Chapter Two

Trends in Affordability of Rental Housing

Considerable attention in recent years has focused on the affordability of rental housing for tenants. The concept of affordability means different things to different people. Most analysts agree that renters today, especially those with low incomes, spend much bigger shares of their financial resources on housing than renters did in the 1970s. But not everyone views that finding necessarily as evidence of declining affordability. For many households, the phenomenon may reflect a choice that a household has made to live in a better-quality (and thus costlier) unit. As such, it may not be a cause for concern. But for some households, especially those with low incomes, it may indicate a lack of choice: a household may be able to find only units that cost more than it would like to spend.

Among those who hold the lack-of-choice view, opinions differ about why renters with low incomes are paying relatively more now for housing than they did in the past. Some analysts attribute it primarily to a decline in the number of relatively inexpensive rental units, whereas others argue that it is mainly a function of low incomes--many renters have become too poor to afford the available units. The policy response in either case could be to give tenants vouchers to rent existing housing so that they can afford to pay the rents charged in today's housing market. Supporters of the argument that there are not enough inexpensive rental units commonly urge another response as well: they call on the federal government to subsidize construction of low-rent housing to boost the supply of dwellings that are affordable to lower-income renters.[1]

1. See, for example, William C. Apgar Jr., "Which Housing Policy Is Best?" *Housing Policy Debate*, vol. 1, no. 1 (1990); and National Housing Task Force, *A Decent Place to Live* (Washington, D.C.: National Housing Task Force, 1988).

This chapter shows how the relative cost of rental housing has changed since 1975 and explores some of the underlying factors that contributed to that change. The analysis focuses on the cost of rental housing to the poorest 25 percent of all renters, hereafter referred to as "relatively poor" renters.

Measuring Affordability

This study defined affordability based on the ratio of housing costs to income. Any conclusion about whether households have an affordability problem depends on the particular standard used to measure it and is therefore somewhat arbitrary; a stricter standard, for example, results in a higher incidence of the problem. For this study, housing costs were considered affordable to renters with low incomes if they did not exceed 30 percent of income. That standard is widely used in the housing literature and is similar to the one that federal rental assistance programs use. Specifically, current law in most instances requires that subsidized households contribute 30 percent of their income--after certain adjustments--toward rent. (Before 1981, the standard was 25 percent.) Households that are eligible for assistance based on their low levels of income and that spend more than 50 percent of their income for rent are considered to have "worst-case needs." Those households have top priority for federal aid.

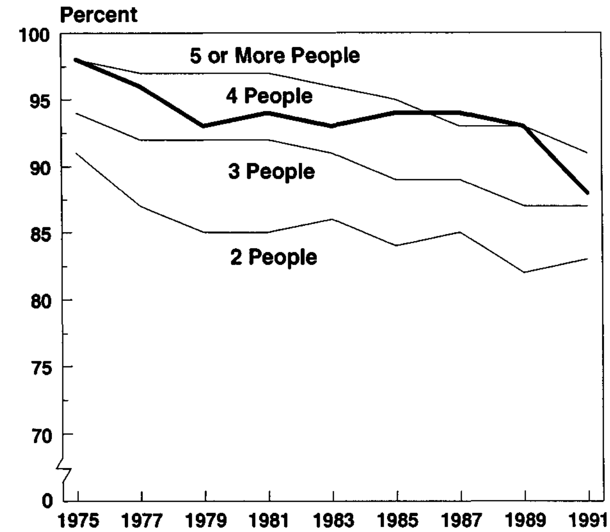
The Congressional Budget Office used gross rent as the measure of housing costs for unsubsidized tenants. Gross rent consists of the rent paid to the landlord (the so-called contract rent) plus any utility costs and property insurance paid by the tenant. For subsidized tenants, housing costs were defined as their out-of-pocket expenditures rather than the amount received by the landlord. To measure the financial resources available to tenants, CBO used the concept of household income. The measure used in this chapter includes the income of everyone 15 years of age and older who lives in the housing unit, whether or not they are related to the primary family living there.[2]

Traditionally, researchers have used only the income of family members to gauge the affordability of housing, perhaps because those data are readily available in published sources. But a yardstick that excludes the income of people who live in the unit but who are not related to the householder understates the capacity of the household to pay rent. That underestimate leads in turn to an overstatement not only of the severity of any affordability problem at a given point in time but also of the increase in severity over time.

In particular, since 1975, the income of unrelated individuals has become increasingly important as a share of the total resources available to renter households, particularly smaller ones. For example, in 1991, the median *family* income for two-person renter households--that is, the level of income just exceeding that of half of all two-person renter households--was only 83 percent of that group's median *household* income, compared with 91 percent in 1975 (see Figure 6). For larger households, the difference between those two definitions of income is somewhat smaller, but it has also increased over time. These trends are probably attributable to a growing number of households with nontraditional living arrangements, such as unmarried couples or two or more roommates sharing rent.

Some caution is warranted when assessing affordability with the ratio of housing costs to income. First, the total amount of financial resources

Figure 6.
Renters' Median Family Income as a Percentage of Their Median Household Income, by Size of Household, 1975-1991



SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey. Data are for odd years only.

NOTES: Household income includes the income of all household members, whether or not they are related to the householder (a person named on the lease). One-person households are not shown because family income equals household income by definition.

The data exclude renters who paid no cash rent.

available to households with low incomes is difficult to measure accurately. Analysts know that the measures of income available in the Census Bureau surveys that CBO used underestimate the actual total income available to households, but the extent of that underestimate is hard to quantify. Those measures include only the cash income of individuals and exclude financial resources provided in kind by the government, such as food stamps and Medicaid. In addition, some evidence suggests that many people understate the level of their cash income in responding to Census Bureau surveys.[3] The total resources available to people with low incomes are therefore greater than the analysis below shows, making any affordability problem at a given point in time seem

2. The Bureau of the Census conducts two surveys that provide information on household income: the Current Population Survey (CPS) and the American (formerly, Annual) Housing Survey (AHS). The CPS has excluded the income of 14-year-olds since 1979; the AHS includes it. CBO used the AHS for its in-depth analysis of housing conditions in 1989 (see Chapter 3). However, it used the CPS for measuring trends in income because the CPS estimates are considered more complete and more consistent over time than those of the AHS.

3. See, for example, Bureau of the Census, *Money Income of Households, Families, and Persons in the United States: 1992*, pp. C-12 to C-13.

worse than it really is. However, if the discrepancy between actual income and measured income is more or less consistent over time, that particular data problem is less troublesome for analyzing trends in affordability.

The second cautionary note concerns whether it is appropriate to use the same yardstick--30 percent--to measure affordability for all households. Arguably, that method could overstate or understate the extent of any affordability problem for certain households because it does not account for differences in their characteristics. For example:

- It does not account for the size of the household. A large household with the same income as a smaller one has less money per person remaining for other needs (such as food and clothing) after paying 30 percent of its income for rent.[4]

- It does not adjust for the level of the household's income. For example, paying 30 percent of income for rent leaves a poorer household with fewer resources than a household with somewhat higher income would have to cover other basic needs that presumably require a certain minimum level of expenditures.

- It does not account for variations in the taxes paid by different types of households with different types of income.

- It does not adjust for the level of a household's assets such as savings accounts--only the returns on assets (for example, interest or dividends) are included in figuring income. Of two households paying the same rent, the household with the lower income but some assets would appear to have less affordable housing costs than the household without assets but with a somewhat higher income. In actuality, the household with the assets may have less difficulty paying its rent.

4. In figuring a household's income on which to apply the 30 percent, housing assistance programs make an adjustment for the number of minor children by reducing annual income by $480 per child. That adjustment decreases a household's rent by $12 per month per child and effectively reduces the percentage of gross income contributed toward rent to less than 30 percent.

Making adjustments in the measure of affordability to account for these problems is difficult and was not attempted here.[5]

Third, although the growth over time in the ratio of housing costs to income (as documented below) suggests a decline in affordability, especially for people with low incomes, it does not shed any light on the part played by people renting better housing. Therefore, the subsequent analysis attempts to quantify the extent to which declining affordability is a product of improvements in the quality of the typical rental unit.

Declining Affordability

Since 1975, rental housing has become more expensive relative to income for tenants in all income groups but particularly for those with the lowest incomes. Two indicators point up this trend:

- the increasing share of income that households at various points in the income distribution would have to spend to afford units at the corresponding points in the rent distribution; and

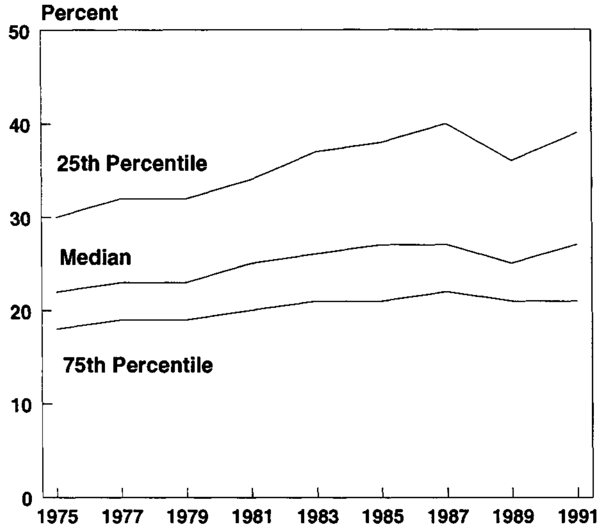
- the growing gap between the number of renters in the lowest quarter of the income distribution and the number of housing units with rents that they can potentially afford.

The Growth of Rents Relative to Income

For renters throughout the income distribution, the cost of housing relative to income increased fairly steadily between 1975 and 1987. By 1989, it had

5. For one approach that tries to address some of these problems, see Michael E. Stone, *One-Third of a Nation: A New Look at Housing Affordability in America* (Washington, D.C.: Economic Policy Institute, 1990).

Figure 7.
Rent as a Percentage of Household Income of Renters, by Income Level, 1975-1991



SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey and American (formerly, Annual) Housing Survey. Data are for odd years only.

NOTES: Each line indicates the percentage of income that renters at a given percentile of their income distribution would have had to spend for a unit with rent at the corresponding percentile of the rent distribution. Household income includes the income of all household members, whether or not they are related to the householder (a person named on the lease).

The data exclude renters who paid no cash rent.

dropped a little, but by 1991 it had risen again.[6] For instance, the share of household income that a renter with the median income would have to spend for a unit with the median rent increased from 22 percent in 1975 to 27 percent in 1991 (see Figure 7). The increases were greater for households with income at the 25th percentile of the income distribution. In 1975, such households already would have had to pay a larger share of their income--30 percent--for a unit with rent at the equivalent percentile of the rent distribution; by 1991, that share had increased to 39 percent. Even for the household whose income was at the 75th percentile of all renters' incomes, the share paid for a unit with rent at the 75th percentile increased from 18 percent to 21 percent.

For the poorest renters in particular, the increase in the cost of housing relative to their income has manifested itself as a shortfall in potentially affordable units.[7] (Those units are defined here as units that rent for 30 percent or less of the income of renters at the 25th percentile of their income distribution.) In 1975, the 5.9 million renters in the lowest quarter of the income distribution coincidentally just equaled the number of units that rented for 30 percent or less of the income at the 25th percentile (see Figure 8). By 1987, the number of relatively poor renters had grown to 7.6 million, but the number of units potentially affordable to them that year had fallen to 4 million. In other words, a shortfall of 3.6 million units had developed. Between 1987 and 1989, the gap narrowed somewhat, but by 1991 it had widened to 3.4 million units.

The Situation Facing Relatively Poor Renters

On the one hand, the figures given above may overstate the actual problem facing relatively poor renters because their incomes are underestimated (as described earlier). Correcting that shortcoming in the data would bring down the ratios of rent to income (displayed in Figure 7) and shift up the number of units potentially affordable to relatively poor renters (shown in Figure 8). On the other hand, there are two reasons that those indicators understate the actual share of income paid for housing by many of the renters in the bottom quarter of the income distribution. First, many of the cheapest units are not available to them (see the discussion below). Second,

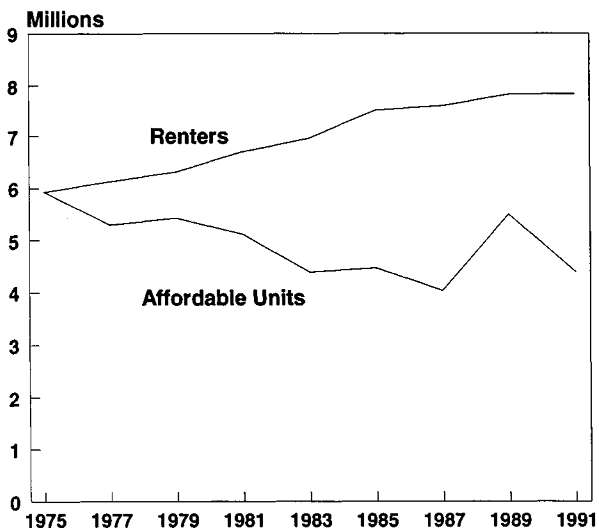
6. Part of the apparent improvement since 1987, however, is the result of an improved methodology adopted by the Census Bureau to correct for households that overestimate their utility costs.

7. These results are supported by a recent study that focused on the increasing shortfall of units affordable to renters with incomes below 30 percent of the median income in their locality. See Kathryn P. Nelson, "Whose Shortage of Affordable Housing?" *Housing Policy Debate*, vol. 5, no. 4 (forthcoming). For other discussions of the increasing shortage of affordable housing, see, for example, Edward B. Lazere and others, *A Place to Call Home: The Low Income Housing Crisis Continues* (Washington, D.C.: Center on Budget and Policy Priorities and Low Income Housing Information Service, December 1991). See also the annual reports produced by the Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing* (Cambridge, Mass.: Joint Center for Housing Studies of Harvard University).

many of the cheap units that they do occupy rent for more than 30 percent of the income of the poorest among them. For those two reasons, the rent-to-income ratios for some relatively poor renters are likely to be substantially larger than those shown in Figure 7, and the numbers of units affordable to those renters are likely to be smaller than those shown in Figure 8.

Many of the lowest-cost units are not available to households with the lowest incomes because households with higher incomes occupy them. In 1991, for example, relatively poor households occupied only 69 percent of the units renting for no more than $250. (That figure was the level of rent equal to 30 percent of the income of a household at the 25th percentile of the income distribution that year; see Table 2.) The remaining 31 percent of the cheapest units were occupied by households with higher incomes.

Figure 8.
Shortfall of Units Affordable to Renters in the Bottom Quarter of Their Income Distribution, 1975-1991



SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey and American (formerly, Annual) Housing Survey. Data are for odd years only.

NOTES: Units are defined as affordable if they rent for 30 percent or less of the income of renters at the 25th percentile of their income distribution.

The data exclude renters who paid no cash rent and renters living in single-family homes on 10 acres or more.

Table 2.
Units Occupied by Relatively Poor Renters and Units Potentially Affordable to Them, by Household Income of the Actual Occupant and Location, 1991

Characteristic	Units Occupied by Relatively Poor Households	Units Potentially Affordable to Relatively Poor Households
	In Thousands	
All Units	8,039	4,400
	As a Percentage of All Units	
Household Income of Actual Occupant		
Not more than 25th percentile	100	69
26th-50th percentile	0	19
51st-75th percentile	0	9
More than 75th percentile	0	4
Geographic Location		
In metropolitan areas		
Central cities	53	49
Suburbs	27	20
Subtotal	80	70
Outside metropolitan areas	20	30
Region of the Country		
Northeast	22	20
Midwest	26	28
South	33	38
West	20	13

SOURCE: Congressional Budget Office based on the Census Bureau's 1991 American Housing Survey.

NOTES: The data exclude renters who paid no cash rent.

Relatively poor renters are households with annual household incomes of $10,000 or less, the income at the 25th percentile of the income distribution of renters. Potentially affordable units are units renting for 30 percent or less of $10,000, which is equivalent to $250 per month.

The total number of units occupied by relatively poor renters shown in the table is somewhat greater than the number of renters shown in Figure 8 because a substantial number of households reported that their income just equaled $10,000 in 1991. In addition, population counts from the 1990 census are used as a benchmark for all table numbers. Consequently, those numbers differ somewhat from their counterparts in Figure 8, which use the 1980 census as a benchmark to make them consistent with previous years.

That mismatch is due in part to geographical factors. Renters in the lowest quarter of their income distribution are more concentrated in metropolitan areas than are the units with rents that they could potentially afford--80 percent versus about 70 percent. Similarly, 20 percent of relatively poor renters live in the western part of the United States, but only 13 percent of the affordable units are located there. The South, by contrast, has a smaller share of the nation's poorest renters than it has of the units affordable to them--33 percent versus 38 percent.

Table 3.
Relatively Poor Renters Living in Potentially Affordable and Unaffordable Units, by Share of Income Paid for Rent, 1991

Share of Income Paid for Rent	Thousands of Renters	As a Percentage of Total
Renters Living in Potentially Affordable Units	3,034	38
More than 30 percent	1,588	20
More than 50 percent	554	7
Renters Living in Unaffordable Units	5,005	62
More than 30 percent	5,005	62
More than 50 percent	4,144	52
Total	8,039	100
More than 30 percent	6,593	82
More than 50 percent	4,698	58

SOURCE: Congressional Budget Office based on the Census Bureau's 1991 American Housing Survey.

NOTES: The data exclude renters who paid no cash rent.

Relatively poor renters are households with annual household incomes of $10,000 or less, the income at the 25th percentile of the income distribution of renters. Potentially affordable units are units renting for 30 percent or less of $10,000, which is equivalent to $250 per month.

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Another reason for the mismatch between units and households is that in localities with rent control, households with relatively high incomes occupy a substantial share of the units that have those controlled rents. Such bargain rents induce very low rates of turnover, even as the incomes of the occupants grow over time. Thus, many households with low incomes have no access to those units and instead live in units with higher rents.

Yet even without such mismatches, most of the poorest renters would not have found units that they could afford. At best, about 55 percent of the poorest 25 percent of renters could have been housed in 1991 in the units affordable to a household at the 25th percentile of income. Because of the mismatches, only 38 percent actually were so housed (see Table 3). And even for that subgroup, the actual rents paid were generally so high relative to income that more than half of those renters spent over 30 percent of their income for rent. As a result, fully 82 percent of all renters in the bottom quarter of their income distribution paid more than 30 percent of their income for rent.

Factors Contributing to Declining Affordability

The decline over the 1975-1991 period in the availability of rental housing affordable to relatively poor renters stemmed from gross rents' increasing faster than those renters' incomes. That phenomenon was echoed in the rental market at large during virtually the entire period. For example, real gross rents increased by over 20 percent at the 25th percentile, at the median, and at the 75th percentile of the rent distribution (see Figure 9).[8] By contrast, real household

8. Both rents and incomes were adjusted for inflation by the CPI-U-X1 (a revised consumer price index for urban consumers).

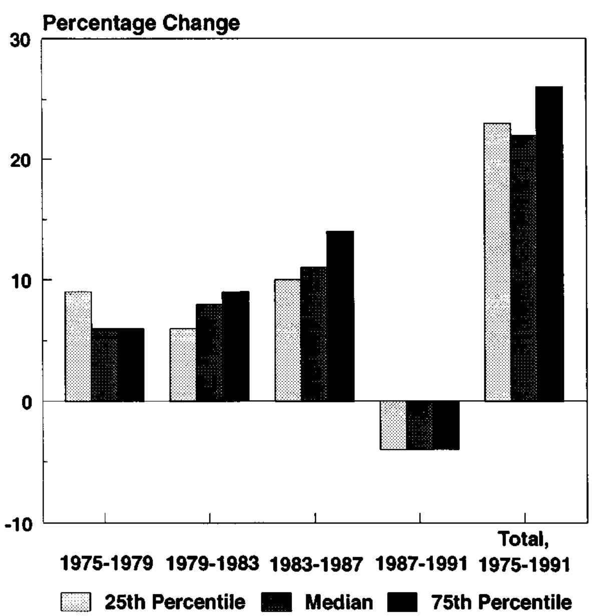
incomes fell by 5 percent for renters at the 25th percentile, remained virtually the same for renters at the median, and increased by 7 percent for renters at the 75th percentile (see Figure 10). Only during the 1987-1991 period did incomes gain slightly relative to rents, and that gain actually came between 1987 and 1989 (see Appendix B, Table B-2). Over those two years, real incomes increased while real rents began to fall. The ensuing recession, however, eliminated those gains. Real rents generally continued to fall, but they dropped substantially less than did incomes.

Components of Change in Gross Rents

Trends in real gross rents are caused by pure price changes and changes in quality. The pure price change can be isolated by looking at how rents (adjusted for overall inflation) changed for a constant-quality unit--one with similar physical attributes (such as the amount of space and appliances) and a similar amount of fuels and other utilities consumed by the occupant. Any difference over time between the actual gross rent and the gross rent for a constant-quality unit is then attributable to a difference in quality.

Pure Price Changes. The real gross rent of a constant-quality unit--one with characteristics similar to those of the typical unit in 1975--did not change much between 1975 and 1991. (The typical unit here means one with the median rent in 1975.) Real gross rent for a constant-quality unit fell from $378 (in 1991 dollars) in 1975 to $370 in 1981, increased to about $400 by 1987, and then dropped back to $387

Figure 9.
Trends in Real Gross Rent for Units with Rents at Various Levels of the Rent Distribution, 1975-1991

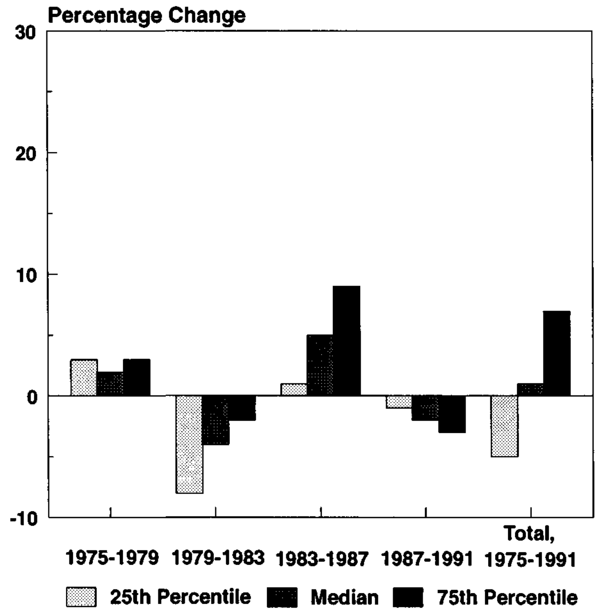


SOURCE: Congressional Budget Office based on data from the Census Bureau's American (formerly, Annual) Housing Survey.

NOTES: Gross rent is the rent paid to the landlord, plus any utility costs and property insurance paid by the tenant.

The data exclude renters who paid no cash rent and renters living in single-family homes on 10 acres or more.

Figure 10.
Trends in Real Household Income of Renters at Various Levels of the Income Distribution, 1975-1991

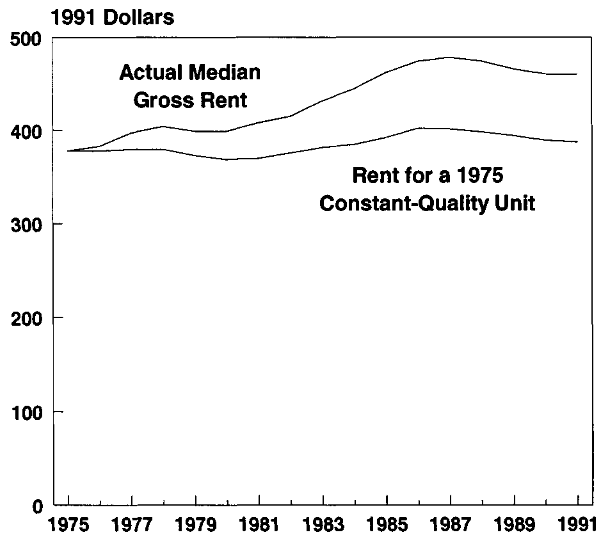


SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey.

NOTES: Household income includes the income of all household members, whether or not they are related to the householder (a person named on the lease).

The data exclude renters who paid no cash rent.

Figure 11.
Actual Median Gross Rent and Gross Rent for a 1975 Constant-Quality Unit, Adjusted for Inflation, 1975-1991



SOURCE: Congressional Budget Office based on data from the Census Bureau's American (formerly, Annual) Housing Survey.

NOTES: Gross rent is the rent paid to the landlord, plus any utility costs and property insurance paid by the tenant. Actual gross rents are interpolated for even years since 1982.

A 1975 constant-quality unit is one with similar physical attributes (such as space and appliances) and a similar amount of fuels and other utilities consumed by the occupant as a unit with median rent in 1975.

The data exclude renters who paid no cash rent and renters living in single-family homes on 10 acres or more.

See Appendix B, Table B-3, for further details.

by 1991 (see Figure 11).[9] Those figures are based on Department of Labor indexes; they assume that changes in the cost of a constant-quality unit are adequately captured by those indexes. But the cost of a unit of truly constant quality has probably risen faster than indicated here because before 1988, the Census Bureau did not adjust the indexes for the loss of quality in the nation's housing that results from aging.

Two components of the gross rent for a constant-quality unit--the contract rent and any utility costs paid by tenants--took turns in helping to explain the pattern of change over the period. The drop in gross rents between 1975 and 1981 was caused by a decline in the real contract rent of such a unit, offset in part by an increase in the real costs of utilities. Between 1981 and 1984, the real cost of both contract rents and utilities rose, explaining the upturn in real gross rents of a constant-quality unit over that period. Between 1984 and 1987, real contract rents for a constant-quality unit continued to rise, but the real cost of utilities dropped sharply. Those opposing forces began to slow the growth in real gross rent somewhat. After 1987, both the contract rent and utility costs declined in real terms, causing the decrease in real gross rent for a constant-quality unit.

Increase in Quality. Between 1975 and 1991, the increase in the real cost of a unit with roughly the same quality as the typical unit rented in 1975 (as measured by the Labor Department's indexes) was fairly small. Therefore, a relatively large part of the overall increase in actual real gross rents that occurred over the period must be attributable to an increase in the quality of the typical rental unit. (In that context, increased quality may also reflect greater consumption of utilities.) In each year since 1975, the actual median gross rent in the United States has exceeded the gross rent of a constant-quality unit. The actual median gross rent (in 1991 dollars) rose from $378 to $478 between 1975 and 1987, and then fell to $460 by 1991 (see Figure 11). Because the cost of a unit of true constant quality increased somewhat faster than is shown here, the share of the increase in rent attributable to increases in quality is somewhat smaller than Figure 11 shows.[10]

9. CBO estimated the median gross rent (in 1991 dollars) of a constant-quality unit by separately tracking median contract rents and estimated median utility costs. The median contract rent of a unit rented in 1975 was inflated with the consumer price index for residential rent. The median cost of utilities not included in contract rents in 1975 (approximated by the difference between the median gross rent and the median contract rent in 1975) was inflated with the consumer price index for fuels and other utilities. The two components were then added for each year, and those annual totals adjusted with the CPI-U-X1 to change the results into 1991 dollars.

10. Calculations that are based on an index in Joint Center for Housing Studies, *The State of the Nation's Housing, 1994*, suggest that the real cost of a rental unit of constant quality may have increased by 14 percent over the 1975-1991 period, once adjustments are made for the aging of the rental stock. According to that index, improvements in quality would have explained roughly 35 percent of the increase in actual real gross rents over that period, compared with 89 percent using the unadjusted indexes published by the Department of Labor.

That the physical quality of the rental stock was improving over the period is also apparent from increases in the proportion of units with relatively costly attributes. For example, rental units became steadily larger: the proportion of units with five or more rooms increased from 34 percent in 1975 to 41 percent in 1991, and the share of units with three or more bedrooms rose from 21 percent to 25 percent. Similarly, the proportion of rental units with two or more complete bathrooms increased from 7 percent to over 15 percent. The share of units with central air conditioning rose from 16 percent to 33 percent.

Why did households rent better-quality units even as their incomes generally stagnated? Part of the increase in quality between 1975 and 1981 might be explained by the fact that increases in the overall rate of inflation exceeded increases in the cost of a rental unit with constant physical quality. Rental housing was thus a bargain relative to other goods and services, and households bought more of it in the form of better units. Between 1981 and 1987, those trends reversed, but with real incomes increasing during at least part of that period, households could still afford to buy more of many commodities, including better rental housing.

Yet for many households with relatively low incomes, renting higher-quality housing may not have been a choice. Instead, it may have been a necessity: low-quality (and low-cost) rental units had disappeared as they were demolished by their owners or converted to higher-rent housing for households with higher incomes. The final section of this chapter presents some evidence for that hypothesis.

Factors Affecting Trends in Actual Gross Rents

The rent for a constant-quality unit and the average quality of rental units are both determined by the demand for and supply of rental housing. The demand for rental housing is influenced by such factors as the rate of formation of new households, the choice of whether people become homeowners or renters and the forces behind that choice, the relative cost of items other than housing that households purchase, and trends in income. The supply of rental housing is affected by a host of other factors that determine whether it is more profitable to invest capital in rental housing or in other sectors. Influencing that decision are the cost of maintaining and operating the existing stock of housing; the cost of new construction; land values; government regulations such as rent control, zoning, and housing codes; features of the tax code; and the cost of borrowing.

The impact of these factors on gross rents is complicated because many of the factors are themselves affected by rents or by each other. For example, high and rising rents may stymie household formation. The cost of home ownership also affects rents. When it rises relative to the cost of renting, many would-be home buyers become or remain renters. Those families tend to have higher incomes than the typical renter; as a result, the average level of income of renters tends to increase. Both of those effects--growth in the number of renters and their increased purchasing power--drive up rents.

Patterns of change in rents at the national level may at times simply reflect geographic shifts in supply and demand forces in the rental housing market. For example, if changes in job opportunities lead renters to move from expensive regions of the country to cheaper ones, the resulting shift in demand could reduce rent levels nationally--at least in the short run--even though none of the above-mentioned factors may have changed overall.

These different forces caused the trend in rents to vary among different segments of the rent distribution and different time periods (as was shown in Figure 9). During the 1970s, for example, the abandonment and demolition of low-rent housing helped to drive up rents at the low end of the distribution. High rates of inflation in utility costs helped to push up rents throughout the rent distribution.

During much of the 1980s, rents in the top half of the rent distribution increased more rapidly than in the late 1970s, and they rose particularly fast at the high end of the rental scale. That trend resulted from both demand and supply factors. Contributing on the demand side to the upward pressure on rents was a sharp increase in the growth of the number of renters, fueled by a decline in the rate of home ownership among young households. The growth in the number of households that were renting increased from 1.4

percent per year between 1975 and 1979 (an average increase of 376,000 households) to almost 2.4 percent per year between 1979 and 1987 (on average, 696,000 households). By contrast, over the same periods, the growth in the number of homeowners declined from 2.3 percent per year (or 1.1 million households, on average) to 1.6 percent per year (or 844,000 households). The growth in income among renters during the mid-1980s, which was partially attributable to would-be home buyers joining their ranks, boosted the demand for higher-quality rental housing, which in turn also pushed up rents.

On the supply side, the increase in demand brought the expected response from developers of unsubsidized multifamily apartment buildings. In addition, certain tax provisions of the Economic Recovery Tax Act of 1981 increased the profits to be made in constructing rental housing. As a result, new construction reached its highest levels since 1975--almost 408,000 units were built during 1986 alone, for example. Those relatively large infusions of new dwellings into the rental stock did not bring rents down immediately, however. Instead, vacancy rates rose in many segments of the rental market during the 1980s. Some analysts view that phenomenon as evidence that landlords react to an oversupply of housing, at least in the short run, by letting some units stand vacant rather than decreasing rents for all of their units.[11]

After 1987, real rents began to decline at all points of the rent distribution. On the demand side, the rate of growth of the renter population dropped to roughly 1 percent per year (an average of 360,000 households). The decline reflected both a significant slowdown in the formation of households in general and, starting around 1990, a reversal in the downward trend of the rate of home ownership. (That rate began to rise in response to lower sales prices for homes and lower interest rates.) As the economy went into recession after 1989, the overall decrease in real income may also have contributed to the downward trend in gross rents.

On the supply side, new construction of multifamily units declined sharply. Some of the factors producing this decline included a response to the Tax Reform Act of 1986, which made such construction less profitable; a decline in the financing available for construction, which was brought on by the crisis in the savings and loan industry; and persistently high vacancy rates in the nation's stock of rental housing.

Factors Affecting the Incomes of Renters

Over the 1975-1991 period, many of the same factors that affected trends in family income in general explain trends in the household incomes of renters. Macroeconomic conditions, demographic shifts in the composition of families, changes in government transfer policies, and trends in the number of wage earners in families all influenced income to some degree.[12] Unlike family income, household income was also affected by changes in the extent to which unrelated individuals with their own sources of income lived together or with other families. In addition, trends in the rate of home ownership contributed to diverging patterns of changes in income for renters versus homeowners. Some of the factors that affected the incomes of renters are discussed below.

Macroeconomic Conditions. The household incomes of renters did not change very much over the 1975-1991 period after adjusting for inflation, but the shifts that were evident among the various categories of income followed the upswings and downswings of the business cycle. To that degree, they were fairly similar to the changes that occurred in the incomes of homeowners (see Figure 12). From 1975 through 1991, the real income of renters at the 25th percentile of their income distribution hovered between $10,000 and $11,000; at the median, it varied from $20,000 to $22,000; and at the 75th percentile, it ranged between $33,000 and $37,000.

11. See, for example, Raymond J. Struyk, "Comment on William Apgar's 'Which Housing Policy Is Best?'" *Housing Policy Debate*, vol. 1, no. 1 (1990).

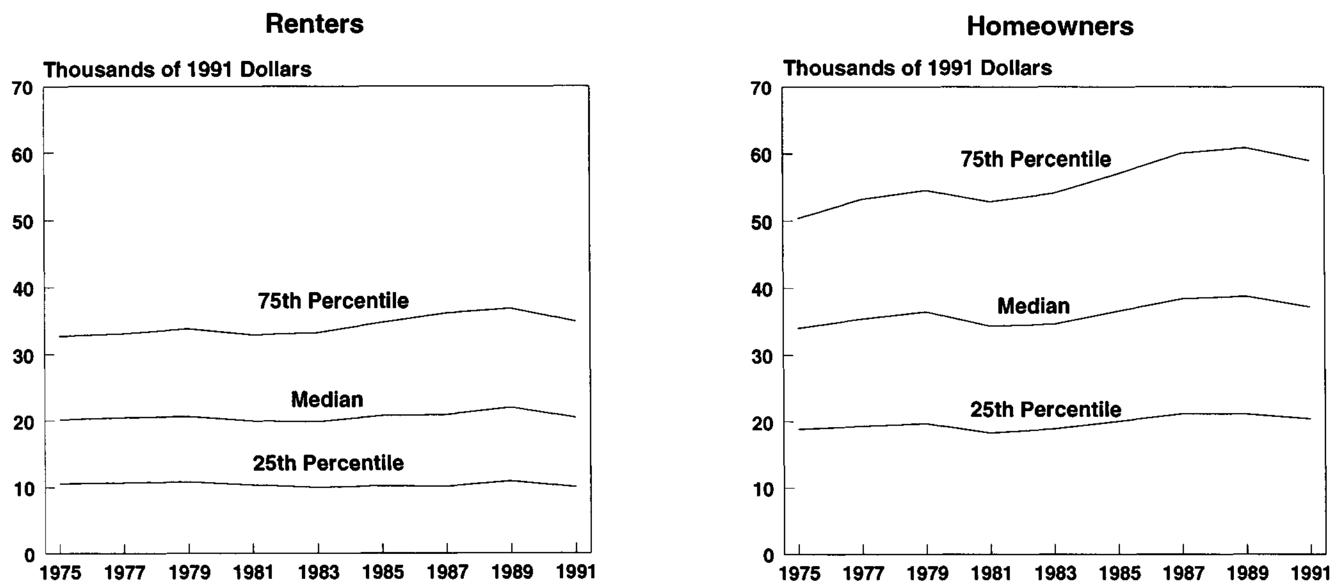
12. For a more detailed analysis, see Congressional Budget Office, *Trends in Family Income: 1970-1986* (February 1988).

The broad gains in real income that occurred for both renters and homeowners between 1975 and 1979--when the economy peaked--were followed by declines during the early 1980s. The incomes of renters at the 75th percentile of their income distribution and of homeowners at all levels had started to increase by 1983, as the economy began to expand. The incomes of renters at the median and 25th percentile of their income distribution did not start increasing until after 1983. In general, all groups of renters and homeowners enjoyed this growth in income through 1989. By 1991, the slowdown of the economy again was causing declines across the board.

Trends in the Rate of Home Ownership. It is difficult to ascertain whether or to what extent the well-documented drop in the rate of home ownership during the 1980s may have masked a less favorable trend in the incomes of typical renters than was actually observed. Some evidence points in that direction, however.

Overall, renters--and particularly the poorest renters--lost ground relative to homeowners between 1981 and 1987 in that the incomes of homeowners grew faster than those of renters (see Figure 13). One factor that may have contributed to that pattern is that would-be home buyers who became or remained renters had lower incomes than the average homeowner. Consequently, they did not drag down the income distribution of homeowners as they otherwise would have. But at the same time, the income distribution of renters was shifted upward to the extent that would-be home buyers had incomes higher than the average renter. That the incomes of homeowners and renters did not move in unison may indicate, therefore, that the increase in the incomes of renters resulting from the addition of would-be home buyers to their population was partially offset by decreases in income among typical renters.

Figure 12.
Real Household Income of Renters and Homeowners, by Income Level, 1975-1991



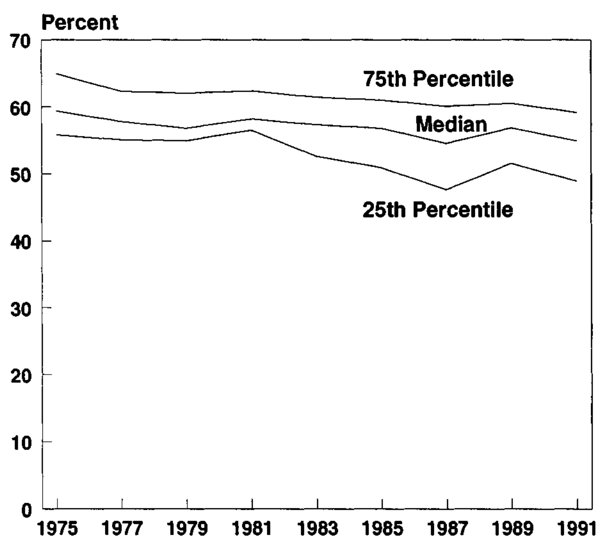
SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey. Data are for odd years only.

NOTES: Household income includes the income of all household members, whether or not they are related to the householder (a person named on the lease). The income levels for renters and homeowners correspond to the percentiles in their respective income distributions.

The data exclude renters who paid no cash rent.

Demographic Factors. Another reason for the relative flatness of the trend in income among renters is that the proportion of renters living alone typically rises during upswings in the economy, when household formation increases, and falls during downswings. Small households generally have much lower incomes than larger households; as a result, relative increases in their numbers will tend to pull down the overall income distribution, and relative decreases will tend to push it up. The proportion of renters who lived alone rose from 32 percent in 1975 to 36 percent in 1979--a peak in the business cycle. By 1983--a little after the business cycle hit bottom--it had declined to 34 percent. By 1987, however, the proportion had climbed back to 36 percent, only to fall somewhat, to 35 percent, in 1991, when the economy was in a recession.

Figure 13.
Renters' Household Income as a Percentage of Homeowners' Household Income, by Income Level, 1975-1991



SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey. Data are for odd years only.

NOTES: Household income includes the income of all household members, whether or not they are related to the householder (a person named on the lease). The income levels for renters and homeowners correspond to the percentiles in their respective income distributions.

The data exclude renters who paid no cash rent.

The impact of this change in the composition of renter households was tempered somewhat because the incomes of one-person households increased relative to those of larger households. For example, during the 1975-1991 period, the real median income of people living alone increased by 17 percent, compared with an increase of only 4 percent for two-person households and decreases of up to 5 percent for larger ones (see Appendix B, Table B-1).

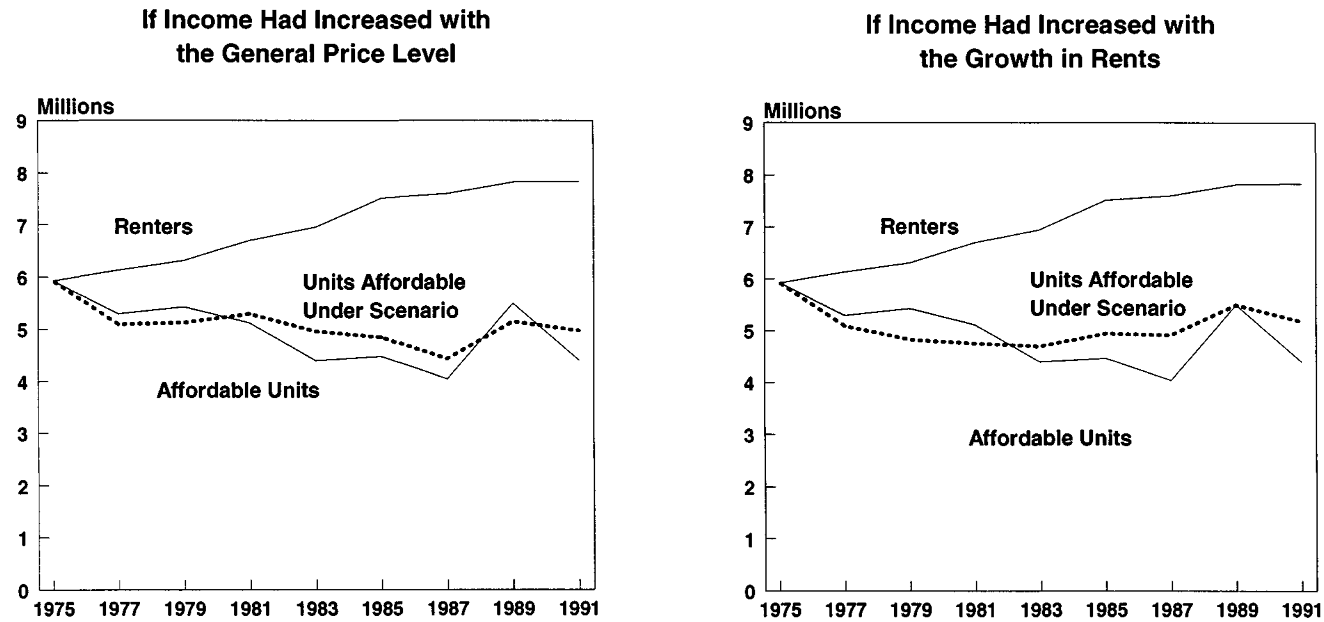
Other demographic factors that have kept the incomes of renters in the lower half of the income distribution from rising much include the well-documented increase in the proportion of the general population of households headed by single mothers or by relatively young people. Both types of households are more likely to be renters than homeowners. Because their incomes tend to be relatively low, the income distribution of renters is pulled down, independent of the changes in income of individual types of households.

A factor that has helped prevent further erosion of the financial resources of renters--particularly the poorest ones--is the income contributed by unrelated people who share homes with each other or with other families. If the incomes of unrelated individuals had not been available to families, for example, the real incomes of renter households at the 25th percentile of their income distribution would have fallen by about 9 percent over the 1975-1991 period (see Appendix B, Table B-4). Instead, their household incomes declined at roughly half that rate. It is not clear, however, to what extent the increases in these nontraditional living arrangements stem from choice or from necessity in the face of increasing costs for housing. To the extent that people prefer privacy over shared living arrangements, such families may be worse off, even if the added income helps to make housing more affordable.

Why Has the Housing Gap Grown?

The growing shortfall since the 1970s of housing that is affordable to relatively poor renters has elicited a

Figure 14.
Change in the Shortfall of Units Affordable to Renters in the Bottom Quarter of Their Income Distribution Under Two Scenarios, 1975-1991



SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey and American (formerly, Annual) Housing Survey. Data are for odd years only.

NOTES: Affordable units are units that rent for 30 percent or less of the income of renters at the 25th percentile of their income distribution.

Increases in the general price level are measured by the CPI-U-X1 (a revised consumer price index for urban consumers). Growth in rents is measured by the consumer price index for residential rent.

The data exclude renters who paid no cash rent and renters living in single-family homes on 10 acres or more.

number of explanations of its causes. Some studies have claimed that a major part of the explanation is a decline in the financial resources of low-income people.[13] According to some observers, the limited number of additional federal commitments of housing assistance has also contributed to the problem. CBO's analysis has indicated, however, that although financial resources declined somewhat for the poorest 25 percent of renters, rapidly escalating housing costs--spurred in part by the inflation of rents and utility costs but also by increases in quality--were a more significant factor. To provide a different perspective on those observations, CBO examined three questions: How big would the housing gap have been if household incomes had kept up each year with overall inflation? How big would it have been if household incomes had kept up each year with increases in the contract rent of a unit with constant physical quality? And what would have happened if there had been no subsidized housing?[14]

13. Several studies claim much larger declines in the financial resources of poor renters than those presented in this study. Some of those analyses (see, for example, Stone, *One-Third of a Nation*) used the unrevised consumer price index for urban consumers (CPI-U) rather than the CPI-U-X1 to adjust income for inflation. But before 1983, the CPI-U overstates increases in the cost of living and therefore makes households seem worse off than they really are. In addition, most studies use data on median family income from the American Housing Survey (see, for example, Joint Center for Housing Studies, *The State of the Nation's Housing, 1994*, Table A-1). Real family income from the AHS shows a precipitous decline between 1975 and 1983, followed by a sharp increase during the rest of the 1980s. Those findings contrast with the trend in median household income (a better measure of total available resources) from the Current Population Survey (a more reliable survey of income), which remains fairly flat over the 1975-1991 period (see Appendix B, Tables B-4 and B-5).

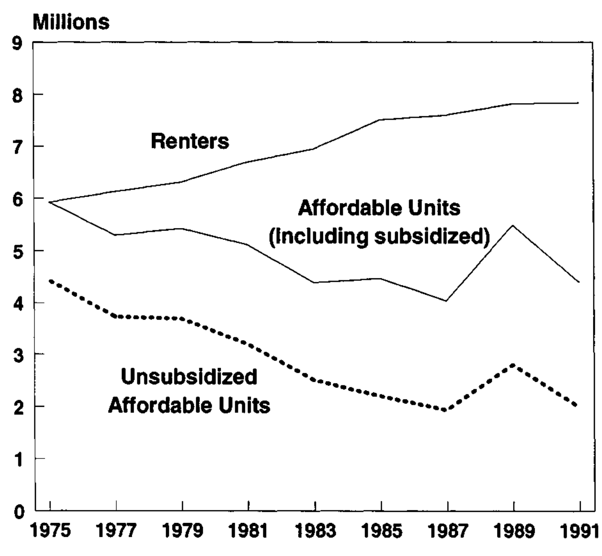
14. Estimates of the number of subsidized households presented in this section reflect primarily federal subsidies. However, data from the AHS--particularly those from earlier years--do not make reliable distinctions between households receiving federal versus other types of housing subsidies.

If, between 1975 and 1991, the household incomes of renters at the 25th percentile of their income distribution had increased each year at the same rate as the overall price level, the shortfall in affordable units would have been somewhat smaller, on average, during that period (see Figure 14). Under this scenario, the largest increase in the number of units that relatively poor renters might have been able to afford would have been an estimated 570,000 units in 1983. An increase of that size would have reduced the shortfall that year by 22 percent.

If household incomes had increased each year at the same rate that contract rents for a constant-quality unit increased, the shortfall in affordable units would also have been somewhat smaller, on average, than what actually occurred. However, the shortfall would have been larger in the late 1970s and smaller in the mid-1980s (see Figure 14). Under this scenario, the number of affordable units would have increased the most in 1987--by an estimated 870,000 units--reducing the shortfall that year by almost 25 percent.

Trends in rental housing assistance since 1975 have prevented the affordability problem from being worse. The number of unsubsidized units with housing costs affordable to renters with income at the 25th percentile of their income distribution fell by 2.4 million units--or 55 percent--between 1975 and 1991. That decrease, however, was partially offset by the addition of 0.9 million assisted units--an increase of about 60 percent (see Figure 15).[15] As a

Figure 15.
Shortfall of Units Affordable to Renters in the Bottom Quarter of Their Income Distribution, With and Without Subsidized Units, 1975-1991

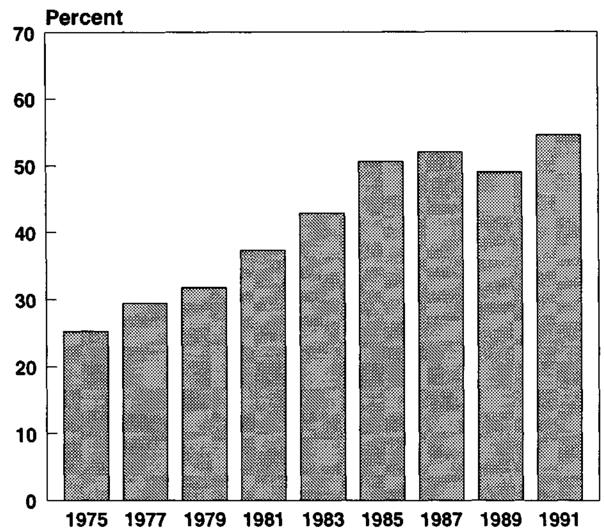


SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey and American (formerly, Annual) Housing Survey. Data are for odd years only.

NOTES: The data exclude renters who paid no cash rent and renters living in single-family homes on 10 acres or more.

Affordable units are units that rent for 30 percent or less of the income of renters at the 25th percentile of their income distribution.

Figure 16.
Percentage of Affordable Units That Are Subsidized, 1975-1991



SOURCE: Congressional Budget Office based on data from the Census Bureau's Current Population Survey and American (formerly, Annual) Housing Survey.

NOTES: Affordable units are units that rent for 30 percent or less of the income of renters at the 25th percentile of their income distribution.

The data exclude renters who paid no cash rent and renters living in single-family homes on 10 acres or more.

15. As is the case with unsubsidized potentially affordable units, not all of these 0.9 million assisted ones are occupied by renters in this income category. Some were occupied by renters that were eligible for housing aid but that were not in the bottom quarter of their income distribution.

result, the total number of units in this rent category fell by only 26 percent between 1975 and 1991 (from 5.9 million units to 4.4 million units). These trends are reflected in the steady increase in the percentage of units that are affordable and that carry rental assistance--from 25 percent in 1975 to 55 percent in 1991 (see Figure 16).

The three scenarios considered here do little to explain the shortfall in affordable units that has developed. Because the growth in assisted units accommodated much of the growth in the number of relatively poor renters, the gap must stem primarily from the disappearance of unsubsidized low-rent units.

Where did those low-rent units go? First, many older units have been demolished. In 1975, for example, the nation's stock of rental housing included 11 million rental units built before 1940. By 1991, that figure had dropped to 8.6 million, a net decrease of 2.4 million such units. Landlords take those older units out of service when the rents they can command fall short of the cost of operating them or when the land on which they are situated can be used more profitably for other purposes (such as office buildings or parking lots). Those phenomena could stem, for example, from residential rents dropping as a result of declining demand for rental units in certain neighborhoods. Alternatively, rising demand for commercial applications could increase the value of land used for purposes other than residential use.

Second, some low-rent units may have become higher-rent units over the period--with or without being upgraded in quality--while relatively poor renters continued to occupy them. A rise in rents without an increase in quality could be caused, for example, by unusually high increases in maintenance and operating costs in areas with high rates of crime.

Third, some low-rent units were upgraded and became occupied by higher-income tenants at higher rents. That phenomenon--called the filtering up of a unit--commonly occurs in revitalizing urban neighborhoods that are becoming attractive to upwardly mobile young households. The 1980s were conducive to such events because, as shown above, the incomes of poorer households lagged increasingly behind those of higher-income households, which often compete for the same housing stock. At the same time, however, additions occurred in the low-rent stock because some higher-rent units deteriorated and became occupied by lower-income people at lower rents--a process known as filtering down. Some evidence suggests, however, that between 1985 and 1991, filtering caused a small net gain--23,000 units per year--in the number of units with relatively low rents.[16] That phenomenon was primarily due to gains in the South. By contrast, the Northeast lost 48,000 low-rent units per year to filtering.

16. See Joint Center for Housing Studies, *The State of the Nation's Housing, 1994*.