MIT CENTER FOR REAL ESTATE
Highlights of the Fall Symposium

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House Poor: The High Cost of Housing

In many areas of the country recent steep increases in home prices have added to homeowner wealth at the same time they have caused many young families to despair of ever owning a place of their own. Why is the cost of shelter rising so steeply. What role does government action--zoning and regulation--play? What is the true cost of housing? Homebuilders, employers, academics and homeowners met in Cambridge to answer these questions and discuss the issues and options available.

Richard H. Davis, President, Homeownership Alliance

William McLaughlin, Regional Vice President, AvalonBay Communities, Inc.

Tony Green, Managing Partner, The Pinehills

Joel Rassman, Chief Financial Officer, Toll Brothers, Inc.

William Pulte, Chairman, Pulte Homes, Inc.

Denise DiPasquale, President, City Research

Richard K. Green, Principal Economist, Freddie Mac

David Mead-Fox, Managing Director, Korn Ferry International

Richard Muraida, Vice President, Eastern Bank

Edward Glaeser, Professor of Economics, Harvard University

Rolf Pendall, Associate Professor of Planning, Cornell University

Anthony Downs, Senior Fellow, Brookings Institution

Rick Davis, *Homeownership Today*

Over the last century homeownership has increased 60% so that today two-thirds of Americans own their own home. This happened because the federal government gave homeownership priority in supplying mortgages and in making mortgage interest tax deductible. Are home prices out of line today? The NAHB housing opportunity index is close to an all-time high for affordability. A family earning the median US wage could purchase 65% of the houses sold. Over the long term the nationwide cost of housing should be about equal to the rate of inflation. However, over the last few years the increase in cost of housing has been much greater. Regulatory barriers are responsible for some of the lack of supply leading to higher costs. In the San Francisco area, 28.6% of the cost of the average home could be trimmed through reform and streamlining of the regulatory process. The Homeownership Alliance promotes a housing market that is dynamic, durable and critical to the performance of the national economy.

Builders' Panel: Why are Home Prices So High?

Bill McLaughlin: The crux of housing costs is regulation. In high-cost markets there is a structural disequilibrium between supply and demand that has taken years to develop and will take years to unravel. What is the barest minimum cost to build a plain vanilla home, omitting any land cost and assuming a ‘plug-in’ site? Say, a construction cost of $100K per unit, with rent payments of $1250 per month. This is affordable to someone earning $50K per year. But it doesn't exist. Land has to pass the highest and best use test, so land adds $20-30K per unit. The reason for high housing costs in Massachusetts is the lack of product. "There is no land zoned for our use. Period." Three quarters of all multifamily built in the last three decades has been under the 1969 affordable housing statute, known as Chapter 40b. If 40b is stripped we'll lose that housing in the future.

Tony Green: Home prices are the buyers' perception of value, and new home prices are the "grades" a builder gets, an evaluation of the job the builder did in creating value. Value is composed of three things: location, sticks and bricks and presentation – the feeling one gets in the buying process. At Pinehills we are satisfying a market for which there has been no supply. Siting homes, and offices, based on views of woods, water or golf creates more value. Pinehills average home price is $500,000 compared to $200,000 in the rest of Plymouth. So price is not just of function of overall demand/supply, but people's willingness to pay for the supply in each micro-market.

Joel Rassman: If you compare housing costs in San Francisco and Boston, the difference between 2 homes of similar size is the difference in obtaining land, and the complexity of the approval process plays a major role. It can take on average 4-6 years to obtain an approval and even then you may be limited to a certain number of homes per year. Hard costs are the same everywhere-a brick doesn't know where it's going. Massachusetts has a constrained labor supply, which means that here 70% of the bricks and sticks cost is labor compared to 50% in New Jersey. When you do get an approval you are striking gold because there is so little competition.

William Pulte: The high cost of housing has nothing to do with sticks and bricks including high labor costs. There are six areas we should look at: first, the time it takes to process zoning and entitlement work during which you are paying interest and carrying costs. Second, is the proliferation of approvals and exactions. Third, building code requirements have proliferated--energy codes, handicap codes, structural codes. All these increase costs. Fourth, insurance costs have increased to the point where most general contractors simply can't afford it. This all adds $2K-$5K in costs per house. Then there is land cost. All the good, easy to develop land is used up. What is left is on rough terrain, lacking infrastructure. And finally, there is what I call snobbery. Snobs want bigger lots, bigger houses and no look-alike housing. They want to restrict building permits and put affordable housing somewhere else.

The Consequences Panel: What are Some Impacts of High Home Prices?

Denise DiPasquale, *Low-Income Housing in High-Cost Areas*
The Senate Banking Committee requested a study of the relative costs of government-sponsored housing under its active affordable housing programs. The programs provide a variety of housing types of differing quality. Unit sizes vary according to target population. Total development costs are all over the map. Hope VI housing averages $143K per unit while low-income housing tax credit units average $73K. However, the tenant pays substantially higher rents for the tax credit housing. The lowest costs are for elderly and disabled housing which are smaller units. As you might expect, the highest development costs of the areas studied are in New York and Boston, where the average cost of a tax credit unit is $116K. Boston is high cost for tenants too. Housing voucher rents average $880, and tax credit rents are at $820. The government pays over 50% of the costs for all programs except the low-income housing tax credit, for which it pays less than 40%. The tenant pays 54% of that and it serves a higher-income population than the others. Conclusions that can be drawn: Expensive housing markets have serious implications for low-income people because serving them with rental housing is very expensive. The tenant has to put a lot of money in. The current fashion in housing policy favors tax-credits where you are leveraging federal subsidies to bring others to the table, but a lot of different entities have to step up in order to make the housing affordable to the poorest people.

Richard Green, *Financial Impacts of Greater Housing Wealth*
Home equity has increased by $2 trillion in the last three years. For the average household that means roughly $7,000 of wealth has been created. Total housing wealth, which was surpassed during the go-go '90s by stock market wealth, has regained its position as the primary repository of wealth in the US. Equity wealth (stocks) are more important only for the top 10% of the population.

Nominal house prices have grown every year since 1950 on a national basis, and have provided a stabilizing effect to the national economy. People hate to sell their house below the price they paid so they'll hold on in a weak market and they tend to default less than expected. In weak markets you tend to see a decline in volume, rather than price. Does housing wealth mean the same as stock market wealth? When prices go up, how does that affect people who are not owners yet? Rising home prices can lead people to save more, but there is a point where there is a discouragement effect. What about financial and wealth effects for those who own? First, increased liquidity adds to integration into capital markets which is important in smoothing economic performance. People who participate in the capital markets self-insure--they smooth their consumption so changes in their income doesn't lead to changes in consumption. The ability to refinance their mortgage allows people to participate in capital markets at a lower cost.

David Mead Fox, *High Home Prices as Employment Barriers*
High housing costs are the single most vexing problem in recruiting senior executives. It may not be such a problem for very highly compensated executives; they can find a house although it may not suit their desires. But in general, employers have difficulty attracting new hires to this high-cost area. At the same time, current employees are willing to be lured away more easily. Thus local candidates have a hiring advantage. On the other hand, when a hire is not made, it may be that housing costs function as a smoke screen. In the current environment, people's risk aversion is going up apart from housing costs. Relocation simply feels too risky. These factors muddy the waters.

Richard Muraida, *Roles for Employers and the State*
Three main programs support affordable housing in Massachusetts. The Employer Assisted Housing Initiative, a new effort by the greater Boston Chamber of Commerce, aims to help employers help their workers understand the home buying process and locate affordable housing. Chapter 40b allows the issuance of a comprehensive permit to a developer with a site who plans to build housing with a minimum of 25% affordable units. Finally, in 1999 Massachusetts enacted a state version of the federal low-income housing tax credits, the Commonwealth Credit, which is designed to create $20 million worth of credits and a much larger investment in affordable housing over 5 years.

Ed Glaeser, *Where and Just How Expensive is Housing?*

House costs are only high in certain heated-up areas. There are substantial differences between regions. In much of the country land is virtually free and in Detroit and some other places, land cost is essentially negative. But in LA in 1999, 90% of the units were 140% or more above the national average. About half of all housing units are now trading at about 50% more than construction costs, sometimes much more. The result is now, for the first time in history, in many areas the cost of homes is not determined by construction costs.

Why is the price of land so great? The conventional economic story is that we are running out of land, and demand is pushing the price up. There is a second story, the zoning theory, which says that demand is only part of it. We've really got plenty of land, but regulation makes it impossible to build on it. The key implication of the classic model is that in expensive places, the density should shoot up. In actuality there is no increase in zoned density in these places. If we had had the same kind of zoning in New York in the 19th century as we have now, we'd have a handful of people in big houses, like the Frick Mansion, living on Fifth Avenue. For the first time in history zoning has shut down the supply response. What is different now? There has been a change in the power of community activists, an empowerment of the community to block development. This has a huge distorting effect and huge economic and social costs. Nobody can possibly think the current system of zoning controls is a sane system.

Rolf Pendall, *Are Land Use Regulations the Culprit?*

I want to expand the frame of reference from housing affordability to housing opportunity and ask how do regulations affect opportunity. Land use regulations can operate on both sides of the demand/supply equation. Standard kinds of regulation like exclusionary zoning reduce density, shift housing toward expensive structures, etc. and in general reduce housing opportunity. There are also new kinds of controls. Studies on those offer much less consistent results. The jury is still out on Portland where the urban growth boundary has been accompanied by strong efforts to increase density and to abolish exclusionary zoning and permit caps.

Deregulation is not the route to housing opportunity. Government has to reshape markets so that builders will provide more housing choices in good locations. Practically speaking the politics of sprawl and smart growth are strong and they are not about deregulating; they are about imposing new regulations. It's a very decentralized and incentive-based kind of system. So the question is will jurisdictions get new regulations that are good? Good regulations encourage higher density, creating a broader mix of housing and even a greater supply than would exist under existing regulations. It provides certainty for everyone about where development will happen and when. Good regulations also help predict and cover the cost of the public services necessary to accommodate new growth.

Housing advocates from both the private and non-profit sector should fight to keep 40b in its current form. At the same time you should work toward housing planning: determine the total housing need and allocate it. And work on new infrastructure to support housing. Regulations can be the culprit in reducing housing opportunity but they can also be the heroes.

Tony Downs, *Policy Responses to the Shortage of Affordable Housing*

Expanding the supply of affordable housing is a solution but it has enormous economic and political forces arrayed against it. All the financial institutions connected with housing, plus homebuilders and the 67% of Americans who are homeowners are opposed to making housing more affordable because they fear their own asset value would decrease if it were. Thus tactics have to focus on expanding the housing supply in specific situations, which shifts the emphasis from the federal government to state and local authorities.

The biggest obstacle is the resistance of many suburban jurisdictions to permitting construction of multifamily or affordable units within their boundaries. As long as we leave full regulatory power over planning, permitting and constructing housing to local governments, there is no realistic chance housing costs can be reduced by changing regulations that increase those costs. The idea of relying on voluntary changes to regulations is a delusion. There are a number of methods that could be used to limit the power of local governments to stop affordable housing. One is creating mechanisms to allow housing developers to override local zoning, as Chapter40b does in Massachusetts. Another is requiring developers to include affordable units in every project, inclusionary zoning. The state government can prohibit local rules against manufactured housing, or plastic pipe, or multifamily housing, or (what would have the biggest pay-off) accessory apartments. Or a state could create financial or other incentives for localities to permit affordable housing. The drawback here is that it is expensive. A state could also adopt housing goals that local governments must follow or face sanctions.

None of these have been adopted widely. It would take a housing crisis affecting politically important groups--employers, public sector workers--to overcome the political disincentives. In a democracy like ours, getting a large majority who benefits from certain arrangements to change those arrangements to benefit a minority is very difficult.

Audio tapes of the full meeting are available for $20. To order, contact Rosrin Srethapramote at the Center (617-253-8311, rosrin@mit.edu). Make checks payable to MIT.