

**Economic Benefits of the
Santa Fe Homes Program Ordinance**

By

Dr. John Talberth

A Policy Brief Sponsored By



Center for Sustainable Economy
1704 Llano Street, Suite 194
Santa Fe, New Mexico 87505
(505) 986-1163

August 2005

Economic Benefits of the Santa Fe Homes Program Ordinance

By

Dr. John Talberth

A Policy Brief Sponsored by the Center for Sustainable Economy

Synopsis

The Santa Fe Homes Program Ordinance is an economically sound policy mechanism to address the affordability crisis in Santa Fe's housing market. The lack of affordable housing in Santa Fe's urban core generates enormous social and economic costs to low income families and the community as a whole by thwarting homeownership, exacerbating segregation and inducing sprawl. The ordinance will help offset at least some of these costs as the City continues its rapid growth and generate additional benefits in the form of increased spending by middle income families.

The ordinance will impose little if any costs on developers. Studies have consistently shown that developers will offset inclusionary zoning costs by negotiating lower land prices or reducing the cost of other inputs. Furthermore, modest incentives – especially density bonuses – tend to more than compensate for any negative economic effects to both developers and owners of large vacant land parcels. Finally, even if there are residual costs, developers can most easily pass these costs on to homebuyers in the highest income bracket since income growth is a much stronger determinant of housing demand than price and since income growth in the top quintile has consistently been the strongest.

Key conclusions

- The ordinance will help offset socio-economic costs of the affordable housing crisis.
- The ordinance will help reduce the trend of economic segregation.
- The ordinance will help prevent further sprawl.
- The ordinance will benefit the community through increased household spending.
- The ordinance will impose little if any costs on developers.
- What little costs developers may incur are likely to be passed on to the wealthiest.

The ordinance will help offset socio-economic costs of the affordable housing crisis

Santa Fe's housing market is characterized by rapidly escalating housing prices and a much slower rate of growth in household income. Between 1994 and 2004, median household income increased by 27% while median home sales price increased by 97% (Planning and Land Use Department 2005). As a result, Santa Fe's housing affordability index plummeted by 38% since 1998. According to U.S. Census data, home ownership rates for low and middle income families have fallen. Between 1990 and 2000, homeownership rates declined by 4 to 9% for income brackets below \$50,000 while rising slightly for households with incomes above \$50,000.

Declining homeownership imposes significant social and economic costs on low and middle income families and the community as a whole. Families who rent rather than own are more likely to be trapped in cycles of poverty because they cannot build a sufficient amount of equity to obtain loans and other forms of credit to buffer income fluctuations or make productive household investments in health care, transportation, and education and because they are left vulnerable to skyrocketing rental rates. Individuals in rental situations suffer higher levels of psychological distress (Cairney and Boyle 2004). Families who cannot afford decent affordable housing have to make frequent moves that have a profound effect on the well being of children. Children of renters suffer from lower educational attainment rates, higher teen pregnancy, and more behavioral problems (Turetsky 2003). The community as a whole incurs costs when homeownership falls because neighborhoods with greater shares of rental units suffer from declining investments in upkeep and improvement, a loss of neighborhood cohesion, and less civic engagement by their residents. Conversely:

- Homeownership not only insulates families from rising rents and home prices, but also enables them to build financial resources that can be tapped for other purposes (Millennial Housing Commission 2002).
- Homeownership builds family stability and cohesion and benefits children by generating higher levels of educational attainment and fewer behavioral problems.
- Homeownership permits low income families to move into higher quality housing with fewer health hazards such as lead based paints associated with dilapidated, older rental housing.
- Homeownership has positive spillover benefits for the community as a whole in the form of increased neighborhood stability, greater levels of investment in upkeep and improvements, higher property values, children who are healthier, safer, and better educated and residents who are far more likely to engage in civic activities which benefit their neighborhoods in the form of better streets, sidewalks, schools, parks, and community centers and more frequent cultural and recreational activities (Coulson 2002).

These benefits are considerable. One recent study estimated that the *external* benefits of homeownership – i.e. not counting benefits that accrue only to the homeowner – are in the order of \$21.8 billion per year in the United States (Coulson et al. 2002). Another recent study estimated the economic value of living in neighborhoods with a higher preponderance of homeowners to be roughly \$5,000 per household per year (Coulson et al. 2003). The magnitude of both direct and spillover benefits is an important justification for affordable housing ordinances such as the Santa Fe Homes Program that increase homeownership for low and middle income families.

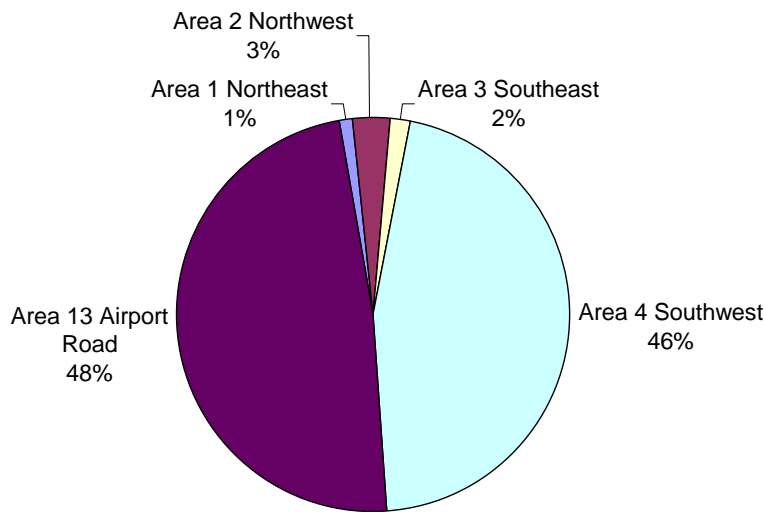
The ordinance will help reduce the trend of economic segregation

The affordable housing crisis in Santa Fe imposes additional costs on Santa Fe associated with exclusionary housing patterns. Santa Fe is a model of exclusionary housing. Whether it evolves through conscious planning and zoning decisions or by market fiat, an exclusionary

housing pattern is one which excludes affordable housing from the most desirable portions of an urban area. An exclusionary housing pattern segregates a city into regions of high cost housing near good schools, jobs, parks, arts and cultural events, and other municipal amenities and low cost housing in areas nearly devoid of these quality of life elements. Such segregation usually follows income and racial lines. As noted by Clinger Mayer (2004) “[t]hose excluded are virtually always poor and quite often non-white.”

Clearly, Santa Fe’s housing market exhibits this pattern, which the City has dubbed “housing stock gentrification” (City of Santa Fe General Plan at 9-5). A sample of four census tracts – two from the northern and eastern fringes of the City and two from the southern and southwestern fringes paint a stark portrait. According to 2000 census data, only 14% of homes within the northern and eastern census tracts fell below the City’s median selling price for homes. In contrast, over 89% of homes within the southern and southwestern tracts fell in this range. Per capita income in the northern and eastern zones was more than twice as large. Householders in the north and east were overwhelmingly white (74-82%) while those in the south and southwest zones were predominately Hispanic (62-68%).

An analysis of home sales data from the Multiple Listing Service shows that, since 2003, 94% of homes priced below \$200,000 sold in Santa Fe have been in the southwest area of the city, while only 6% have been in the northern and eastern areas.



Percent of City Home Sales Under \$200,000 Since 2003

This exclusionary housing pattern adversely impacts Santa Fe’s economy in a number of ways:

- Segregated housing erodes a community’s social capital – the social links and networks which help to create a cohesive, productive society (Putnam 1998).

- Tourism “depends critically” on the image and substance of a city or region as diverse, multi-cultural, equitable, and tolerant. As noted by Berry (2002) “[t]he reality – or even the public perception – of communities rent by polarizing differences, visible poverty, and homelessness, souring crime and an impoverished public realm raises strong barriers to the influx of investors and key workers.”
- Valuable service workers such as police officers, bus drivers, sales persons, nurses, and teachers are forced to live far away from jobs and community attractions. This spatial separation increases their cost of living, diminishes their quality of life, and creates labor shortages that undermine regional economic efficiency (Berry 2002; EPS 2002).

Inclusionary zoning requirements help offset these costs as a community grows and can reduce such costs in existing high income housing enclaves if packaged with responsible infill developments. By requiring that affordable housing be included in all new developments, the ordinance will help reverse the economic segregation that currently characterizes Santa Fe’s housing market.

The ordinance will help prevent further sprawl

Exclusionary housing patterns also impose community-wide costs in the form of urban sprawl. The links between exclusionary housing and sprawl are obvious, and well documented. “Expensive housing out of the reach of most households in many close-in neighborhoods creates pressures to pave over and build on open space in outlying areas as people decide that they have to move outwards to build a future” (Katz 2004). Indeed, the lack of affordable housing in Santa Fe’s urban core is a significant factor driving the boom in residential construction in sprawling developments on the City’s southern and western fringes. The vast majority of affordable housing units sold over the past five years are located in such areas.

Development in these sprawl prone areas comes at a steep price. Relative to more compact forms of urban development, sprawl greatly increases the fiscal costs of providing schools, roads, sewer and water extensions, and police, fire, and emergency services (Burchell 1997; Urban Land Institute 1191; Katz 2004). Sprawl necessitates large scale commuting from outside city centers thereby overtaxing existing roads and other transportation facilities, worsening air and noise pollution, and “engendering greater than normal turnover in the businesses, industry, and public agencies” (Burchell and Galley 2003). Sprawling, automobile dependent developments destroy open spaces with significant ecological, scenic, and historic values, increase storm water runoff, exacerbate erosion, degrade water quality, and reduce groundwater recharge (Anderson 1999).

Inclusionary zoning ordinances such as the Santa Fe Homes Program help mitigate these sprawl related costs by deflating at least some of the pressure to continually build outward to remedy affordable housing shortfalls in areas that are already developed.

The ordinance will benefit the community through increased household spending

The Santa Fe Homes Program will also benefit the community as a whole because it generates additional spending in the local economy by low income households. High housing costs crowd expenditures on other forms of consumption (Burke et al. 2002). Without having to spend 50% or more of their incomes on housing, low and middle income families have more disposable income to spend on goods and services in the local economy (Brunick 2004). For example, a recent study in Colorado found that the State's affordable housing program would generate \$1.4 million in direct, indirect, and induced economic activity each year as 2,105 households spent an additional \$2,460 on local goods and services rather than housing (EPS 2002).

Taken together, the economic benefits associated with increased home ownership, reductions in segregation and sprawl, and extra spending by low income households provide a compelling justification for the Santa Fe Homes Program Ordinance.

The ordinance will impose little if any costs on developers.

In response to inclusionary zoning requirements developers have four basic choices for defraying all or a significant portion of any increased costs: (1) raise prices on market housing; (2) develop less housing; (3) reduce profits, or (4) negotiate to pay less for inputs such as land or materials. According to a comprehensive review of the literature commissioned by Business and Professional People for the Public Interest, the last option is the most likely (Brunick 2004).

This fact has been borne out well by a rigorous study of the impacts of affordable housing regulations in Long Beach California (Rosen 2003). Using land residual analysis, the study compared the effects of various affordable housing packages on underlying land values. The study relied on interviews with developers as well as all available market transaction data. "The land residual methodology calculates the value of a development based on its income potential and subtracts the costs of development and developer profits to yield underlying value of the land" (Rosen 2003). When comparing development scenarios, the scenario that generates the highest value to a site is considered its highest and best use. The methodology is useful in predicting how different regulatory requirements will affect the negotiated price developers pay for lands on which they are contemplating development.

According to the Long Beach study, affordable housing requirements without any offsets for developers cause underlying land values and the price paid by developers to fall. For rental townhomes, flats, and apartments residual land values dropped by 40 to 43% below market rates with an inclusionary requirement that 10% of units built must be affordable for households earning 45% or less of the area median income. For owner occupied single family homes, townhomes, and condominiums, residual land values dropped by 14 to 16% below market rates with a requirement that 10% of units built must be affordable to households earning 90% or less of the area median income. Faced with affordable housing standards, then, it is clear that developers negotiate lower land prices with owners of vacant land parcels.

However, with the appropriate offset packages, residual land values can rise *above* market rates and more than offset any costs to these landowners. For example, the Long Beach study found that with a 25% density bonus, impact fee deferrals, and flexibility in affordable housing unit design, residual land values for rental townhomes rose 10% above market rates. For owner occupied single family homes, residual land values rose by 50% above market rates. Density bonuses have the single largest impact. Importantly, what this implies is that affordable housing ordinances can be used to promote developments that represent a more efficient use of the land than what the market would yield on its own.

In addition to negotiating lower land prices, developers can also reduce construction costs to insure that affordable housing units remain economically feasible. According to Roberta Feldman, co-founder of the City Design Center at the University of Illinois, “[t]here are ways to get construction costs down significantly without compromising quality” (Shimberg Center 1999). One example is to eliminate the tons of waste left over after the construction of an average single family home through more efficient design.

Thus, by negotiating lower land prices and saving on construction costs, developers need not incur any additional costs in meeting affordable housing requirements. In fact, studies have shown that affordable housing can be constructed well within the range of acceptable developer profit margins. For example, a Bay Area Economics study of affordable housing in Salinas, California found inclusionary requirements as high as 40% could be profitable for developers of owner-occupied and rental units when supported by a density bonus (Brunick 2004).

What little costs developers may incur are likely to be passed on to the wealthiest

Even if developers cannot escape all costs associated with affordable housing requirements, it is unlikely that such costs will be passed on to lower or middle income homebuyers. If costs are passed on, they will be passed on to those best able to absorb them without significantly reducing their demand for housing. By far, homebuyers best able to absorb higher housing costs are those in the wealthiest income brackets. There are two primary reasons for this.

First, those in the wealthiest brackets are far less likely to opt out of homeownership and seek rental housing in the face of significant home price increases. Homeownership rates in Santa Fe clearly depict this pattern. In response to skyrocketing median home prices homeownership rates for households earning less than \$50,000 dropped by 4-9% while the rate for households earning more than \$50,000 increased slightly. This tenure choice effect dampens a developer’s ability to pass on increased housing costs to low and middle income families.

Secondly, income growth has a stronger influence on willingness to pay for housing than price and since income growth has been strongest in the highest income group, it makes sense that homeowners in this group are better able to tolerate housing price increases. According to Zabel (2004), the elasticity (responsiveness) of housing demand to income changes is up to four times the elasticity of housing demand with respect to price. Thus, if a household’s income is growing rapidly it may pay more for housing even in the face of rapidly rising home prices. In New Mexico, and across the United States, income growth over the past twenty years or so has

been strongest in the highest income bracket. From the late 1970s through 2000, the richest fifth of New Mexico's households experienced a 15.4% increase in inflation-adjusted income (EPI 2002). For the poorest fifth, this figure was just .4%.

Given this, we would expect to find evidence in Santa Fe that housing prices have increased fastest in areas of the City where the highest income families tend to locate. Indeed, census data reveal this pattern, at least for the census tracts we sampled earlier. In the northern and eastern parts of the city, inflation adjusted median value for owner-occupied housing units increased 32% between 1990 and 2000. In the southern and southwestern portions of the city, median value increased 20%. The differences in housing price appreciation rates in Santa Fe provide at least some indirect evidence that higher income families are more willing and able to absorb any cost increases that developers feel they must pass on.

Conclusion

From an economic standpoint, the Santa Fe Homes Program Ordinance is an effective tool for addressing the affordability crisis in Santa Fe. The Ordinance will generate significant social and economic benefits by stimulating home ownership for low and middle income families, building neighborhood stability and cohesion, and reducing the fiscal and environmental costs of sprawl. Income saved on housing by low and middle income families will be spent in the local economy on other goods and services.

The Ordinance will generate little if any additional costs to developers. By negotiating lower land prices or using more efficient construction practices, any costs associated with the Ordinance are likely to be defrayed. Density bonuses, fee reductions, fee waivers and other incentives included in the Ordinance should more than offset any additional costs that may be incurred.

Although it is unlikely that any residual costs will remain, developers will most likely pass on any costs to homebuyers in the very highest income brackets since these homebuyers are far less likely to seek rental housing and since these homebuyers are experiencing the fastest rate of growth in personal income.

References

- Anderson, G. 1999. Why Smart Growth: A Primer. Washington: International City/ County Management Association and the Smartgrowth Network.
- Berry, Mike. 2002. Affordable Housing Project: Background Paper. St. Laurence: Brotherhood of Saint Laurence.
- Brunick, Nicholas. 2004. The Impact of Inclusionary Zoning on Development. Washington: Business and Professional People for the Public Interest.
- Burchell, R. W. 1997. "Economic and Fiscal Costs (And Benefits) of Sprawl." The Urban Lawyer 29(2): 159-181.

- Burchell, R.W. and C. Galley. 2003. "Inclusionary Zoning: Pros and Cons," in The California Inclusionary Housing Reader. Sacramento: Institute for Local Government.
- Burke, T., S. Pickney, and S. Ewing. 2002. Rent Assistance and Young People's Decision-making: Final Report. Melbourne: Australian Housing and Urban Research Institute.
- Cairney, John and Michael H. Boyle. 2004. "Home Ownership, Mortgages and Psychological Distress." Housing Studies 19(2): 161-174.
- Clingermayer, James C. 2004. "Heresthetics and Happenstance: Intentional and Unintentional Exclusionary Impacts of the Zoning Decision-making Process." Urban Studies 41(2): 377-388.
- Coulson, N. Edward. 2002. "Housing Policy and the Social Benefits of Homeownership." Federal Reserve Bank of Philadelphia Business Review 2nd Quarter 2002: 7-16.
- Coulson, N. Edward, Seok-Joon Hwang, and Susumu Imai. 2002. "The Value of Owner-Occupation in Neighborhoods." Journal of Housing Research 13(2): 153-174.
- Coulson, N. Edward, Seok-Joon Hwang, and Susumu Imai. 2002. "The Benefits of Owner-Occupation in Neighborhoods." Journal of Housing Research 14(1): 21-48.
- EPI. 2002. Pulling Apart: A State by State Analysis of Income Trends. Washington: Economic Policy Institute and the Center on Budget and Policy Priorities.
- EPS Inc. 2002. Final Report: Colorado Housing Trust Fund Impacts Study. Denver: Economic and Planning Systems, Incorporated and the Colorado Housing Trust Fund Coalition.
- Katz, Bruce. 2004. A Progressive Agenda for Metropolitan America. Washington: Brookings Institution, Center on Urban and Metropolitan Policy.
- Millennial Housing Commission. 2002. Meeting Our Nation's Housing Challenges. A Report of the Bipartisan Millennial Housing Commission Appointed by the Congress of the United States. Washington: United States Congress.
- Planning and Land Use Department. 2005. Santa Fe Trends. Santa Fe: City of Santa Fe Planning and Land Use Department.
- Putnam, R. 1998. "Social Capital: Its Importance to Housing and Community Development." Housing Policy Debate 9(1): v-viii.
- Shimberg Center for Affordable Housing. 1999. "Design Matters in Affordable Housing." Affordable Housing Issues 10(6): 1-4.

Turetsky, Brian. 2003. *The Lack of Affordable Housing and Its Impacts on Minorities*. Washington: Lawyer's Committee for Civil Rights Under Law.

Urban Land Institute. 1991. *The Case for Multi-Family Housing*. Washington: Urban Land Institute.

Zabel, Jeffrey E. 2004. "The Demand for Housing Services." *Journal of Housing Economics* 13(2004): 16-35.