COMMENTARY

The High Cost of 'Affordable Housing' Mandates

'Inclusionary zoning' laws create a vicious circle of higher prices and reduced demand.

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As housing prices recover from the Great Recession, municipalities across America are considering laws that will raise the cost of homeownership. The Wall Street Journal reports that cities like Philadelphia, Detroit and Atlanta are requiring developers to set aside some portion of their new units to sell or rent at below-market prices to low-income households. Like many progressive promises, this is a fool's errand. These laws will reduce the cost of housing for targeted political groups if they increase the cost of housing for everyone else.

The concept, called "inclusionary zoning," has been implemented by 886 communities, nearly 90% of which are in California, Massachusetts and New Jersey. While the intent of these laws is to increase the supply of affordable housing, history shows they increase the cost of housing and limit the supply of new affordable units.

Consider a project plan to produce 100 identical new housing units with development outlays for land, materials, zoning site preparation and other costs of $23.75 million. Including a 5% return for the developer, the project costs $25 million. Without government involvement, the market price for each housing unit will be $250,000. The successful sale of 100 units at this price would cover all out-of-pocket development costs and earn the developer a competitive profit.

What happens if the municipality requires the developer to sell 10% of these new units at below-market prices? Laws are rarely so specific, but assume that the municipality caps the price on affordable units at $125,000. The law doesn't change the cost of building. It merely changes the price the developer can legally charge for some of its new housing units. The total cost of $25 million must now be spread over 10 units, each with a maximum legal price of $125,000, and 90 units priced to cover the remaining cost. Each of the 90 "market price" units must sell for $263,889 for the developer to cover costs.

Policy makers may view inclusionary zoning as a free lunch, but requiring developers to sell or rent 10% of their housing units at below-market prices to "qualified households" means charging above-market prices to everyone else. The affordable-housing requirement increases the median house price in the development by 5.5%.

The impact on nonsubsidized home prices can be even more counterproductive. Inclusionary zoning laws impose significant costs on developers, which are forced to find buyers with the necessary qualifications and financing to purchase the subsidized units. If the potential pool of nonsubsidized qualified home buyers falls short of 90 households when new units are priced at $263,889, the developer won't undertake the project. In that case the overall supply of houses will be smaller as new developments are abandoned, putting additional pressure on the prices of existing homes.

The example is simplistic, but the historical record bears out its common-sense predictions. A 2004 study by the Reason Foundation found that inclusionary zoning laws led to less affordable housing in the San Francisco Bay area. The total production of new housing units declined, and the production of new affordable-housing units declined precipitously. The drop in new home construction also coincided with significant price increases for resales and new "market price" units.

Studies by both the Cato Institute and the Brookings Institution show that housing is more affordable where there are fewer land-use restrictions. If zoning, building codes, fees and inclusionary zoning laws raise development costs, housing will be expensive. Many zoning codes place restrictions on unit density, parking capacity, the size of dwelling units, landscaping and countless other factors that drive up building costs and price many households out of the market.

Rather than promise the impossible—making housing affordable by decree—municipal governments should embrace practical solutions. They should adopt land-use and building code regulations that reduce development costs. They should expedite approval processes, lower impact fees and taxes, and reduce other unnecessary regulations. Only by adopting measures that trim development costs can municipal governments stimulate the production of new housing that is more affordable for everyone.

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