

Housing Economics: An Introduction

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Slides Overview

These slides cover:

1. Why economists care about housing
 2. What determines housing prices
 3. Why housing in Orange County costs so much
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Why Do Economists Care About Housing?

- The **largest purchase** most households ever make
 - A major store of **household wealth** (for those who own)
 - A key determinant of **where people can live and work**
 - Heavily influenced by **government policy**
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What Determines Housing Prices?

If you ask 10 Californians why housing is expensive, you might get 10 different answers

- Overall demand/CA's large population
 - Amenities like the weather/beaches
 - Macro factors (e.g., interest rates)
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The Basic Economics of Housing Prices

Demand Side:

- Population growth/decline, changes to income, etc.
- Interest rates (cheaper borrowing = more buyers)
- Preferences (people want to live in nice weather)

Supply Side:

- Available land
 - Construction costs
 - **Regulation** (zoning, permits, environmental review)
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Let's Think About Supply

Question: If housing demand increases in a city, what happens to prices?

The answer depends on the **elasticity** of housing supply

- **Elastic supply:** Builders can easily construct new homes → prices stay relatively stable
- **Inelastic supply:** Hard to build new homes → prices rise

California has inelastic housing supply

Three Types of Housing Markets

From the journal article we'll read, define three archetypes:

1. Declining cities (*think: Detroit*)

- Lots of old housing stock, falling demand
- Prices often below construction costs

2. Elastic cities (*think: Houston, Atlanta*)

- Plenty of land, few building restrictions
- Prices stay close to construction costs

3. Inelastic/regulated cities (*think: San Francisco, LA, Orange County*)

- High demand + restricted supply = high prices
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Orange County as an Example

Median home price in Orange County (2024): ~\$1.1 million

Physical cost to build a house: roughly \$150-200 per square foot for construction

- For a 2,000 sq ft home, that's maybe \$300-400K in construction costs – including land improvements.

So where does the other \$700K+ come from?

The Gap Explained

Price gap reflects several things:

- **Land scarcity:** We're squeezed between the ocean and mountains
- **Zoning restrictions:** Limits on what can be built where
- **Environmental review:** California's CEQA adds time and cost
- **Local opposition:** Existing homeowners often fight new development

In economic terms, we'd say there's a large **regulatory tax** on housing in CA.

Why Does This Matter?

- **Wealth inequality:** Homeowners gain, renters fall behind
 - **Labor market distortions:** Workers can't move to productive cities
 - **Longer commutes:** People "drive until they qualify" for housing they can afford
 - **Delayed household formation:** Harder to move out, buy homes, start families
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A Local Example

Consider someone with a job offer in Irvine paying \$80,000/year.

- If they're coming from Houston, with ~\$350K median home prices, that sounds great.

If they're trying to move from Riverside to Irvine?

- The math gets harder.
- They might turn down the job even if they'd be more productive here.

Economists call this **spatial misallocation of labor**.

The Political Economy Problem

If high housing costs are bad, why don't we just build more?

Existing homeowners benefit from restricted supply.

- Your home value goes up when fewer homes get built
- New development brings traffic, noise, "changes the neighborhood"
- Homeowners vote; potential future residents don't

This creates a political economy trap that's hard to escape.

Looking Ahead

The assigned journal article covers:

- A framework for measuring housing regulation (comparing prices to construction costs)
- Evidence on which cities are most restricted
- Estimates of the economic costs of housing restrictions

Homework: Read the Glaeser and Gyourko article, specifically:

- Introduction section (first 3 pages) laying out general questions/analysis
 - "Variations in Regulations on Land Use and Building" and "A Closer Look at Three Types of Markets" sections
 - You should be able to describe how demand shifts affects prices in each market type
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Key Takeaways

1. Housing prices depend on **both supply and demand**
2. **Regulation** plays a huge role in constraining supply, especially in California
3. The gap between housing prices and construction costs tells us something important
4. The politics of housing make reform difficult