

Regulation and the Rise of Housing Prices in Greater Boston

(reprinted from Connecticut Builder, Summer 2006)

Copyright 2006 HBA of CT

In well-functioning markets, when prices rise, supply increases and then prices stop rising and sometimes even fall. By this definition, the housing market in the greater Boston area is not working and it offers many lessons for Connecticut.

The market is sending clear signals about the demand:

- Between 1980 and 2004, housing prices in three of the Census Bureau's divisions of the Boston metropolitan area grew by between 179 and 210 percent (adjusted for inflation), which made these areas—Boston-Quincy, Cambridge-Newton, and Essex County—second through fourth in the nation behind only the New York areas Nassau-Suffolk Division.
- According to data from the National Association of Realtors in the third quarter of 2005, **the median sales price for existing single-family homes in the Boston metropolitan area was \$430,900, more than any other region in the continental United States except for portions of California, greater New York City, and the Washington, D.C. metropolitan area.**

Supply, however, is not keeping up:

- In the 1960s, there were 172,459 units permitted in the Boston metropolitan area; in the 1980s, 141,347. However, despite the sharp rise in prices in the 1990s, only 84,105 units were permitted in that decade.
- The **decline in permits** has been particularly striking for units in multi-family buildings. In the 1960s, less than 50 percent of all permits in the Boston metropolitan area were for single-family homes. In the 1990s, over 80 percent of all permits were for single-family homes.

Some of the price increase can be explained by the region's dramatic economic renaissance in the past three decades. However, other regions have boomed without experiencing dramatic increases in house prices. Until the last quarter, for example, median housing prices in the Phoenix area were less than \$200,000 and in the Houston area the current median sales price is \$142,000. **Local governments in Phoenix area handed out 57,273 permits for single-family homes during 2004, Las Vegas area localities 35,579—local governments in the greater Boston area only 5,001.**

Is Greater Boston Running Out of Land? Data suggests that regulation, not density, has caused low levels of new construction and high housing prices in Greater Boston.

There is little evidence to support the view that greater Boston simply lacks the land to build new homes. While densities outside of the core are high relative to the United States as a whole, they are still quite low, averaging 1.4 acres per home for communities within 50 miles of Boston. Moreover, if land were just scarce, then the price of a quarter acre of land would be the same whether it extends an existing lot or if it sits under a new home. However, Glaeser and Gyourko (2002) find that **a quarter-acre of land is worth 20 times more in greater Boston if it sits under a new house than if it extends the lot of an existing house, suggesting that surviving the regulatory process adds enormous value.**

Greater Boston's Regulatory Web

Such data suggest that ***regulation, not density, has caused low levels of new construction and high housing prices in Greater Boston.*** To help test this claim, over the past two years

the Pioneer Institute for Public Policy Research and Harvard Rappaport Institute for Greater Boston developed a unique new database on land-use regulation in 187 cities and towns in eastern and central Massachusetts. Researchers answered more than 100 questions about each community's land-use regulations by reviewing official documents and interviewing local officials, who were subsequently given the opportunity to review the data about their community.

The most striking fact that emerges from the data is that ***developers face an incredibly heterogeneous set of local regulatory regimes***. This heterogeneity begins with ***minimum lot size***, which remains the ***most important restraint on the use of land***. The 22 municipalities in the region with average minimum lot sizes of less than a quarter of an acre contain more than 25 percent of the region's population. In contrast, the 14 municipalities where minimum lot size is greater than 70,000 square feet (1.625 acres) cover ten percent of the region's land but hold only four percent of its population.

Communities have at their disposal a number of other regulations that they can use to limit new construction.

- **Growth caps and phasing schedules.** Communities can use growth caps to limit the number of new units that can be built during a given year, or phasing schedules to limit the number of units per year that can be built within a single subdivision. Rappaport identified 54 communities that made use of growth limitations, the vast majority having adopted them in the last ten years.
- **The prohibition of irregularly shaped lots.** More than half of the communities with the largest minimum lot sizes make it even harder to meet their standards by requiring that those lots be sufficiently compact.
- **Wetland regulations.** More than two-thirds of the 187 communities also have wetlands bylaws or ordinances that are stricter than state wetland regulations. Only a handful of these bylaws or ordinances were adopted before 1980. More than 50 communities adopted them in the 1980s, and more than 50 have adopted them since 1990.
- **Septic-system regulations.** We counted 109 communities with septic-system regulations stricter than the state standards, which is two-thirds of municipalities that are not entirely served by public sewer systems.
- **Subdivision rules.** All but six communities have rules for subdivisions. Some adopted the regulations before 1950 and most did so by 1980. More than 70 amended their bylaws after 2000. While communities in the greater Boston area have also adopted measures that relax minimum lot size requirements, they often find ways to discourage their use.
- **Cluster provisions** allow developers to build at higher densities if they set aside some amount of open space. The lot size reductions due to cluster zoning are quite dramatic. In communities with large minimum lot sizes, cluster zoning typically allows almost a two-thirds reduction in the minimum lot size requirement for each home. At the same time, however, many of the communities allow no more units in a development built under cluster zoning than would have been allowed under a conventional zoning plan.
- **Inclusionary zoning** provisions often allow builders to construct at higher densities if they include some housing units designated as affordable to lower moderate-income households. Ninety-nine of the municipalities in our sample have adopted some type of inclusionary zoning provision and nearly half of those have adopted the provision since 2000. Seventy-seven of these communities offer a density bonus for including the affordable units. However, the provisions have never been used in at least 43 of the 99 communities.

- **Age-restricted zoning** is often used to allow smaller minimum lot sizes if the development is open only to older adults. Almost 60 percent of those communities with more than 20,000 square foot minimum lot sizes have some form of provision for such age-restricted housing. More than 40 percent of those communities with minimum lot sizes that are greater than 35,000 square feet have provisions that allow for age-restricted multi-family housing.

Impacts on Permits: Do Regulations Matter?

The evidence linking minimum lot size to development is persuasive. On average, as average minimum lot size increases by one-quarter of an acre, there were approximately ten percent fewer houses in 1970, nine percent fewer houses in 2000, and ten percent fewer houses permitted between 1980 and 2002. These results are, perhaps, unsurprising, but they do confirm the important role that zoning has on new development.

Perhaps, more surprisingly, the connection between minimum lot size and development is declining over time, as even places with smaller minimum lot sizes radically reduce the amount of new construction they allow.

Glaeser found that ***when localities impose wetlands regulations stricter than those imposed by the state, new construction appears to fall by about ten percent.*** When localities impose rules for ***septic systems that are stricter than state standards, new construction falls by about four percent.*** Adoption of subdivision rules, finally, is ***associated with about a twelve percent drop in new construction.***

What about features that alleviate the burdens of zoning?

Adoption of cluster zoning is correlated with an increase in the amount of new development, but the Rappaport study was not able to discern an impact of inclusionary zoning, or assess the impact of Chapter 40B, the Massachusetts Anti-Snob Zoning Act, which allows the state to overrule local land-use decisions for projects, because they impact most municipalities. Nonetheless, more than 30,000 units constructed under Chapter 40B have accounted for a significant part of new development in many areas.

Housing Prices

The reduction in permits caused by the regulations has had a significant effect on regional housing prices. Since 1990, for example, the housing stock in greater Boston increased by only 9 percent. Published estimates of housing demand elasticities (Ermisch, Findlay, and Gibb 1996), suggest that **if the housing stock had instead increased by 27 percent, as it did from 1960 to 1975, housing prices would be 23 to 36 percent lower.** That is, the median house price, which is now \$431,900, would have been as low as \$276,100.

Regulations reduce new construction permits, and an additional acre in minimum lot size raised the median sales prices of homes in the locality in question by 15.8 percent in 1987, 11.3 percent in 1995 and 19.5 percent in 2001.

Land-use regulation has also reduced the amount of affordable housing. The study found that ***as lot size increases by one acre, the share of homes that qualify as affordable by this definition drops by 8-to-20 percent.***

Addressing the Problems

Four policy approaches could address the problems created by these features.

1. The state could alter local incentives by using state aid to reward localities that encourage new construction and punish those who discourage it. While the recently passed Chapters 40R and 40S, which are designed to eliminate fiscal problems created

by new development, are small steps in the right direction, the state needs to use the bulk of its local aid to successfully encourage new construction.

2. The state could, more intrusively, follow the lead of Chapter 40B and give state or regional entities the power to overrule local land-use decisions in communities with low density levels, high prices, and few permits. Such an override, moreover, should be linked with impact fees at a level set by the state. Overriding local control is sure to be unpopular, but it is also the surest way of breaking local bottlenecks on new construction.
3. The state could take policy actions that clarify rights and limit the potential for litigation while simultaneously increasing protections for current homeowners, thus improving the lot of both developers and local homeowners. Such measures might include requiring plaintiffs who unsuccessfully challenge a project in court to pay a fee or to pay the developer's legal costs.
4. The state could substitute existing regulations with a well-designed impact-fee system that would reduce uncertainty, promote new construction, and enhance the welfare of developers, abutters, and communities. We want to emphasize, however, that impact fees could only increase new construction and housing affordability if they replace existing barriers to new construction.

If the residents and businesses in greater Boston are seriously interested in making affordable housing a reality, they must lower the barriers against new construction. However, since there is no reason to expect that localities will act against the self interest of homeowners, it is up to the state to take action to change the schedule of incentives and relieve the externalities burdening those who have yet to buy a home and businesses. Because the only way to reduce the price of something is to produce more of it, ***it is logically incoherent to be both an advocate of affordable housing and an opponent of new construction!***