects and Fannie and Freddie were established to provide liquidity for the residential lending market. These are incredibly influential programs and initiatives that have shaped American residential markets. Moreover, the guidelines within these programs are often adopted by private lenders, further expanding their impact.

The report does not argue against these programs, rather it calls for certain rules within the programs to be amended, so that they better support the type of the development that many Americans prefer. The primary critiques of these program are as follows:

- They prioritize single-family housing over multifamily development: "Since 1934, FHA and HUD have insured mortgages for 34 million homes, of which only 7.4 million were in multifamily buildings."
- They include outdated restrictions on the amount of non-residential space allowed to be included in mixed-use residential projects, making it difficult to finance midrise, mixed use projects.

Impact on Physical Form

According to the American Planning Association, less Americans want to live in auto-oriented suburbs and an increasing number would like to living in more walkable, mixed-use communities. This is a common refrain these days in any discussion of real estate and urban development. However, according to this report, developers are not able to keep pace with this demand due to the specific challenges of financing the construction and/or renovation of mixed-use residential projects—some of these challenges are directly related to the aforementioned government programs.

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To participate in these programs, residential mixed-use developers must maintain the commercial areas of their buildings below certain Gross Floor Area or Income restrictions, seen in the table. These restrictions can discourage mixed-use buildings or put upward pressure on the size of the buildings in order to maintain the correct ratio. In short, it creates a financing disincentive to construct or renovate three to four story, mixed-use buildings at a time when increasing numbers of Americans desire to live in these communities. It also runs the risk of encouraging buildings that are too large for their neighborhoods.

Even more serious, some of our most disadvantaged communities are characterized by midrise, mixed-use development. According to the report, these rules can make it more difficult to receive financing to renovate or redevelop these buildings, contributing to the lack of investment in these communities and calling into question whether the federal financing rules are truly aligned with the policy goals of the parent agency.

Secondary Market

An additional way that mixed-use projects face financing hurdles is through their lack of access to the secondary market. The mortgage secondary market occurs when mortgage originators sell their loans to third parties, namely Freddie Mac and Fannie Mae. Fannie and Freddie were created by the government to buy these loans, pool them together and sell them as bonds in an effort to create greater liquidity in the domestic residential lending market; put simply, they provide banks the ability to sell their mortgage loans providing capital to make more mortgage loans. Unfortunately, there is not a notable secondary market for mixed-use loans, according to the report, which means banks are less likely to originate these loans without a clear market to sell them.

Couple this with the aforementioned rules and it begins to be clear why developers may find it easier to get financing for single-family homes or single purpose buildings, thereby increasing the development of those projects vis-à-vis mixed-use projects.

Solutions

The report offers many solutions to address these problems, including raising non-residential caps on loans for mixed-use projects, as well as aiding in the creation of a secondary market for mixed-use loans. In general, it calls for greater flexibility in the programs, particularly when dealing in underserved communities that may be in greater need of reinvestment. While the tradeoffs of rule changes may be debated, the report serves as a good reminder of the innumerable influences behind local development patterns and the necessity for government agencies to examine both the positive and negative externalities of their programs and initiatives.

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