HOUSING: A SHORTAGE OF CITIES

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The housing crisis in California, as in many other states, manifests itself as a shortage and high price of housing, but is in fact symptomatic of a deeper and different shortage: a shortage of cities. The demand for urban living is growing, propelled by the urban-centric nature of knowledge-based industries and a growing consumer demand for dense, diverse, interesting, walkable city neighborhoods. The supply of great urban spaces is constrained by locally controlled land use plans that make it difficult to build housing in the places where it is most highly valued—in dense urban settings.

THE GROWING DEMAND FOR CITIES

Cities make us more productive and innovative. They help workers get matched to job opportunities that best suit their interests and aptitudes. They help workers quickly acquire new skills and move to jobs or firms that can make best use of them (Hsieh & Moretti, 2015). Cities offer huge advantages in consumption as well (Glaeser, Kolko, & Saiz, 2000). Consumers are spending a larger and larger fraction of their income on services. Higher income consumers, faced with a twenty-four hour day, place great value on close proximity to work and to a wide range of consumption amenities (and opportunities for social interaction). Cities are, in effect, an enormous laborsaving technology, reducing the amount of time consumers need to spend learning about, searching for, and traveling to places where they might consume services. In addition, by virtue of their size and diversity, cities offer a wider array of highly differentiated services enabling consumers to get just what they want. The same applies for social interactions, from everything from dating to "club goods" (Mills, 1972) and group activities that require a minimum number of participants, whether its mahjong, Ultimate Frisbee, square dancing, or Dungeons & Dragons.

There's a growing demand for urban living. It's driven by the preference of young workers for dense, diverse, interesting cities. Census data show that well-educated young adults are increasingly likely to live in closed-in urban neighborhoods. In 1980, 25- to 34-year-olds were about 10 percent more likely than other residents of large metropolitan areas to choose to live with 3 miles of the center of the central business district. By 2000 they were 32 percent more likely than other residents, and by 2010 51 percent more likely (Cortright, 2014). Data show that the share of well-educated young adults living in the nation's 50 largest cities increased 19 percent, nearly 5 times faster than the overall increase in city population between 2010 and 2016. In part because of the preference of young workers for urban areas, economic activity is increasingly concentrating in the nation's large metro areas, and within those metro areas, in city centers.

The growing demand for urban living is reflected in the relative price of housing within metropolitan areas. Since 2000, housing in city centers has increased in price much more rapidly than in suburbs (Edlund, Machado, & Sviatchi, 2015).

The growing demand for urban living, propelled by deep-seated shifts in consumer preferences, and reinforced and intensified by the growth of knowledge-based industries in cities is running into a relatively inelastic supply of urban housing. The rate of home construction in the center of metropolitan areas has fallen precipitously over the past several decades (Romem, 2018).

THE HOUSING AFFORDABILITY PROBLEM

A portion of the problem manifests itself as gentrification: the growing demand for urban living has led to disproportionate price increases in some previously low demand, low rent neighborhoods in urban areas. While gentrification can produce financial gains for long-time homeowners, rising rents may lead to less affordability, and the possibility of displacement for renters.

It is not housing solely in the sense of shelter, although homelessness is a rising problem in and of itself, but rather a shortage of places where the non-shelter components of housing, especially the access that housing provides to jobs, schools, social interaction, consumption, and environmental amenities and economic opportunity.

TREATING HOME OWNERSHIP AS A WEALTH CREATION STRATEGY

Underlying our housing affordability problem are stated national and local policies for treating home-ownership as a vehicle for wealth creation. The wealth-building performance of housing depends directly on an ever-increasing real price of housing, which has the net effect of transferring wealth to homeowners from home purchasers. As a result, rising real prices for real estate are a straightforward transfer of wealth of younger generations to older ones (Glaeser & Gyourko, 2018).

Federal tax policy subsidizes homeownership; local land use policy inflates and maintains the value of housing by restricting the construction of competitive supply, particularly in the most desirable locations.

For decades, and unlike many other high-income countries such as Germany, Switzerland and Japan, the U.S. has made the real appreciation of single-family homes the principal means through which most families accumulate wealth. There’s an inherent contradiction between relying on ever-increasing home values to promote wealth creation and achieving housing affordability.

DEVOLVING LAND USE CONTROL TO THE NEIGHBORHOOD LEVEL

In California cities and within cities, neighborhoods have strong incentives to discourage the construction of additional housing. Additional housing likely increases the externalities they experience (traffic, pollution) and may raise the cost or diminish the quality of local public services. Individual jurisdictions face a prisoner’s dilemma: a city that allows apartments is likely to be overrun by the demand for them and end up bearing a disproportionate share of the costs of such development. As William Fischel has argued, homevoters dominate local government politics and decision-making and support measures that restrict housing supply

(Fischel, 2001). Older voters and homeowners represent a disproportionate share of the electorate, especially in local elections. Municipal elections tend to have an electorate that is approximately a generation older than those who vote in national elections.

ESTABLISHING WHAT IS EFFECTIVELY A QUASI-FEUDAL PROPERTY TAX SYSTEM

Under Proposition 13 and its subsequent amendments, the amount of property taxes one pays hinges importantly on how long one has owned property in the state, and thanks to inheritability provisions, whether one was fortune to be born to parents (or grandparents) who had the foresight and resources to become homeowners. The ability to inherit a favorable tax assessment costs local governments in excess of one billion dollars per year and also results in taxes on otherwise similar properties in a single neighborhood varying by a factor of up to four (Legislative Analyst, 2017). These provisions discriminate against newcomers, and given the state's demographic change, effectively impose higher taxes on people of color. Proposition 13 also intensifies the incentives local governments face to exclude low-cost housing because it can't generate tax revenues sufficient to offset the costs of providing public services to incremental citizens.

MASSIVE SUBSIDIES TO HIGH INCOME HOME OWNERSHIP THROUGH THE FEDERAL AND STATE TAX SYSTEMS

The federal government has skewed the tax code to greatly favor homeownership, especially for higher-income households. Interest on home mortgages has been fully deductible for households that itemize deductions, as are state and local property taxes (although both of these provisions have been scaled back by the recent tax reform act). Less noticed, but equally important, most households pay no capital gains taxes on the appreciation of the home they own, and in addition, the tax code excludes from income the value that households receive from the ability to live in homes rent free (imputed rental income). Together these tax provisions constitute a subsidy more than $250 billion annually to homeownership (Office of Tax Analysis, 2016).

PROPOSALS

Recognize the national interest in encouraging the growth of dense, vibrant urban centers and in constructing more housing in these areas. There are many thoughtful proposals for addressing the problems of housing affordability in California (Metcalf, 2018), and the full range is beyond the scope of this paper. Broadly speaking, the solution should embrace four main concerns: expanding the supply of land available for urban development, shifting subsidies away from high income homeownership, fixing California's property tax system, and figuring out ways to make more intensive use of the existing housing stock.

1. Local land-use laws that limit density in high demand areas are clearly implicated as a principal cause of affordability problems. The state should consider a range of measures that would liberalize the densification of residential development such as SB 827 (Wiener, 2018), which would allow by-right development of multi-family housing in transit rich areas (Wiener, 2018).

2. Our current federal and state tax systems subsidize homeownership, particularly for higher-income households, and tend to drive up the cost of housing. Meanwhile, subsidies for renters are scant, reaching less than a quarter of technically eligible households. Capping homeownership benefits for higher-income households would free up considerable revenues to subsidize rents and affordable housing construction. The tax savings might also support a system, such as individual development accounts, which would be tax-favored and for low-income persons, government-subsidized vehicles for saving, and wealth accumulation, without the need to invest in housing.

3. Proposition 13 and subsequent legislation have ossified the California housing market; homeowners have strong incentives not to downsize; local governments are strongly incentivized not to allow additional housing, especially apartments, and the system creates vast inequities between newcomers and long-time residents. The state should replace Proposition 13 with a universal housing credit; allow low-income and senior populations to defer (with interest) property tax payments until sale or death, and restore the principle of assessing all properties equally, based on market value, regardless of the tenure of their owners.

4. There's a growing mismatch between a housing stock composed of large, single family homes and the declining average household size in California. Promote innovative-shared housing strategies. Ironically, the U.S. has more housing, relative to the size of its population, than it has ever had. We estimate that households in the U.S. have more than 40 million empty bedrooms (defined as bedrooms in housing units where the number of bedrooms in the housing unit exceeds the number of persons residing in the housing unit). We should encourage shared housing services that intentionally match people who have space in their homes (a key demographic being "house-rich, cash-poor" seniors who want to age in place) with people who need a home (individuals and families either working or with stable means to pay reasonable rents) (Sandoval & Huerta Nino, 2015). Making better use of our existing housing supply would reduce demand for housing and help make rents more affordable.

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