

# Will Transportation Credit Mortgages Work in Practice ?

By Daniel G. Chatman

**I**nterest in the transportation credit mortgage (TCM), known more commonly as the location-efficient mortgage, flows from its status as a market mechanism with the potential to accomplish what regulation and legislation cannot. Such programs offer financial incentives intended to simultaneously increase access to public transit, enhance homeownership opportunities for low and moderate income households, encourage more compact development, and reduce auto use — in short, many of the goals associated with “smart growth.”

Transportation costs make up a significant part of the average American’s household budget, ranging from 20.9 percent in Houston to 14 percent in Baltimore. Those who buy homes based solely on getting “the most house for the money” — which generally means buying further from the urban core (and transit stops) — necessarily spend more on transportation than those closer to the center. It follows that those who can buy more

expensive housing closer to transit can spend less on transportation, offsetting greater housing costs or perhaps even coming out ahead financially.

TCM programs allow lenders to credit reduced transportation costs to household income, or use a relaxed loan-to-income ratio in setting the terms of mortgages, typically based on how close the home is to public transit as well as the development density of the neighborhood. The Natural Resources Defense Council estimates that households who do not own or use cars can save up to \$400 per month. Recognizing this potential savings enables homebuyers to bid more on houses in high-density neighborhoods with good transit access—the closer to transit and the higher the density, the larger the credit to income. The effect on house-buying capability will vary, but Fannie Mae estimated that in 2004 a median-income family in Georgia could bid as much as an additional \$12,500 based on expected transportation savings. In some markets, and for some households, that additional amount could make a critical difference in making it possible to purchase a house.

Will the TCM work as intended? Achieving the intended benefits requires two outcomes. First, a higher share of those in target neighborhoods must consist of households who use transit and walk. Second,

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there must be more housing provided in target neighborhoods. But both outcomes depend on conditions that may not hold, as discussed below.

## Spatial Sorting

The first outcome — increasing the share of transit users and walkers — requires that the use of TCMs leads over time to a residential “spatial sorting” according to preferences for transit. That is, households preferring public transit are expected to take advantage of the mortgages, relocate to the area and make up a greater share of the neighborhood.

But there are two reasons why the sorting process may be weak. First, although transit is clearly valued in the housing market, research suggests it is a relatively minor criterion for location decisions and does not strongly determine the final neighborhood choice, even for low-income households. Housing and neighborhood choice involves optimizing over multiple criteria, including criteria that may be more salient to most households (such as the quality of the school district); and every dimension cannot be simultaneously optimized. This means that more liberal mortgage terms in TCM neighborhoods may not change spatial sorting by travel preferences very much. TCMs may instead allow higher bids in TCM-targeted areas by low- and

**Daniel G. Chatman** is an Assistant Professor at the Edward J. Bloustein School of Planning and Public Policy, and director of the Alan M. Voorhees Transportation Center, at Rutgers University.

moderate-income households irrespective of their likelihood to own and use autos.

Second, gentrification may occur in urban core areas that are near transit stops for historical reasons. New development or significant refurbishment near rail stops may be attractive to both non-transit-using and transit-using households and, depending on the relative time and money costs of parking and driving in such neighborhoods, may dampen the anticipated sorting process.

Even an influx of low income homeowners does not guarantee that the travel habits of those living near transit stops will change. Though household income is positively correlated with auto ownership and use, and negatively correlated with transit use and walking, the mobility bestowed by the automobile is sought after and obtained by most low-income families. Households earning less than \$20,000 in 2001 made around 76 percent of their trips by car. As of 1990, even households that did not own a car made twice as many auto trips as transit trips, despite ready access to transit. Some households living in new development near transit can have auto usage rates higher than that of surrounding areas, suggesting that land use patterns, life-stage, or personal preferences underlie their travel decisions.

## Housing Production

Likewise, questions can be raised about the effectiveness of TCMs in achieving the second outcome—increasing housing supply. The idea is that TCMs will spur the market for “smart growth” housing development—through new construction, refurbishment, subdivision of existing units, or conversion of rental to ownership stock — attracting addi-

tional transit-using residents to targeted areas.

But like the residential sorting process, such housing production is potentially hindered by policies limiting the development of housing, particularly high-density housing. Paradoxically, the TCM program is particularly likely to be seen as a valuable tool in places where there are affordable housing problems. But the housing costs in such areas are likely increased by policies that limit housing development, particularly dense multifamily housing development. These policies include minimum lot-size zoning, off-street parking requirements and floor-to-area ratio limitations. In addition to formal policies there is of course often local opposition to housing development expressed in ad hoc policy making and building permit decisions.

These hurdles can be mitigated by rezoning or other measures, but whether doing so will help achieve TCM goals depends on the broader housing market. If development restrictions remain in place throughout the larger metropolitan area, or if there is high demand for housing due to population growth — creating a tight housing market — then freeing up development in targeted areas may end up attracting higher-income, auto-preferring buyers, without an aggregate reduction in auto use. In such tight markets, while TCMs may spur housing production, they may also cause housing costs to be permanently raised to a higher level, with existing owners of land realizing a windfall in the form of a higher sales price for their homes. In this case, low- and moderate-income households will pay more for housing with little or no benefit to show for it.

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## Conclusions

It appears TCMs can work — but only under specific and restrictive circumstances. In tight housing markets, TCMs will likely result in higher bids, but without necessarily increasing residential sorting. Implementing TCMs in such markets will require significant attention to other policies to produce the desired results -- for instance, eliminating minimum parking requirements and reducing constraints on affordable housing production throughout the metropolitan area. In low-demand markets —for example, low-growth areas with few if any limits on development — there may not be a need for TCMs. Most households will already be able to purchase housing near public transit. Still, TCMs will allow some low-income households to purchase homes through higher offers. In areas of low population growth, few constraints on housing production, and relatively rapid turnover of housing stock (e.g., university towns), the TCM might be more likely to result in sorting by travel preferences as intended. □

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