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Unpacking the Question “Can Housing Be an Investment and Affordable?”

Daniel Herriges · March 27, 2024

(Source: Pexels/Pavel Danilyuk.)

In *Escaping the Housing Trap*, which Strong Towns founder Chuck Marohn and I co-wrote to detail the Strong Towns response to housing scarcity and precarity, we define the “housing trap” in a simple way. Americans are stuck with increasingly unaffordable and unsatisfactory housing options because we have engineered a system where housing prices cannot be allowed to fall—not in any significant or lasting way. Yet we have reached a point where tens of millions of us desperately need them to fall.

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a good financial investment. Shelter must remain broadly affordable, but an investment must appreciate in price. These objectives are therefore contradictory.

This is not an insight unique to us by any means. But it's one that merits some unpacking.

Our book offers a harsh critique of the prevailing system of housing finance and regulation in America, which largely took shape in the 1930s, and which policy makers have since doubled down on repeatedly in ways that have amplified its basic contradictions.

The book does *not* offer a harsh critique of homeownership. In virtually every society in human history, homeownership has been both common and desirable. Owning a home is, for many, an important way to secure your future and make tangible your stake in your community. This is not about to go away.

The simplified assertion that "housing can't be both affordable and a good investment" raises eyebrows because it is deeply conventional wisdom in American society that buying a house *is* an investment. We use that word all the time. In fact, we often say, and hear, that a home is the most important and the best investment many of us will ever make.

Homeownership is not only has a basic moral valence for a lot of Americans—we associate it with commitment, maturity, responsibility, thrift—but it is also financially smart in some really obvious ways. At least, for those in a position to pay the increasingly steep ante to access it. (In Los Angeles, only 1.9%

This attitude is not actually wrong. And it's not in conflict with the observation above about the trap, even though it sounds like it might be. The key is to understand that "investment" has multiple, subtly different meanings in plain English.

An investment can be an asset intended to provide passive income to its owner through mere ownership, like a stock. An investment can also refer to something you buy not because it will sit there getting more valuable, but because its *use* will allow you to do things that are productive and valuable.

If we are to escape the trap, housing largely cannot be the first type of investment. It can be and will remain the second type.

I'm not writing this piece as an economist (I am not one) and economics nerds might nitpick a lot of what follows. But my goal is to unpack the language around this issue for everyday Americans and make it a bit clearer what it means to say housing can't be both affordable and an "investment."

Should a House Itself Appreciate in Value?

Let's separate out the two components of homeownership: the land, and the house itself.

A house, under all normal circumstances, ought to be a depreciating asset. It is a physical object that can undergo wear and tear and requires maintenance. Without maintenance, it will fall apart.

of machinery for your business. You "invest" in these things, in the sense that you're going to use the thing to do stuff that is of greater value than what it costs you to own and maintain the equipment.

Your car is an expense, but it provides you with transportation you need to earn money and meet your basic needs. Your house is an expense, but it provides you with shelter services. You need shelter to meet your basic need for safety and security, and to remain physically near stuff you value, like a job.

It's an even better deal because homes don't depreciate as inexorably as, say, cars do. Very few people are still driving 40-year-old cars, but plenty of people are still living comfortably in 140-year-old houses, having put in the requisite maintenance and upgrades.

Short of being homeless, which has obvious and enormous downsides, your choice for shelter is simple: either you own your source of shelter services, or you pay someone else for that service. This is why economists and the IRS have the concept of "imputed rent": owning a home, in a technical but counterintuitive sense, pays you a regular income. Specifically, it pays you the rent that you pay yourself, which you would have otherwise had to pay to someone else.

Should Land Appreciate in Value?

happen to the price of that underlying urban land over time?

First, understand where the market value of land comes from. The price of land is essentially based on the *economic rent* that can be collected: in a market transaction, it's determined by what the highest bidder is willing to pay for it. That bidder, in theory, is the one who can put the land to the most economically profitable use.

Farmland is directly useful for production, as is mineral-rich land which can be mined. Urban land is not generally valued for its natural resources. The foundation of land value in cities, rather, is *access*: people will pay to be near stuff they value.

As a city grows in size and prosperity, the economic advantage that can be attained by being in that place increases. If you're running a business, you have access to more and richer customers. If you're a resident, you have access to more job prospects, education options, cultural amenities, and so on. As a city gets bigger, the land becomes more valuable, and land with the best access becomes most valuable of all. (Best access typically means closest to the center, though this really depends on transportation infrastructure.)

It is thus normal for land in a growing city to appreciate in price. The price of land in New York City is many times the price of land in Omaha. The price of land in central Omaha is much higher than the price of land in North Platte. Bigger economy, more central location, bigger gains from access to that location.

Appreciation Mean Housing Is Doomed To Become Unaffordable?

In principle, no. The way a city can retain a generally affordable housing stock, even as the value of its land increases, is through two mechanisms: development of new land at the edge, and redevelopment, or the creation of additional homes on existing land.

In already developed neighborhoods, rising land values and depreciating structure values are what ultimately spur redevelopment. We've written about this cycle many times before. If you own appreciating urban land, and you have a depreciating house that sits on that land, eventually it will make economic sense for someone to buy your property and put up, say, a small apartment building. Let's think about what happens to housing costs when that leap in development intensity (from homes to apartments) occurs.

The cost of delivering a unit of housing is basically the construction cost plus the land cost. The way to build housing on expensive land for a comparable price to a standalone home on cheap land is by building at higher density. This distributes the land cost across multiple households.

The average New Yorker lives on extraordinarily expensive land (per square foot). If housing in New York is to be at all affordable, the average household must not consume very much land. That is, they must live in an apartment—and they do. Even in downtown Omaha, most people live in townhouse.)

If you’re lucky (or foresighted) enough to own a house with a nice yard in a booming urban center before it becomes a booming urban center, you are going to make some money on the appreciation of that land. This is an example of land as a lucrative, passive investment asset.

There is a whole philosophical and moral debate about this that I’m choosing not to center in this piece. Let’s be clear, though: on a basic level, these are unearned gains. The value of urban land derives not from anything *you*, the owner did, but from what all your neighbors, collectively, did to make the location desirable. It’s socially created. As the owner, you are extracting economic rent—a bribe, if you will—from anyone you sell to or charge rent to.

This is the basic moral intuition behind the Georgist idea of land value taxes: because the land’s value, unlike that of the buildings that sit on it, is created by society, it should be heavily taxed so that the return accrues to the public and not to the rent-seeking owner.

But for our purposes here, recognize that even if we don’t tax away all windfall gains on land, those gains are not wholly incompatible with housing remaining broadly affordable. Some owners will sit on valuable urban land and underutilize it (in an economic sense). Basically, you can choose to be Carl from *Up*, who stubbornly refuses to sell his house even as high-rises are built flanking it. But in aggregate, as land value pushes up, most of the Carls out there are eventually going to

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As long as developable sites are plentiful and so are developers, there should in *theory* be a ceiling on what people must pay for housing in even a large, prosperous city. Wherever the cost of a typical existing home goes above the development cost of a comparable new home, developers can build a competing product (that is, new homes), sell or rent them at the prevailing market rate, and run a viable business doing so.

When Homeowners Reap Extraordinary Windfall Gains

The normal appreciation of urban land as a city grows incrementally won't make all or most landowners filthy rich. Intuition says this appreciation, on average, shouldn't outpace the growth of the general economy, since urban land rent is basically just the price of entry for participation in that economy. This is true even if a handful of lucky Carls-from-*Up* who speculated on the right location win the proverbial lottery.

outpacing inflation or even the returns they would get in the stock market. They're not equally distributed geographically, but consider, for example, San Jose, California, where in 2018, the owner of the median-valued home made $100 per hour in appreciation on their property value (house plus land). This is far more than San Jose's median salary. And it's basically all in the land value—the homes in San Jose are mostly unremarkable mid-century ranch houses.

This is what we mean when we say housing cannot be a good investment and affordable. It cannot be *that* kind of investment, one that appreciates far beyond the rate of normal inflation or wage growth. That is mathematically incompatible with broadly affordable housing.

Why is this kind of housing windfall happening in many of America's prosperous cities? San Jose is extreme, but it's not entirely exceptional. Home prices have outpaced incomes virtually everywhere, though the price-to-income ratio is highest in places like coastal California.

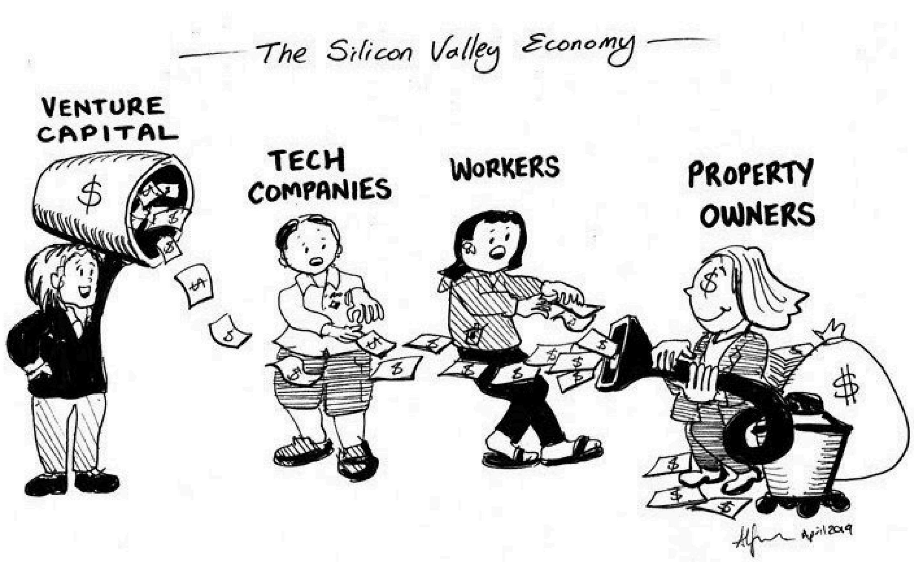
The simple answer is two things working in tandem: regulatory restrictions on supply, and financial inducements for people to spend more on housing.

The Zoning Cartel

What if all the Carls-From-*Up* out there were to conspire to keep their land off the market? To act as a cartel? People would become desperate for housing, willing to pay quite a lot to continue living in a city in which they have a career and social and family ties. Developers would be willing to pay

Because shelter is essential for life, and because people have very deep reasons to want to remain in a community instead of moving somewhere far away and cheaper, home seekers are captive. If housing costs 30% of your income, you'll pay it. If it costs 40%, you'll pay it. If it costs 50%, and better deals aren't forthcoming, you'll probably suck it up and pay it, making other sacrifices in your quality of life in order to make rent.

This cartoon by Alfred Twu illustrates how, when the housing supply is constrained, the owners of housing can basically suck up all the surplus value from the economy in the form of land rent:



Earlier I described land price as a sort of bribe that a buyer must pay you to acquire your land or to make use of it. But you can't just extort as big a bribe as you want. There are limits. A would-be developer, like anyone else, is going to shop for the best deal. And in a big enough city with enough landowners, there will be people who want to sell, and the market will establish a prevailing price.

often personal and idiosyncratic: They get old, or sick. They take a different job. Their family situation changes. Nobody gets to hold out endlessly against the march of time. And so, in a big enough city with enough small-time landowners, *where redevelopment is broadly legal*, redevelopment sites ought to become available at a sufficient rate.

Note the italics. *Where redevelopment is broadly legal.*

In post-Great-Depression America, we have a very widespread policy tool that has created a *de facto* homeowner cartel in many neighborhoods of many cities. It's called zoning.

On 70–90% of the urban land in most American cities, it is illegal to add housing. I'm talking mainly about areas built out with single-family homes and subject to single-family zoning. The process of redevelopment I described earlier cannot occur, because it is illegal to build any sort of apartment—even a duplex or triplex unit or a backyard cottage.

Under these conditions, there can be something approximating a hard cap on housing supply across a whole region. It's never a completely hard cap, of course: every city builds new homes. But it functions like a hard cap across many submarkets—categories of homes with similar features that might attract similar residents, such as access to the same sorts of neighborhoods, job centers, transit lines, or amenities.

The homeowners in such places may not think of themselves as a cartel, but the gains they are reaping because their neighborhoods are closed off to incremental redevelopment are far above normal urban land appreciation.

The other thing we've done to turn regular old homes into a speculative, passive asset is that we've used financial means to massively increase what Americans can spend on housing.

The financialization of housing is another concept, like "investment," that is broadly misunderstood. The primary engine of "financialization" is not the fact that financial institutions, such as hedge funds, own houses. These firms are still a relatively minor presence in the market in most places. No, the primary engine of financialization is the fact that the whole U.S. economy is backstopped by the market in mortgage-backed securities.

Pension funds, insurance companies, university endowments, banks. The solvency of countless institutions in which you and I have a stake depends on financial assets—pieces of paper, not pieces of real estate—whose value is determined in turn by long-term debt instruments used to buy real estate. This is the truly pernicious thing: not that housing is an investment for the specific homeowner, but that Housing, as an abstract noun, is an investment for our *entire society*. We're all bought in.

Throughout the late 20th century and into the 21st, every time home prices have threatened to undergo a sustained collapse, federal institutions have intervened to forestall it. Their tools have included lowering interest rates, lowering down payment amounts, allowing a wider range of mortgages to qualify for federal mortgage insurance, and allowing a wider range of mortgages (including risky subprime loans) to be bundled and

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These strategies have, every time, induced more mortgage lending and allowed home prices to resume their inexorable rise.

Note that these financial inducements for rising home values would probably not work if it were not for the blanket of restrictive land-use rules covering most of urbanized America. The countervailing force would be new development, creating new homes at comparatively affordable prices with which existing home sellers would have to compete.

We've created a perfect trap, though, by simultaneously allowing the owners of existing housing to operate like a cartel, charging extraordinary prices, and creating the financial tools to allow Americans to continue to pay those prices (by going ever deeper into mortgage debt).

This system is at a breaking point. We need a new housing paradigm for America's cities. Chuck and I wrote *Escaping the Housing Trap* to make this case, and to offer some insight into what that paradigm looks like. I hope you'll preorder your copy if you haven't already.

Daniel Herriges

Daniel Herriges has been a regular contributor to Strong Towns since 2015 and is also a founding member of the organization. His work at Strong Towns focuses on housing issues, small-scale and incremental development, urban design, and lowering the barriers to entry for people to participate in creating resilient and prosperous neighborhoods. Daniel has a Masters

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Daniel's work with Strong Towns reflects a lifelong fascination with cities and how they work. When he's not perusing maps (for work or pleasure), he can be found exploring out-of-the-way neighborhoods on foot or bicycle. Daniel has lived in Northern California and Southwest Florida, and he now resides back in his hometown of St. Paul, Minnesota, along with his wife and two children.

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