Public Policy & Portland's Real Estate Market

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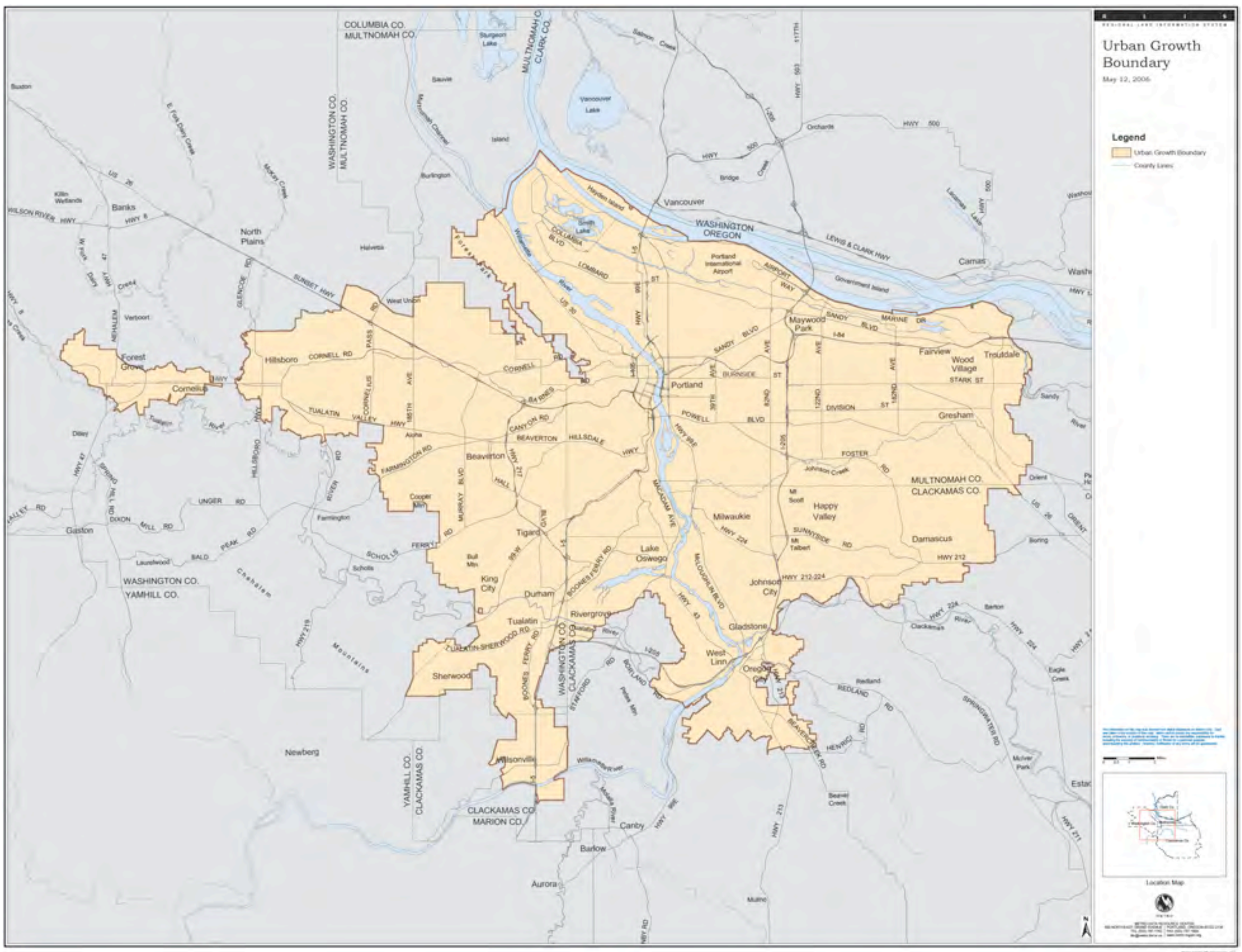
[Editor's note: This article is adapted from Dr. Mildner's speech before the Institute of Real Estate Management on December 3, 2009 at the Oregon Convention Center. These remarks belong to Dr. Mildner and do not necessarily reflect the views of Portland State University or the PSU Center for Real Estate.

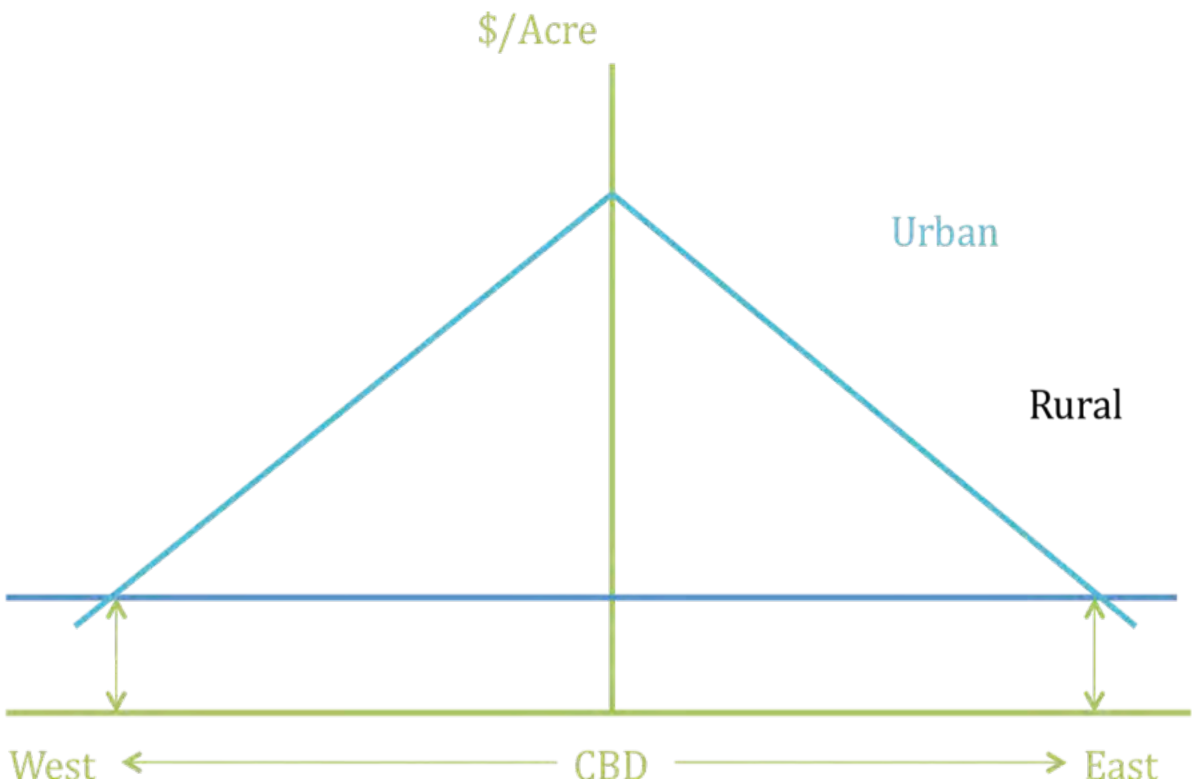


As many of you know, I recently moved my academic position this summer from the PSU School of Urban Studies and Planning to the PSU School of Business Administration, so I would like to offer my reflections as an economist who has been teaching a generation of urban planners and discuss how urban planning relates to the real estate market.

Given the state of the economy, the central feature of the Oregon planning system – the urban growth boundary – may seem beside the point or irrelevant. Housing prices have fallen in the past two years, and vacancy rates for commercial space are high. Land prices and lot prices have collapsed. Yet these conditions will change. The economy is expected to recover in 2010 and the question is will Portland keep pace with the nation as a whole? What will our future be like?

Also, I know that many of you work for firms and clients who probably *benefit* from the development restrictions of the UGB. Recently, one of my friends told me he hoped that city planners would block one of his competitor's projects, helping his own project to succeed.

We need to challenge this kind of zero-sum thinking. Most of you make your living by leasing, selling, developing, managing, designing or financing property space. For the sake of your career, it is the *volume of activity* and the *size* of the market that matters, *not the price*. It is the urban growth boundary that will influence how wide and how vibrant that market will be. And as Adam Smith taught us, out of the narrow commercial interest of your individual activity, the broader and nobler goal of the prosperity of the region will result.

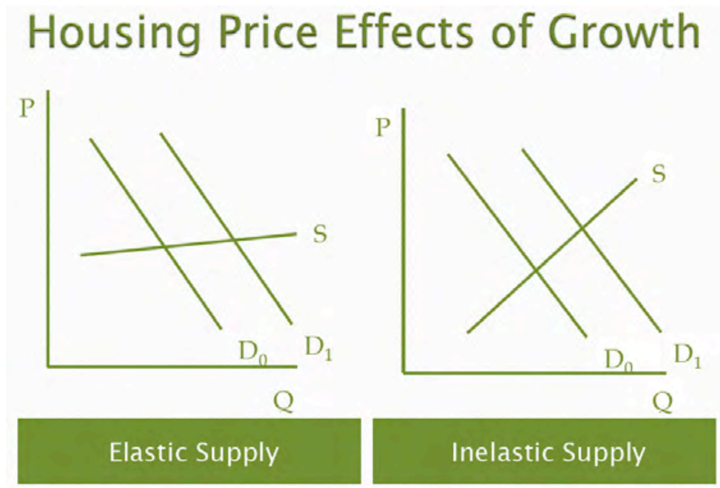


Land Markets

Let's me take you back to Economics 101. Land prices tend to decline from a peak at the center of a metropolitan area, until they meet the underlying value of agricultural land.

At the margin, urban and agricultural land prices will equalize as farmers and developers compete for land. Through the interaction of real estate markets, land is allocated to its highest and best use. The demand for urban land grows in two ways. One, as incomes and employment grow and people demand more land. Two, as transportation costs fall, inaccessible areas become accessible.

And as the demand for property in a region grows, the increase in demand translates into some combination of more space and high prices, depending upon the elasticity of supply.



Regions of *elastic supply*, such as Dallas, Chicago, Phoenix or Atlanta, can experience very rapid population growth and yet see relatively little price impact.

Regions of *inelastic supply*, such as San Francisco, Los Angeles, Boston, or Washington, D.C., will experience more rapid price increases for the same amount of population growth. Eventually, an inelastic region will grow more slowly, as companies and individuals decide that amenities of living in the region and the network economies of employing workers in the region are insufficient to justify the high housing, labor, and property costs.

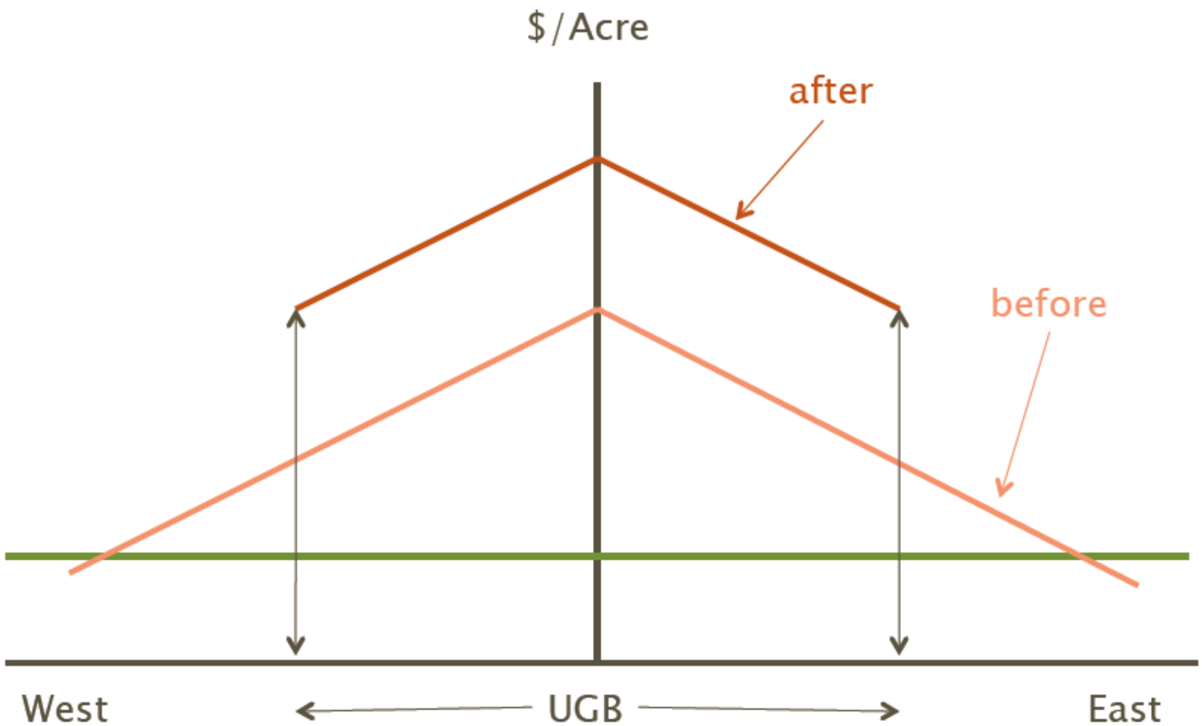
Cities can develop inelastic property markets for a couple of reasons. One is exclusionary zoning, where high-density uses are kept out. Most homeowners are conservative in wanting to insure its value against unwanted land uses, and often this leads towns to put prohibitions against apartments and high-density construction.

However, in *most places* in the country, developers are able to search out unincorporated areas or welcoming jurisdictions that will accept these higher density projects that satisfy that niche of the market.

For *entire regions* to develop inelastic property markets, there needs to be some collusion among the various towns and jurisdictions. For Massachusetts, that comes from the home rule of New England towns and the absence of any unincorporated land. For California, it comes from the NIMBY-ism of small towns and statewide anti-growth legislation like the California Coastal Act. In Oregon, it comes from statewide land use planning. Every location within the state of Oregon has a zoning designation and some restriction on its development. That may bring some benefit, but it also comes at some cost.

Implementing a growth boundary for urban development constrains population growth, causing land and property prices inside the boundary to rise higher than otherwise. That growth may continue for a long while, until the high price of property chokes off new development. Hence, there may be delays and a disconnection between the policy action and its unintended consequence.

Between 1994 and 2005, we estimate that land prices in the region grew by 18.0% per year. Under those conditions, the wise investor bought land and kept it off the market. That inelasticity of supply shifts the burden of the regulation to consumer.



Impact of the UGB

And as development was steered inwards, home prices in low-income neighborhoods of Portland rose by 10% per year, more than twice the rate of suburban jurisdictions, creating substantial burdens for the low-income renters in those communities. As a general rule, low-income households rely upon the stock of aging housing to find something affordable. But if we aren't building sufficient new properties, the rich outbid the poor for the older housing stock and affordability suffers.

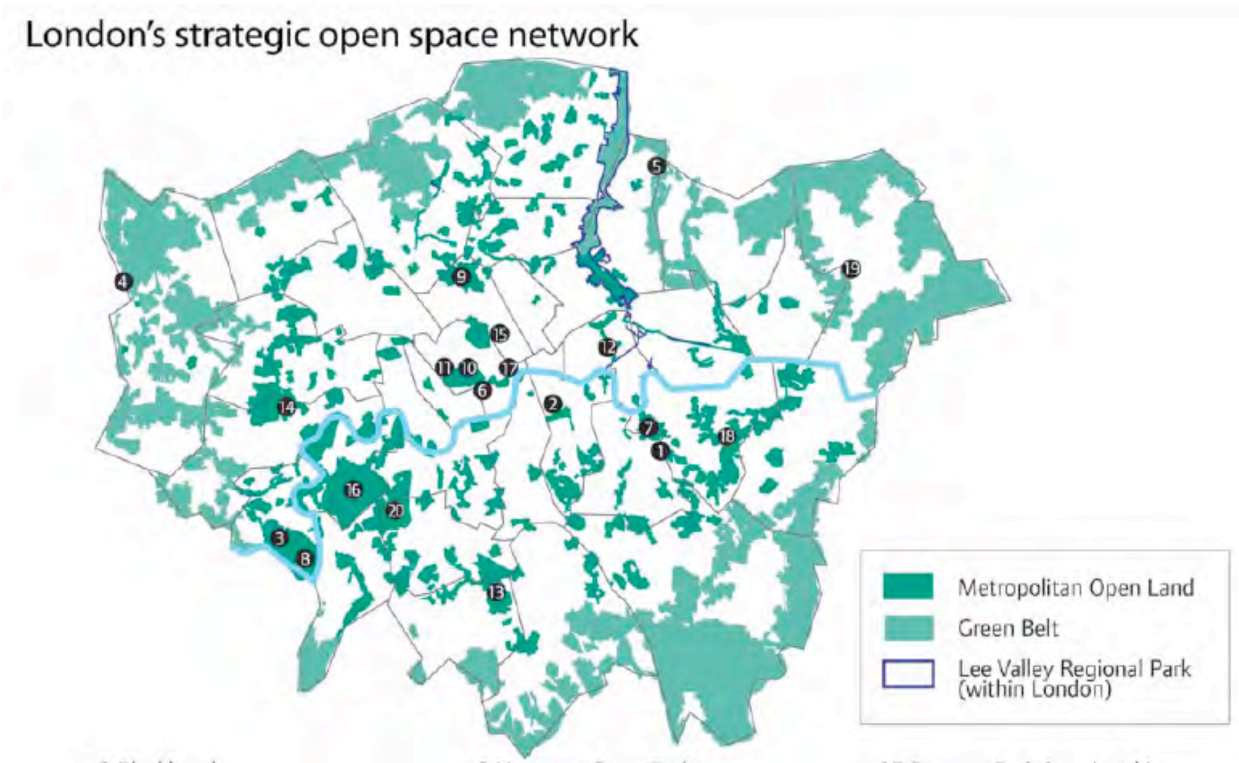
Current estimates are that land prices at the metropolitan fringe are ten times higher inside the growth boundary as compared to outside the growth boundary. While this system creates some benefits for wildlife protection and the production of wonderful things like strawberries, grass seed, Christmas trees, and hazelnuts, it is hard not to call this outcome a gross misallocation of resources. And unlike the market, there is no feedback loop in the land use planning system to correct this

Area	1982	1990	2007	1982 – 1990	1990 – 2007
N. Portland	42.9	41.3	245.0	-4%	593%
SE Portland	53.2	59.2	245.8	11%	415%
NE Portland	56.8	64.2	289.0	13%	450%
Hillsboro/Forest Grove	69.5	87.0	265.5	25%	305%
Gresham/Troutdale	70.3	88.9	254.8	26%	287%
Beaverton/Aloha	75.3	105.5	238.3	40%	226%
Oregon City/Mollala	58.5	89.2	260.0	52%	291%
Milwaukie/Gladstone	68.9	94.0	264.5	36%	281%
Tigard/Wilsonville	86.2	125.6	334.9	46%	267%
NW Portland	99.1	144.2	400.0	46%	277%
W. Portland	97.1	143.4	406.7	48%	284%
Lake Oswego/West Linn	119.1	183.6	480.0	54%	261%
Area Average	74.7	102.2	307.0	33%	328%
Area Median	69.9	91.6	265.0	38%	285%

Portland Housing Prices by Submarket

misallocation of resources.

What are the long-term implications of Oregon's system? After all, Oregon has only 37 years[1] of experience with urban growth boundaries and we cannot conduct a controlled experiment of a Portland without a UGB. Fortunately, however, we have a city with a 60-year experience with an urban growth boundary and it is London, England.



Now, London is a beautiful city, and for Britons, London is New York, Washington, D.C., and Los Angeles all rolled into one place. Or as Samuel Johnson once said, "When a man is tired of London, he is tired of life, for there is in London all that life can afford."

Yet London suffers from a highly regulated land market that is almost inflexible to market demands. After World War II, the newly elected Labour government nationalized land development rights by implementing the Town and Country Planning Act of 1947 to steer development from southern England to northern England. Under the Act, unfortunately, planning permission by local authorities was required for all land development.

The system has proven to be highly effective in preventing new property development, particularly in the region around London. Under England's system of local government with very low local property taxes, local authorities have little incentive to permit new development. Land prices on the urban-rural

[1] Senate Bill 100 was passed May 29, 1973 and the Land Conservation & Development Commission first met in October, 1973.

fringe in London are estimated to be 200 times higher when land has development permission compared to not having development permission. Given those differentials, local authorities are able to extract significant concessions from property owners and developers for receiving permission, whether that means parks, open space, new school facilities, new roads, or other public amenities.

These restrictions have led to significant housing price increases. According to the United Kingdom Government's Barker Commission, housing prices in Britain have risen in real terms by 2.5% per year over the last 30 years, while prices in the rest of Europe have risen 1.1% per year. Housing production has been stagnant despite the enormous rise in housing prices, or, in the language of the Barker Report, housing supply is completely inelastic. In London, modest suburban houses sell for well over one million pounds each, equivalent to $1.6 million, and the high cost of property influences everything from the price of clothing to the price of a pint of beer in a pub.

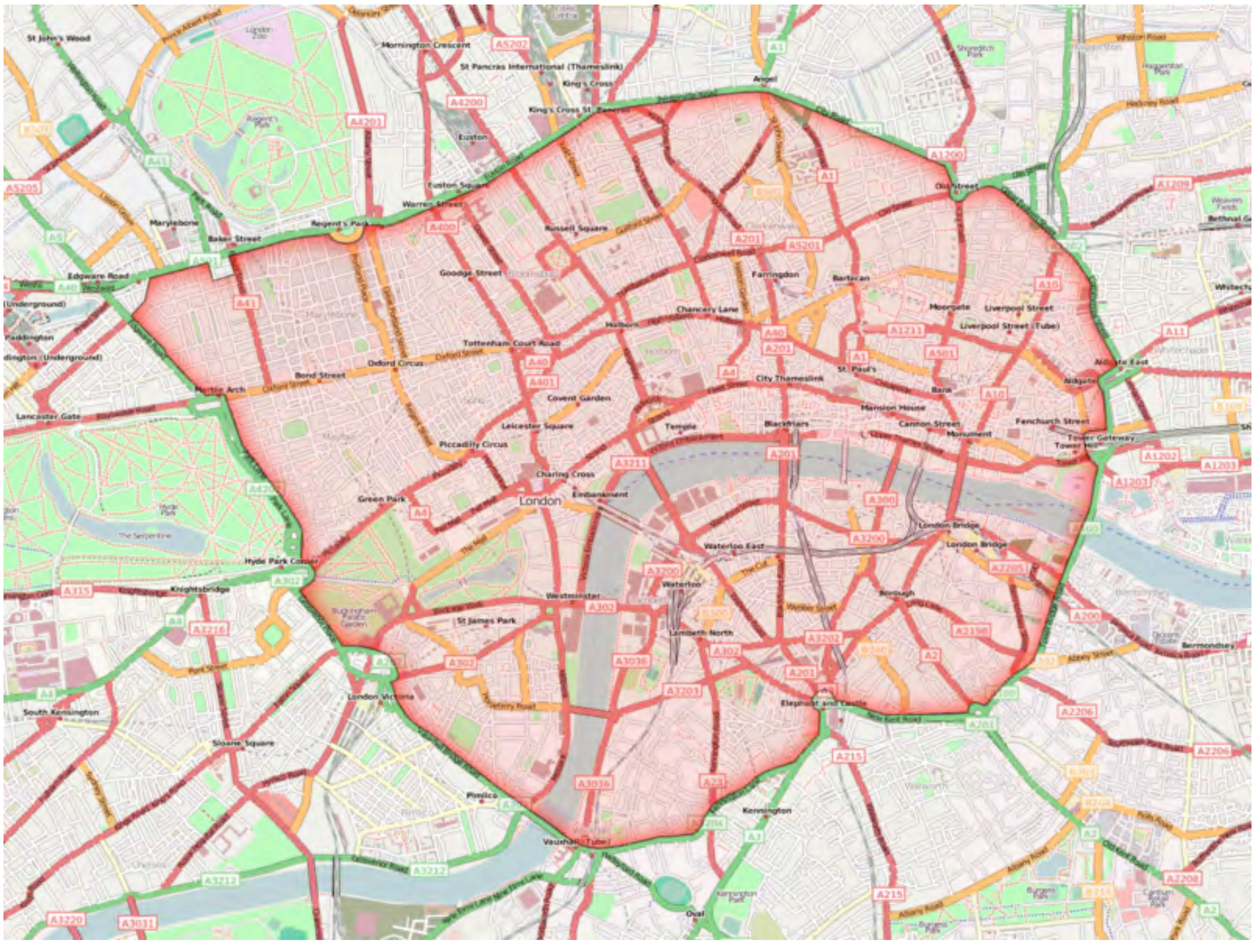
What can we do to change the city's fate? The lesson from London is that once central authorities monopolize development permission, affordability suffers. As a result, we need to think clearly about the purposes of Oregon's land use planning system and develop better ways of achieving its intended purposes.

The first objective is to find new ways to protect unique natural areas and agricultural areas, such as the Columbia Gorge or the Willamette Valley's wine producing region, without constricting human settlement. I contend that we should draw lines around those unique natural areas to protect them, rather than draw lines around urban areas to constrain human settlement. We should establish corridors for new urban growth that allow the population to grow in the Willamette Valley without significant impacts on housing prices.

Second, we need to return land use planning back to county government. It is quite clear from the last 20 years that communities within the Portland region have different visions of how they should develop. The City of Portland promotes a vision of high-density living. At the same time, the City of Hillsboro is eager to see new industrial and commercial development along the Sunset Corridor, and many people prefer the suburban lifestyle. We should let both strategies move forward. Research from the University of Pennsylvania suggests that prosperous suburbs and prosperous central cities go hand in hand, rather than function as a zero sum game. So, rather than continue with a regional monopolization of zoning power, we should return that power back to local authorities.

Third, we need to tackle our transportation congestion problem more effectively. Our current transportation planning system treats real estate development as a transportation problem, views traffic congestion as an engineering problem, and assumes that the only answer to our transportation woes is more federal construction projects and switching to mass transit. To pick one egregious example, to address the congestion on Interstate-5, the DOTs in Oregon and Washington have proposed a $4.2 billion engineering project, which includes a $1 billion bridge, $2 billion for various interchanges, $1 billion for light rail, and won't be completed until any earlier than 2018.

This last issue demonstrates one of the hidden costs of our urban containment system. By choosing to constrict development within fixed boundaries, we have chosen to load our existing highway network with higher traffic levels, concentrating our traffic on highways that can only be expanded at very high cost. And unfortunately, mass transit is a very poor substitute, both in terms of travel time and cost of delivery. Most transit trips in the region take two or three times longer than an automobile trip, and the marginal cost of producing one additional light rail journey is approximately $15 per ride. This is another gross misallocation of resources. When our most precious resource is human time, we need the convenience of automobiles.



London's Congestion Pricing Network

However, one of the few things I like about the I-5 Bridge proposal is its recognition that tolling is necessary for our transportation future. Many cities around the world utilize tolling – London, Stockholm, Sweden, Singapore, Santiago, Chile, and Houston, Texas, among others. Santiago, for example, used capital markets and electronic tolling to upgrade its entire highway system in five years. London implemented its congestion charging system within three years. By pricing existing facilities, we allocate the existing infrastructure to its highest valued use, much as real estate markets allocated commercial space to its highest and best use.

Now these are tough times to be in the real estate industry. The current recession has its origins in the real estate bubble of the last decade and it will take some time for the industry to get back on its feet. The recession has affected all sectors of the industry – commercial, residential, and industrial, condominium, multi-family and single-family. However, we should not apologize for working in the real estate industry or seeing our purposes as disconnected from larger public purposes, such as providing affordable housing or protecting the environment or promoting employment.

The real estate industry in Portland needs to continue to be a player and participant in local, regional, and statewide decision-making. We need to advocate for a growing and competitive real estate industry. We need a vision to counter the view that we will all be living in small housing units, working in smaller offices, taking longer commutes, and paying more of our incomes for housing. Within the Center for Real Estate, we have taken a leadership role to insure that the future generation of real estate leaders has a solid training. But the industry has a larger purpose in insuring that our region remains a vital place to live and do business.