

February 25, 2008

Housing Policy Perils

Seattle: 44 percent of housing prices driven by regulations

John LaPlante

Any student in Econ 101 can tell you the two words that determine the price of any item: “supply” and “demand.” Two other words, however, are almost as important: “government” and “regulation.”

Regulations allegedly bring benefits, such as improvements in product safety. But they also add costs to the things we buy, including our housing. Laws that govern who can build a house, where they can build, what they can build, and how they build it all figure into the cost of housing.

It's easy to overlook or underestimate the affects of regulations. Theo Eicher, a professor of economics at the University of Washington in Seattle, looked at the relationship between regulation and housing prices. Though his report focuses on five cities in Washington, it has lessons for people in cities everywhere.

Eicher's report, “Growth Management, Land Use Regulations, and Housing Prices,” is available on the university's web site (<http://depts.washington.edu/teclass/landuse/>).

To study the relationship between housing prices and regulations, Eicher used a database compiled by the Wharton School of Business at the University of Pennsylvania. The database covers 2,730 cities nationwide and includes 70 variables for each city, each having some effect on the supply of housing. The variables fall into three categories: urban growth boundaries, density requirements, and construction delays caused by regulations. Some of them are binary (either the regulation exists or it doesn't), while others are on a scale (very little, very much and so forth.) Eicher used the common technique of regression analysis to analyze the data.

Findings

Of the five cities in Washington, the effect of regulation was most significant in Seattle. Inflation accounts for some of the increase in housing prices. But after that, 80 percent of the increase in the median housing price between 1989 and 2006 was due to government land-use regulations. In 2006, the median price was a staggering \$447,000, and 44 percent of that was due to government regulations. Eicher discovered similar though not

as dramatic results in Tacoma, Vancouver, Everett and Kent. Statewide regulations were important in all cities. City regulations were much more costly in Seattle than in the other cities. In Seattle, then, city regulations compounded the cost of state regulations.

The data tables in Eicher's report have some interesting points for Minnesotans. Hawaii is the state with the costliest land-use regulations. Minnesota ranks 17th, meaning that only 16 other states have greater restrictions. It is slightly more restrictive than Wisconsin (19) but much more restrictive than South Dakota (47), and more so than any Midwestern state. The fact that Minnesota is a regional outlier shows up in the rankings of cities as well. Of the top 50 major metropolitan areas, the Twin Cities rank as the 22nd most expensive, higher than any other Midwestern city. (Milwaukee is 25; Chicago is 29; St. Louis is 45 and Kansas City is 47.)

Implications

Cities, states, and regional governments impose a variety of requirements on the use of land. Portland, Oregon (rank: 24) uses an urban growth boundary, as does Minnesota's Metropolitan Council. Other regulations include comprehensive plans; restrictions on so-called McMansions; set-aside requirements for natural habitats; impact fees for new housing; design review boards; and so forth.

Each regulation on the development and use of land is implemented with specific goals: combating sprawl; preserving the character of an area; preserving the natural environment from change; or providing for green space. New restrictions are being proposed all the time, including those responding to global warming, promoting mass transit and other ostensibly worthy goals.

Each restriction has a cost. Statewide and regional rules tie the hands of local officials. As Eicher demonstrates, regulations have financial costs that affect the affordability of housing. True to his calling as an economist, he lays out the numbers and leaves the decision of what to do with them to others. "This analysis," he writes, "does not address whether more regulations are better or worse."

So the political scientist, the policy analyst and the citizen all must ask "are we better or worse off as a result of these regulations?"

It depends on who you are, and where you sit. If you can afford expensive housing, you may think that these regulations are good: They keep out the riff-raff and (through green space regulations) promote a visually appealing environment. If you're already a homeowner, restrictions on the supply of housing make your house more valuable. If you can't afford expensive housing, these regulations aren't so useful.

As with laws and regulation generally, not all the effects of land use controls are visible. We can see the impact fees being added to the city budget. We can see the parks and green space that they fund. We can count the number of people who attend a public meeting. Hey, democracy in action!

But there are many important things going on that we can't see: Some people are denied the opportunity to purchase a house because society has, through government, increased the cost of housing. (Since apartments substitute for houses, it's likely that there is an effect on rents, too.)

Regulations are established through the political process. As Eicher points out, they have real-world consequences.