



How to Increase Housing Development While Maintaining Local Control

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High housing prices in major U.S. metro areas have severe social and economic consequences. In 2013, about one in ten American households lived in houses with prices more than double current construction costs; and in coastal California, the typical home price was about three times the cost of construction. Such high housing prices prevent low-income people from moving to economically productive regions, impeding social mobility and economic growth.

Studies from many U.S. cities find that higher housing prices are associated with stricter local land-use regulations. These regulations include permitting, minimum lot size requirements, maximum density limits, minimum parking requirements, development impact fees, and mandatory environmental reviews. Some regulation is justified, because housing and related development can negatively affect communities and the local environment. Nevertheless, patterns of regulation influence costs for the development of housing. Regulations that are excessive or poorly designed can reduce supply and increase prices for prospective homebuyers and renters.

Current Solutions Focus on Reducing Local Control

Many policymakers and scholars blame local control over housing policy for the constrained housing supply and rising costs. Based on such views, the California State Legislature recently considered Senate Bill 50, which would override local regulations to increase housing development around transit stops. Proponents of such state-level laws to preempt local land-use regulations argue that local governments are inherently ill-suited to the task of managing land use. Local governments are said to represent current residents, who often see new development as a threat to home values or a cause of rising rents or high traffic. Critics point out that potential new residents do not have a say in local regulatory steps that can affect new housing development.

The substantial gap between construction costs and housing prices in places like coastal California means that there are large potential profits for developers from building new housing. Current residents could make local approval of new projects conditional on splitting these profits. While developers sometimes negotiate with residents, offering community benefits such as park funding in exchange for approval, demand for new housing clearly outstrips such efforts. Why, then, are developers unable to overcome local opposition by offering compensation to existing residents?

While some “not in my backyard” voters will simply never accept new housing, no matter the compensation offered, local opposition is neither overwhelming nor inevitable. In many cases, most local voters are willing to support new developments – when the negative impacts are small or developers provide sufficient

compensation. The challenge is to ensure that developers are able to provide this compensation.

The Real Problem is Insufficient Resident Compensation

The costs of land-use regulations for developers can be grouped into two broad categories. **Compensation** helps address the concerns of local residents by providing funds to offset negative impacts of new developments. **Transaction costs**, in contrast, do not benefit local residents. These include expenses developers often incur for public relations campaigns to forestall city council pressure, payments to lawyers and experts to navigate the regulatory process, and costs of delays associated with overly complex, prolonged approval processes. Existing land-use regulations often require developers to spend large sums on transaction costs.

Project approval processes can be lengthy and expensive. Regulations often have worthy goals, such as protecting the environment or public health. However, when transaction costs comprise a large share of developers' expenses, little is left over to compensate residents, and so residents oppose new housing development more intensely than they would if compensation were greater. When transaction costs are sufficiently low, in contrast, developers may be able to compensate residents and thereby increase local support for new housing.

Given a better understanding of the tension between compensation and transaction costs, it becomes clear that the structure of local land-use regulations restricts housing supply, not simply the fact of local regulation in itself. Put another way, **local control is not always detrimental to housing development**. Yet local regulation can be dysfunctional if the transaction costs for project approval deplete developer resources that might otherwise be used to mitigate problems for local residents. Effective policy solutions would disentangle the institutional mechanisms that allow local residents to express their preferences from mechanisms that offer too many opportunities to delay projects and impose transaction costs on developers.

Based on our research, we suggest that policymakers create streamlined project approval processes so that residents can negotiate with developers for community benefits. For example, local governments could facilitate negotiations between residents and developers by allowing residents to establish neighborhood institutions to approve projects through simple majority votes – replacing prolonged, multi-stage approval processes. Neighborhood institutions could be modeled on labor unions. Elected neighborhood leaders would negotiate with a developer on a project, just as elected union leaders negotiate with an employer. The membership would then vote on the project. Such neighborhood project approval could replace existing procedures that impose high transaction costs and provide limited community benefits.

If transaction costs can be lowered in this way, developers would have resources and incentives to provide higher compensation to local residents to offset negative impacts of development. Neighborhood-level institutions could reduce inefficiencies in the existing land-use regulatory process without disempowering local residents. Such reforms could create land-use regulatory structures that facilitate more housing, preserve the power of local residents to veto truly bad projects, and compensate local residents for the inevitable costs that accompany many new housing development projects.

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