

# Assessing the Future of Housing in Kentucky

*The author provides a brief national history of housing and focuses on long- and short-term demographic and economic trends influencing the housing market in Kentucky. Long-term demographic trends, particularly the aging of the Baby Boom generation and its movement into peak earnings and move-up years, signals continued strength in the quantity and quality of single-family housing in the state. In addition, increases in the number of two-income households will continue to be a force in the demand for upper income housing. Housing for low-income Kentuckians, on the other hand, is becoming increasingly scarce, and government assistance less certain.*

By F. Lynn Luallen  
Kentucky Housing Corporation

Fifty years ago, Franklin D. Roosevelt recognized that we were “one third of a nation ill-housed.” Today, while conditions are quite different and much of the nation is overhoused, some 20 percent of households in the nation and 24 percent of households in Kentucky remain, as Roosevelt described, “ill-housed.” Fifty years ago, the majority of housing problems related to the condition of people’s housing. Today, conditions have improved markedly, but the affordability of housing has become a more serious problem, one that is affecting current housing and will continue to do so in the years ahead.

The following trends must be addressed in any assessment of the likely future of Kentucky’s housing market:

- Changes in population and demographics
- The impact of interest rates and employment on housing affordability
- Housing starts and home ownership
- Options for lower income housing

## Changes in Population and Demographics

The largest and most important impact on the housing market is tied to changing demographics, specifically the aging of the Baby Boom generation. Born between 1946 and 1964, Baby Boomers are now in their peak move-up years, signaling corresponding strength in the quantity and quality of single-family housing. Members of the Baby Boom generation are also in their peak earning years now, which indicates continued strength in the move-up market. Two-income households continue to grow among all household segments and will remain a force in the demand for upper income housing. During the second half of the 1990s and into the early 21st century, the trend for housing is positive. After that, the nation and Kentucky could face some real problems due to the long-term demographics of the population.

The whole of the nation’s housing has two identities: much higher standards at the top than at the bottom. Market rate construction is geared toward the top third of the market where profits are readily made and where the industry has achieved very high production levels. This portion of the market drives the industry. On the other side, housing has its problems, including the decay of cities, where poverty, crime and drugs have escalated, as places to live. Some corporations, for example, have chosen to abandon existing urban sites rather than pursue rehabilitation and modernization. In turn, jobs have been relocated, and people have abandoned cities.

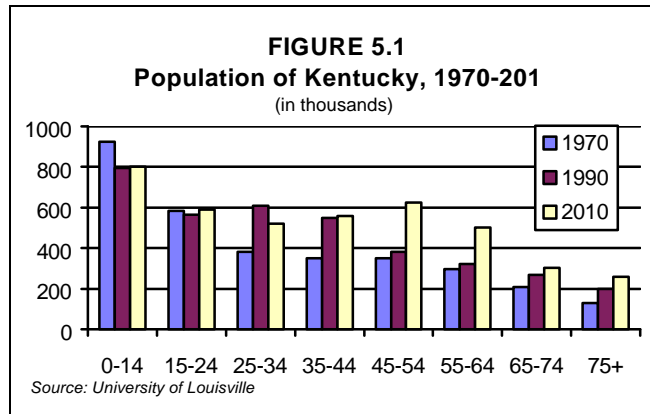
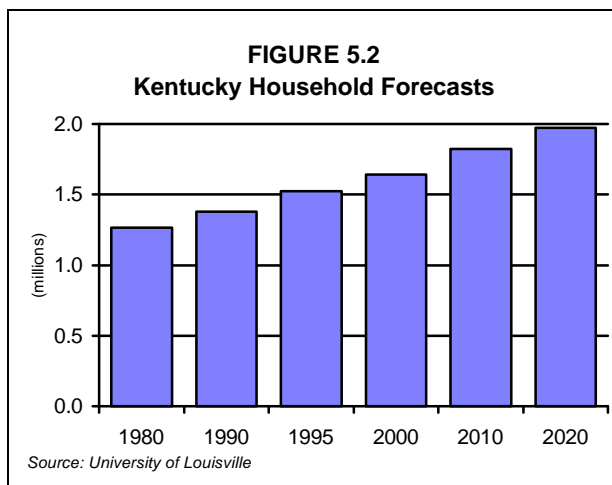
U.S. and Kentucky households have typically chosen to live in low-density, auto-oriented and auto-dependent communities, close to metropolitan areas but not actually in them. Today, the majority of Kentuckians live in single-family houses located in relatively low-density subdivisions. The majority of past and projected future growth is in and around the state's three largest metropolitan areas with housing near the interstate highway systems of I-64, I-65, I-71, and I-75. The clear preference is for the stand-alone subdivision.

A question or concern often raised is: Can this development preference continue as it moves farther out from the support of urban areas? Since the underlying forces that drive these patterns have not changed, and are not likely to do so until some time after the last of the Baby Boom generation passes through its housing move-up phase, this pattern will continue well into the next century. In addition, improvements in communication and transportation will enable these development trends to continue unchecked. However, basic subdivision design may change, as low-density, auto-oriented, stand-alone community developments, also known as "urban sprawl," have many critics.

Vocal critics suggest that the stand-alone subdivision corrodes neighborhood values by increasing dependency on cars, separating people and diminishing community life. Nationally, there is a move fueled by a school of planners called New Urbanists who advocate the creation of "villages" instead of subdivisions. The concept calls for mixing housing sizes and styles, commercial entities, and recreational amenities all in the same development. The end result is a community with a variety of architecture, income levels, and business establishments.

This theory of New Urbanism is being met with resistance in traditional states like Kentucky. However, it is a trend that is likely to become more prevalent. It is a design approach that uses land more conservatively by clustering buildings and services and preserving open spaces. As recent history has illustrated, land use is a top concern for local governments which must provide infrastructure and services to citizens. Moreover, many citizens wish to preserve more green space and plan housing developments accordingly.

Long-term trends in housing will be determined primarily by the numbers and the composition of households. The number of households is dependent on the age structure of the population.



Historical trends have shown that the majority of household formation occurs in the 25- to 34-year age group. Nationally, this group will decline from 19.8 million in 1990 to 17.2 million in 2000. In Kentucky, 25- to 34-year-olds are projected to decline from 610,000 in 1990 to 522,000 in 2010. In addition, household composition is changing; 25- to 34-year-olds are delaying marriage and childbearing, as well as getting more divorces, choices

which strongly influence housing decisions. Single heads of household with children are also increasing; nearly one in four children lives with one parent. Because they are far more likely to be poor or low-income, housing decisions are profoundly influenced by household composition. The impact of these trends and the aging of the Baby Boom generation on the housing industry will become more significant after the turn of the century. Total households in Kentucky are projected to increase from 1,379,782 in 1990 to 1,643,609 in 2000.

## Housing Affordability

During the 1970s, poverty in the state declined dramatically, from 23 percent of the population in 1970 to 18 percent in 1980. The improved economic circumstances of the lives of Kentuckians were accompanied by a corresponding decline in substandard housing. The number of homes without a bath, kitchen, or water was substantially reduced. In 1970, more than 20 percent of homes in Kentucky had no indoor plumbing, but by 1980, only 9 percent were without indoor plumbing.

By the late 1970s, mobile homes had also assumed a significant role in Kentucky's housing market, moving from 4 percent of the state's housing to 10 percent in just one decade. Mobile homes are usually moved only once, inexpensive, and financed like a car on the installment plan, enabling home ownership among lower income households. The number of mobile homes increased in Kentucky from 43,000 in 1970 to more than 125,000 in 1980, a 190 percent increase.

In the 1970s, Kentucky followed housing trends similar to those which were evident nationally. Population was increasing rapidly and employment and income grew strongly. The national recessions of 1970-1971 and 1974-1975 did not affect Kentucky as severely as other states. Employment growth remained several percentage points above the nation from 1970-1976. At the same time, Kentucky was producing record levels of housing, with the majority of housing growth occurring around urban areas. The stand-alone subdivision was the favored development. New housing units increased by 29 percent between 1970-1979, with nearly all the growth in single-family detached homes. This growth in housing was supported by a great expansion of mortgage debt—a growth that has continued, now doubling every six to seven years.

In the early 1980s, Kentucky saw a rapid reversal of trends of the 1970s. The 1980-1983 recession affected Kentucky more adversely than the nation as a whole, and in many ways, the state has never been the same. During the 1980s, employment growth slowed dramatically as did population growth, and out-migration increased. With interest rates prohibitively high, employment down and incomes below the rising cost of goods, housing demand in Kentucky declined. Household formation and employment expectations were also depressed. Housing prices increased 18 percent per year from 1980 to 1983, while median family income declined by 10 percent overall during this period. The loss of demand hit the housing industry in Kentucky hard, as housing starts declined 23 percent each year from 1979 to 1982.

The nation and Kentucky began a recovery in 1983, but the remainder of the 1980s were far from stellar for housing in Kentucky. Progress made in the 1970s all but halted. The volume of housing construction throughout the 1980s remained weak. More importantly, incomes, while improved from the recession, never fully recovered, and growth in income remained well below national averages. Housing prices, however, which had increased during the recession, continued at a strong pace—almost three times as fast as average incomes. When housing production began to pick up again, it continued to be concentrated in the state's urban areas, the majority within the interstate highway triangle of I-75, I-71, and I-64. The favored development continued to be the stand-alone subdivision on the edges of the state's cities. Over 70 percent of Kentucky's housing production was of this type and in these areas.

The 1980s found the affordable and assisted housing market in even worse shape. Federal housing funds were cut by more than 70 percent. Since the 1980s, a fairly strong correlation

has existed between declines in federal housing support and increased housing problems and poverty. As noted, poverty in Kentucky was reduced in the 1970s from 23 percent to less than 18 percent. During the 1980s, poverty in the state increased from below 18 percent to 19 percent.

The 1990s have been a period of more stability for Kentucky with some recovery from the economic changes of the 1980s. Population and household formation have stabilized in a slow-growth pattern, and the state has benefited from five years of economic growth. However, this has been a sluggish period, only about half as strong as previous expansions. The housing industry, on the other hand, has been fairly strong with the majority of growth in the move-up market.

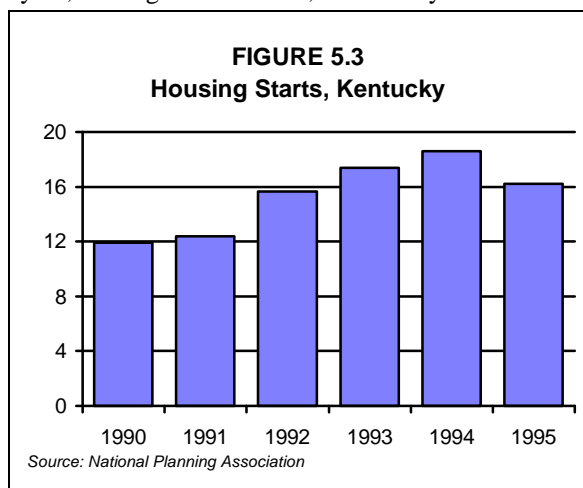
Housing starts in the state have averaged over 15,000 per year since 1990, 43 percent greater than the same period in the 1980s. In addition, the size and cost of new housing have been increasing, providing greater profit margins for builders. Housing conditions are clearly an important component in continued economic growth and in the overall improvement of the standard of living in the state. In the middle market, the population is moving up in quality and moving from renting to owning, or at least obtaining better quality rental housing. At the bottom is housing that is minimally adequate. The disparity in wage and income inequality, which began in the early 1980s, continues to manifest in the housing market. The vast majority of housing is built for the top third of the market.

The recession in early 1990 slowed housing production, but since then, the state and national housing sectors have been growing at a fairly strong pace. As the economy enters its sixth year of expansion, the total housing market has enjoyed over four years of growth, with a short pause in 1995 and stable growth expected through 1997. Interest rates should stay at a reasonable level through the year, moving within a fairly narrow range of 7.25 to 7.75 percent. So while mortgage interest rates are important to short-term housing activity, other variables will be more influential over the next biennium, primarily employment and employment expectations.

## Housing Starts and Home Ownership

Households pass through relatively predictable housing cycles—starting out as young renters, to first-time buyers, to move-up buyers, to long-term owners, and finally to retirement home buyers. The Kentucky housing market is now dominated by the move-up buyer, with households aged 45 to 64 providing most of the demand. In addition, the young adult population, aged 25 to 34, is declining and slowing the demand for apartments and starter homes. This trend will continue into the next century as this portion of Kentucky's population continues to decline. Between 1990 and 2020, the move-up market will increase by 58 percent while young renters and first-time buyers will increase just 3.5 percent.

Housing starts have been on an upward trend since 1990. Nationally, on average, more than 1.3 million new starts of single-family and multifamily housing have occurred each year over this period. Generally, one million annually is considered a good pace for housing starts. Kentucky's housing market has



equaled or bettered this trend, with starts averaging more than 15,000 per year since 1990. For Kentucky, a healthy pace of housing starts is around 10,000 annually.

Forecasts for 1996 indicate a 2.6 percent increase in housing starts over 1995. Single-family starts are expected to increase 2 percent to just over the one million unit level. Housing starts in the state have been increasing at an *average annual rate* of 7 percent and should continue at or near this pace during 1996-1997. The first quarter of 1996 indicates that the year could be one of the best ever for home builders in Kentucky. Market conditions are solid, interest rates are among the best in a decade; job growth is decent; and the misery index (the sum of unemployment and consumer price levels) has descended to levels not seen since the 1960s. Both the economy and the housing sector are expected to continue at current rates into the foreseeable future.

## Options for Lower Income Housing

The U.S. Department of Housing and Urban Development (HUD) celebrated its 30th anniversary recently, but dramatic change is on the horizon. Started in 1965, HUD was to be a key player in the nation's war on poverty and the Civil Rights Act, efforts that sought to raise incomes and give families the means to improve their own housing. Potential changes to this federal agency are vitally important to Kentucky. For example, last year alone, the department insured more than 10,000 home mortgages in Kentucky and since 1974 has financed or subsidized more than 41,000 affordable rental units in the state—enough housing for a city the size of Bowling Green or Owensboro. Unfortunately, some of HUD's programs are regarded by many as ineffective. It must be remembered, however, that the agency has never received funding adequate to meet its lofty goals. Now threatened, HUD has proposed rather dramatic changes, which, if implemented, will pose fundamental challenges for housing policy at the national and the state level.

One proposal called Portfolio Reengineering would potentially affect 38,700 households in Kentucky whose apartments are subsidized by the Section 8 program. The goal of Portfolio Reengineering is to end project-based rental assistance oversubsidization. It is an effort to put the affordable housing portfolio on sound footing. In addition, it may move federally subsidized and regulated rental projects to state and local control. It is clear that HUD must do something with its Section 8 project-based portfolio. The costs are simply too high. For example, 140,000 project-based contracts are expiring in 1996; renewal will cost an estimated \$4 billion. If significant changes are not made soon, Section 8 contract renewals will consume HUD's entire projected budget by the year 2000. The Portfolio Reengineering concept moves away from project-based (where assistance is tied to the rental housing) and focuses on tenant-based (where assistance is tied to the renter). This policy has strong support from both Congress and HUD. While it may cost more in the short-term, it should save over the long run.

Another proposal that may also be considered by HUD is consolidation of 60 separate programs into three block grants: the Certificates Fund, Housing Fund, and Community Opportunity Fund. This block grant approach has been implemented in several HUD programs in recent years. It is an approach that offers states flexibility in designing programs that meet local needs. Block grants for local housing authorities are a new concept. Instead of receiving funds directly from HUD, local housing authorities may compete for funds to operate public housing through the three block grants noted above, primarily the Certificates Fund, and they must submit a strategic plan. In addition to competing for funds, local housing authorities may have to compete for residents. Competition may be fueled by new units produced through the FHA Multifamily, Low-Income Housing Tax Credit, and HOME Programs.

Kentucky Housing Corporation (KHC) has developed a strong working relationship with HUD and implements many of its own lower income housing initiatives. Created in 1972, KHC has been a source of lower rate mortgage financing. In 24 years of existence, the Corporation has touched 1 out of every 20 Kentuckians primarily by: (1) issuing more than 40,000

mortgage loans to qualified home buyers through the sale of tax-exempt bonds; (2) providing more than 36,000 lower income households with rental assistance through HUD programs; and (3) financing and/or funding grants for rehabilitation, new construction and revolving loan pools.

The Corporation's primary directives are to provide below market rate mortgage financing to low- and moderate-income Kentuckians; offer home ownership education and loan servicing programs; provide below market rate construction financing to home builders and developers to produce affordable single-family and multifamily housing; serve as the state public housing authority to administer federal rental assistance in areas without local housing authorities; administer the Low-Income Housing Tax Credit Program; and administer the federal HOME Investment Partnerships, Emergency Shelter Grant, and Housing for Persons with AIDS Programs.

There is the potential for major changes on the horizon in the affordable and assisted housing markets of Kentucky. While KHC works with a wide range of federal housing agencies, clearly HUD is of major importance. As previously noted, the changes proposed for HUD will have a major impact on the Commonwealth. For Kentucky, block granting of HUD programs will mean more control and flexibility, but also fewer federal resources. Even if basic funding survives, the need to manage programs at the local level will require more resources from state and local governments. In the coming biennium, expect HUD to focus on the reform of public housing, the consolidation of homeless assistance, Portfolio Reengineering, and home ownership initiatives.

The state's housing stock provides one of its greatest resources—a home and family life for over one million Kentuckians. In too many cases, however, Kentucky households are not fully benefiting from this resource. The cost of quality housing continues to climb while economic opportunities and subsequent wages have not kept pace. In addition, the state still faces many discriminatory barriers which restrict housing opportunities for minorities. Working to remove these can improve the quality of life for many Kentuckians and at the same time, open markets to first-time buyers and the underserved, which will benefit the entire housing industry. As indicated previously, the federal government's role in housing has been important to Kentucky. The current trend toward delegating more responsibility to the states will impact Kentucky's low-income households.

All levels of government and the private sector must continue to work in partnership if Kentucky is to improve housing for the bottom one third of the market. Housing that is affordable to low-income households continues to disappear, and housing programs designed to assist these households have been hard hit and could shrink more if current proposals are carried forward.

Kentucky also continues to face the possibility of losing the important Low-Income Housing Tax Credit Program. It is practically the only way to finance low-income rental housing and accounts for a large percentage of total multifamily production in the state. At best, Kentucky will see housing funds for the lower third of the market being distributed through block grants with slightly more flexibility, but at reduced levels. Over the next biennium, expect strength and growth in the top one third of the housing market, slight improvements in the middle third, and loss of available assistance and declines in quality in the bottom third.

## Conclusion

Affordability is the key issue in housing. If the economy is favorable and current trends prevail into the next century, Kentuckians will continue to seek single-family housing in stand-alone community developments. With shrinking federal housing assistance, state and local governments will be charged with more responsibility for the housing of lower income individuals and families.

To decrease the growing difference and distance between higher income single-family housing and lower income multifamily housing, the concept of New Urbanism offers a potential alternative that may become increasingly influential in planning. Designed to blend economic diversity and instill neighborhood pride at all income levels, this concept is gaining acceptance in many areas. Several years will have to pass before the success of the New Urbanism can be measured, but it may be a positive approach to meeting future housing needs of all income levels with equal access to jobs, schools, and transportation.

The next biennium will be one of continued strength and growth for housing in the Commonwealth. Look for housing production and prices to increase, especially in the move-up market. More responsibility will be given to local governments for housing lower income individuals and families. Historically, Kentucky is a state that has met challenges and will continue to do so.