Why doesn’t the housing market produce the housing we need?

Unless you’ve been living under a rock, you know that—with a few notable interruptions—rents and home prices in many regions have been rising faster than incomes for the last few decades. This is true not only in places like San Francisco, Boston, New York, and Los Angeles, but also in Miami, Minneapolis, and Pittsburgh. As a result, housing is taking a bigger and bigger chunk of our incomes.

To understand why this is happening, we need to review the basic laws of supply and demand

In a well-functioning market, increases in demand are met with increases in supply that moderate price increases. For example, let’s say Starbucks develops a wildly popular new chocolate drink. In the short run, the increased demand for cocoa may lead prices to go up. Eventually, new suppliers will emerge to supply additional cocoa, moderating prices. In the long run, prices will settle at a new equilibrium.

The housing markets in high-cost cities, towns, and counties don’t work this way. In many cases, increases in demand are not met by increases in supply. That means rents and home prices rise much faster than incomes.

There are a lot of reasons for this. First of all, housing markets are very different from the markets for cocoa and other consumer goods. New houses and apartment
buildings last a long time; they are expensive to produce and often command a premium relative to older homes; and housing costs reflect more than just the features of the unit itself, but also the features of the neighborhood. These include things like schools, access to jobs and transportation, access to arts and cultural amenities, and safety.

It also takes time to produce new housing in response to an increase in demand. And new construction requires land, which is in limited supply. As Will Rogers famously said, “Buy land. They ain’t making any more of the stuff.”

The Approvals process for new construction
There’s not much that cities, towns, and counties can do about these things. But there is one major factor that cities, towns, and counties CAN control: the approvals process for new construction. According to research, a major explanation for rising housing prices is that it is getting harder and harder to get the approval needed to build new housing.

Roadblocks in the construction approvals process make it hard for builders and developers to create enough new homes to respond to rising demand. And when supply can’t keep up with demand, prices go up. Economists believe these roadblocks are one of the major reasons why rents and home prices have increased over the past 45 years, despite declines in construction costs.

One important roadblock is land use regulation that limits the number of homes that can be built in a given space—a factor known as density. Other roadblocks include cumbersome development processes that increase the length of time and cost of getting approval from the city to begin construction, and high impact fees that are intended to cover the cost of roads and schools to serve the new residents but also add to development costs. Because of these kinds of restrictions, it’s increasingly difficult for developers to build new housing, leading rents and home prices to be higher than would otherwise be the case.

To learn how to fix this problem, tune in to the video, What can cities, towns, and counties do to make housing markets work again? on LocalHousingSolutions.org.