



THE CATO INSTITUTE

# HANDBOOK ON AFFORDABILITY

# 3. Housing

**STEPHEN SLIVINSKI**

**H**ousing is the largest single expense for most American households. Since 2020, average house prices have grown by more than 50 percent and rents have grown by at least 30 percent. These are both substantially above the general rate of inflation (around 25 percent). The median sale price for a single-family home is 5 times the median household income, up from 3.5 times in the 1990s.

Unsurprisingly, housing costs have been on the front line of affordability politics. Some politicians have advocated rent freezes or controls as a means of relief. Federal policymakers, including the president, have advocated severely restricting how institutional investors can invest in and own single-family homes to moderate house prices, and for government institutions to support 50-year mortgages to lower monthly payments. Both sets of policies would introduce new inefficiencies to deal with the symptoms of housing market dysfunction, rather than address the underlying drivers of high prices.

Like all prices, house prices are determined by the interaction of demand and supply. As incomes and the population grow, the demand for housing services increases. For decades, federal policy has amplified this demand with support from Fannie Mae and Freddie Mac and the Federal Reserve's direct purchases of mortgage-backed securities. These interventions expand borrowing capacity and have contributed to structurally higher housing demand.

Even more important dysfunctions come on the supply side. For example, there is broad evidence that decades of restrictive land-use regulations explain a significant portion of high house prices. These laws—zoning rules, urban growth boundaries, height restrictions, and more—limit the responsiveness of the housing supply relative to growing demand, particularly in high-growth metropolitan areas.

The result of the growing gap between the desired housing and what actually gets built is rising prices.

The cost of construction also matters. Federal and state laws that artificially increase the cost of both materials and labor drive up prices too. Overall, misguided policy means we are left with millions fewer homes than people want or would be willing to pay for, given other conditions in the market.

Unwinding federal demand support is a worthy long-term goal toward creating a more efficient housing sector. But the near-term effect will be worse affordability for some. The simplest and best solution to improving housing affordability today is therefore expanding all types of housing options by removing government-imposed barriers to and cost pressures on new construction.

## **FEDERAL POLICIES TO IMPROVE HOUSING AFFORDABILITY**

- **Eliminate tariffs on home construction materials and appliances.** Key homebuilding inputs—such as lumber, aluminum, steel, gypsum, and household appliances—are made more expensive by both existing and newly imposed import tariffs. These trade barriers are hidden taxes on housing construction. Estimates from the National Association of Home Builders (NAHB) indicate that the cost of building materials has increased by 34 percent since December 2020. The recent tariff actions alone raised the cost of construction for the homebuilders the NAHB surveyed by an average of \$10,900. Congress and the executive branch should eliminate or suspend these tariffs to reduce per-unit construction costs and allow homebuilders to meet demand at more affordable prices.

- **Sell off federal land for private housing development.** Several Western states are predominantly composed of federally owned lands. Much of that land is not environmentally sensitive or reserved for conservation but is locked out of productive use nonetheless. The federal government can create a process—much as they have already done around Las Vegas—to identify and expedite the opening of appropriate parcels (ones that don't already have a special designation, like national parks) for the purposes of private development. The Bureau of Land Management controls approximately 250 square miles of land within existing city limits or 2–10 miles outside those cities (primarily in the West) that could be sold to developers and lead to the building of an estimated 1.5 million new homes over the next 10–20 years. Permitting private use of such land near existing infrastructure could help reduce per-unit development costs and improve the responsiveness of supply.

## STATE AND LOCAL POLICIES TO IMPROVE HOUSING AFFORDABILITY

- **Enact broad-based zoning reform.** Most of the housing supply constraints in high-cost US metropolitan areas come in the form of local zoning laws that mandate what types of housing (if any) can be built on existing parcels of land. These rules often mandate large lot sizes, ban multifamily housing from vast swaths of residential land, or impose costly aesthetic and design requirements. Economists have estimated that the increase in housing costs due to local government regulations—what they term a “zoning tax”—can be as high as \$500,000 per quarter-acre in certain metropolitan areas. This isn't a problem for just single-family homes. Over 40 percent of the cost of building an apartment complex is the result of local government regulation. Reform should be geared to allowing more development on existing parcels (increasing density through “upzoning”) and expanding the amount of land available for

development. That should include allowing different types of residential (single-family and multifamily) to exist in the same zones, as well as expanding mixed-use zones (commercial and residential).

- **Eliminate minimum parking requirements.** Rules that require a minimum number of parking spots per square foot of building artificially restrict the amount of land available for housing. They also increase the cost of building new housing units, particularly apartment units. A recent estimate suggests that minimum parking requirements can add an average of \$50,000 or more per unit in development costs. Removing or sharply reducing these requirements would allow the market to determine the right balance of housing and parking.
- **Loosen urban growth boundaries.** Many cities, such as Portland, Oregon, and some in California, have limits on how far development can expand beyond the city center into agricultural or undeveloped areas. Most studies find this land rationing substantially drives up land prices within the boundaries and leads to development forms that homebuyers would otherwise spurn. While the effect on finished home prices varies, research shows that in high-demand areas, growth boundaries can meaningfully raise house prices, especially when zoning inside the boundary remains restrictive and demand is expanding. Liberalizing or eliminating these boundaries could therefore dampen house price inflation and broaden the variety of homes available.
- **Allow accessory dwelling units (ADUs) and manufactured housing on residential lots.** Removing local prohibition on ADUs (small units on an existing home's lot) and manufactured homes increases housing supply diversity. This could expand lower-cost alternatives to conventional single-family development. Allowing ADUs on existing residential property can also lower prices for all housing options overall in an area: A study of California's recent reforms estimates that a 0.5 percent increase in ADU density (measured by the number of units per mile) was accompanied by a 3 percent decline in housing costs.

- **Eliminate or lower minimum lot size requirements.** Requiring a certain number of acres per housing structure creates an artificial scarcity of units on every individual residential-property parcel. A recent study estimates that in cities that doubled their minimum lot sizes, house prices went up by 14 percent and rents by 9 percent. For the median-priced home in the sample studied (\$185,000), this translates to an increase of \$26,000. Reducing or eliminating these requirements would enable “missing middle” housing—such as duplexes and cottage courts—that open up cheaper options.
- **Reform building codes.** Building codes should ensure safety, not obstruct innovation or impose costly aesthetic mandates. Existing building codes often fail to account for innovations in design and engineering or require attributes that do not pass a cost-benefit test. Estimates suggest that extraneous changes to these codes account for 11 percent of the cost of building a new apartment building, for instance. States and cities should revise their codes to allow innovation, modular construction, and materials that meet performance-based standards.
- **Liberalize occupational licensing.** Government regulation routinely increases labor costs in the construction industry through licensing that reduces the number of electricians, plumbers, contractors, and related occupations. This reduces workforce supply and increases the price in ways not usually accompanied by a significant and commensurate increase in quality. Studies indicate that the “wage premium” of licensing is as high as 18 percent. To make it easier for skilled tradespeople to work, states should recognize out-of-state licenses and reduce barriers to entry.
- **Streamline and expedite permitting, reduce discretionary review, cut fees, and decentralize inspections.** Even where zoning allows new housing, the permitting process can be slow, costly, and opaque. Homebuilder surveys estimate that permitting fees average more than \$7,500 for a 2,600-square-foot house. Meanwhile, the time it takes to receive permits can sometimes exceed several months and the inspections required can be time-consuming, because they in turn require a government inspector to fit a given project into their overloaded schedule. States and localities should instead automatically approve applications that comply with zoning laws—so-called by-right development—and eliminate discretionary reviews in favor of clearly stated criteria that, if met, guarantee approval. A challenge culture should be encouraged in local permitting offices by imposing “shot clocks” of no more than a few weeks for permit decisions. The permit fees should be lowered too. Finally, local governments should allow inspection and building-plan review from private-credentialed specialists, not just government inspectors.
- **Pare back impact fees.** Homebuilder surveys estimate that impact fees—taxes on the homebuilder meant to approximate the infrastructure cost of new construction—can exceed \$16,000 per home on average. Most of those costs are passed on to the homebuyer. Where impact fees are used, they should be narrowly tailored, predictable, and designed to reflect true marginal infrastructure costs. Better yet, localities should explore more transparent and efficient financing tools—like user charges—that more closely align infrastructure costs with usage.