

Regulatory Costs and Affordable Housing

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Home building is a highly regulated activity. Perhaps in no other industry must the producer obtain permission for each individual unit of production. The basis of such regulation includes the perceived need to protect the home buyer, but is largely a reflection of the externalities of home building—the effects on third parties, especially neighbors.

The effect of regulation on the affordability of housing is undoubtedly negative. The extent to which housing cost is increased is difficult to measure, however, in part because the standard of comparison—the cost in the absence of regulation or under a regime of only “necessary” regulations—is not well defined.

The Joint Venture

One valuable indication of the nature and magnitude of costs associated with regulations is the savings achieved under demonstration projects of the Joint Venture for Affordable Housing (JVAH).

The JVAH is a program initiated by HUD in 1982 involving the housing industry and state and municipal officials. Developments were built in sites throughout the country, where local officials agreed to relax normal regulations and simplify the approval process. NAHB's National Research Center was heavily involved in arranging the demonstration and assessing the results.

The extent to which regulations were relaxed, the restrictiveness of the original regulations, the extent to which savings represented actual regulatory change (rather than changes

that could have occurred without changing regulations), and the type of housing varied among the demonstration projects. These demonstrations were by no means controlled scientific experiments. The information obtained from the JVAH demonstrations does, however, provide some valuable insights.

In 132 recent projects developed in connection with the JVAH, the average savings per unit in land and construction cost was \$8,573. The savings can be grouped into four categories:

- Land use regulations (density restrictions)
- Development standards (street width, sidewalk requirements, less expensive sanitary and water pipes, etc.)
- Construction innovations in building the structure (wider spacing of studs,

Table 1 Savings in Demonstration Projects

| Place | Total Unit Savings | Admin. & Process Savings | Land Dev. Savings* | Direct Constr. Savings | Price Range | Savings Based on Avg. Price |
|---------------------|--------------------|--------------------------|--------------------|------------------------|------------------|-----------------------------|
| Blaine, MN | \$ 4,963 | \$ 283 | \$ 2,680 | \$ 2,000 | \$ 44,900/48,900 | 10.6% |
| Birmingham, AL | 4,278 | 86 | 4,191 | — | 51,900/58,900 | 7.7 |
| Boise, ID | 2,119 | — | 2,119 | — | 65,000/95,000 | 2.6 |
| Christian Cty., KY | 8,886 | (400) | 3,279 | 6,007 | 28,000/37,400 | 27.2 |
| Crittenden Cty., AR | 6,294 | — | 4,789 | 1,505 | 26,885/35,040 | 20.3 |
| Elkhart Cty., IN | 855 | — | 855 | — | 37,500/54,920 | 1.8 |
| Everett, WA | 10,047 | 1,477 | 7,089 | 1,418 | 64,500/76,500 | 14.3 |
| Knox Cty., TN | 2,545 | 443 | 1,487 | 615 | 43,500/55,000 | 5.2 |
| Lacey, WA | 7,396 | 2,052 | 3,083 | 2,261 | 39,000/62,000 | 14.6 |
| Lincoln, NE | 7,045 | 1,116 | 4,953 | 975 | 38,450/46,000 | 16.7 |
| Mesa Cty., CO | 5,663 | 770 | 3,174 | 1,313 | 39,000/47,500 | 13.1 |
| Oklahoma City, OK | 5,477 | 181 | 5,296 | — | 39,000/57,500 | 11.4 |
| Pheonix, AZ | 8,037 | 2,198 | 3,674 | 2,165 | 45,000/63,000 | 14.9 |
| Portland, OR | 15,647 | 2,047 | 12,387 | 1,213 | 50,000/55,000 | 30.0 |
| Santa Fe, NM | 9,140 | 2,992 | 3,845 | 2,303 | 49,950/61,950 | 16.3 |
| Sioux Falls, SD | 1,640 | — | 1,640 | — | 55,000/70,000 | 2.6 |
| Tulsa, OK | 13,969 | — | 10,390 | 2,079 | 47,000/63,000 | 25.4 |
| Valdosta, GA | 9,685 | 300 | 7,650 | 1,735 | 42,500/46,500 | 21.8 |

* Including savings from higher density

new plumbing and electrical materials, etc.)

- Streamlined processing

Of these, the biggest savings came from changes in density and changes in the development standards. Changes in the way the home itself was built accounted for smaller savings, and streamlined processing, while significant, accounted for the smallest savings. The distribution of savings reported for some earlier JVAH demonstrations is shown in Table 1.

...the biggest savings came from changes in density...

Most of the JVAH savings involved changes in the character and performance of the home, rather than simply the elimination of inefficiencies. Streamlined processing is probably an example of pure savings, with no impact on the product. Use of newer wiring and plumbing materials may be essentially invisible to the homeowner. But those changes don't have large effects on the price of homes. The changes that translate into substantial differences in price are those that involve readily-apparent alteration of the product, such as smaller lots, narrower streets, or the elimination of sidewalks. Regulations increase costs primarily by requiring features that might not be demanded by informed homebuyers in an unregulated market, rather than simply by requiring that homes be produced using archaic methods and materials.

Most features mandated by regulations are viewed positively by home buyers in the absence of cost considerations. Most homeowners prefer having a larger lot to a smaller lot, for example. Even where the regulations result in a product that is viewed by home buyers as being of higher quality, however, the homebuyer might prefer a lower cost, if the choice were offered.

Other features mandated by regulations are viewed as neutral or negative features by the home buyer.

For example, requirements of wide street widths encourage more through traffic and higher speeds, presenting increased danger to children playing in the neighborhood. Requirements for sidewalks mean that homeowners must shovel snow and otherwise maintain those sidewalks. While such requirements have limited attraction to home buyers, they are arguably important to other members of the community who want to travel through the neighborhood.

Land Use Regulation

Most (about 3/4) of the savings in land and development cost in the JVAH are attributed to changes in density. By allowing more units to be built on the same amount of land, the land cost per unit is reduced. Also, smaller lots mean lower development costs because the cost per lot for streets, etc., is reduced as well.

The savings shown from higher density in the JVAH were due to the fact that the land had already been purchased with a price based on existing density restrictions, and the builder committed to passing on the savings to the home buyer. If the supply of land subject to high-density zoning is artificially restricted, the raw land cost of a quarter-acre lot will normally be nearly as high as for a half-acre or larger lot, since the price will reflect the value of permission to build a house, rather than the inherent value of the amount of land. Only if an adequate supply of land is zoned as high density will the cost of land be roughly proportional to the size of the lot.

In addition to the cost of raw land, the cost of a developed lot will reflect the cost of improvements and of development fees. A 1987 NAHB survey found that the national average breakdown of the cost of developed lots was as follows:

| | |
|------------------|-----|
| Raw Land | 38% |
| Development Cost | 39% |
| Fees | 23% |

The cost of development reflects the standards in the local subdivision

ordinance. Where builders are required to build suburban residential streets to the same standards as major urban thoroughfares, with square curbs and wide sidewalks on both sides, it makes a big dent in affordability. Requirements that structures be set way back from the street and other restriction on the placement and character of structures will further add to cost and may even offset the advantage of high-density zoning by effectively setting the minimum lot size.

The Building Code Process

Rules regarding the manner in which homes are constructed are primarily the province of local government, administered by over 9,000 local agencies. Most localities base their building codes on one of three national model codes. The model code developed by Building Officials and Code Administrators International is followed by most jurisdiction in the Northeast. The model of the Southern Building Code Congress (SBCCI) is followed by most jurisdictions south of the Virginia-North Carolina border and east of Dallas. The dominant model in the West is the code developed the International Conference of Building officials. Those codes cover all types of buildings.

The three model code organizations are joined in an umbrella group called the Council of American Building Officials (CABO). There is a special CABO code for one and two family dwellings that is simpler and somewhat less restrictive than the model codes designed for all building types. Where CABO is recognized, a home builder has the option of building in conformity with either the CABO code or the relevant one of the three general model codes.

The national model codes are regularly amended, with new editions issued every three years. In general, the model codes adequately reflect new technologies and do not impose unreasonable requirements.

New versions of the model codes are not automatically adopted by localities. There must be an explicit action. When localities do adopt new versions of the model code they often add amendments of their own or adopt only parts of the model and retain sections based on older editions of the model codes.

While there are some unnecessary costs as a result of delays in adoption of code revisions, most of the adverse cost impact of building codes comes in the interpretation of codes and in inspections. There is an institutional bias in the administration of building codes against departures from accepted practice, and building code officials feel no obligation to take a proactive role in promoting housing affordability.

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Rather than face the possibility of rejection or delay, builders tend to shy away from seeking acceptance of new methods. The significance of the administration—rather than the adoption—of building codes and the problems with diffusion of new technology are reflected in the fact that about half of the savings from construction innovations claimed by participants in the Joint Venture come from changes that were permitted under preexisting Codes.

The Politics and Legality of Regulation

Regulation of land use and construction is primarily a responsibility of local government. The authority for imposing such regulations derives primarily from local police powers to protect public safety, health, and welfare. Although the powers of localities vary among states and among localities

within states, their legal authority is circumscribed by state and federal law.

The economic interests and social preferences of current residents often favor restrictions on overall growth, limitation of new construction to very expensive homes, or requirements that new developments include amenities that benefit long-term residents. Certainly, if the use of lower-cost methods and materials permits a builder to provide new homes at 20% lower cost than my home and the new home provides equivalent service, the value of my home will be adversely affected.

When localities impose regulations that further the economic interests or social preferences of current residents without a valid basis in terms of health and safety, they do so on tenuous legal grounds.

Some local regulations would not stand up in court, but the fact that they are illegal doesn't mean they are not present and effective. Builders are not willing to challenge regulations because the cost and time of a legal challenge would not be cost-effective. Moreover, they cannot afford to antagonize regulators with whom they hope to work successfully in the future.

State governments have a broader constituency and a different set of incentives than local governments. They can't blithely decide that poor people can just go live somewhere else. Increasingly, states have become active in ensuring that all communities provide affordable housing. The authority of local governments derives from the states. This is in contrast to the relationship between states and the federal government, where state sovereignty is somewhat protected.

The federal government's role in local regulatory matters is more limited, both by practicalities and by legalities. Restrictions on federal funds theoretically provide some leverage, but unlike highway funds, where that leverage is overwhelming, there isn't enough money in federal housing assistance to scare anyone, and exclusive communities are perfectly willing to forego federal subsidies.

The federal government can play an important demonstration role and has attempted to do so in the JVAH. The JVAH demonstrations have been of limited effectiveness, however, in changing behavior. Even in those communities where demonstrations have occurred, the relaxation of regulations has not always extended beyond the demonstration. Despite widespread media attention to housing affordability, the JVAH is rarely mentioned and is not well known. Perhaps that situation will change under a new, highly-visible HUD Secretary.

Conclusion

Unnecessary regulations contribute significantly to housing cost, and have a particularly adverse impact on the construction of housing for lower-income households. It is often in the discretionary exercise of regulatory authority, rather than the legislative function by which regulations are adopted, that unduly restrictive regulation occurs. This makes it difficult to solve the problem by legislative means.

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Building inspectors and builders often are not adequately conscious of the opportunities for cost-saving innovations. An effective program of demonstrations and public information could have substantial impact on the availability of affordable housing. The federal government can more effectively encourage cost-saving regulation and practice.

State government may play the primary role in ensuring that localities do not abuse their authority. States can see to it that localities don't use housing regulations to exclude people from their communities or impose inequitable burdens on new residents.