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FACT SHEET

How Too Little Housing—Not Too Much Credit—Led to the Great Recession

Policymakers and economists broadly attributed the 2005 housing bubble to excessive home lending and construction. This misdiagnosis of the problem led to misguided public policies that were the primary cause of the subsequent financial crisis. Rather than a simple narrative of building too many homes, the actual story was that not enough homes were built in the right places. The United States suffered from a *shortage* of well-placed homes, and the housing bubble that peaked in 2005 was more a refugee crisis than a credit bubble.

So argues Kevin Erdmann in his new book, *Shut Out: How a Housing Shortage Caused the Great Recession and Crippled Our Economy*. The author highlights the role of what he calls Closed Access coastal cities, such as New York City and San Francisco, in blocking access to economic opportunity. Cutting-edge urban labor markets in sectors like tech and finance call for a new wave of urbanization, but a few cities have developed overwhelming local obstacles to new residential construction. According to Erdmann, these gentrifying urban centers have become exclusionary bastions in the new postindustrial economy, characterized by

- high and rising incomes,
- very low rates of homebuilding,
- rising rents,
- rising home prices, and
- a turnstile migration pattern of high-income households moving in and low-income households moving out.

Erdmann lays out a timeline leading up to the crisis.

1. *Moderate- and low-income households moved out*. As demand surged for limited urban housing, moderate- and low-income households could no longer afford to live in Closed Access cities. They relocated to other parts of the country.
2. *Wealthier individuals moved in*. Poorer households were replaced by those with financial means who were able to take advantage of the opportunities presented by the Closed Access cities.
3. *The effects were felt elsewhere*. Displaced families caused a brief contagion of high prices in the cities where they moved. The so-called Contagion cities in Arizona, Nevada, and Florida were the epicenter of this housing boom.
4. *The US government and Federal Reserve (Fed) reacted poorly*. Erdmann concludes that a sort of moral panic about supposed excesses in home lending and construction led to policies that restricted credit and limited home construction. As the economy slumped, a sense of fatalism prevented the government and the Fed from responding appropriately to the worsening situation.

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KEY TERMS, TELLING FACTS

Closed Access Cities

These are cities with a housing supply so constrained that large numbers of households with lower incomes can no longer afford housing and move away to make room for households with financial means. A number of political tools—including zoning rules, environmental and historical preservation standards, rent affordability mandates, and others—have added up to a practical veto by local residents on many new residential construction proposals.

Examples of Closed Access cities include the following:

- New York City
- Los Angeles
- Boston
- San Francisco (and San Jose)
- San Diego

Characteristics of Closed Access cities:

- *Shrinking size*. In 1960, Los Angeles was zoned for a maximum population of 10 million, but by 1990 its zoned capacity had shrunk to 4 million (about the population of the city today).
- *Out-migration*. Despite the strong demand for living space, there is an astounding out-migration from cities such as New York, which has net domestic out-migration levels that look like Detroit's. In San Francisco, even the suburbs experience out-migration.
- *Housing economics outside of historical norms*. The development of mortgages with risky terms and high payments has attracted broad concern. But in these cities, the portion of the typical family's budget going to rent is far greater than historical norms. It isn't credit markets that are introducing risk and recklessness into American family budgets; it is the cost of Closed Access housing that creates that stress, for both renters and owners.

Open Access Cities

Most US cities are Open Access cities, where mortgage affordability was never out of line. Credit suppression since the boom has pushed home prices down in these cities, especially in entry-level neighborhoods where homeowners cannot access reasonable mortgages today.

Examples of Open Access cities include the following:

- Atlanta
- Houston
- Dallas
- Most smaller metro areas

A primary characteristic of Open Access cities has been a disproportionately high number of housing permits. Three Open Access cities—Dallas, Houston, and Atlanta—accounted for only 5 percent of the US population from 1999 to

2006, but they accounted for 9 percent of housing permits. In contrast, even though Closed Access cities accounted for 16 percent of the US population from 1999 to 2006, they accounted for only 7 percent of housing permits.

Contagion Cities

The housing bubble in these cities was a result of a mass migration event as hundreds of thousands of households fled the high costs of the Closed Access cities. Contagion cities had an “anti–Gold Rush,” of sorts—that is, a wave of families moving away from places where others were “striking it rich.”

Examples of Contagion cities include the following:

- Miami
- Las Vegas
- Phoenix
- Riverside, CA
- Tampa
- Essentially, all of Florida, Arizona, Nevada, and inland California

Characteristics of Contagion cities:

- *Limited bubble*. Despite home prices briefly shooting up in Phoenix at the height of the boom, they never even reached the long-term bottom range of prices in the Closed Access cities.
- *Refugee crisis*. In 2005, nearly as many 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 those cities were even capable of building in total.