Hood River Economics of Housing Market

Frequently Asked Questions

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As conversations continue about long range growth management policy, the City of Hood River is increasingly hearing questions from community members, civic and institutional leaders, and others regarding how the economics of the regional and local housing market affect the City's current and future supply and affordability of housing. These stakeholders have observed that demand for housing in Hood River outstrips available supply and home prices have risen rapidly. Meanwhile, adding developable land is challenging, given that Hood River is surrounded by the Columbia River and Columbia Gorge National Scenic Area.

In this context, what policies can Hood River consider to support the development of a range of housing types at different price points that match residents' income? Furthermore, how can production of housing play a role in post-COVID-19 economic recovery.

Questions addressed in this FAQ:

This FAQ will address two broad housing market economic topics affecting Hood River:

Factors affecting housing demand:

- What factors influence Hood River's growth and housing market? Will they change over time?
- What might Hood River look like in the future if current development patterns continue?

Effects of housing production:

- How can Hood River increase housing supply to positively impact housing affordability?
- What impact does allowing increased development capacity have on the housing market?
- What's the relationship between SDC's and housing prices?

1. Factors Affecting Demand for Housing in Hood River

What factors influence Hood River's growth and housing market? How might those factors change over time?

Hood River's economy and population is growing. Between 2014 and 2018, Hood River County's annual wage increased 5.5 percent –– the largest increase of all counties in Oregon[1]. During this same time period, median household income rose 14 percent[2]. Wage and income growth are strong evidence of the general economic growth that has increased business productivity, personal income, and economic diversity in Hood River.

At the same time, however, median housing prices across all housing types have risen 41 percent, a much larger increase than median incomes or wages[3]. Housing prices have increased for a variety of interconnected reasons, but primarily because **housing production has not kept pace with demand**. The moderate low supply of housing[4] has created a shortage of housing that has consequently increased demand and housing prices. While average incomes have grown, so have **wage disparities**: **the gap between high-income earners and low-income earners has grown**. This exasperates the need for housing that is affordable to a wide range of incomes at the same time that housing production, when it has occurred, has met the needs of only the highest income earning residents. This also makes the existing housing stock less affordable to current residents.

One of the challenges to producing more housing in Hood River is the **availability of land**. For a variety of reasons, expanding Hood River's Urban Growth Boundary (UGB) will be very difficult. Hood River is surrounded by the Columbia River Gorge National Scenic Area and by farmland which will make expanding its UGB extremely difficult. A UGB expansion process for Hood River could take years to be approved; this long lead time creates challenges for policy to be responsive to growing housing needs.

Housing supply constraints such as the **high cost of labor**, **high land prices**, and **tightened financial lending standards from banks** have all contributed to higher development costs. As a result, housing has been underbuilt relative to population growth in the past decade. Even in the nation's fast-growing metro areas, new housing construction is not keeping pace with demand.

[1] Oregon Office of Economic Analysis. County Wage Growth (Map of the Week). Available from: https://statelibraryeclips.wordpress.com/2019/09/06/county-wage-growth-map-of-the-week/

[2] ECONorthwest Analysis. American Community Survey, 2009-2014; 2013-2018 5-year estimates, Table XXX or the City of hood River.

[3] ECONorthwest Analysis of housing appreciation, Hood River County Assessor's Office

[4] Hood River had a vacancy rate of 6% during the 2013-2017 period, compared to 4% in Oregon

The rise in the number of **second homes** has further decreased the availability of new and existing homes. As housing prices increase and the number of housing units that are affordable decrease, people are pushed to find housing that is affordable to them elsewhere. Increasingly, Hood River's workforce is locating and relocating in other counties or nearby smaller towns where housing is more affordable and traveling further away to continue working in Hood River.

The COVID-19 pandemic has pushed us all into uncharted territory. While it is remains unclear how, it will certainly affect housing need and demand in Hood River. Claims filed for unemployment assistance have hit previously unknown heights. Just as in past crises, we know that our lowest-income and historically marginalized communities are likely to experience the worst impacts. Stable housing is needed to stop the spread of COVID-19. However, **changes in employment security lead immediately to housing insecurity for many**, and **those without housing face even more dire circumstances**.

We are only just beginning to understand how COVID-19 and social distancing might impact housing markets and what opportunities recent federal and local crisis response funding might create. We see three phases of this crisis: (1) the shutdown; (2) the reopening, and (3) the recovery. Oregon is now in the reopening phase, but the pandemic continues. Broadly, ECO has observed several key trends related to the pandemic:

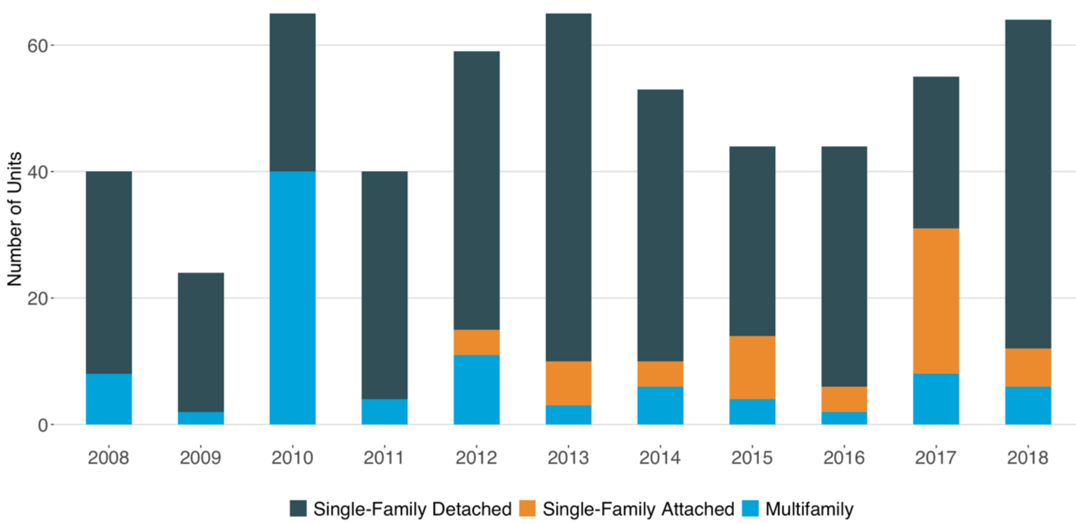
- In the shutdown phase, it appears that the combination of policy decisions and federal relief funding through the CARES Act may provide substantial relief for renters and homeowners.
- Oregon's eviction moratorium will stabilize some households for the time being, and protect some multifamily property owners.
- During the shutdown period, we expect current and new construction starts to slow or stop.
- While interest rates are low, financial markets—including secondary mortgage markets where residential mortgages are packaged, bought, and sold—are in turbulence.
- Protections in place for home owners and renters are limited, temporary, and do not address back-debt.

It is unclear at this point what the longer-term impacts will be on housing markets and housing production. Our view is the impacts will be contingent on the depth and duration of the pandemic, the continuation of federal support for the unemployed, and the nature and amount of federal and state subsidy to support rebuilding the economy.

What might Hood River look like in the future if current development patterns continue?

Single-family detached homes make up the largest share of new housing development since 2008 (Exhibit 1). This housing type is increasingly unaffordable to most residents and people who work in the City. **Without changes to development policies, affordability and land supply challenges will continue and intensify further.**

Exhibit 1 Hood River Recent Development Trends, 2008-2018



Source: City of Hood River Permitting Database

Note: Multifamily is separated into two subgroups of attached structures other than single-family detached units, manufactured units, or single-family attached units. The two subgroups are defined as (1) duplexes, triplexes, and quadplexes; and (2) multifamily buildings with five or more units.

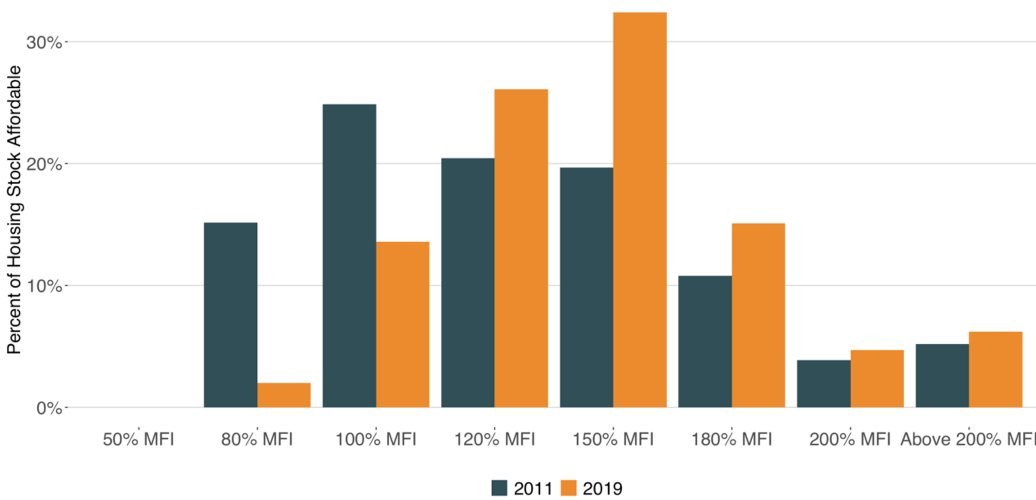
Between 2011 and 2019, the median home sales prices increased 41 percent, or $148,000, across all housing types in Hood River[5]. In comparison, between 2011 and 2019, median incomes across the county increased 27 percent, or $16,000. **Home sales prices are rising far more quickly than incomes**. New housing construction is predominantly marketed to households with higher incomes who can afford to purchase single-family detached and secondary homes. This buying power of higher income households is driving the changes in affordability across the City.

Exhibit 2 below shows how increases in home prices has decreased housing affordability over time. **Housing affordability has decreased for families making 100 percent or less of MFI** between 2011 and 2019. In 2011, 40 percent of the housing stock was affordable to families making 100 percent or less of median family income (MFI). In 2019, only 15 percent of the housing stock was affordable to the same families making 100 percent or less of MFI. Housing affordability has brought changes to Hood River, for example:

[5] Zillow Research. Inventory, listings, and sales. Available from: https://www.zillow.com/research/data/

- **More of Hood River's housing stock is now second homes**. The percent of second homes have increased to 6.4 percent in 2019, up from 4.2 percent in 2014[6].
- **New residents have more buying power and demand different types of housing**. More than half of new Hood River County residents are from out of state, and on average earn about 18%, or $11,753, more than county residents[7].
- **Hood River increasingly imports its workforce**. Only 23 percent of Hood River's workforce lives in the City limits. The rest of the workforce lives in Hood River County and other neighboring counties in Oregon and Washington. As prices rise, people have to commute farther to work in Hood River
- **Hood River is increasingly becoming an affluent community.** Demographic changes have shifted toward increasingly older residents with higher incomes and a fewer workforce of working age.

Exhibit 2 Housing Affordability Change, 2011 to 2019



Source: ECONorthwest Analysis of Assessed Real Market Values; Hood River County Records and Assessor Office, 2019; HUD MFI, 2019

Note: the chart x-axis indicates the income range of median family income (MFI) in Hood River (100% MFI represents the median county household income). The y-axis represents the percentage of housing stock that is affordable to families in a specific income range.

Exhibit 3 below, illustrates how much a household in Hood River can afford to pay for housing and the type of housing that is typically affordable to households with different income levels. In general, households on the lower-end of the income scale can typically afford to pay less for housing than those making 100 percent or more of MFI and the type of housing affordable is predominately renter occupied such as apartments or lower-costs ownership housing like manufactured homes. In contrast, households earning 200 percent or more of MFI can afford to pay more for housing and have a greater number of housing types that they can afford. For

[6] City of Hood River.

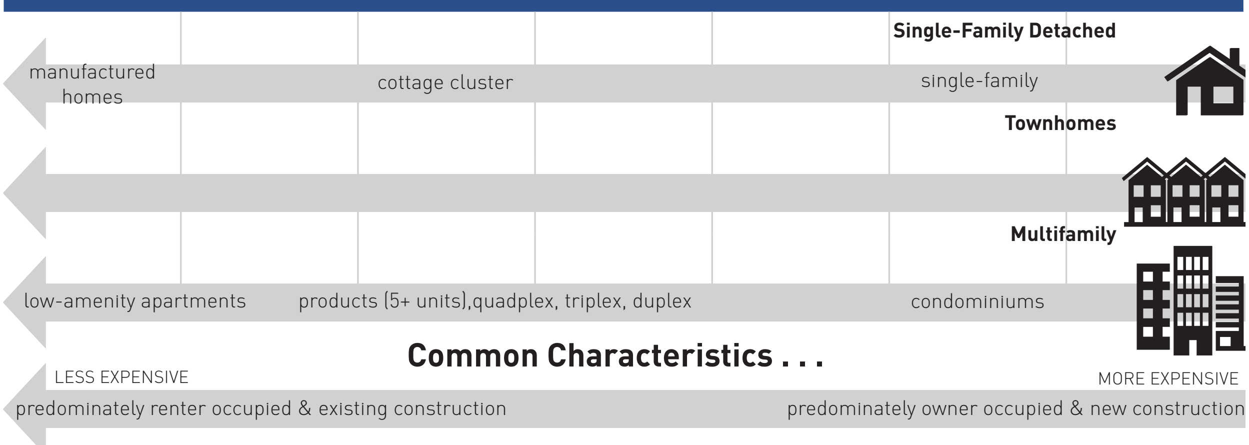
[7] IRS data for Hood River County.

example, these higher earning households can afford newer construction single-family homes and condominiums, including older housing stock affordable to households with lesser incomes. In a housing market with relatively low new housing construction, higher income households can put downward pressure on other housing types that would be affordable to households with lesser income and increase demand and housing prices.

Exhibit 3 Housing Affordability in Hood River, 2020

If your household earns . . .	$35,900 <50% OF MFI	$57,700 80% OF MFI	$71,700 100% OF MFI	$86,000 120% OF MFI	$107,600 150% OF MFI	$130,000 180% OF MFI	$143,400 >200% OF MFI
Then you can afford . . .	<$900 PER MONTH	$1,400 PER MONTH	$1,800 PER MONTH	$2,150 PER MONTH	$2,700 PER MONTH	$3,200 PER MONTH	$3,500< PER MONTH
Share of Hood River housing stock affordable . . . (2011)	0%	15%	25%	20%	20%	10%	9%
Share of Hood River housing stock affordable . . . (2019)	0%	2%	14%	26%	32%	15%	11%

Housing types generally affordable to these households are . . .



Source: ECONorthwest, HUD MFI 2020

Note(s): 1. MFI is based on HUD 2020 MFI income limits for Hood River County.
2. Affordability is calculated based on a household should not pay more than 30% of their income on housing costs.

To understand what affordability could look like in the future, we developed an affordability projection model that estimate what percentage of Hood River's housing stock will be affordable at different income ranges. Exhibit 4 below shows the projected affordability in 2028.

Housing Stock - refers to all housing units within a geographic area and are not necessarily up for sale currently.

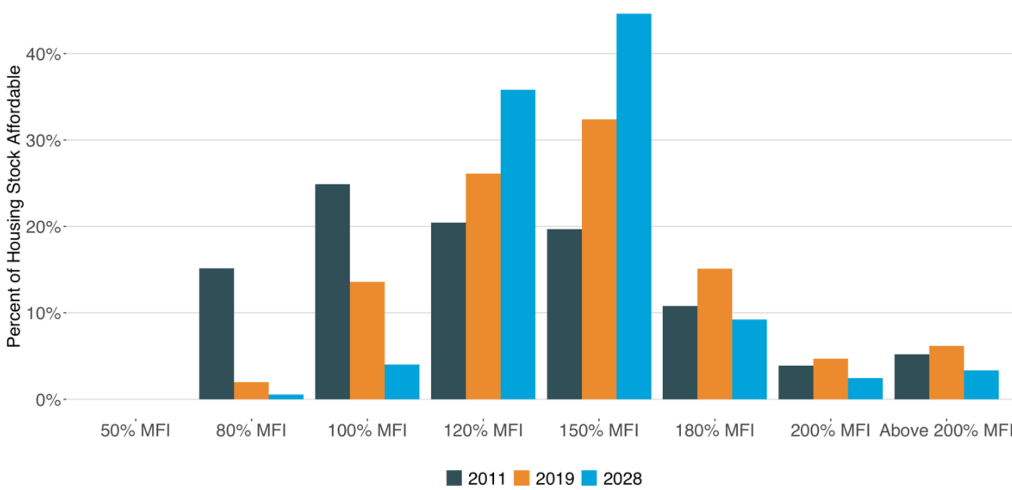
By 2028, if current housing market trends continue, **5 percent of the housing stock will remain affordable to households making 100 percent or less of MFI,** compared to 15 percent in 2019. In the long run, the only way to slow rising home prices and affordability issues is to add housing stock to match household growth. **Without more units available in Hood River's market, housing will continue to be increasingly unaffordable**, creating a **growing need for highly priced subsidized affordable units**, and **driving workers to live farther and farther away from Hood River**. The current development patterns in Hood River are unsustainable. Hood River had just enough land to accommodate 20 years of growth[8]. Without policy changes, Hood River will face a limited land supply to build and have greater housing affordability issues.

Using inputs from development patterns from building permits, home value appreciation, and housing affordability changes since 2011 in Hood River, we developed a projection model that can estimate how housing affordability might look like 8 years from now. Furthermore, our model assumes incomes increasing (at the rate they were) and a status quo development pattern and permitting continuing. These assumptions mean that there will be the same number of housing units constructed yearly, and the same housing construction type of predominantly single-family detached homes

Affordability Projection Model

our model takes into account assessed home values and home appreciation percentages between 2011-2019 to forecast housing affordability. This is a conservative model knowing that home sale prices on average are about 20 percent higher than assessed home values.

Exhibit 4 Projected Housing Affordability, 2028



Source: ECONorthwest Analysis of Assessed Real Market Values; Hood River County Records and Assessor Office, 2019; HUD MFI, 2019

Note: the chart x-axis indicates the income range of median family income (MFI) in Hood River (100% MFI represents the median county household income). The y-axis represents the percentage of housing stock that is affordable to families in a specific income range.

[8] Update on Housing Market & Demographic Changes in Hood River: 2015 to 2019

2. Effects of New Housing Production

How can Hood River increase housing supply to positively impact housing affordability?

Building new housing supply, even if it is priced at the high end of the income distribution, can have two important impacts on Hood River's local housing market.

First, building new housing in the high-market segment can keep higher income households from moving down-market and bidding up the price of older housing that would otherwise be affordable to middle- and lower-income households. When there is not enough supply in the high-end of the market segment, demand from higher income households manifests in older housing stock, increasing the demand and prices while further crowding out housing options for lower income households.

Second adding new high-priced housing will, over time, increase the supply of housing that is affordable to middle-income families as the housing stock ages and becomes more affordable. As higher income households move into newer more expensive housing units, the vacated units at lower prices become available, in addition to the steady depreciation of all homes in the market.[9]

Building new market-rate housing alone cannot solve housing affordability issues across all income levels. **Subsidized affordable units** will need to be part of Hood River's solution for the City's lowest-income earners, because the housing market will not produce units at these price points. In all housing markets, the lowest-income households face challenges of cost burdening (often spending 50% of more of their income housing) that require public funding. Subsidies such as housing vouchers for renters or tax credits for developers can help bridge the gap. The City needs to take a proactive role in ensuring that its most vulnerable households can still afford to live and work in the City by partnering with local housing service providers and developers and state entities.

[9] Rosenthal, Stuart S. 2014. "Are Private Markets and Filtering a Viable Source of Low-Income Housing? Estimates from a "Repeat Income" Model." The American Economic Review 104(2): 687-706.

Muth, R. 1972. "A Vintage Model of the Housing Stock." Regional Science Association 30: 141-56.

Sweeny, James L. 1974. "A Commodity Hierarchy Model of the Rental Housing Market. Journal of Urban Economics 1: 288-323.

Additionally, **middle housing development** is a key strategy for achieving a supply of units that are more affordable to more people. Middle housing development is a mix of residential housing types where the size and number of units fall in between a traditional single-family house and a multifamily apartment building and are compatible in the look and feel with single-family detached homes. Middle housing units are generally smaller, making them more affordable than larger detached units, while requiring less land than current stock of detached housing units.

What is Middle Housing?

Middle housing varies in the number of housing units that it contains; however, they are compatible in the look and feel with single-family homes.

Middle housing types include:

- Townhomes
- Cottage Cluster
- Duplex
- Triplex
- Fourplex

Even before the COVID-19 pandemic, there was a lack of affordable housing across all income levels, and now it has made housing ever more critical. COVID-19 has had an impact on the production of housing which include construction delays as a result of supply chain interruptions, construction slowdowns, and the inability to issue inspections or permits. These delays will keep housing developers from meeting critical deadlines and will likely increase costs, keeping badly needed housing units from being completed and causing serious business sustainability issues for organizations developing homes.

Building more housing should be a cornerstone of Hood River's response to the unfolding economic crisis. Increasing housing production can better meet housing need that existed even before COVID-19 struck. Additionally, housing production could reduce the depth to which the City's economy slows down. Building more housing employs people in construction jobs (including those along the supply chain). It also adds to the City's tax base and could also help lessen the tax revenue short falls that several local governments are experiencing during the COVID-19 pandemic crisis.

What impact does allowing increased development capacity have on the housing market?

> **Zoning Entitlements Influences Development in Two Ways:**
>
> 1. It limits land use by separating residential, commercial, industrial, and agricultural zones from one another.
>
> 2. It directs physical built form by prescribing the size of a building, often by setting maximums in terms of height, lot coverage, density, and occupancy, and minimums in terms of unit size, setbacks and parking.

Due to geographic constraints and other land use regulations, the amount of land available to build new housing is and will continue to be limited throughout the region. In Hood River's land use context, increasing the buildable capacity of land is a necessary first step toward increasing housing supply, and creating the financial feasibility of new housing types without expanding outside City limits (UGB). Increasing buildable capacity of land means allowing more units per residential lot (or designating land for residential use that previously did not allow it).

Increasing entitlements also provides a pathway for middle housing to be built. The price of land, the cost to build housing, and what the market is willing to pay for housing all factor into the financial feasibility of what type of housing gets built. If the cost of land is low enough that developers can meet required rates of return, then they will build it. In a housing market where land prices are high, increasing the number of units that can be built on a single lot can lower the cost of land per unit, and ultimately the completed unit's market price – compared to a newer traditional single-family house. Increasing buildable capacity of land can also provide other benefits such as creating more walkable areas, and supporting neighborhood amenities like transportation, retail, parks, and schools.

Getting more housing through increasing buildable capacity of land can vary significantly across different geographies. For example, if a neighborhood is zoned to allow a ten-story building, but demand can only support a two-story building, the result is that developers will only construct a two-story building. As a result, changes to zoning entitlements alone might not be enough to increase the number of housing units, especially affordable units, that the City needs or would like to build. Appropriate policies will need to be developed that incentivizes and/or provides subsidies to allow for affordable housing units built. For example, zoning entitlements can be tied to income restrictions to ensure that new units are affordable to households who work in Hood River but cannot afford to live in the City.

One common concern attributed to increasing the entitlements on a parcel of land is that it will increase the speculative value of land, therefore making it more difficult to build new units, or will result in the creation of wealth for the current landowner. There are several considerations that mitigate the potential for land speculation:

1. Increasing the total value of the land may not increase the cost per unit. Therefore, higher land prices do not necessarily reduce the financial feasibility of adding new units.
2. Without increasing development capacity, prices of land will continue to increase as demand is greater than the supply of units. The counterfactual should always be

considered when discussing policy changes—in this case, it is possible land prices could increase less than they would have otherwise, absent the increase in buildable capacity.

3. Through voluntary incentive policies, additional capacity can be permitted, but need to be purchased through a transfer of development rights program, thereby mitigating the speculative value of the land. Alternatively, additional capacity could be granted at no charge through an inclusionary housing policy that provides development capacity in exchange for producing a rent/price regulated unit.

What's the relationship between SDCs and housing prices?

What are SDCs?

In general, System Development Charges (SDCs) is a one-time fee on new construction or additions imposed by cities and towns. SDCs are an important funding source for cities and towns to pay for new infrastructure.

Successful housing developers must balance three financial variables: land price, cost of construction, and the market price of housing. The price of land, the cost of building housing, and what the market is willing to pay for housing all factor into the financial feasibility of what housing type developers can build while making a decent return on their investment.

Because SDCs are one-time fees, they are viewed as costs by developers and added to a developer's budget for construction costs. The primary effect of an SDC and an individual development project is as an added cost to construct the project. In the terms of economics, prices change in response to changes in factors of supply and demand, and SDCs affect primarily the supply (cost) side of the that relationship. They can, however, affect the demand side to the extent that they lead to the building of better infrastructure that provides better services that businesses and housing consumers are willing to pay for—for example sewer compared to septic, or the addition or improvement of a local park.

Reducing the cost of building housing through lowering SDCs does not directly translate to lower housing prices. The price of housing is influenced by demand relative to supply. In a market where demand is high and the cost of building is lower, housing prices will still remain high due to the demand for housing and consumer's willingness to pay. The effect of reducing SDCs will increase the probability of development – especially middle housing – to achieve financial feasibility because of lower construction costs.

The key when understanding the impact of an SDC on the amount of development is to understand the incidence of the fee—that is to say who pays for the fee—the landowner, the developer, the buyer. The incidence rarely is absorbed entirely by one party, however, the share of who pays varies based on local market conditions and the type of development.

One key distinction in the incidence of the SDC is for single-family homes compared to apartments. For a single-family home developer, they have the option of building more square feet when not constrained by density limits. If they do not change the bedroom and bathroom count, presumably that would not change the SDC amount. In doing so, they are able to decrease the impact of a fixed fee SDC over more square footage, thereby reducing the impact and increasing the ability to pass on the fee to the buyer. The implication of this is that there is an incentive to increase the price of new homes as SDCs increase. There are three possible market impacts that follow:

1. The market preferences and ability to pay for higher price homes are present, and developers will deliver homes that have higher prices and therefore less affordable to the broad market.
2. The market demand does not support higher price homes, therefore the supply of new construction is decreased.
3. The landowner decreases the price of the land and incurs the full incidence of the increased SDC. In order for this to happen, the lower land price must be a higher and better use than the current use of the property.

Conversely, for apartment development, the incentive structure does not apply in same manner. The relationship between apartment size and rent is non-linear—that is to say as you increase the size of the apartment, the per square foot rent decreases.[10] Developers would be worse off building larger units, so there is not the same ability to distribute a higher fixed SDC and pass it off to the tenant. Therefore the incidence of the SDC is more likely to be paid by the landowner or developer.

[10] Another constraint is that apartment developments are more likely to be constrained by height and FAR limits, so they can not increase the size of the development.