

David Rusk  
4100 Cathedral Avenue, NW #610  
Washington, DC 20016-3584  
(202) 364-2455 (phone)  
(202) 364-6936 (fax)  
[drusk@starpower.net](mailto:drusk@starpower.net)  
[www.davidrusk.com](http://www.davidrusk.com)

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TO: Empower Hampton Roads

SUBJECT: Reason Foundation reports against inclusionary zoning

You have advised me that some local opponents of inclusionary zoning have been citing “Do Affordable Housing Mandates Work? Evidence from Los Angeles County and Orange County (June 2004),” a study by the Reason Public Policy Institute. This study tracks almost word for word the same group’s “Housing Supply and Affordability: Do Affordable Housing Mandates Work (April 2004)?” that examined data for the San Francisco Bay Area. I have read both studies carefully and have the following observations:

**[1.] The studies’ “findings” were pre-ordained.**

The Reason Public Policy Institute is a division of the Reason Foundation, a California-based member of a multi-state chain of libertarian think tanks whose national flagship is the Cato Institute in Washington, DC.<sup>1</sup> The Reason Foundation’s mission is “to advance a free society by developing, applying, and promoting libertarian principles, including individual liberty, free markets, and the rule of law.”

In the field of public policy, libertarians have two fixed principles:

- they are opposed to governmental regulation ... at least, of private businesses; and

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<sup>1</sup> See “The Boys of Sprawl” by Christopher R. Conte in *Governing Magazine* (May 2000). At the time of the article *Governing* identified 12 libertarian think tanks with a collective budget of almost \$30 million in 1999. A February 2005 article by Chicago-based The Heartland Institute (“A Guide to Classical-Liberal Think Tanks”) identified 68 such state-based libertarian public policy institutes, including the Thomas Jefferson Institute for Public Policy and the Virginia Institute for Public Policy.

- they embrace the so-called “public choice” model of governance by which the more a region is divided up amongst multiple municipalities, the better.<sup>2</sup>

Interests opposing public policies such as inclusionary zoning, growth management, etc. commission studies by libertarian think tanks like Reason Public Policy Institute because they can count on the studies to support their opposition to such measures.<sup>3</sup>

I would not normally invoke such an *ad hominem* argument. Sometimes libertarian think tanks can produce good basic analysis, but I might differ on its interpretation or policy proposals based on it. Indeed, I cited the Virginia school study conducted several years ago by the Thomas Jefferson Institute in one of my presentations for Empower Hampton Roads.<sup>4</sup> However, good analysis is not the case with these studies.

## **[2.] The studies’ economic analysis is totally invalid.**

A statewide survey of inclusionary zoning laws in California showed that 95 percent of all IZ laws include automatic density bonuses. I believe that all provide density bonuses at least equal to the inclusionary set-aside and most provide higher density bonuses that yield additional bonus market-rate units as well. That means that the marginal cost of land for the inclusionary units is zero (greatly contributing to their affordability) and the marginal cost for any bonus market-rate units is zero (greatly contributing to their profitability).

However, the Reason studies’ devote only two sentences to the crucial role of density bonuses and fail to incorporate density bonuses in any way into their economic analysis.<sup>5</sup> The studies’ simple model is as follows:

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<sup>2</sup> Thus, libertarians would argue that the 425,000 residents of the City of Virginia Beach would be much better served if the 248-square mile, Aaa-bond rated, unified city were divided up into 20, 30, or 40 separate municipalities (a few very wealthy, others struggling, and some very poor).

<sup>3</sup> The San Francisco Bay Area study was financed by a grant from the Home Builders Association of Northern California and the Los Angeles-Orange County study by a grant from the California Building Industry Association.

<sup>4</sup> See both my overhead presentation to E.H.R. (June 12, 2004) and my issue paper to the E.H.R. Education Task Force (July 5, 2004).

<sup>5</sup> The San Francisco report states (on page 2) “Ostensibly, some jurisdictions also offer incentives for compliance. These can take the form of ‘density bonuses’ (giving builders the option of increasing the density of their developments *in return for* making more of the units affordable [emphasis added]), fast-track permitting (speeding up the process of issuing permits for new development), fee waivers, or

“If a [new, market-rate] home could be sold for \$500,000, but must be sold for \$200,000, the revenue from the sale is \$300,000 less. In half the Los Angeles County and Orange County jurisdictions the cost associated with selling each inclusionary unit exceeds \$575,000 [i.e. in builder’s profits, local taxes on sales, etc.]”

Of course, such a simplistic analysis ignores

- a) the fact that inclusionary units are not \$500,000 units being sold for \$200,000 but units costing \$200,000 (hopefully) because 1) they are smaller, 2) they include no land cost, 3) other “incentives” (really, cost offsets that the city provides) bring the cost down further, and 4) the builder *may* be giving up some or all of his customary profit (but not necessarily) on the inclusionary units; and
- b) the fact that a win/win IZ law should provide a sufficiently large density bonus that the builder ends up with more market-rate units than he would have had in the first instance – a fact that totally reverses the conclusion of the studies’ economic analysis.

Why should the researchers ignore a fundamental feature of IZ laws?<sup>6</sup> I would speculate that, as libertarians, they cannot acknowledge that the exercise of local governments’ legitimate zoning power (as confirmed by the US Supreme Court in 1926) can actually create private wealth. In effect, in hot housing markets, local government actions to upzone land for more housing units (including through IZ-linked density bonuses) are printing presses churning out additional profits for homebuilders.<sup>7</sup>

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exemptions from growth control.” That partially captures correctly one of two purposes of density bonuses. Just two months later, however, the Los Angeles report re-states the issue (on page 2) as “These can take the form of ‘density bonuses’ (giving builders the option of increasing the density of their developments *instead of* making more of the units affordable [emphasis added])...” – totally distorting density bonuses’ purposes. Just muddled thinking or a subtle but deliberate effort to conceal a key element of both increased affordability and increased profitability?

<sup>6</sup> The researchers, Dr. Edward Stringham and Dr. Benjamin Powell, are both faculty members (in economics) of San Jose State University and adjunct scholars of the Reason Foundation. They received their Ph. D.s from George Mason University in 2002 and 2003, respectively. George Mason University is home to the Mercatus Center, another libertarian think tank.

<sup>7</sup> Upzoning the Cornerstone project in Virginia Beach from 576 units (as-of-right) to 846 units (requested) generated an estimated \$10.7 million in *added* profit for Sandler Brothers (as contrasted with an estimated \$7.2 million in *added* profit with 87 inclusionary housing units as a condition of the city’s approval).

With their economic analysis so fundamentally flawed, we must reject their general conclusions that “inclusionary zoning has high costs,” “inclusionary zoning makes market-priced homes more expensive,” and “inclusionary zoning costs government revenue.”

**[3.] The studies’ conclusion that housing production has been reduced in municipalities adopting IZ laws ignores the fact that the same trend is occurring in non-IZ municipalities as the regional market becomes more densely developed and raw land disappears.**

For researchers committed to the principle of “free markets,” it is notable that the Reason Foundation researchers examined only what happened before and after adoption of IZ laws within six municipalities (out of 34 total municipalities) in Orange County and within seven municipalities with IZ laws (out of 88 total municipalities) in Los Angeles County before leaping to their conclusion that IZ laws caused a long-term decline in overall housing production in IZ. What happened to “markets?”

From Census 2000 data on municipal area, current housing stock, and when current units were built, I analyzed housing development trends from 1970 to 2000 in all 34 municipalities plus the seven “Census-Designated Places (CDPs)” in unincorporated Orange County.<sup>8</sup> The decade-by-decade results for “urbanized” Orange County, a 510-square mile area that includes 97.7 percent of all housing units, are summarized in Table 1(a).

Table 1(a)  
Housing Production Trends for Urbanized Orange County  
1970 to 2000

period	housing density per square mile at outset of period	annual housing units produced	pct addition to initial housing stock
1970-79	756	26,387	69%
1980-89	1,274	16,718	26%
1990-94	1,602	13,012	8%
1995-99	1,729	12,723	8%

<sup>8</sup> Analyzing trends for the 88 municipalities of Los Angeles County or the 105 municipalities in the ten-county San Francisco Bay Area (plus scores of CDPs in both regions) was beyond the time and energy I could devote to this volunteered effort.

Thus, in urbanized Orange County, where the five municipalities<sup>9</sup> that (at various times) adopted inclusionary zoning accounted for less than 12 percent of the entire housing stock in 2000, there has been a steady downward trend in annual housing production as housing density rises and undeveloped land disappears. County-wide annual housing production in the late 1990s was less than half the annual housing production of the 1970s.

Table 1(b) provides the same data for Irvine that adopted its IZ law in 1977. (Because of census data constraints, I have treated its IZ law as taking effect in 1980, which, given “grandfathered” development projects already in the pipeline, was probably close to the production of the first inclusionary units anyway.

Table 1(b)  
Housing Production Trends for Irvine (IZ law: 1977)  
1970 to 2000 (**IZ period boldfaced**)

period	housing density per square mile at outset of period	annual housing units produced	pct addition to initial housing stock
1970-79	69	1,908	595%
<b>1980-89</b>	<b>483</b>	<b>1,738</b>	<b>78%</b>
<b>1990-94</b>	<b>859</b>	<b>1,003</b>	<b>13%</b>
<b>1995-99</b>	<b>968</b>	<b>1,720</b>	<b>20%</b>

The City of Irvine is a planned community begun in the 1960s by the Irvine Company on land owned by the Irvine Ranch; it was incorporated in 1971. With a single land owner enforcing its inclusionary housing requirements, Irvine has the USA’s second largest IZ program (4,469 inclusionary units built through 2002). After the Southern California-wide housing industry slump of the early 1990s, inclusionary housing production levels rebounded from 1995-99 to match its annual level during the 1980s.

The second oldest IZ law in Orange County was adopted by San Clemente, (ex-President Richard Nixon’s retirement home). Table 1(c) tracks its housing trends with the period of IZ coverage beginning in 1980.

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<sup>9</sup> Since Huntington Beach did not adopt its IZ ordinance until 2001, it falls outside the time frame of census-provided data.

Table 1(c)  
Housing Production Trends for San Clemente (IZ law: 1977)  
1970 to 2000 (**IZ period boldfaced**)

period	housing density per square mile at outset of period	annual housing units produced	pct addition to initial housing stock
1970-79	430	477	63%
<b>1980-89</b>	<b>700</b>	<b>540</b>	<b>44%</b>
<b>1990-94</b>	<b>1,007</b>	<b>327</b>	<b>9%</b>
<b>1995-99</b>	<b>1,099</b>	<b>244</b>	<b>7%</b>

Technically, San Clemente still appears to be a very low-density community (only two-thirds of the urbanized county’s density in 1995). It undoubtedly has many large-lot homes (median home value was \$372,400 in 2000 – 38 percent above the county-wide median). However, given its Oceanside location with protected beaches and other parklands and natural areas, it is probably approaching build-out.

Laguna Beach is far wealthier than San Clemente. (Its median home value was \$653,900 in 2000.) Though it adopted its IZ in 1985, I had to begin its “post-IZ period” in 1990-94.<sup>10</sup> The same comments apply to Laguna Beach as apply to San Clemente.

Table 1(d)  
Housing Production Trends for Laguna Beach (IZ law: 1985)  
1970 to 2000 (**IZ period boldfaced**)

period	housing density per square mile at outset of period	annual housing units produced	pct addition to initial housing stock
1970-79	987	198	23%
1980-89	1,210	117	11%
<b>1990-94</b>	<b>1,343</b>	<b>105</b>	<b>4%</b>
<b>1995-99</b>	<b>1,402</b>	<b>86</b>	<b>4%</b>

Brea adopted its IZ ordinance in 1993 and its post-IZ period covers 1995-99. Its downward trend in housing production was well-established in

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<sup>10</sup> With access to the 1990 census, I will be able to split housing production between 1980-84 and 1985-89.

the decades before 1993. Post-IZ production levels (118 units per year) matched the immediate pre-IZ production levels (a period that also experienced a housing industry slump, however).

Table 1(e)  
Housing Production Trends for Brea (IZ law: 1993)  
1970 to 2000 (**IZ period boldfaced**)

period	housing density per square mile at outset of period	annual housing units produced	pct addition to initial housing stock
1970-79	445	434	93%
1980-89	857	304	34%
1990-94	1,145	117	5%
<b>1995-99</b>	<b>1,201</b>	<b>118</b>	<b>5%</b>

Finally, San Juan Capistrano (IZ law: 1995) completes the list. After adopting its IZ law (and after the regional housing slump had receded), the city's annual housing production levels rebounded to approach its annual production levels in the 1980s.

Table 1(f)  
Housing Production Trends for San Juan Capistrano (IZ law: 1995)  
1970 to 2000 (**IZ period boldfaced**)

period	housing density per square mile at outset of period	annual housing units produced	pct addition to initial housing stock
1970-79	94	589	443%
1980-89	509	223	31%
1990-94	665	160	8%
<b>1995-99</b>	<b>721</b>	<b>207</b>	<b>11%</b>

It would be tedious to continue these tables for each of the 29 municipalities and seven CDPs in Orange County without IZ laws. However, as a substitute, for each of the four time periods I have conducted least-squares linear regression analyses for each period, using a common measure – percentage addition to the initial housing stock – as the dependent

variable (Y) and housing density per square mile at the outset of each period as the independent variable (X1). In addition, from 1980 onward, I created a dummy variable (x2) to indicate the presence or absence of an IZ ordinance, assigning a value of 1 to the five municipalities that had such an ordinance and a value of 0 to the 36 other communities that operated without them. The results are summarized in Table 2.

Table 2  
 Linear Regression Results  
 Y = pct addition to initial housing stock  
 X1 = housing density per square mile at outset of period  
 X2 = IZ/no IZ  
 n = 41

period	adjusted R-square	<i>t stat</i> X1 = housing density per sq mi at outset of period	<i>t stat</i> X2 = IZ law/no IZ law
1970-79	0.24	-3.72***	na
1980-89	0.17	-3.22***	-0.86#
1990-94	0.22	-3.62***	-1.12#
1995-99	0.12	-2.67***	-1.17#

\*\*\* statistically significant at 99% probability level # not statistically significant

The analysis shows that

- a) **the relative density of housing development at the outset of a study period has a statistically significant (and powerful) explanatory impact on the rate of new housing construction during the forthcoming period (ten or five years); and that the impact is negative (that is, the higher the housing density at the outset of a period, the lower the percentage addition to the city’s housing stock over the next ten or five years); and**
- b) **the existence of an inclusionary zoning ordinance does *not* have a statistically significant relationship to the rate of housing construction.**

What are the weaknesses of this analysis? Census reports are very accurate with regard to a community's total housing units and many of their attributes (e.g. owner-occupied vs. rental, number of rooms, gross rent, even estimated value of owner-occupied homes, etc.). It strikes me that census housing statistics are least accurate when occupants are asked "when was this housing unit built?" which is the basis for the census reports on past housing construction. Municipal building permit reports would probably be a more accurate measure (though permits can be issued that are never used).

The greater weakness of this analysis is the crude measure of housing density (number of housing units in a jurisdiction divided by the jurisdiction's area). How much land is actually available for residential development rather than being committed to parks, environmentally protected areas, industrial, commercial, and public uses? Ascertaining that would require detailed analysis of each municipality's zoning map – clearly a task beyond this critique.

I have examined only the five IZ-cities and 36 other communities in Orange County. Would covering the same ground as the Reason Foundation report by adding the seven IZ cities, 81 non-IZ cities, and probably a dozen or more non-IZ CDPs in Los Angeles County significantly change my findings? I doubt it. For that matter, what would applying the same analysis to the 53 IZ cities, 52 non-IZ cities, and several dozen CDPs in county-administered areas show for the San Francisco Bay Area? In other words, what would the test of regional housing market trends show with regard to both studies?

An evaluation of the Reason Foundation's San Francisco Bay Area report concluded that "the narrow scope of the research, the flawed research design, the data limitations and the weakness of the analysis are so consequential that few, if any, of their conclusions are useful to policy makers."<sup>11</sup>

The Hampton Roads community and decision makers should reject such deeply flawed research as justifying inaction on implementing Virginia's Affordable Dwelling Unit (ADU) law.

David Rusk

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<sup>11</sup> "Policy Claims with Weak Evidence: a Critique of the Reason Foundation Study on Inclusionary Housing Policy in the San Francisco Bay Area (June 2004)" by Dr. Victoria Basolo, Associate Professor of Planning, Policy, and Design at the University of California-Irvine and Dr. Nico Calavita, Professor in the Graduate Program of City Planning at San Diego State University.