

## URBAN GROWTH BOUNDARIES: DO THEY RAISE HOUSING COSTS?

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Last year, the Fannie Mae Foundation asked housing expert Anthony Downs to examine the trend in housing prices across the major U.S. metropolitan areas. Downs looked at data from 1980 to 2000. He looked specifically at Portland, Oregon, the city with perhaps the strictest controls over development, concluding: "Portland ... had statistically significant effects on home prices only in the first half of ... [the 1990s] and then only small effects." Others observe that the development industry in Portland was not able to respond to rapidly increasing demand, so that a housing shortage contributed to rising prices. Downs observed that uncertainty at the time the growth boundaries were adopted kept land prices from escalating right away. What did occur is that after a period of general stability, the median price of housing in Portland began to climb in 1989, surpassing the national median in 1994 and reaching the same level as other major western metropolitan areas in 1996. Then the rate of increase slowed somewhat.

What we know is that absent the full societal collection of location rent land markets operate dysfunctionally, even as land owners and investors in land generally act rationally. Picture a supply curve for land in any region. The supply curve is vertical. How far out on the horizontal axis the curve sits is something of a subtraction calculation. The net land available for utilization is the gross supply, less the quantity unusable because of physical characteristics (e.g., topography, wetlands, etc.), less the quantity deliberately set aside for open space and parks, less the quantity allocated for roads, highways, less the quantity controlled by government agencies, less locations held idle by speculators and owners who simply ignore their landholdings because the cost of doing so is so low. The analysis performed by Anthony Downs was based on "an estimated 20-year supply of developable land, so its constraining impact on housing markets was not felt for quite awhile until a lot of that land had been absorbed." Moreover, job growth slowed after 1994 and developers increased construction of multifamily (i.e., rental) housing. He concludes with the following:

"Only one thing seems crystal clear: There is no simple relationship between containment programs and housing prices. Therefore, condemnations of [urban growth boundaries] and other containment programs as always undesirable because they inevitably cause higher housing prices are as unwise and unreliable as unqualified claims that UGBs [Urban Growth Boundaries] never accelerate rates of housing price increase. The truth lies somewhere in between."

Several other analysts responded to the findings presented by Anthony Downs. Arthur C. Nelson of Virginia Tech states the obvious, that "the principal feature of urban containment is limiting the supply of land available for devel-

opment," with the result that "prices go up." He failed to say, of course, that prices go up in the absence of an effective tax on location rents. The variables presented by Anthony Downs set the stage for a presentation of how fast and how far. The question, then, is when compared to other metropolitan areas without similar growth restrictions, is the supply of land available for development - and the economics of development - less or more favorable when there is an UGB in place? Other variables include permitted densities and the presence of height restrictions. As Nelson adds: "If [cities] restrict the supply of land while facilitating housing production at a level needed to meet market demand, housing prices need not rise."

William A. Fischel of Dartmouth College confirms that the City of Portland improved what would have otherwise been a worse situation by promoting infill development. At the same time, he reminds readers that rising housing prices "give resident homeowners a nice capital gain to reap when they retire or move away for other reasons." What actually happened in Portland, he says, is that the desire for suburban-style housing caused developers to "scramble for land within the existing boundary." The price of land and then of housing naturally escalated. Developers also had to compete with investors eager to gain control of prime sites for speculative holding. The players with the deepest pockets are best positioned to profit from the future increases in land prices. Most actual developers are, on the other hand, dependent on obtaining acquisition and development financing from banks and insurance companies.

Portland was one of the regions that benefited by the relocation of businesses out of California, in search of a more pro-business (i.e., lower cost of doing business) climate. The arrival of new businesses when combined with the adoption of urban growth boundaries shifted the market equilibrium in favor of land owners. With bank credit readily available to developers at historically low rates of interest, Portland's developers responded by adding new office space to the market. The construction activity was not quite matched by growth in business formations or employment. Vacancy rates began to increase, particularly on the west side of the city's suburban market. And so, the rise in land prices began to slow. Yet, Portland's overall vacancy rate at the end of 2002 remained well below that of most larger cities and significantly below Greater Boston, which was suffering a 21% vacancy rate. On balance, then, Portland seems to have adjusted to the deliberate reduction in the supply of land available for development - even though the potential for profitable investment in land for future gain was redirected to a smaller geographical area. This was accomplished, in part, by establishing minimum densities and requiring that half of all housing units constructed (continued on p. 10)



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were multifamily or attached single family housing. Up-to-date property assessments could help Portland by capturing a higher percentage of location rental values than in most other communities.

If the analysis of markets provided by Henry George is accurate, none of the measures adopted by the City of Portland will outrun the speculative upward spiral in land prices. At some point, the cost of land will drive some businesses from Portland. Those who must compete for revenue with producers operating in lower cost environments and cannot compensate with greater productivity gains will relocate. If this occurs over a relatively short period of time, causing high unemployment in the Portland area, the result will be a chain reaction of defaults by businesses and consumers on outstanding debt and yet another period of regional bank failures.

The United States economy has managed to bounce back from some serious regional downturns over the last quarter century. One reason to worry today is that there are few low cost regions to which businesses can relocate to protect or recapture necessary profit margins. Land costs have escalated across the entire country, in virtually every metropolitan area. Preventing a prolonged and widespread downturn will require, I think, a masterful use of the neo-Keynesian demand management, monetarist, and supply-side tools that have been not all that effectively employed up to this point. We ought not hold our breath. A word of advice is to make sure your debts are manageable and that you have enough savings to weather a period of reduced income (whether from invested assets or employment).

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