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Why New Home Prices Are Too High

by Peter G. Miller

You have to wonder: Just how terribly -- if at all -- does government regulation raise the cost of new home construction?

The National Association of Home Builders reports that "rising interest rates and high land and production costs will continue to push the cost of housing beyond the means of many American families, and a disproportionate share of the blame for today's sky-high prices goes to misguided local government policies."

Really?

"The '90s were a pretty dog-gone good decade for housing. But we expect this decade and the next to be even better," said David Crowe, an NAHB senior staff vice president. "We expect interest rates to climb a little bit more this year, but then to level off. And we're expecting overall economic growth to be positive but not outstanding."

Does it not seem odd that while there are claims of "local" government over-regulation, the building industry did "pretty dog-gone good" in the 90s and expects to do "even better" in this decade? If builders did so well, perhaps that's evidence suggesting we need more local regulation.

The most obvious reason for steeper home prices and less affordability is that we simply have bigger houses. According to the Census Bureau, the average house now contains 2,434 square feet, up from 1,660 square feet in 1973.

If you super-size a home by 47 percent then even if construction expenses remained constant it's not hard to see why today's housing dreadnoughts cost more than homes in previous years.

This is not to say that minimum lot and home sizes add anything to the cause of affordable housing, or to suggest that rising costs for building permits, impact fees and transfer taxes are helpful. But c'mon, homes on steroids can't be overlooked -- homes which surely yield bigger builder profits per unit than smaller homes.

There would surely be a lot more money for affordable housing programs if a quasi-federal entity, Fannie Mae, had not overstated profits by some $10.6 billion, an accounting mess that will require enormous sums to resolve. You sure can't blame that one on local governments.

And then, of course, there's HUD. The record left by former Secretary Mel Martinez is fading with the speed of light. Martinez, you'll remember, said that closing rules should be revised so that settlement providers would be forced to be more competitive. Martinez estimated that consumers would save $10 billion a year.

The Martinez proposals arose in 2002. Let's see, 2002 was four years ago so by failing to enact modest reforms consumers have spent an additional and needless $40 billion on excess settlement costs.

Given that a typical new home cost $297,000 at the end of 2005, that means 134,680 new homes could have been built with $40 billion in settlement savings. That sure sounds like a lot of good work for builders.

Failing to reform closing monopolies doesn't seem to be the fault of local governments, either.

Of course, if FHA financing was more competitive that too could create more affordable housing. Efforts are now underway to "reform" the FHA program, including the idea of having loans with nothing down. In 1999 FHA loans were used to finance 9 percent of all new construction, a figure that fell to 4 percent in 2005. Again, local governments have nothing to do with FHA's falling market share.

There are good reasons to make homes more affordable. In some cases local policies and practices are an issue, but local governments do not exist in a vacuum. There's also plenty of reason to look at federal policies and practices as well.

If the idea is that we need to re-think regulation, then let's start with something quick, easy and practical: How about a zoning rule which says no new home on any lot must have more than 1,660 square feet under roof?

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