

# Development Regulations and Housing Affordability

*A legendary homebuilder  
on the impact of regulations  
on housing affordability  
in Charlotte, N.C.*

THE 2006 EDITION of Harvard's annual *State of the Nation's Housing* reports, "Of the rental problems facing the nation, affordability is by far the most widespread and is getting worse. As of 2005, nearly half of all renters were cost burdened, up from only about one-third in 1980. Burdens are worst and often excessive among those with the lowest incomes. For example, approximately half of extremely low income renters spend 79 percent or more of their incomes on rent. Even as the incomes of those at the bottom of the distribution have stagnated and the percentage of jobs paying middle-income wages dropped, rents have been creeping up for those with low-wage work."

JOHN CROSLAND, JR.

The *Charlotte Observer* confirmed that Charlotte, N.C., is no exception to this national trend: in 2006, 55,580 renter-households—almost half of all renters in Mecklenburg County—were overburdened with rental payments, meaning that they were spending over 30 percent of their income on housing. This compares with only 45,071 overburdened renters in 2002. This means that the number of households spending more than 30 percent of their income on rent increased by more than 10,000 in just five years. The *Observer* article went on to state that of these overburdened households almost 30,000 devoted at least half of their incomes to rent.

During the five-year period when the number of overburdened households in Charlotte increased so dramatically, there were nearly 10,000 new market-priced units built. However, it is unlikely that any of the overburdened households could afford these new units; the average rental and utility cost for a new two-bedroom apartment in Mecklenburg County was \$12,000 a year. Assuming that rent is 30 percent of household income, a family would need to earn at least \$40,320 to afford this new housing. Approximately 72,000 families in the Charlotte area fall short of that threshold.

At the other end of the housing spectrum in Mecklenburg County are units more than thirty years old. The average

rent and utilities for a two-bedroom unit in older apartment buildings are \$8,496 per year. Although this is considerably less expensive than a new unit, a family would still need to earn at least \$28,320 to afford such a unit. In Mecklenburg County, 39,000 households earn less than \$28,320 a year. The challenge is even greater for larger families. Average monthly rent and utilities for a thirty-year-old, three-bedroom unit are \$10,476 annually. At that price, a family of five needs to earn at least \$34,920, or 50.5 percent of the median income in the area, in order to avoid spending more than 30 percent of their income for shelter. More than 51,000 Mecklenburg County households would not qualify.

A Robert Charles Lesser & Co. study concluded that by 2012 there will be a need for approximately 17,000 affordable rental housing units in Mecklenburg County. To be affordable, 10,262 (61 percent) of those units would need to be offered at rents of \$300 or less per month; another 6,662 (39 percent) would need to be offered at rents of \$300 to \$500 per month. Since rents even in older buildings average more than \$600 per month, this represents a massive housing problem. In recent years, 2,000 additional households are overburdened by housing costs each year. Approximately half of these overburdened households can be classified as severely overburdened

because they are spending more than half of their income on housing. It is safe to say that the number of severely overburdened households is increasing at a rate of more than 1,000 annually.

The National Association of Home Builders and Wells Fargo have published a history of housing affordability, the *Housing Opportunity Index*, which tracks the percentage of families that can afford to purchase a median-priced home in a given market. In the Charlotte-Gastonia-Concord area during the first quarter of 2004, for example, 76.9 percent of families could afford to purchase a median-priced home. By the end of the fourth quarter of 2007, however, this number had dropped to 62.9 percent. Nevertheless, low-income families in Charlotte are better off than those in the Los Angeles-Long Beach-Glendale, California area. The median income in the Los Angeles area is \$61,700, which is comparable to Charlotte's \$60,200, but in the fourth quarter of 2007, the median price of a Los Angeles area home was \$456,000, compared to \$172,000 in Charlotte.

#### INCREASED LAND USE REGULATION

The 2006 Harvard report concluded that the housing crisis nationwide is the result not only of the growth of low-paying and

part-time employment, but also of regulations on residential development. To appreciate how dramatically land-use regulations affect the cost of housing, one must understand some of the basic economics of building and development. In the world of residential development there are general rules regarding the ratio between the cost of land and the sales price of a house. The balance sheets for several Charlotte-area builders indicate that the lot cost typically makes up 16 percent to 20 percent of the selling price of a new house. This is in keeping with other areas in the Southeast. The fact that lot costs make up approximately 20 percent of the selling price of a house is the origin of the general rule of thumb that, in this region, the typical "home-price-to-lot-price ratio" is 5 to 1. In other words, for a house priced at \$200,000, a builder would expect to pay \$40,000 for the lot. (Ratios may be significantly lower in areas where land prices are especially high due to regulatory costs or an exceptional location.) Because of this ratio, every additional dollar a builder spends on a lot increases the selling price of the house by five dollars.

It is important to note that increased costs resulting from land-use regulations have a disproportionate effect on low-income families, because costs arising from land-use regulations do not vary significantly based on the value of the housing being developed. Regulatory costs are

passed on to all buyers regardless of income level. For example, if a new land-use regulation increases lot development costs by \$10,000, it will result in a \$50,000 increase in sales price. A \$50,000 increase is significant regardless of one's income, but it can easily make homeownership prohibitive for low-income families. In an entry-level house, for example, adding \$50,000 might change the sale price of a \$120,000 house to \$170,000, a nearly 30 percent increase.

Although existing homes are generally unaffected by new land-use regulations, the prices of existing homes will generally increase if new homes are priced higher. This means that owners of existing homes receive the perceived benefits of new regulations without paying for them, as their home values increase in response to the new development regulations. This windfall for existing owners creates a powerful political incentive for ever-more regulations to further boost existing home prices.

In 2007, Charlotte adopted a new set of development policies. The goal of the Urban Street Design Guidelines (USDG) is to improve quality of life by implementing design standards that will encourage greater street connectivity and pedestrian friendliness. To achieve these objectives the USDG discourage cul-de-sacs, require reduced block lengths, and in some cases require the construction of bridges across

streams and creeks. The implementation of these standards will also have a direct impact on the price of residential units. According to the USDG, typical block lengths for local residential streets should be 600 feet. However, it should be pointed out that Myers Park (laid out by John Nolen in 1911) is often held up as an ideal example of neighborhood planning; transportation planners marvel at how well its street network serves pedestrians, cyclists, and motorists. However, nearly two-thirds of the block lengths on local streets in Myers Park, as well as neighboring Eastover, are greater than 600 feet.

Another new land-use regulation recently adopted in Charlotte is the Post Construction Controls Ordinance (PCCO). This ordinance seeks to improve water quality and prevent stream degradation by requiring that all new developments capture, hold, and treat storm water runoff. I would argue that neither the state and federal standards nor the additional local requirements provide any economic value to the property owners funding their costs. While these regulations increase the price of housing in new developments, they do not necessarily improve or add value to the property. Storm water systems require maintenance and their operating costs are substantial.

The purpose of storm water retention systems is to improve water quality throughout the county. Clearly these

requirements are intended for the benefit of all citizens, not just those living in new houses and apartments. This being the case, why is the entire cost of their installation placed on renters or people buying new homes, while existing owners enjoy the benefits without paying a dime? The direct result is that those least able to afford housing suffer the most, since the PCCO has the greatest impact on the price of low and moderately priced housing. If these improvements are needed for environmental reasons, they should be funded in a manner whereby all citizens share in the cost.

Many of Charlotte's neighborhoods, such as Dilworth, Wesley Heights, Elizabeth and Wilmore, are enjoying a revival. City planners and residents alike point to their interconnected street networks, pedestrian friendliness, tree canopies, and well-built homes. Interestingly, these neighborhoods were built before there were any land-use regulations. In the early 1900s, when they were developed, it was the public sector that provided—and paid for—infrastructure improvements such as streets, sidewalks, and water and sewer lines. In 1937, in the planned community of Club Colony, for example, the only infrastructure for which the builder (John Crosland, my father) was responsible was a gravel road. All remaining

infrastructure was the responsibility of the City of Charlotte, including sewer, water, and the eventual paving of the street. Later, curb and gutter and storm sewer piping were added at the expense of taxpayers.

In time, elected officials looked for ways to pay for infrastructure other than by raising property taxes, and shifted the burden of the infrastructure cost to the land developer. Sometime before the 1950s, developers became responsible for installing streets, curbs, gutters, and storm sewers, although as late as 1951 and 1952, the City of Charlotte was still furnishing water and sewer lines. Then, during the 1950s, the city began requiring that developers install water and sewer lines, although the construction cost was reimbursed through the water and sewer rates. During the mid-1960s, the total cost of on-site water and sewer lines became the responsibility of the developer, who incorporated the cost into the home price and passed it on to buyers. Thus, home buyers are not only paying for their houses and their lots, but also for a portion of the costs of streets, sewer, and other infrastructure. Depending on the price of a home, the cost of installing basic infrastructure can range from 3 percent to 13 percent of the cost of a home, with modest-priced homes seeing the higher percentages.

## THE COST OF REGULATION

Land-use regulations likewise have a major effect on housing prices in the Charlotte area. Pre-PCCO and USDG, a 17.8-acre site, for example, could be developed into eighty-three single-family lots. After factoring in development costs as well as profit and overhead, lots could be sold for \$40,000; hence the projected selling price of a house was approximately \$200,000. The impact of the PCCO and USDG regulations was then estimated. In addition to the significant capital costs related to the required water retention and water quality infrastructure, the PCCO requires stream buffers, which reduce the amount of developable land. The USDG requires the construction of additional streets and sidewalks, which increase costs and likewise reduce the amount of buildable land. (Ironically, while the PCCO encourages developers to reduce the amount of impervious coverage, the USDG increases impervious coverage by requiring additional streets and sidewalks.) The result was that instead of eighty-three lots, a developer could create only seventy-four lots. Fewer lots and the additional infrastructure costs increased the price of an improved lot from \$40,000 to \$53,682, and the selling price of a house increased from \$200,000 to \$270,000, a 35 percent increase.

What about the effect of regulation on rental housing, which is an important option for low-income families? Because the apartment marketplace in most southeastern metropolitan areas is highly competitive, operating margins are modest. In North Carolina, for example, a commonly accepted target is a net operating income (NOI), or net rental income, equal to 10 percent of total capitalization employed (sometimes referred to as “replacement cost”). From this NOI come financing costs (such as mortgage payments) and pretax profit. When costs to build apartments increase as a result of new regulations, the rents also increase proportionately in order to preserve an acceptable return on total capital.

To maintain a 10 percent rate of return, each \$1,000 in additional development costs per apartment unit must produce an additional \$100 per year in NOI, or a monthly rent increase of \$8.33 per apartment. A recent analysis evaluated the direct impact of land use regulations on apartment rents in the Charlotte area by comparing the cost to develop and build an actual apartment project prior to the adoption of the PCCO and USDG, with the estimated cost to develop a similar project that would comply with the new regulations. The analysis concluded that compliance with the PCCO and USDG would increase development costs by \$6,861 per unit, which would result in a

rent increase of \$57.15 per month, or \$690 per year.

There are approximately 120,000 households in the Charlotte area that live in rental housing, many with limited incomes. As mentioned earlier, 29,000 of these households spend more than half of their income on housing. To these families, a \$60 increase in rent is significant, because in most cases their incomes are not even keeping up with inflation. This is \$60 that cannot be spent on transportation, food, clothing, medical care or other necessities. Land-use regulations clearly have the very real effect of taking money out of the pockets of low-income families and diverting it to pay for infrastructure improvements.

## IMPACTS AND SOLUTIONS

Increased land development costs greatly affect housing affordability in the Charlotte area. It's no wonder that developers cannot provide affordable housing. As land-use regulations continue to proliferate, the connection between regulations and the rise in housing prices will become more obvious. Reducing the costs of land-use regulations would improve affordability across the board. Lowering development costs would enable public agencies and private developers to stretch their

affordable housing dollars further. At the same time, reduced development costs would benefit workforce and middle-class families by keeping single-family housing prices at reasonable levels.

Higher development costs have a disproportionate impact on low-income families. To illustrate this, I compared the development costs of two luxury housing developments in Charlotte with two moderately priced developments. In all cases, development costs included land clearing, erosion controls, sanitary sewer installation, water distribution systems, storm sewer systems, curbing, sidewalks, and street paving (but not land costs). The two luxury developments included houses priced from \$800,000 and houses priced from \$900,000. Development costs made up 2.9 percent of the houses priced in the \$800,000 development, and 4.0 percent of the houses priced in the \$900,000 development. In the two more moderately priced developments, houses started at \$90,000 and \$383,000. The development costs made up 13.2 percent of the houses priced in the \$90,000 development and 7.5 percent in the \$383,000 development. In other words, the impact of development costs can be more than four and a half times greater on moderately priced housing than on luxury homes.

A new law that would allow an alternative funding mechanism for residential infrastructure could be a key to providing

more affordable housing. Recently, the state legislature approved a statute that will allow local governments to issue revenue bonds that can be used to finance development infrastructure. The statute allows these bonds to be paid back over a thirty-year term through assessments paid by future property owners. This should enable local governments to fund infrastructure such as streets, water, sewer, and storm water controls. Using such bonds to fund required infrastructure could prevent those costs from being capitalized into home prices and should increase housing affordability.

I have already discussed how land-use regulations affect the cost of homeownership and tenancy in the Charlotte area. But could certain provisions of the regulations be waived when developing workforce or affordable housing units? The PCCO already contains provisions that exempt certain types of development from full compliance with the ordinance. For example, projects that are developed within a transit station area or within a distressed business district may not be required to comply with some of the most expensive requirements of the PCCO. Also, most industrially zoned properties are exempt from the PCCO's open space requirements. These exemptions are necessary because the city realizes that the expense of compliance with the PCCO would make it cost-prohibitive to develop

in certain areas. So, developers of high-end condominiums along the light-rail lines may avoid these costs, while those developing lower-priced housing in other areas are required to install these expensive measures and pass the costs along to low- and middle-income families. Why not extend the same exemptions to affordable housing projects?

Another alternative would be to modify the USDG regulations so that they have less impact on the cost of housing. This could be done without sacrificing the goals for more connectivity. The current ordinances require the installation of sidewalks on both sides of all residential streets, which ensures that there will be miles of additional impervious surface and millions of dollars in future maintenance costs, when, in some cases, the sidewalks provide very little benefit. On residential streets where sidewalks are warranted, millions of dollars could be saved by providing sidewalks on one side of a street rather than both sides. On shorter residential streets and cul-de-sacs, sidewalks could be dispensed with altogether—a recent *Charlotte Observer* article described residents who didn't want any sidewalks in their neighborhoods.

Although the USDG maintains that “the shorter the block length, the denser the street network,” I would argue that denser street networks reduce the amount of developable land; require



more pavement, which generates additional storm water runoff; require more intersections, which increase commute times, generating greater air pollution; and are expensive to build and more expensive to maintain—which in turn make all housing less affordable.

I don't believe that requiring denser street networks in individual developments is the answer to our transportation and congestion challenges. We need a more comprehensive approach that considers the bigger picture. The Charlotte Department of Transportation, working with property owners, could develop a comprehensive transportation plan for all areas in the county, avoiding the rigid and costly provisions of the recently approved guidelines. City leaders should consider changes to the USDG that would encourage transportation planners to focus on solutions to specific traffic and congestion problems rather than the inefficient, one-size-fits-all standards of the current guidelines. Most important, we should seriously consider how changes to these standards could improve affordability throughout our housing market.

Costly land-use regulations and affordable housing are usually mutually exclusive. Therefore, it is essential that we critically examine the economic impact of regulations. Reduced development costs could place housing within the reach of thousands of families. According to David

Engel, director of HUD's Division of Affordable Housing Research and Technology, the removal of regulatory barriers "should be viewed as an essential component of—but not a substitute for—an affordable housing strategy." And if regulations are necessary to further a substantial public benefit, the costs of such regulations should be spread as broadly as possible to avoid placing an even greater cost burden on those least able to afford housing. If the costs of regulations are shared by all of those who benefit from them, the impact on housing prices can be minimized, resulting in greater housing affordability throughout the market.

## CONCLUSION

We cannot afford to continue the current trend of housing prices that greatly outpace income growth. We must, therefore, look for ways to maintain affordable housing prices throughout all levels of the market. While Charlotte has done a better job of addressing the housing needs of its low-income citizens than many larger cities, it is unacceptable for this city to continue to have families and individuals without an affordable place to live. The first goal should be to reduce the number of households that are spending more than 50 percent of their incomes on shelter to zero in twelve to fifteen years. Our second goal

should be to address workforce housing for our citizens who perform essential jobs in our community, including, teachers, fire-fighters, police officers, and healthcare workers to ensure that affordable housing is available to them in our community. These objectives can best be accomplished by reducing the cost of development, by performing a cost-benefit analysis of all land use regulations and fees to determine if they meet the test of fairness, and then eliminate or modify the regulations or fees that do not pass muster.

I have no doubt that if Charlotte gives priority to these goals, we can actually achieve adequate housing for all our citizens over the next twelve to fifteen years. For my dream of housing affordability to come true, however, we will need long-term financial commitments and strong leadership from the private sector, the local faith-based community, all housing agencies, private citizens and, of course, all levels of government.