

Research Summary Prescriptive Land Use Regulation & House Price Increases

As economics teaches, scarcity raises prices. In a number of metropolitan markets, *prescriptive land use regulations* or policies have been adopted, such as urban growth boundaries, huge areas declared off-limits to development, building moratoria, population limits, unit construction limits, expensive unprecedented impact fees, and excessively large minimum lot sizes. Prescriptive land use regulation allows development only prescribed under strict conditions that are consistent with stringent land use plans and policies.

These policies, often referred to as “smart growth,” (“urban consolidation in Australia”) create a scarcity of land, artificially raise the price of housing, and, again, have increased the exposure of the market to risky mortgage debt.

The alternative to prescriptive land use regulation is responsive *land use regulation*, which largely allows development to respond to the market as reflected in the preferences of people and businesses (and subject to reasonable environmental and health regulation).

When more the profligate mortgage loan policies were implemented, especially in the United States, metropolitan areas that had adopted prescriptive land use policies lacked the resilient land markets that would have allowed the greater demand to be accommodated without inordinate increases in house prices. These price increases were unprecedented and led to the intensive mortgage losses than precipitated the international financial crisis).¹

Assessments from Leading Economists

There is general agreement top world economists that strong land use planning (smart growth) is associated with severe housing cost escalation.

- Nobel Laureate economist Paul Krugman of Princeton University and the *The New York Times* noted that the house price bubble has been limited to metropolitan areas with strong land use regulation²
- Thomas Sowell of the Hoover Institution has made similar points.³
- More recently, Theo Eicher of the University of Washington produced a working paper placing much of the blame for house price escalation on land use regulation in cities around the nation.⁴

¹ See: <http://www.heritage.org/Research/Economy/wm1906.cfm>,

² <http://www.nytimes.com/2005/08/08/opinion/08krugman.html> and <http://select.nytimes.com/2006/01/02/opinion/02krugman.html>

³ <http://article.nationalreview.com/print/?q=YjgwYzI4Njg3OWMxOGUzYmY0ZDMwYzYwNzkzYjc1NDI>

- A United Kingdom government report by Kate Barker, a member of the Monetary Policy Committee of the Bank of England, blamed that nation's loss of housing affordability on its prescriptive land use policies under the Town and Country Planning Act of 1947 (The *Barker Report*).⁵
- A New Zealand government report by Arthur Grimes, Chairman of the Board of the Reserve Bank of New Zealand blamed the loss of housing affordability in the nation's largest urban area, Auckland, on prescriptive land use policies.⁶
- Reserve Bank of Australia Governor Glenn Stevens told a parliamentary committee that "An increase in state government zoning regulations is a significant factor driving up the cost of housing." He also noted the increase in local and state government levies on new developments as a driver of higher housing prices.⁷
- Former Reserve Bank of New Zealand Governor Donald Brash wrote that *the affordability of housing is overwhelmingly a function of just one thing, the extent to which governments place artificial restrictions on the supply of residential land*.⁸
- William Fischel of Dartmouth University shows that the diversion of house prices between California and the rest of the nation from 1970 to 1990 was associated with stronger land use regulation.⁹
- Research by Harvard University's Edward Glaeser the University of Pennsylvania Wharton School's Joseph Gyourko others shows a strong relationship between prescriptive land use policies and higher housing prices, noting:

*America does not uniformly face a housing affordability crisis. In the majority of places, land costs are low (or at least reasonable) and housing prices are close to (or below) the costs of new construction. In the places where housing is quite expensive, zoning restrictions appear to have created these high prices.*¹⁰

⁴ http://depts.washington.edu/teclass/landuse/housing_020408.pdf

⁵ Kate Barker (2004 and 2006). *Review of Housing Supply: Delivering Stability: Securing Our Future Housing Needs: Final Report—Recommendations*. Norwich, England: Her Majesty's Stationery Office. www.hm-treasury.gov.uk/consultations_and_legislation/barker/consult_barker_index.cfm, and *Barker Review of Land Use Planning*, http://www.hm-treasury.gov.uk/media/4EB/AF/barker_finalreport051206.pdf.

⁶ Arthur C. Grimes, *Housing Supply in the Auckland Region*, Center for Housing Research Oater New Zealand (2007). <http://www.hnzc.co.nz/chr/pdfs/housing-supply-in-the-auckland-region-2000-2005.pdf>.

⁷ "RBA says land shortage driving house prices," *Adelaide Now*, 17 August 2007, <http://www.news.com.au/adelaidenow/story/0,22606,22260763-5005962,00.html>.

⁸ Donald Brash, Introduction to the *4th Annual Demographia International Housing Affordability Survey*, <http://demographia.com/dhi4-preface.pdf>.

⁹ William Fischel, *Regulatory Takings, Law, Economics and Politics*, Cambridge, MA: Harvard University Press, 1995 (pp. 218-252).

¹⁰ Edward L. Glaeser and Joseph Gyourko, *The Impact of Zoning on Housing Affordability*, (Cambridge, MA: Harvard Institute of Economic Research, 2002), <http://www.economics.harvard.edu/pub/hier/2002/HIER1948.pdf>.

- Glaeser et al further show that Boston’s house prices had been inflated 60 percent by scarcity created by prescriptive planning that relies heavily on large lot zoning (rural zoning).¹¹
- Anthony Richards, head of the Economic Analysis Department of the Reserve Bank of Australia recently said that: *...supply-side factors should have a much greater influence on prices towards the fringes of cities, where land is less scarce and accounts for a smaller proportion of the total dwelling price. In principle, the price of housing there should be close to its marginal cost, determined as the sum of the cost of new housing construction, land development costs, and the cost of raw land.*¹² In fact, in prescriptive markets this is no longer the case.

- Research by Raven Saks of the Federal Reserve Board indicated that:

*In places with relatively few barriers to construction, an increase in housing demand leads to a large number of new housing units and only a moderate increase in housing prices. In contrast, for an equal demand shock, places with more regulation experience a 17 percent smaller expansion of the housing stock and almost double the increase in housing prices.*¹³

- An analysis by the Federal Reserve Board of Dallas notes the association between metropolitan area house price increases in the 2000-2006 housing bubble and the presence of prescriptive land use regulation.¹⁴

Demand for housing, driven by low interest rates and a growing economy, combined with supply restrictions—such as zoning laws, high permitting costs and “not in my backyard” regulations—to contribute to rapid price appreciation. ... low levels of construction in the face of strong demand contributed to significant price appreciation...

The analysis notes that in the responsive markets of Atlanta, Dallas-Fort Worth and Houston, flexibility with respect to housing supply spared those metropolitan areas the price increases that occurred in prescriptive markets.

... Atlanta, Dallas-Fort Worth and Houston “weathered the increased demand largely with new construction rather than price appreciation because of the ease of building new homes.

¹¹ Edward L. Glaeser, Jenny Schuetz, and Bryce Ward, *Regulation and the Rise of Housing Prices in Greater Boston*, Pioneer Institute for Public Policy Research and Rappaport Institute for Greater Boston, Kennedy School of Government, Harvard University (2005). http://www.ksg.harvard.edu/rappaport/downloads/housing_regulations/regulation_housingprices.pdf.

¹² http://www.rba.gov.au/Speeches/2008/sp_so_270308.html.

¹³ Raven E. Saks, *Job Creation and Housing Construction: Constraints on Metropolitan Area Employment Growth*, <http://www.federalreserve.gov/pubs/feds/2005/200549/200549pap.pdf>.

¹⁴ <http://www.dallasfed.org/research/houston/2008/hb0801.pdf>

OECD Research

A report by the Organization for Economic Cooperation and Development (OECD) provides further evidence that prescriptive land use regulations inordinately raise the price of houses. The report is a Chapter in *OECD Economic Outlook Number 78* (“Recent House Price Developments: the Role of Fundamentals”).¹⁵ The OECD noted that

House prices can also be affected by other features that are particular to this market. Of note are restrictions on the availability of land for residential housing development that can constrain the responsiveness of supply. These would include tough zoning rules, cumbersome building regulations, slow administrative procedures, all of which would restrict the amount of developable land.

The report highlighted United Kingdom for the house price increasing influence of prescriptive land use regulations, consistent with the conclusions of the *Barker Report* (above).

In the United Kingdom, complex and inefficient local zoning regulations and a slow authorisation process are among the reasons for the rigidity of housing supply, underlying both the trend rise of house prices and their high variability.

Further, the OECD notes the substantial differences in housing affordability between US markets.¹⁶ The OECD notes housing land regulation related affordability problems in California, New Jersey, Massachusetts, New Hampshire and the Washington DC area. The OECD also shows Texas as having superior housing affordability.

Thomas Sowell put the matter squarely in *The Housing Boom and Bust*:

*It is very doubtful if many in academic communities who have campaigned zealously for land use restrictions under any of the heady and lofty labels used for these restrictions, have any idea that they are in any way responsible for the dire financial conditions in the country today or for the hundreds of thousands of workers who have lost their jobs.*¹⁷

Prescriptive Land Use Regulation Generates Greater Speculation

The Federal Reserve Board of Dallas associates the rising prices from prescriptive land use regulation with higher levels of real estate speculation, which of course drives prices even higher.

*These price increases then fed off themselves. Rising prices—whether for gold, corn or houses—often foster a bubble mentality, contributing to speculative demand.*¹⁸

As prescriptive land use regulation thus drove the price of housing to unprecedented heights in California, it also set off a speculative frenzy. The result bankrupted a large portion of the

¹⁵ <http://www.oecd.org/dataoecd/41/56/35756053.pdf>.

¹⁶ Box III.2, Page 211.

¹⁷ Thomas Sowell, *The Housing Boom and Bust*, New York: Basic Books, 2009, p. 116.

¹⁸ <http://www.dallasfed.org/research/houston/2008/hb0801.pdf>

mortgage finance industry, which led directly to the international financial crisis (the “Great Recession”).

Prescriptive Land Use Regulation Leads to Greater House Price Volatility

Not only does prescriptive land use regulation artificially increase house prices, but it also makes prices more volatile. Prescriptive land use regulation brings more chaotic “boom and bust” cycles to housing markets. They convert what would have otherwise been modest price bubbles into extreme price bubbles.

This is noted by Glaeser and Gyourko, who summarize the findings of a number of studies:

Recent research also indicates that house prices are more volatile, not just higher, in tightly regulated markets.

...price bubbles are more likely to form in tightly regulated places, because the inelastic supply conditions that are created in part from strict local land-use regulation are an important factor in supporting ever larger price increases whenever demand is increasing.¹⁹

Finally, they note that housing bubbles generally do not occur in responsive markets.

It is more difficult for house prices to become too disconnected from their fundamental production costs in lightly regulated markets because significant new supply quickly dampens prices, thereby busting any illusions market participants might have about the potential for ever larger price increases.²⁰

Erroneous Predictions from Smart Growth Advocates

These results are not what proponents of smart growth had predicted. The authoritative smart growth advocacy volume, *The Costs of Sprawl---2000* predicted that from 2000 to 2025 house prices in smart growth markets would decline relative to house prices in markets without smart growth. Yet between 2000 and 2007, median house prices in major metropolitan area smart growth markets rose \$161,500 more than in major metropolitan markets without smart growth.²¹

Realistic Admissions from Smart Growth Advocates

Smart growth proponents usually claim that prescriptive planning does not raise house prices or they attempt to minimize the extent to which it does. Yet in the authoritative smart growth advocacy volume, *The Costs of Sprawl---2000*, the authors note the potential for the first seven of their top ten strategies to increase house prices (Table).²² Thus, despite the denials of the

¹⁹ Edward L. Glaeser and Joseph Gyourko, *Rethinking Federal Housing Policy: How to Make Housing Plentiful and Affordable* (American Enterprise Institute, 2008), p.78.

²⁰ Edward L. Glaeser and Joseph Gyourko, *Rethinking Federal Housing Policy: How to Make Housing Plentiful and Affordable* (American Enterprise Institute, 2008), p.78.

²¹ Robert W. Burchell, George Lowenstein, William R. Dolphin, Catherine C. Galley, Anthony Downs, Samuel Seskin, and Terry Moore, *Costs of Sprawl—2000*. Washington, DC: Transportation Research Board, 2002.

²² Robert W. Burchell, George Lowenstein, William R. Dolphin, Catherine C. Galley, Anthony Downs, Samuel Seskin, and Terry Moore, *Costs of Sprawl—2000*. Washington, DC: Transportation Research Board, 2002.

advocates, the question is only the extent to which smart growth strategies increase housing prices.

Table Prescriptive Planning (Smart Growth) Policies: Including Potential for Increasing Housing Prices		
	Strategy	Potential to Increase Housing Prices
1	Regional Urban Growth Boundaries	YES
2	Local Urban Growth Boundaries	YES
3	Regional Urban Service Districts	YES
4	Local Urban Service Districts	YES
5	Large-Lot Zoning in Rural Areas	YES
6	High Development Fees & Exactions	YES
7	Restrictions on Physically Developable Land	YES
8	State Aid Contingent on Local Growth Zones	(Note) ²³
9	Transferable Development Rights	
10	Adequacy of Facilities Requirements	
From Table 15.4, <i>Costs of Sprawl</i> ---2000		

There is thus no dispute about the tendency for smart growth land rationing policies to raise housing prices, the only question is *how much* smart growth raises housing prices.

*While there is little agreement on the magnitude of the effect of growth controls on home prices, an increase is always the result.*²⁴

Thomas Sowell noted, however, a general lack of economic understanding among advocates of more restrictive land use policies, in his book *The Housing Boom and Bust*:

*It is very doubtful if many in academic communities who have campaigned zealously for land use restrictions under any of the heady and lofty labels used for these restrictions, have any idea that they are in any way responsible for the dire financial conditions in the country today or for the hundreds of thousands of workers who have lost their jobs.*²⁵

Prescriptive Land Use Regulation Diminishes Economic Growth

There is also indication that stronger land use regulation can diminish economic growth rates. The research by the Federal Reserve Board's Raven Saks concluded:

²³ Any successful implementation of Strategy #8 would lead to higher housing prices because it would involve implementation of Strategies #1 through #4 and #7, all of which have the potential to increase housing prices.

²⁴ Lopez-Aqueres, Waldo, Joelle Skaga and Tadeusz Kugler (2002). *Housing California's Latino Population in the 21st Century: The Challenge Ahead*. Los Angeles, CA: The Tomas Rivera Policy Institute, http://www.trpi.org/PDFs/housing_ca_latinos.pdf

²⁵ Thomas Sowell, *The Housing Boom and Bust*, New York: Basic Books, 2009, p. 116.

*... metropolitan areas with stringent development regulations generate less employment growth than expected given their industrial bases.*²⁶

Consistency with International Planning Research

These points are consistent with the work of Princeton University and New York University Professor Shlomo Angel, a co-author of the United Nations and World Bank housing indicators program:

*Enabling mortgage finance and subsidy policies, for example, can increase the demand for housing, while heavy-handed regulations and infrastructure shortages can constrain supply. The overall result can be a shortage of housing, accompanied by high prices and low affordability for all. If, on the other hand, supply-side policies are enabling, then housing supply may be able to expand quickly to meet demand, with the result that higher demand will result in more housing at affordable prices.*²⁷

The 2007 United Nations Population Report indicates that *Lack of good regulation actually increases poverty*. The United Nations characterizes the situation facing developing world urban areas as follows: *An alleged shortage of land has been a main obstacle to more effective housing policies for the poor. The need to safeguard environmental and agricultural land from chaotic urban expansion is a genuine concern. However, most cities still have buildable land in good locations, but it is owned or controlled by private interests or by state agencies with no interest in socially directed uses of the land. The real shortage is thus not of land, but of serviced land at affordable prices.*²⁸

www.demographia.com

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²⁶ Raven E. Saks, *Job Creation and Housing Construction: Constraints on Metropolitan Area Employment Growth*, <http://www.federalreserve.gov/pubs/feds/2005/200549/200549pap.pdf>.

²⁷ Shlomo Angel, *Housing Policy Matters: A Global Analysis*, Oxford University Press, 2000, p. 19.

²⁸ United Nations Population Fund (2007), *State of the World Population 2007: Unleashing the Potential of Urban Growth* (http://www.unfpa.org/swp/2007/presskit/pdf/sowp2007_eng.pdf).