Forbes Business

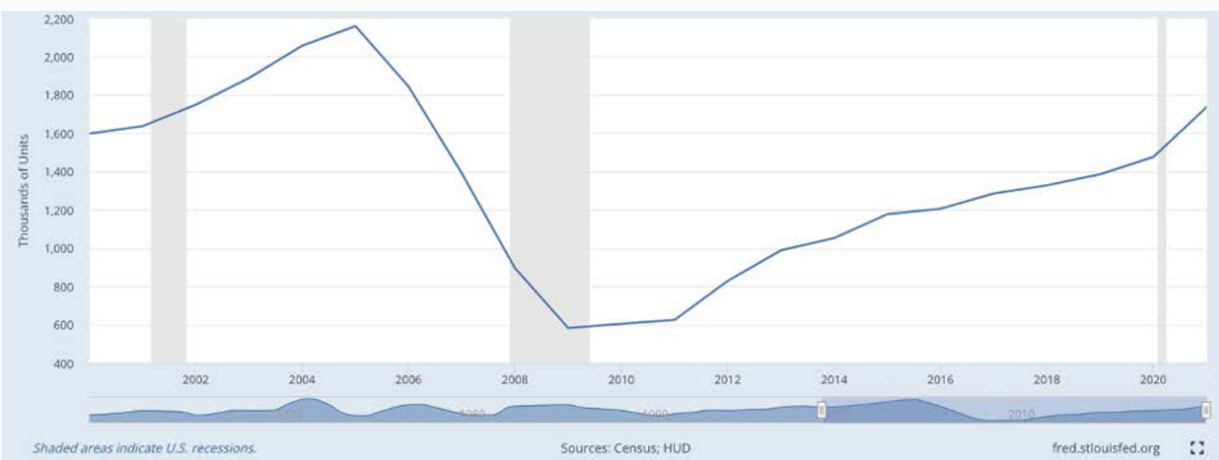
Build, Baby, Build! In 2023, Cities Need To Incentivize New Housing

Roger Valdez
Contributor
Roger Valdez is Director of the Center for Housing Economics.
Dec 5, 2022,01:54pm EST

NO MATTER WHAT HAPPENS TO THE ECONOMY, STATE AND LOCAL GOVERNMENTS NEED TO PUSH MORE HOUSING ... [+] GETTY

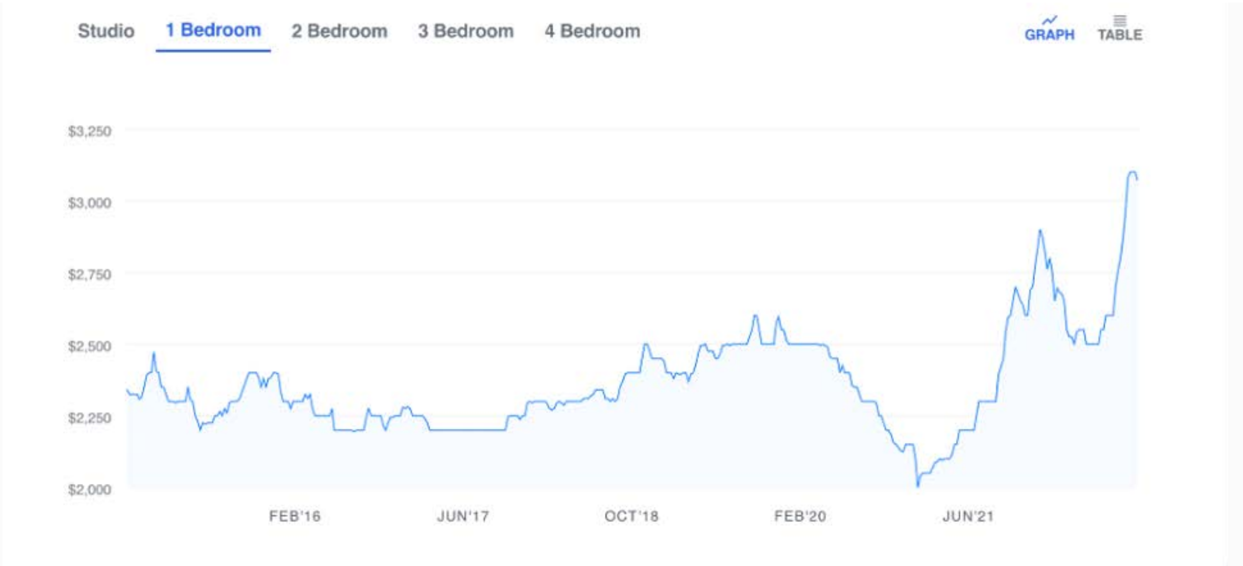
Pundits and prognosticators will try to predict whether and how long the American economy will suffer from inflation. The answers to those questions will also impact their assessment of recession; are we win one, is one coming, and how deep and long will it last? When it comes to the housing economy, the tea leaves are hard to read. Mortgage interest rates are up, and so are rents adding to overall inflation. Meanwhile, single-family housing prices soared in 2021 as remote workers took advantage of cheap money and remote work to fuel a buying frenzy in previously sleepy markets like Boise and Bozeman. Now prices in those market are falling rapidly. What does it mean and how should local governments that control housing supply through regulation respond? In every scenario, the answer is the same: incentivize more building with fewer regulations and more incentives.

Remember the big housing bust in 2008? Single-family housing production never recovered, or at least the level of production of housing has not reached the same numbers. A look at single-family permits from 2000 to now shows the precipitous fall production took. True, the Federal Reserve Bank of Saint Louis' data shows the fall beginning well before the crash, but regardless, even with the big buying boom in 2021, supply has not kept up with demand, meaning higher prices.



HOUSING PRODUCTION NEVER RECOVERED FROM THE LAST BIG DOWNTURN. SCREEN CAPTURE BY AUTHOR.

Rents have been volatile. Zumper data for Boston shows a perfect example of how rents fell during the pandemic then rocketed back up to pre-pandemic levels, then kept going up.



RENTS FELL AT THE BEGINNING OF THE PANDEMIC, THEN ROSE BACK TO PRE-PANDEMIC LEVELS. SCREEN SHOT BY AUTHOR.

So, what happens next? Here are some scenarios.

The worst-case scenario is that the Fed doesn't just take away the punch bowl fool of booze, but it shows up with cops to break up the party. In this case, housing production drops to zero with very few transactions as money gets more expensive and investors seek other investments. It might not be as bad as 2008, but the result will be slowed or stalled production and flat demand.

Inflation Eases, Fed Backs Off, a Short and Shallow Recession Ensues

Even in this scenario, there's going to be a kink in the housing production hose because of recent increases in interest rates. Multifamily projects are likely to slow as well; they're built with borrowed money as well. As the clouds part, and the sun starts shining it will take time for production to ramp up, and surges in demand will be greeted with short supply and higher prices in late 2023.

Lagging Indicators Overstate Inflation, Fed Backs Off, No Inflation or Recession in 2023

Government indicators are always behind the actual economic events. It's like a meteorologist showing up a couple days after a tornado destroys your home and says, "It's official, your house was knocked down by a tornado." In a discussion at the The Ringer's Plain English podcast, Mark Zandi of Moody's explains this phenomenon. "When you get a rent increase in the marketplace, say back in the month of February, it takes about six months for that to translate through into what it means for rent inflation as measured by the BLS." Maybe we're ok, we just don't know it. But money is still getting more expensive, and by the time the Fed backs off, we'll still see production slowdowns in housing.

Now Is the Time to Prevent the Next "Housing Crisis"

In each of the scenarios above, there is going to be a slowing of housing production across typologies. If we can learn anything from 2008, it should be that slumps in investment in new housing, softening demand for housing, and slowed or stopped production of housing are a signal: Build, baby, build! Developers hate risk more than they love profit. In fact, it only makes sense that housing becomes attractive when prices rise after a big fall. That vacant lot that could be housing will likely sit still until demand surges, prices rise, and then building on it rationalizes the cost and risk. Usually, when the housing economy recovers government panics because prices rise and then they impose rules and regulations to "fix" prices.

We can avoid this when the housing economy stabilizes and recovers by acting now to eliminate all the things that slow production. Next, if a developer is worried that building now is too risky, local government can invest – yes, put money on the table – to build on that vacant lot and subsidize potentially high vacancy rates and losses. When the economy turns around, and demand for housing returns, that tsunami of demand will be met with an abundance of housing. Had government made hay in 2009, 2010, and 2011, when the sun *wasn't shining*, we'd have had fewer housing price problems when it finally did.

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