

Bureau of Land Management Assists Drop in Housing Affordability

The National Association of Home Builders (NAHB) recently released the first quarter of 2006 NAHB-Wells Fargo Housing Opportunity Index (affordability index) for U.S. metro regions. Las Vegas ranked 168th out of the 199 regions with an affordability index of 16.1%. The decline in housing affordability in Las Vegas sparks vigorous debate amongst affected parties – households, businesses, homebuilders, and government. A strong case exists to charge the Bureau of Land Management (BLM) land auctions as the primary culprit for plunging housing affordability.

What does housing affordability mean? The affordability index starts with the ratio of monthly housing expenses to monthly income – an expense-to-income ratio of under 28%. Worsening affordability, a rising expense-to-income ratio, occurs when monthly expense rises more quickly than monthly income. Monthly housing expense depends on the purchase price of homes, the mortgage down payment percentage of 10%, the mortgage interest rate, and other expenses such as property taxes and property insurance.

What does a 16.1% affordability index mean? Households earning the median household income (i.e., \$58,200) can afford to purchase 16.1% of the single-family homes sold in Las Vegas in the first quarter of 2006. In a “balanced” housing market, should not the household with the median income be able to purchase the median priced home? Well, no.

Some fraction of the households in the housing market will rent, where “renters” stand for households not living in single-family homes. Assuming that renters largely occupy the bottom half of the income distribution, then the median-income household should qualify to purchase less than 50% of the single-family homes sold. How much less? That depends on the number of renters. For example, the 16.1% affordability index for Las Vegas would occur in a “balanced” market, if renters equaled 40.4% of the households in the housing market.

Why has housing affordability jumped into the headlines? The median-income household could afford almost 70% of the homes sold in Las Vegas in 2002. Since then, affordability plummeted. What caused the tumble? Median household income rose, so the fall in affordability reflects monthly expense rising much more quickly.

What fueled rising monthly housing expense? Several factors could have contributed. Rising home prices -- reflecting land costs, construction costs, homebuilders' insurance costs, and so on -- affect the sales price of new homes, and indirectly the prices of existing homes. In addition, zoning regulations on the number of units per acre modulate the extent to which land prices pass through to new home prices. Other factors - - such as the home mortgage interest rate, property tax rates, property insurance, and so on -- all contribute to the determination of monthly housing expense.

Land costs clearly prove the dominant factor. The average price per acre at BLM auctions rose from well under \$100,000 in 2001 to well above \$250,000 in 2004 and 2005. Land values zoomed making land value a much larger percentage of assessed value than 5 years ago.

Assuming that a housing affordability problem exists and that affordable housing will get supplied in the valley, who will pay the price? Will households, businesses, homebuilders, government, or some combination foot the bill?

If government imposes inclusionary zoning, then homebuilders will pay. Inclusionary zoning requires developers to include housing options for low- and moderate-income households. Anecdotal evidence benchmarks the cost of such zoning restrictions. In November 2003, the BLM auctioned a 1940-acre parcel with inclusionary zoning. With an appraised value of \$250 million, no bid emerged. In June 2004, the same parcel sold for \$557 million without inclusionary zoning. If the bidders at those auctions calculated properly -- a big if, then something in the neighborhood of a \$300 million implicit cost existed in providing affordable housing in that parcel of land.

Aggressive actions by developers, as they see the impending build-out of the valley, fuels higher land prices. In this environment, the BLM's slow release of new land forces its price to new highs. In short, with a limited supply, growing demand, and the aggressive activity to acquire scarce land resources, the BLM land auctions generate huge economic rents.

Can rising income ameliorate the affordability problem? Of course, but in this case, private businesses and/or government bear the cost. Private businesses either reduce their profit or pass on the added labor cost in higher prices. Government passes higher labor costs on to taxpayers.

BLM policy led to rising land prices, which created the bulk of the affordability problem. Three alternative solutions jump to mind. One, the BLM can accelerate the sale of land, increasing land supply in the market and lowering its price. Two, BLM land auctions can link affordable housing to the sale through inclusionary zoning. As such, land prices will fall and the BLM takes the hit on paying for affordable housing. Three, BLM land auctions continue as before, but a share of its revenue subsidizes affordable housing.

All three solutions, if successful in lowering land values, may impose an implicit cost on current homeowners through lower resale values. The first solution will improve the affordability for purchases of all new and existing housing. The second and third solutions will provide improved affordability for the buyers of homes in the new developments with inclusionary zoning. The second solution spreads the improvement across all homebuyers while the third solution restricts the improvement to buyers of affordable housing.

In sum, Las Vegas experienced a dramatic worsening of housing affordability in recent years. BLM land auctions are the probable culprit. All the solutions just proposed will lower the BLM's economic rent, dunning the culprit with the major cost of doing so. As such, one gains more affordable housing and loses money for the programs in the Southern Nevada Lands Management Act of 1998.

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