

June 15, 2015

**NEW MCKINSEY REPORT UNDERSCORES IMPORTANCE OF
UNLOCKING LAND SUPPLY FOR HOUSING AFFORDABILITY,
IN UNITED STATES AND GLOBALLY**

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A major new report on solutions to affordable housing problems in the United States and around the world declares: “Unlocking land supply at the right location is the most critical step in providing affordable housing.” McKinsey Global Institute, *A blueprint for addressing the global affordable housing challenge*, 7, 48 (October 2014) (“*Blueprint*”), posted at: http://www.mckinsey.com/insights/urbanization/tackling_the_worlds_affordable_housing_challenge. (McKinsey Global Institute is the research arm of the influential, multinational management consulting firm McKinsey & Company. The report was unveiled in conjunction with UN-Habitat, the United Nations program focused on urban development issues worldwide.)

“Unlocking land supply” consists basically of governments adopting rules and policies that promote—rather than create barriers to—ample, suitable housing opportunities for low- and moderate-income people, in the right locations. The Equitable Housing Institute (EHI) works for the adoption of the appropriate rules and policies.

The right locations for affordable housing are places “where residents are within reach of jobs, schools, and vital services and where they can become part of the diverse fabric of the city.” (“City” includes an entire metropolitan area, as McKinsey uses the term.) McKinsey notes many examples showing that “housing built in the wrong location, no matter how well constructed and maintained, will fail.” (*Blueprint* at 49)

McKinsey documents the fact that unwarranted governmental restrictions on housing development and preservation—through flawed land use planning, zoning, and housing policies—aggravate housing shortages and other problems in various parts of the world. Currently, more than 1 billion low- and moderate-income people occupy unsafe and inadequate housing or are financially stretched by housing costs. Under current trends, by 2025 that number could exceed 1.5 billion such people. (*Blueprint* at ii)

McKinsey's report focuses on solutions. In addition to unlocking urban land, McKinsey identifies three other major levers that can substantially narrow the affordability gap. They are:

- An industrial approach to housing production to deliver it quickly, on a large scale, and at the desired cost;
- Efficiencies in operations and maintenance; and
- Expanding access to lending and reducing financing costs.

(*E.g., Blueprint* at v) McKinsey quantifies the potential cost reductions associated with each of the four basic levers. It estimates that six approaches it describes for unlocking urban land can combine to reduce the annualized cost of a standard housing unit by an average of 23 percent, worldwide. (*Id.* at vii) For the other three major levers, its estimates of potential cost reductions are:

- Industrial approach—16 percent;
- Efficiencies in operations and maintenance—2 percent; and
- Improved lending and financing—7 percent.

Thus, with the use of all four basic levers, McKinsey estimates that the annualized cost of a standard housing unit could be reduced by an average of 48 percent worldwide. (*Blueprint* at viii)

The *Blueprint* provides many concrete examples and statistics from around the world to illustrate its points. This memorandum will concentrate on McKinsey's observations regarding mechanisms for unlocking urban land relevant to the United States, where EHI has focused its efforts so far. If the United States get its own house in order (its housing rules and policies, that is), we believe it will provide models that hasten progress worldwide.

Mechanisms for unlocking urban land

"Around the world, six major policy approaches have been used successfully to develop or unlock land or to increase the density of land to create affordable housing at the right location." (*Blueprint* at 49) Those approaches are:

1. **Smart, transit-oriented development (TOD).** Housing development along with commercial development close to rapid-transit routes improves the employment opportunities of low-income workers, who often cannot afford a car. Also, capturing a share of the increased value of private land in those areas due to governmental TOD actions can help pay for the infrastructure investment and the cost of affordable housing. "In cities where new transit facilities have been

built, land values in the surrounding areas have risen by 30 to 60 percent.”
(Blueprint at 8)

2. **Releasing public land.** In many nations (not the United States), the government owns more than half of the land in a city. Because this land is frequently valued below market prices and is “not used to its full potential, it can be a good source of land for affordable housing.” *(Blueprint at 8, 55)*
3. **Unlocking serviced idle land.** “In many cities around the world, significant amounts of serviced residential land (with access to utilities and infrastructure) within urban areas are unused or under-developed.” *(Blueprint at 8)*
4. **Enabling development through land assembly or readjustment.** “Ownership of idle or underused land or dilapidated properties is often fragmented, making development of such land parcels complex and time consuming. Land assembly and readjustment (also known as land pooling) have been used successfully in Japan, South Korea, and Gujarat, India. Under these schemes, owners pool their land in exchange for higher density and infrastructure investment.” *(Blueprint at 9)*
5. **Ensuring clear titles and formalizing informal land use.** “Often in developing economies, land-registration systems have not evolved; upwards of 70 percent of land in developing economies is unregistered, according to UN-Habitat.” *(Blueprint at 9)*
6. **Improving urban land-use rules and using inclusionary planning.** “By changing land-use rules, cities can significantly lower the amount of land used per housing unit, usually by adjusting the permitted floor-area ratio.” Doing so permits more stories in residential buildings. “Developers then can construct more square meters of space for each square meter of land and can fill more demand for housing, particularly in areas close to transit stations where the infrastructure can support it.” *(Blueprint at 9)*

In the United States, the greatest challenge appears to be improving urban land use rules and policies for transit-oriented developments and other urban communities. The United States doesn’t have as severe problems as many other nations with some of the other approaches McKinsey discusses.

For example, the United States has an advanced land title system, unlike many developing nations. So, the United States does not have major, widespread problems with informal settlements (squatters) or unregistered land.

Also, urban areas of the United States typically have less serviced, idle land and publicly-owned land than many nations, and fewer challenges with land assembly and readjustment (land pooling). Among the nations with greater challenges along those lines are those with current or former communist governments, and those in the Global South.

However, like many other nations with a full panoply of land use laws, including zoning and various growth controls, the United States has tremendous affordability challenges due to extensive restrictions (generally by local governments) on residential land use.

“Land is generally costly and often unavailable.” (*Blueprint* at 49) “Minimizing land cost is essential for creating housing at affordable price points, and it is critical that the land be in the right location.” (*Id.*) The highest land costs (as a share of total housing unit costs) that McKinsey cites are in the United States—San Francisco (78 percent) and New York City (49 percent). (*Blueprint* at 49, Exhibit 16)

Where land is available at a lower price—on the fringes of the city—housing projects may fail due to lack of infrastructure (schools, hospitals, transportation to employment). We find that urban land markets do not respond well to normal supply and demand forces for several reasons, including fragmented or public ownership, poor land records, and *regulations and zoning laws that discourage development.*

(*Blueprint* at 7, emphasis added) Again, the latter problem is especially prominent in the United States, as its land records system is advanced and public ownership of urban land is relatively limited.

“Regulations affecting land supply, particularly zoning and permitting processes, play a large role” in whether price increases lead to sufficient, additional housing being produced to meet the demand. (*Blueprint* at 50) “In practice, restrictive zoning can severely limit new construction and result in higher housing prices than in comparable cities that have fewer restrictions, exacerbating the affordable housing challenge.” (*Blueprint* at 50, citing Rolf Pendall, *et al.*, *From traditional to reformed: A review of the land use regulations in the nation’s 50 largest metropolitan areas*, Brookings Institution, August 2006) As to solutions:

Cities typically restrict density of land use by imposing maximum floor-area ratios, minimum lot sizes, and open-space requirements. Comparison of some of the largest and densest cities reveals large differences in maximum density, even within these cities. Typically, density falls with distance from the city center. So, while Manhattan has some of the highest floor-area ratios in the world, the outlying boroughs of Queens and Staten Island have some of the lowest among major cities.

(*Blueprint* at 65) “Too-stringent rules on land use force households in all income brackets to use more land than they would likely purchase at prevailing prices and reduce the affordability of housing for all.” One example is Boston. After it “introduced regulations limiting land uses, the number of permits per acre fell by about 40 percent from 1980 to 2002, leading to constrained supply and higher housing prices.” (*Blueprint* at 66, citing Edward L. Glaeser and Bryce A. Ward, *The causes and consequences of land*

use regulation: Evidence from Greater Boston, Journal of Urban Economics, Vol. 65, No. 3, May 2009)

Cities can adjust floor-area ratio rules at a block level, taking into account spatial distribution of housing, infrastructure capacity, and demand for land for various uses within the city. This allows for a market-based approach for land and floor-space regulation. Cities can also adjust regulations setting open space requirements, minimum lot sizes, building heights, or parking requirements to alter land use. These adjustments can be used to increase land use, particularly in areas close to transit stations where the infrastructure can support it, and reduces house prices for all by increasing supply of housing for residents at all income levels. And as new supply is occupied, older housing becomes available in appropriate locations for low-income households.

(*Blueprint* at 67) Those adjustments are keys to permitting enough housing for an urban area’s workforce, in the right locations. In EHI’s view, many cities have not included enough housing in and near their transit-oriented development (TOD) plans to effectively balance the job growth for which they are planning.¹ Thus, many low- and moderate-income workers cannot take jobs there or must travel unreasonably long distances to those jobs. Lack of enough housing in TODs limits the ability to reduce problems such as sprawl, traffic congestion, road building, air pollution, poverty, homelessness—and even economic development in TODs.

An important target standard for jobs-housing balance has been identified by the American Planning Association (APA)—generally about one housing unit for every 1.5 workers in the community. APA Advisory Report, *Jobs-Housing Balance* (2003), p. 4, posted at: <http://www.planning.org/pas/reports/subscribers/pdf/PAS516.pdf>.²

If cities manage land-use reforms to increase density well, they can make an enormous contribution to efforts to narrow the affordable housing gap. Increasing the floor-area ratio of a plot of land raises the potential income from development and, overnight, the value of the land rises. This value can be used to cross-subsidize affordable housing. Indeed, with

¹ The Center for Transit-Oriented Development’s (CTOD’s) *Performance-Based Transit-Oriented Development Typology Guidebook* (2010) gives numerous examples of predominantly commercial TODs, and other TOD types, in the United States.

² CTOD’s idea of “balanced” transit-oriented development should not be confused with “jobs-housing balance.” To CTOD, “balanced” TODs generally are places where the total number of workers is roughly equal to the total number of residents. In that situation, there are more workers than *resident* workers in the TOD. CTOD does not express a position on jobs-housing balance. See, e.g., *CTOD Typology Guidebook*, *supra* n. 1 at 10 and Table 2.

well-calibrated inclusionary zoning rules and negotiations with builders, land can be made available at virtually any cost that is needed to make housing affordable

(*Blueprint* at 68) McKinsey identifies a strategy that has been used successfully to encourage use of higher-density urban land for affordable housing. It is the allowance of a “density bonus”—which allows developers to build more units on a property, and thus increase the total value of that land—coupled with:

- a. Inclusionary zoning requirements—*i.e.*, that a percentage of those extra units be affordable to low- and moderate-income people; and/or
- b. Transferrable development rights, which allow developers to provide some or all of the required affordable units on a different site.

Such a program “must be implemented with great care” to avoid numerous unintended consequences, including arbitrage opportunities for developers and owners to buy urban land and sell it almost immediately at a substantial profit. Nonetheless, density bonuses coupled with affordable housing development strategies have been used successfully to provide lower-cost housing. (*Blueprint* at 69)

Vulnerability of housing markets to bubbles and crashes

McKinsey points out that the stakes involved in housing policy are high around the world.

The global financial crisis of 2008 had its roots in housing finance, and the world economy still suffers from the aftermath. But it was only one in a long series of housing-related bubbles, crashes, and financial crises that have roiled nations around the world with astounding regularity; according to the International Monetary Fund, these crises occur at least once every 15 years.

(*Blueprint* at 108, Box 7) “The housing market is particularly susceptible to bubbles for several reasons, including a lack of knowledge and transparency in the market.”

Homes sell for what buyers are willing to pay, based on incomplete information. Value is determined largely from the sale price of similar homes, rather than by objective assessment. So, when prevailing prices begin to rise, so do expectations of further increases, leading to speculation. Loose lending standards can fuel speculation.

(*Blueprint* at 108, Box 7) Regulatory barriers to housing affordability greatly exacerbate housing bubbles by unduly restricting housing supply where it is needed. The housing market crashes that follow those bubbles result in great suffering for low- and

moderate-income people. Among the frequent consequences are a spike in foreclosures on both homeowner and rental properties. (The latter foreclosures can result in evictions of large numbers of tenants.) Suffering also results from increased unemployment and general economic decline related to housing market slumps.

Here, we will not address the other three major levers McKinsey discusses (mentioned above) for improving housing affordability. However, we will note that government regulation and policy play an important role in promoting or impeding progress in those areas, too.

Conclusions

McKinsey's new *Blueprint* is a major step forward in its detailed documentation and quantification, for a general audience, of the housing affordability challenge worldwide. The report identifies numerous strategies for improving access for low- and moderate-income people to suitable housing they can afford, in sensible locations.

The most critical step is unlocking urban land, by correcting counterproductive restrictions on residential use and density. Those restrictions consist basically of flawed governmental rules and policies—especially planning, zoning, and housing policies. Those rules and policies contribute strongly to unsafe, and inadequate, or unaffordable housing for a high percentage of the world's low- and moderate-income people (already well over 1 billion people, and rapidly rising).

Correction of counterproductive rules and policies can produce a tremendous improvement in housing affordability, safety and adequacy for low- and moderate-income people worldwide. For example, McKinsey estimates that six approaches it describes for unlocking urban land can reduce the annualized cost of a standard housing unit by an average of 23 percent worldwide. With the use of all four basic levers, McKinsey estimates that the annualized cost of a standard housing unit could be reduced by an average of 48 percent worldwide.

In the United States, the greatest challenge appears to be improving urban land use rules and policies for transit-oriented developments and other urban communities. The United States doesn't have as severe problems as many other nations with some of the other approaches McKinsey discusses.

Land costs are particularly high in many metropolitan areas of the United States, as a percentage of total housing unit costs. The key reason for that is government regulations and zoning laws that discourage development to meet the true demand, and thus inflate housing costs in areas reasonably close to employment hubs.

Metropolitan areas with thriving job markets can reduce inflated land prices and other unnecessary housing costs by adjusting zoning rules to permit many more housing units in areas appropriate for multi-family housing. Crucial areas for permitting greater residential density are those close to transit stations that have sufficient infrastructure (roads and other public utilities). EHI notes that to date, government planning regarding many transit-oriented developments has not included enough housing to balance the expected job growth.

A related strategy is providing “density bonuses” to private developers in return for their building more units affordable to low- and moderate-income people. The density bonus protects the developer from financial loss and has proven successful in many jurisdictions.

The McKinsey report shows that regulatory barriers must be addressed effectively, in order to meet the housing affordability challenges of the United States and other nations. EHI’s essential mission is to promote that goal, starting in the United States. If the United States “gets its house in order,” we believe it will provide models that hasten progress worldwide.