MERCATUS CENTER
George Mason University

POLICY BRIEF

The Link Between Local Zoning Policy and Housing Affordability in America's Cities

Kevin Erdmann, Salim Furth, and Emily Hamilton

March 2019

Throughout American history, cities have experienced rapid population growth during periods when they offered exceptionally well-paying jobs. But population growth in high-wage cities is only possible when people can find housing within a reasonable commuting distance. Unlike in the past, policymakers in some regions have implemented land use regulations that block new housing development, creating "Closed Access" cities. These are highly regulated cities that are not experiencing rapid population growth despite offering some of the highest wages and best career opportunities in the country.[1]

When housing demand increases in Closed Access cities, prices rise sharply.[2] From 2012 to 2018, for example, rent grew 29.5 percent in the Closed Access San Francisco metro area while housing supply grew just 2.8 percent. In Open Access Austin, by contrast, rent grew only 13.8 percent and the housing stock grew 15.9 percent.[3] The burden of Closed Access rules falls disproportionately on low-income people, both because those people spend a greater percentage of their income on housing than high-income people do and because they are more often renters, paying more without enjoying an increase in home equity.[4]

The lackluster growth and high prices of Closed Access cities are caused by land use regulations that limit property owners' rights to build new housing. To restore the longstanding American traditions of national mobility and inclusive growth, policymakers from town halls to Capitol Hill must work to open up access to all of America's cities.

LAND USE REGULATIONS CREATE CLOSED ACCESS CITIES

Land use regulations include zoning, subdivision regulations, growth boundaries, fees, parking requirements, and environmental liabilities. These regulations place limits on property owners' ability to expand their city by building up or out. Every city in the United States—even Houston—places some limits on growth, but the Closed Access cities are those that make it very difficult to build either up or out. In particular, the Bay Area, Boston, Los Angeles, and New York have restricted the supply of housing in the face of increasing demand, causing high and rising prices.

In many cases, mountains and bodies of water also block outward expansion. But instead of mitigating the lack of land by allowing especially dense development, Closed Access cities have exacerbated the problem. For example, Hawaii and Oregon require land surrounding urban areas to be preserved as open space or farmland. These urban growth boundaries prevent cities from growing out while zoning regulations prevent them from growing up. Today the median house in the Portland region costs nearly $400,000, compared to $225,000 nationally.[5]

New York, before the adoption of its 1961 zoning resolution, allowed vertical growth and steady densification in the outer boroughs to counteract its lack of nearby land. The 1961 code placed new limits on how dense new housing can be. Population growth in New York has not been matched with growth in the housing supply, leading to high prices and crowding.[6] While topography can certainly raise prices and make growth more challenging, Closed Access cities are a creature of regulation, not an accident of geography.

THE MYTH OF A NATIONAL HOUSING GLUT

A new book, *Shut Out: How A Housing Shortage Caused the Great Recession and Crippled Our Economy*, makes the case that the popular history of the housing price boom and bust of the 2000–2010 period is incorrect.[7] The crisis was not primarily the fault of irresponsible lenders and bankers pushing housing demand to unsustainable heights; it was the fault of local regulations that limit access to America's best job markets. *Shut Out* characterizes these as "Closed Access" cities.[8] Although the specific market conditions in the middle of the 2000–2010 period have passed, the same high-wage cities are still Closed Access places.

Poorly underwritten mortgages have been blamed for creating a housing glut early in the 2000–2010 period. But far from a glut, the recent decades have been characterized by a shortage of housing. During the boom years, the ratio of national housing starts to population growth only modestly exceeded its long-run average.[9] Closed Access cities largely exempted themselves from growth, issuing building permits at a lower rate than Rust Belt cities such as Detroit and St. Louis.[10]

Instead of growing, Closed Access cities generated out-migration to make space for the high-income workers migrating in. Every year in the middle part of 2000–2010, nearly 2 percent of homeowners in the Closed Access cities sold and departed.[11] Renters fleeing high costs and homeowners cashing out and moving away from their high-priced homes fueled the rapid growth into Florida, Las Vegas, Phoenix, and inland California. As *Shut Out* notes, "Just to handle the out-migration from New York City and Boston in 2005, nearly as many additional homes were being built *in Florida* for New Yorkers and former Boston residents as in New York City and Boston. The rate at which Nevada, Arizona, and Oregon were building homes *just to accommodate* refugees from San Francisco and Los Angeles was higher than the rate at which San Francisco and Los Angeles are even capable of building in total."[12]

Meanwhile, rent was becoming more important as a determinant of price differences between metro areas.[13] Growing mortgages were facilitating new residential investment across the country, which was counteracting Closed Access supply constraints. But in the aggregate the rise in debt did not constitute unsustainable mortgages to unqualified borrowers. Where rising mortgage levels were associated with extreme valuations, it was mortgages to highly-skilled young workers buying access to the exclusive, housing-deprived cities and to the fast-growing markets where many of the new buyers were trying to escape the rising costs of the Closed Access cities.

The same problems cities are dealing with today— tight supply and rising costs—were at the heart of what became known as the housing bubble. What appeared to be a glut was really triggered by a mass migration created by localized shortages.

HOW CAN CLOSED ACCESS CITIES OPEN UP?

Local Reform

Several US cities provide models for accommodating growth and maintaining affordability. Houston is famous for not having a zoning code and for allowing rapid suburban development on its urban fringe. But it also allows dense redevelopment. In 1999, Houston reduced the minimum lot size within its Interstate 610 loop to 1,500 square feet, making townhouse development possible.[14] In 2007 it expanded this reform to cover a larger part of the city.[15]

Atlanta recently updated its zoning code to allow accessory dwelling units in some of its single-family zones and to reduce parking requirements in areas served by rail transit.[16] Minneapolis updated its comprehensive plan to allow duplexes and triplexes in all areas of the city that were previously restricted to single-family development.[17]

While Minneapolis will begin permitting moderate density everywhere, Seattle has taken the approach of allowing for high-density housing in specific "urban villages." For two years, Seattle has had more cranes up than any other US city, and the new supply is now leading to falling rent.[18]

These four cities show that local reform is possible, politically as well as economically. However, local reform ends at the municipal limits, and metro areas comprise many jurisdictions, each of which sets its own land use regulations and is responsive to its own voters. Large, rapid changes in policy thus require state action.

State Reform

States have clear legal and economic bases for setting limits on local land use regulations. Local jurisdictions are "creatures of their states," so even "home-rule" states can limit local regulatory authority.[19] The effects of local restrictions on new housing spill across local political boundaries, limiting population growth, economic growth, and income mobility at the state and national level. Because these are valid objectives for state policymakers, they have a role to play in limiting exclusionary zoning and protecting property owners' rights to build more housing.[20]

California is leading the way in state preemption of local land use rules. In 2016, state policymakers passed a law that requires all of the state's localities to allow accessory dwelling units (also known as granny flats or backyard cottages) on all lots that have single-family homes. California lawmakers are considering further preemption, including a bill that would set limits on localities' ability to restrict housing construction in transit-rich and job-rich areas.[21]

Other states, including Oregon and Connecticut,[22] have similar bills under consideration that would restrict local zoning authority. Washington state policymakers have a bill under consideration that would legalize accessory dwelling units, following California's model.[23]

Federal Reform

The federal government is limited in its potential to reduce the harms that Closed Access cities cause. Direct federal preemption of local zoning rules would probably exceed the constitutional powers granted to the federal government and would infringe on states' role of authorizing local governments and designating responsibilities for them.

The federal government should, however, steer its support toward more open jurisdictions. Both Senator Cory Booker and Secretary of Housing and Urban Development Ben Carson have proposed using Community Development Block Grants (CDBGs) as a tool to encourage zoning reform.[24] CDBGs are one of the few grants that the federal government allocates to municipalities directly. While these grants are statutorily required to support projects that primarily benefit low- and moderate-income people, CDBG funds are often spent on small public works projects, such as façade improvements for private businesses, that have dubious value for low-income residents. Withholding funds from jurisdictions that have both high house prices and exclusionary policies would raise the profile of the harms that land use regulations cause renters in Closed Access cities.[25]

The federal government could make greater progress by shrinking its own distortions of housing markets. Federal subsidies to homeownership, including the mortgage interest deduction and tax-free capital gains for homes, encourage single-family development at the expense of density.[26] Progress has been made: the 2017 Tax Cut and Jobs Act curtailed the distortion that the mortgage interest deduction causes by increasing the standard deduction and capping major itemized deductions.

To reduce the incentive that homeowners have to oppose new housing supply, federal lawmakers could institute a lower cap on the mortgage interest deduction in exclusionary jurisdictions.[27] Alternatively, a complete elimination of the mortgage interest deduction and a phase out for the capital gains exclusion for homeowners would reduce the federal government's role in encouraging Closed Access orders.

Finally, in an attempt to address high home prices rather than the more fundamental problem of high rents, federal monetary policy and mortgage regulations were tightened up during and after the financial crisis.[28] This pushed prices down in cheap markets as well as expensive ones. But rents have not come down—just prices.[29] This has made new construction in cities and neighborhoods where incomes are lower difficult because builders cannot profitably build at the new, lower price levels, contributing to a tighter overall housing supply. Responsible, yet accommodative monetary and credit policies would help to fund the new supply that will bring down rents.

ABOUT THE AUTHORS

Kevin Erdmann is a visiting fellow at the Mercatus Center at George Mason University. Erdmann is currently engaged in two book projects with Mercatus on housing finance, land use restrictions, and monetary policy. His first book, *Shut Out* (Lanham, MD: Rowman & Littlefiled, 2019), offers a contrarian theory on the causes of the housing boom and bust.

Salim Furth is a senior research fellow for the Urbanity project at the Mercatus Center at George Mason University. He studies regional, urban, and macroeconomic trends and policies. Previously, he has worked at the Heritage Foundation and Amherst College. He is a graduate of the University of Rochester, where he studied economics.

Emily Hamilton is a research fellow at the Mercatus Center at George Mason University. Her research focuses on urban economics and land use policy. Hamilton has authored numerous academic articles and policy papers. Her writing has appeared in *USA Today*, the *Christian Science Monitor*, *Economic Affairs*, and the *Philadelphia Inquirer*. She contributes to the blog *Market Urbanism*.

NOTES

1. Peter Ganong and Daniel Shoag, "Why Has Regional Income Convergence in the U.S. Declined?," *Journal of Urban Economics* 102 (2017): 79–90.

2. Rent growth figures are adjusted for inflation. See Salim Furth, "Housing Supply in the 2010s" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2019), 32.

3. Furth, "Housing Supply in the 2010s."

4. Sanford Ikeda and Emily Hamilton, "How Land-Use Regulation Undermines Affordable Housing" (Mercatus Research Paper, Mercatus Center at George Mason University, Arlington, VA, 2015).

5. Zillow research, "United States and 50 Larges Metro Areas: January 2019," https://www.zillow.com/research/local-market-reports/.

6. Peter D. Salins, "Simple Rules for a Complex Society: Redesigning New York's Zoning," *City Journal*, Winter 1993.

7. Kevin Erdmann, *Shut Out: How a Housing Shortage Caused the Great Recession and Crippled Our Economy* (Lanham, MD: Rowman & Littlefield, 2019).

8. Here and throughout this paper, "cities" refers to metro areas rather than to political cities.

9. Erdmann, *Shut Out*, 14, figure 1-1.

10. Erdmann, 20, figure 1-4.

11. Closed Access cities are Boston, Los Angeles, New York, San Diego, and San Francisco. See author calculations based on Census Bureau, American Community Survey.

12. Erdmann, *Shut Out*, 121 (italics in the original).

13. Erdmann, "High Home Prices Are Caused by Limited Supply," in *Shut Out*, 13; Zillow, "Mortgage Affordability, Rent Affordability, Price-to-Income Ratio," accessed February 21, 2019, https://www.zillow.com/research/data/; Zillow, "Median Household Income," accessed February 21, 2019, https://www.zillow.com/research/data/. Median household income measures were taken for each metropolitan area.

14. Nunu Chang, "Planning the Houston Way, Part II: Special Minimum Lot Size," *Off Cite*, March 21, 2018.

15. Chang, "Planning the Houston Way, Part II."

16. Robert Steuteville, "Atlanta Zoning Update Addresses Parking, ADUs, Missing Middle," *Public Square*, February 11, 2019.

17. Salim Furth and Emily Hamilton, "Cities and States to Watch in 2019," *The Bridge*, January 11, 2019.

18. Furth and Hamilton, "Cities and States to Watch in 2019."

19. Emily Hamilton and Salim Furth, "California Can Improve Housing and Transit by Preempting Local Ordinances" (Mercatus on Policy Series, Mercatus Center at George Mason University, Arlington, VA, March 2018); Jon D. Russel and Aaron Bostrom, "Federalism, Dillon Rule and Home Rule" (Arlington, VA: American Legislative Exchange Council, 2016).

20. Emily Hamilton, "The Case for Preemption in Land-Use Regulation," Mercatus Center at George Mason University, July 20, 2017.

21. Emily Hamilton and Salim Furth wrote about a bill with similar objectives that was introduced in the 2018 legislative session. See Hamilton and Furth, "California Can Improve Housing."

22. The Oregon bill would allow up to fourplexes to be built on land currently zoned for single families in cities with populations of 10,000 or more. See H.B. 2001, 80th Gen. Assemb., Reg. Sess. (Or. 2019); the Connecticut bill would preempt local rules that prevent multifamily housing from being built near fixed-route transit. See H.B. 5273, Gen. Assemb., Jan. Sess. (Conn. 2019).

23. H.B. 1797, 66th Leg., Reg. Sess. (Wash. 2019).

24. Richard Kahlenberg, "Taking On Class and Racial Discrimination in Housing," *American Prospect*, August 2, 2018; Laura Kusisto, "HUD Moves to Shake Up Fair-Housing Enforcement," *Wall Street Journal*, August 13, 2018.

25. Salim Furth and Emily Hamilton, "Conditioning HUD Grants on Housing Market Outcomes Furthers Fair Housing" (Public Interest Comment, Mercatus Center at George Mason University, Arlington, VA, October 3, 2018).

26. Edward L. Glaeser, *Triumph of the City: How Our Greatest Invention Makes Us Richer, Smarter, Greener, Healthier, and Happier* (New York: Penguin, 2011), 265.

27. Edward L. Glaeser and Joseph Gyourko, *Rethinking Federal Housing Policy: How to Make Housing Plentiful and Affordable* (Washington, DC: AEI Press, 2008).

28. For an example of Federal Reserve pressures to tighten monetary policy, see Richard W. Fisher, "Responding to Turbulence (With Reference to Bob Dylan, Alan Brooke, Washington Irving, Anna Fisher and Marcus Nadler)" (lecture, Money Marketeers of New York University, New York, September 25, 2008). For signs of tightened lending standards, see *Quarterly Report on Household Debt and Credit* (New York: Federal Reserve Bank of New York, February 2019); and "Housing Credit Availability Index," Urban Institute, January 17, 2019, https://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-credit-availability-index.

29. For comparisons of mortgage expenses and rents within various metropolitan areas, see Zillow Research, "Mortgage Tier Affordability," accessed February 21, 2019, https://www.zillow.com/research/data/; Zillow Research, "Rent Tier Affordability," accessed February 21, 2019, https://www.zillow.com/research/data/.