Housing Affordability: Some Thoughts from a Couple of Skeptics

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Far from reflecting social problems, higher housing prices are among the most effective signals in redirecting human migration. For example, California is seen as a very desirable place to live; the economy is stable and diversified, and the natural and man-made environments are attractive. If subsidies held prices in check, even more people would try to move to our most populous state (and fewer young Californians would move to less congested areas).

Higher prices also reflect the progressive substitution in recent decades of capital for labor in housing. For example, houses used to require painting, but many of those built today have costlier exterior finishes that are easier to maintain. Most have aluminum storm/screens or sealed double-glazed windows instead of bulky wooden units attached and removed with the changing seasons. We pay more for housing capital, but pay less for the services of tradesmen (or expend less of our own efforts) in maintaining our homes.

It is not logical to say that housing is less affordable in some parts of the country or state than in others. There are always households at the margin, ready to move if the mix of home prices/home amenities/locational amenities/job security/income is more favorable in another region. In a mobile society, relative housing prices reflect the market's perception of the benefits of living in particular areas. A dwelling with specified physical features would sell for less in Decatur than in Los Angeles, but would provide its owner with access to a less diversified economy, less friendly weather, and a less expansive set of cultural options.

Even within a region people wrongly assign "affordability problem" labels. Suppose that two cities located near each other are similar in economic and demographic terms. However, in City A the residential areas surround the employment center, so average commuting distances are minimized, while in City B the workplaces are located relatively farther from residences. If the average house value in City A is higher than that in City B, the issue is not affordability, but rather a rational substitution of housing costs for commuting costs.

Declining home ownership can be rationalized as arising from something other than affordability problems. Some potential buyers may view houses as unwise additions to their portfolios. A properly managed portfolio contains assets whose values react differently to changing economic events. Lower rates of ownership do not necessarily provide evidence that housing is less affordable. Households might find renting to be an effective hedging technique, similar to short selling in some asset markets.

Consider a portfolio consisting of human capital (job skills) and a house. If a sour economy forces the individual's employer, the area's only major firm, to close, her job's value evaporates and the home value plummets. Housing is a less-than-optimal portfolio addition for any individual whose return on human capital parallels changes in real estate values. (Should builders, architects, and real estate brokers own their homes?)

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Excessive government regulation is not always an obstacle to affordability. Buyers confronted with higher improvement prices because of restrictions can still afford their desired bundles if they pay less for their desired parcels of land. Consider a case in which government decrees that anyone who wants to have a house built must now pay for a professionally prepared multi-media presentation to show the planning commission what the house will look like at various stages of completion. This requirement obviously would increase the cost of a house without adding any features that a reasonable home buyer would value.

Assume that the supply of land is fixed (the case represented by a vertical supply curve). A lowered demand curve for land intersects a lower point along a vertical supply curve; the result is an unchanged quantity of land sold, but with each parcel selling at a lower price that exactly offsets the higher cost of building the home.

Of course, while the quantity of *land* is fixed, the supply curve for *buildable sites* could be non-vertical, even horizontal (if each vacant parcel could be put to competing uses that were not subject to the new presentation requirement). A lower demand curve for land intersects a horizontal supply curve farther to the left; a smaller quantity sells (for a particular use) at a constant price per parcel. In this case, the higher building price is not offset by cheaper land; the price of the package increases.

Regulation does, however, disrupt the market's ability to provide solutions. Society's poorest members used to have refuges; they could live in flop houses or in shantytowns of tar paper shacks. Of course, no compassionate person would suggest that such places provide suitable family dwellings. Yet is it not troubling that some people sleep in cars or on heat grates, while government "protects" them from living in new buildings with wall studs spaced 48 inches apart?