

Civil Society Institute

*Occasional Paper #1
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WHY IS HOUSING SO EXPENSIVE IN SILICON VALLEY?

Erin Adrian



Santa Clara University

Executive Summary

- Compared to the rest of the country, housing prices in Silicon Valley have been exceptionally high for decades.
- Artificial limits to growth are the single most important cause of the Valley's high (and volatile) housing prices.
- "Lack of space" is *not* the problem – housing density is not especially high in Silicon Valley, nor is open space especially scarce.
- In a normal housing market, sudden growth in demand for housing can cause prices to increase in the *short run*. This, in turn, encourages increased construction, which eventually causes prices to adjust back to normal levels.
- Unfortunately, Silicon Valley's housing market is *not* normal. Numerous regulations limit housing growth.
- Housing restrictions that are exceptional in Silicon Valley include zoning, building codes, affordable-housing requirements, development fees, urban growth boundaries, environmental review, and "open spaces."
- These policies are plagued by an *intervention dynamic*. Each new set of regulations leads to additional problems, which provide the motivation for yet another round of regulatory "solutions."
- Environmental and other anti-development attitudes have thus made the Valley's housing market progressively less open, affordable, and responsive to consumer needs.
- Housing restrictions especially hurt the poor, including immigrants, minorities, unmarried women, and young families.
- Freedom is the best "affordable housing" policy – freedom of contract, private property rights, and minimal regulation.

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Why is Housing So Expensive in Silicon Valley?

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Foreword

Students, staff, and faculty have a great experience at Santa Clara University – if they can afford housing! We live in the heart of Silicon Valley and at an epicenter of high housing prices. Those who own homes find their interests divided. Those who rent, wish to move in, or wish to move up find their options severely constrained by extraordinary housing prices. Quite modest homes sell for half-a-million dollars or more.

Erin Adrian shows that we also live at an epicenter of government restrictions on housing supply. Like the shockwaves of an earthquake, these housing restrictions (many of which originated or are most severe in our area) have made Silicon Valley prices high relative to the rest of California, and California prices high relative to the rest of the nation. Indeed, compared to out-of-state communities of similar density, the residents of Silicon Valley “enjoy” housing prices *four times* higher than normal.

Ms. Adrian argues that the situation is too extreme and too long-standing to be chalked up to the Valley’s economic boom. For decades, restrictions have been preventing supply response.

She builds her case with care, starting with supply and demand diagrams. If you don’t remember your Econ 101, don’t be put off. Skip the diagrams and move on. The rest of the paper is down to earth.

Ms. Adrian is well qualified to analyze the Silicon Valley housing market. A life-long resident of the area, she majored in economics and political science, graduated Magna Cum Laude, and received the Charles and Barbara Hazel award as her class’s most distinguished economics major. She is now studying law at Stanford University.

While at SCU, Ms. Adrian was a leading participant in the programs of the Civil Society Institute and received summer support from CSI to write the present paper. The Civil Society Institute seeks to nurture excellence, engagement, and enlightenment. Ms. Adrian’s example demonstrates that such hopes are not in vain. We are proud to distribute her work as the first in our series of occasional papers.

Professors Daniel Klein and Laurence Iannaccone
Directors, Civil Society Institute
Santa Clara University

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Hilary Martin's Santa Clara University honors thesis, "Why is Housing so Expensive in Silicon Valley?" was a major inspiration for this project and gave my research a big head start.

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Gene Adrian, a Silicon Valley homeowner, helped me develop a computer program to sort and analyze Census data.

To all, thank you.

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Chapter One

The High Cost of Supplying Housing

My parents bought their home in Cupertino, California in 1977 for \$95,000. Increasingly over the past few years, real estate agents have called to encourage them to sell their house. One recently pointed out to my mother that the home two houses down just sold for around \$800,000, which would surely be a starting point for my parents' home. If the house is now worth over \$800,000, as the agent said, that would be an increase in value of almost 750 percent in 23 years. That is an increase of about 10 percent per year, compounded continuously. Such a level of appreciation over 23 years is remarkable, but not unusual for homeowners in the Silicon Valley.¹

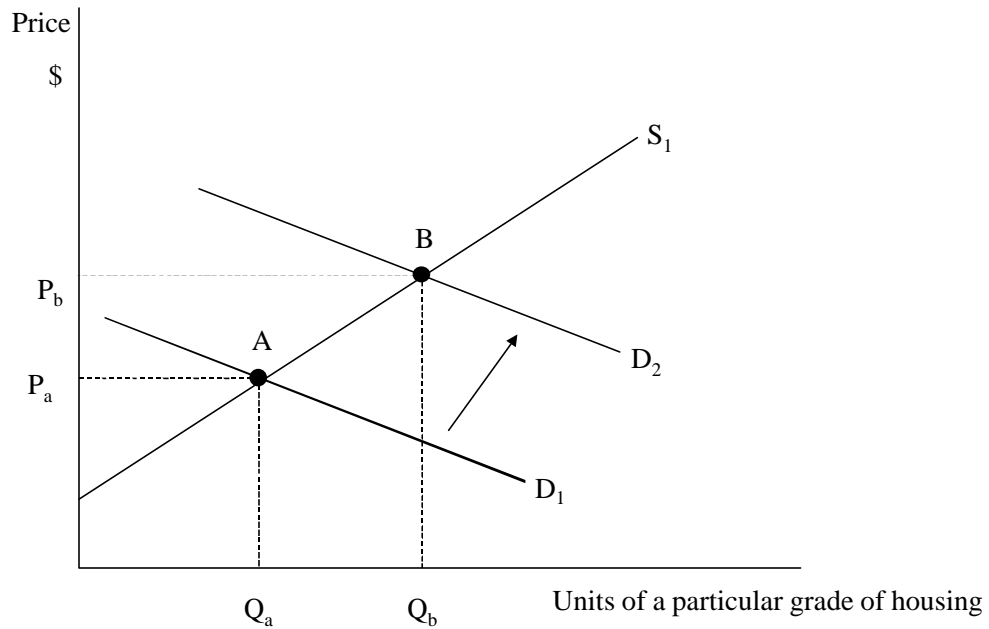
In 1990, average home prices in California were 147 percent above the national average (U.S. Census Bureau). The San Francisco Bay Area, in particular, has seen tremendous increases in home prices, with an increase in prices of 34.2 percent between 1995 and 1999 (Bay Area Futures). Even more striking is the increase in prices in the Silicon Valley during the same period: 46.2 percent (Bay Area Futures). Silicon Valley housing prices are exceptional in the Bay Area, which is exceptional in the state of California, which is exceptional in the country. Thus, Silicon Valley appears to be an epicenter of increased housing prices. In October 2000, the median home price in Santa Clara County was \$495,000, higher than any other county in the nation (McAllister 2000).

Why are prices sky-high in the Silicon Valley? It is easy for people to say that increased demand has caused the high prices. The enticing climate and close proximity to the city, coast, and mountains makes Santa Clara County attractive. And as high-tech

¹ For the purposes of this paper, Silicon Valley will be defined as the 15 cities in Santa Clara County (Campbell, Cupertino, Gilroy, Los Altos, Los Altos Hills, Los Gatos, Milpitas, Monte Sereno, Morgan Hill, Mountain View, Palo Alto, San Jose, Santa Clara, Saratoga, and Sunnyvale). An often used, broader definition of Silicon Valley includes several additional cities in southern San Mateo County, southern Alameda County, and eastern Santa Cruz County (SV Projections '99, 3).

industries become more important and high-tech jobs more lucrative, people pour into the Valley looking for work. The more people there are, the greater the demand for housing.

Figure 1: High Demand Seems to Explain High Housing Prices



The simplest explanation, illustrated graphically in Figure 1, seems the most reasonable. Twenty-five years ago the Valley was covered with fruit orchards as far as the eye could see. Housing prices were very much in line with other areas of the country. The market for housing in 1975, before prices became exceptionally high, is represented by supply curve S_1 and demand curve D_1 . The curves intersect at point A, the first “equilibrium,” so that Q_a units are transacted in the housing market at a price of P_a per unit. But during the following few years there occurred unanticipated growth and interest in Silicon Valley, causing an unanticipated increase in the demand for housing. This increase in demand is represented by a shift in the demand curve from D_1 to D_2 . The market equilibrium moves along supply curve S_1 from point A to point B. At this new equilibrium, which represents the housing market for, say, 1979, a quantity of Q_b units are transacted at a higher price of P_b . This increase in demand certainly seems to explain the rise in price. If

we replayed the story every four years up to the present, we would get something like the 750 percent appreciation in the case of my parents' house.

One problem with this story is that the supply curve S_1 only represents supply in the short run—just a few years. Given an unexpected increase in demand, prices go up in the short run. In the short run, suppliers cannot easily add or vacate housing units to cash in on the growing demand. People who build houses or make housing available, including current residents, lack in the short run the flexibility they normally have in the long run. In the short run, developers, for example, are constrained by their contracts with employees, existing scale and organization, span of managerial attention, existing technology, and other factors. But, given time, all of these factors can be adjusted, expanded or contracted, in seeking to service the high demand. By ending the story with the demand shift, the conventional story fails to recognize that, with time to make adjustments, the supply side would respond in a way more fundamental than the mere slide along the curve S_1 from A to B.

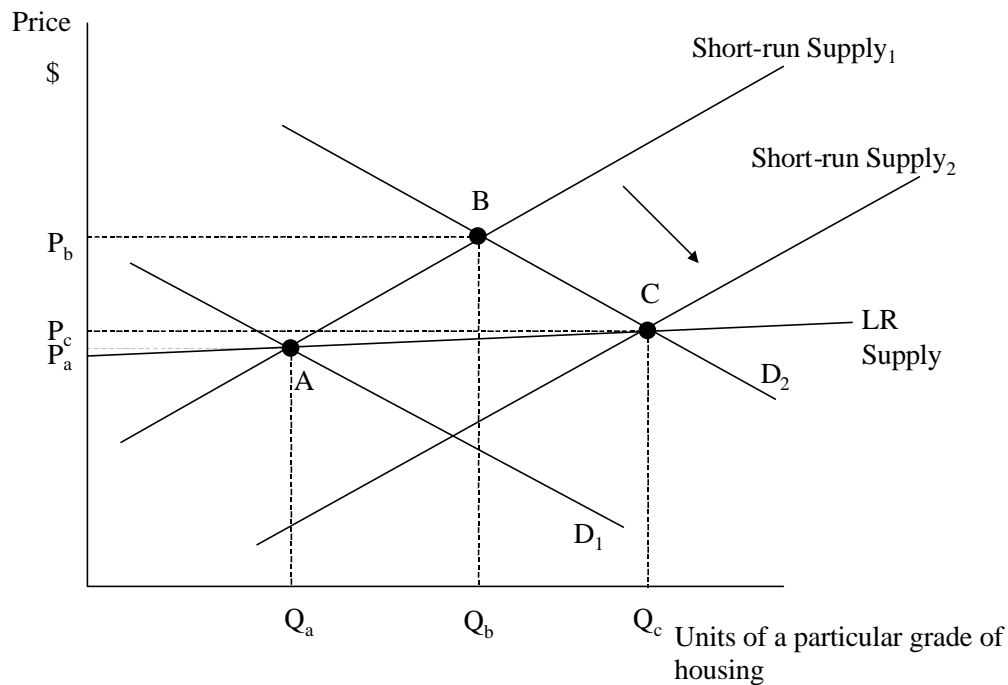
Over time, people would try to capitalize on the new high prices in the housing market. A higher price acts as a signal to producers that there are profits to be made. Nobel-laureate economist Friedrich Hayek discusses the importance of price signals in prompting entrepreneurs to innovate or adjust their activities:

The most significant fact about [the price] system is . . . how little the individual participants need to know in order to be able to take the right action. In abbreviated form, by a kind of symbol, only the most essential information is passed on and passed on only to those concerned. It is more than a metaphor to describe the price system as a . . . system of telecommunications which enables individual producers to watch merely the movement of a few pointers . . . in order to adjust their activities to changes of which they may never know more than is reflected in the price movement. (Hayek 1948, 87)

Producers of housing may not recognize that an increase in demand (as opposed to a reduction in supply) has caused increased prices in the market. Nevertheless, current suppliers of housing would see rising prices as a good reason to adjust the factors that currently constrain them, factors such as employees, organization, equipment, and

technology. Wholly new suppliers, including ordinary homeowners, may perceive a profit opportunity and enter the housing market. These adjustments of more fundamental factors would reduce the current costs of supplying housing. Such a reduction is represented graphically in Figure 2 by a shift out in the supply curve from S_1 to S_2 . The new supply curve represents the market's willingness to supply housing given time to react to higher prices. Now, in the third and final act, the market would equilibrate at a new point, point C, yielding a quantity transacted of Q_c . At this point, the price per unit of housing falls from P_b to P_c , which is much closer to the original price.

Figure 2: With time to react to higher prices, suppliers will adjust their activities in a manner that shifts the short-run supply curve outward.



Over time, we should see fluctuation in housing prices due to unanticipated changes in demand, but in the long run, the supply side would make the necessary adjustments that bring prices back down in line with the fundamental costs of producing housing. The long-run supply curve, S_{LR} , in Figure 2 represents the supply of housing when the fundamental

costs of producing housing are fairly constant and suppliers are able to make adjustments that reassert the fundamental, not temporary, cost conditions. The curve goes through both point A and point C, at which suppliers have fully responded to the shift in demand. The normal long-run supply curve is quite flat, illustrating that although prices may fluctuate, prices gravitate back to normal levels.

Indeed, long-run supply curves often slope downwards. Ballpoint pens, computers, and most things of 1975-quality now cost much *less* than they did in 1975 (adjusting for inflation). In other words, the long-run supply curves for these products slope downward. Over time, humans make discoveries and accumulate knowledge of how to make things better and more efficiently. In a free market, this principle would apply to construction, maintenance, and management of housing, even if it does not apply to usable ground surface.

Yet, housing prices in Silicon Valley have remained exceptionally high for more than the few years that constitute the short run. In fact, median home prices have been increasing at a high rate since 1975. Thirty years is not the short run. Factors driving increases in demand, such as high-tech jobs, prosperity, and the inflow of population are, by now, long-standing. Housing suppliers should have picked up on this and built more residential developments, condominium complexes, and apartment buildings. The Association of Bay Area Governments (ABAG) estimated that population in Silicon Valley grew by 36 percent between 1980 and 2000 (Silicon Valley Manufacturing Group, 4). Almost half of this growth occurred from the period from 1980-1990, suggesting that developers might have been able to anticipate the similar level of growth in the following decade and produce accordingly.

There have been similar trends in Silicon Valley jobs. Between 1980 and 2000, employment grew by 48 percent, a net increase of approximately 415,000 new jobs (SVMG, 4). In Santa Clara County in the 1980s, for every additional job an additional half of a new home was built; in the 1990s, for every additional job only an additional one-seventh of a new home was built (SVMG, 4). It seems as though, rather than expanding in response to high demand, supply has become increasingly restricted. Between 1995 and 1997, the number of jobs in Santa Clara County increased by 15.2 percent, but the number of housing

units increased by only 1.3 percent (Bay Area Futures). The Silicon Valley Manufacturing Group estimates that, by 2020, the county will gain 50 percent more jobs, but only 20 percent more housing units. In 1990, Santa Clara County had 1.64 jobs per employed resident (SVMG, 5). Housing scarcity has induced great numbers of people to seek residence in surrounding areas with more affordable housing. As a result, freeways in the Bay Area become more congested. On any given day, Bay Area commuters collectively lose more than 128,300 hours sitting in highway traffic (*SJ Mercury News* 9-21-00).

Are we running out of space?

One reason for the remarkable long-term rise in prices may be that suppliers or would-be suppliers cannot even in the long term adjust one important factor: land. The total amount of land is fixed. Some might suggest that the fixity of this resource causes the long-run supply curve to be much steeper than the flat, even downward sloping curves I have suggested. When demand shifts out, housing prices increase dramatically and stay high even in the long run. We are running out of space and cannot absorb everyone who wants to come, so prices continue to rise until people decide to live elsewhere.

If this running-out-of-space theory were true, other areas with similar densities would be experiencing similar increases in price, as they too would have steep long run supply curves. Equal density would seem to imply equal space constraints. I compared the 1990 median home and rental price in each of 12 cities in Santa Clara County with the median home and rental price of American cities with similar, corresponding densities. My method avoided any possible sample selection bias (see Appendix A). Silicon Valley cities generally have much higher prices. Every Silicon Valley city compared had higher median housing prices than the average median price of all cities with similar densities. Some were significantly higher, including Cupertino, Saratoga, Los Altos, and Los Gatos. These data, shown in Table 1, reveals that the exceptional prices in Silicon Valley cannot be explained by sheer land capacity. The table can be read to show that Silicon Valley is exceptional for California, and California is exceptional for the United States.

**Table 1:
Comparing 1990 Home Prices in Silicon Valley Cities
to Prices in other Cities of Similar Population Densities***

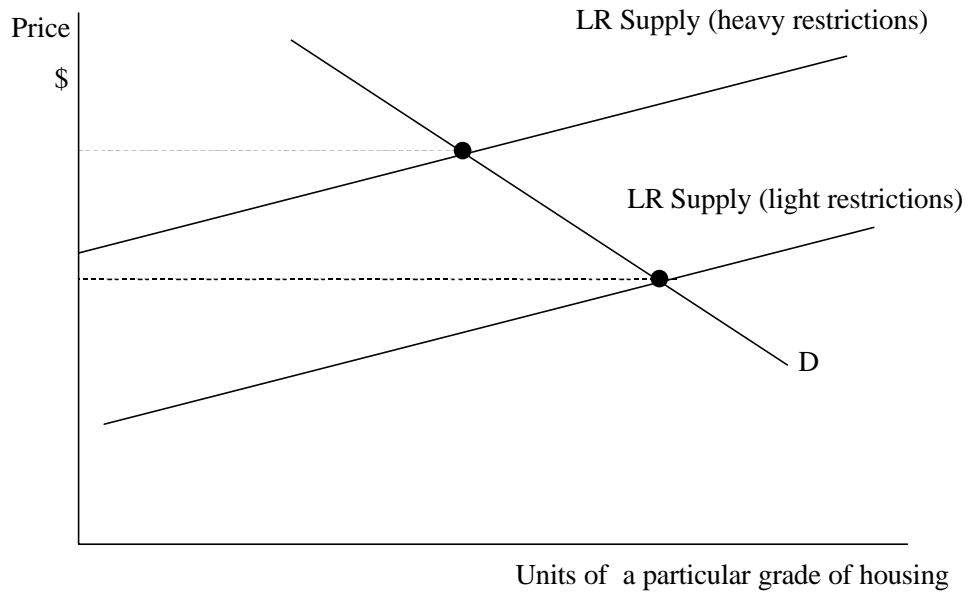
Silicon Valley City	Median Price of Homes	Prices in Comparable Californian Cities	Prices in Comparable Non-Calif. Cities
Campbell	276,700	266,233	60,167
Cupertino	328,900	NA	60,167
Gilroy	243,300	318,400	72,770
Los Altos	500,001	NA	72,611
Los Gatos	439,900	71,500	72,972
Milpitas	255,600	255,950	94,813
Mountain View	347,000	317,351	121,950
Palo Alto	457,800	308,500	72,600
San Jose	259,100	248,850	159,760
Santa Clara	270,400	222,150	91,043
Saratoga	500,001	151,967	79,409
Sunnyvale	332,700	262,500	123,767

* Source: See Appendix A. Note: The price reported in each row is the mean of a set of median prices.

An Epicenter of Government Restrictions

I submit that restrictive government regulation is the fundamental reason why housing prices in Silicon Valley have remained so high for so long. Exceptionally restrictive policies governing construction, land use, and residential development have dramatically reduced the supply of housing relative to that which would have obtained in a freer housing market. The graphical effect of these regulations is seen in Figure 3. The practical effect is well known: houses that are excessively scarce and expensive.

Figure 3: Housing restrictions shift up Silicon Valley's Long-Run Supply curve.



Scholarship indicates the following facts about housing-supply restrictions:

- restrictions in Silicon Valley are exceptional for the Bay Area,
- restrictions in the Bay Area are exceptional for California,
- restrictions in California are exceptional for the United States.

Silicon Valley is thus a national epicenter of housing market restrictions – and housing price extremes. Table 2 displays several of the housing policies used in Silicon Valley cities.

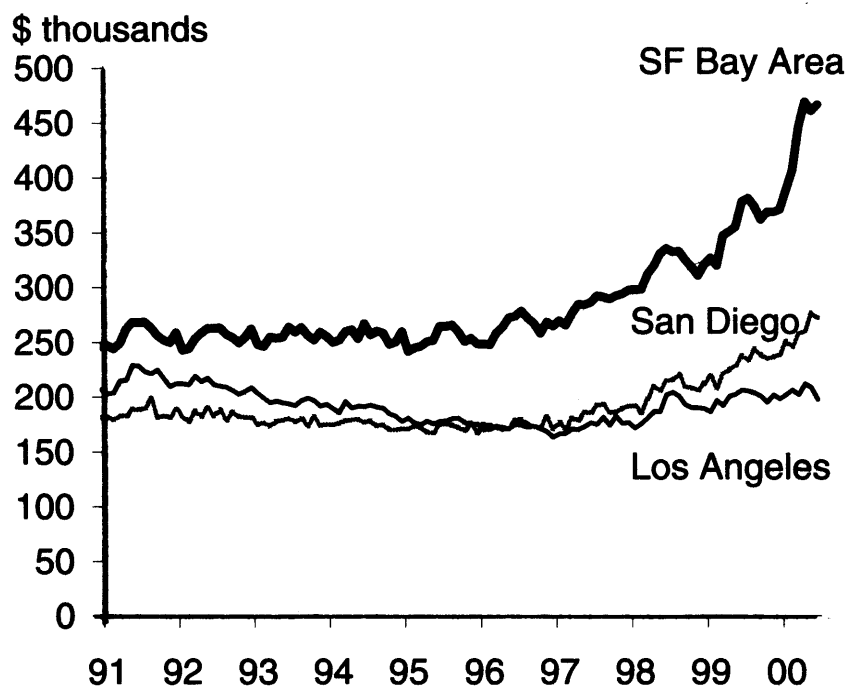
**Table 2:
Restrictive Policies in Silicon Valley Cities**

Type of Regulation								
City	Urban Growth Boundaries	Building Codes	Zoning	Redevel't Agencies	Affordable Housing Requirements	Rent Control	Develop-ment Fees	Environ'tl Impact Reports
Campbell	No	Yes	Yes	Yes	*	No	Yes	Yes
Cupertino		Yes	Yes		Yes	No	Yes	Yes
Gilroy		Yes	Yes		Yes	No	Yes	Yes
Los Gatos		Yes	Yes			No	Yes	Yes
Los Altos	No	Yes	Yes	No	Yes	No	Yes	Yes
Los Altos Hills		Yes	Yes			No	Yes	Yes
Milpitas		Yes	Yes			No	Yes	Yes
Monte Sereno		Yes	Yes			No	Yes	Yes
Morgan Hill	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Mountain View	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Palo Alto		Yes	Yes		Yes	No	Yes	Yes
San Jose	Yes	Yes	Yes			Yes	Yes	Yes
Santa Clara		Yes	Yes	Yes		No	Yes	Yes
Saratoga		Yes	Yes			No	Yes	Yes
Sunnyvale	No	Yes	Yes	Yes	Yes	No	Yes	Yes

Notes: Cells are left blank if general policy (“yes” vs. “no”) could not be determined. Asterisk * denotes “yes, but only in redevelopment agency areas.

Some further proof of the restrictions theory is shown in Figure 4. As will be shown later, the Bay Area has taken the lead on restricting growth. Restrictive policies have caused Bay Area housing prices to be significantly higher than other metropolitan areas of the state. Figure 4 shows a significant discrepancy *over the past ten years* (I do not have the data for prior years).

Figure 4: California Median House Prices



Source: Scanned from a Federal Reserve Bank of San Francisco *Economic Letter*, September 15, 2000. The authors, Krainer and Furlong (2000), cite the California Association of Realtors as their source.

Chapter Two

The Forsaken Alternative: The Invisible Hand

As a Silicon Valley native, the only housing “market” I know is one filled with government restrictions and regulations. There is an alternative to heavy government intervention in housing: let free enterprise provide housing in the context of government enforcement of contract and property rights. In this kind of setting, housing suppliers can easily expand their operations (or enter the market) to accommodate growth in demand. They can also better meet the specific needs and concerns of consumers if they are not hampered by restrictions.

It is true that the producer seeks a profit. And the consumer tries to find high quality products at the lowest possible price. But this does not necessarily mean that society suffers. In *The Wealth of Nations*, Adam Smith explains that the individual pursuing his own self interest often produces social benefits:

[The individual producer] generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. [By] directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it (Smith 1776, 423).

Smith’s invisible hand functions to bring us a multitude of products and services, including items vital to our survival and well-being such as food or medical services.

The free market does not work perfectly. In some areas, its normal mechanisms face particular difficulties. Economists have developed theories to describe types of imperfections or problems that sometimes plague free markets. The categories of market imperfections include the following: systemic externalities, public goods, natural monopoly,

poor consumer information, and self-injuring behavior (such as addiction). Most economists believe that only when such imperfections seriously plague the free market should we even consider government intervention (since government itself is plagued by problems; Tullock 1971). The housing market does not suffer unduly from *any* of the market imperfections. Economists generally believe that the “invisible hand” if permitted, would function effectively in the housing market.

It makes more sense to allow individual builders and consumers to make their own decisions regarding housing. Individuals involved in the housing market have specific knowledge of their own particular circumstances, knowledge that no government official or body of officials can ever have. Hayek discusses this type of knowledge, called *local knowledge*:

The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess. (Hayek 1948, 77)

Local knowledge is like the knowledge that a skater in a roller rink has. He knows where other skaters are around him, how fast they are going, and how fast he is going. He can use this information to promote his own goal of not colliding with others. At the same time, his collision-free intentions promote the interests of all of the other skaters, who also want to avoid collision. Not remarkably, a kind of order, *spontaneous order*, develops out of the coincidence of interests of the skaters. In the housing market, landowners, landlords, builders, tenants and others seek to promote their own interest in profiting in a voluntary exchange with others. In doing so, they also promote others’ interest in profiting in a voluntary exchange with them. Like in the skating rink, the free housing market is a spontaneous order.

Any attempt by a central planner to direct the movements of the skaters would have disastrous results because there is no way the planner could keep track of all of the skaters’ changing circumstances and direct them accordingly. Like the planner in the roller rink,

government officials cannot possibly keep track of all of the changing opportunities and circumstances in the housing market. Attempts to improve the market through intervention are obstructive and, on the whole, fruitless because government officials, even if truly selfless and motivated, nonetheless lack the local knowledge that is possessed only by players in the market.

The Intervention Dynamic: Intervention Begets Intervention

Often when the government does create policies that intervene in the market, unforeseen, unintended, and undesired consequences occur. When citizens and politicians begin to see the negative effects of government policies, they often call for more government policies to alleviate the problems created by the initial intervention. Intervention begetting intervention is called the *intervention dynamic* (Mises 1978, 75-78).

Rent control, a classic example of a price ceiling, is one regulation that clearly initiates an intervention dynamic. Rent control laws set acceptable rents at below the market equilibrium rate, which creates excess demand, i.e. a shortage.

Obviously, suppliers do not like renting their properties for below-market value. However, owners of apartments do not have an exit option; they cannot take their good to a city without price controls and sell it there. Instead, landlords may try to exploit the regulation-induced shortage by cutting back on maintenance, neglecting the civil order of the building or driving away existing tenants in cities where new tenants are not subject to rent control. In response to these problems caused by the enactment of rent control, officials are forced to intervene again to set things straight. They create tenant protection acts and rent reduction policies to protect tenants faced with poorly maintained buildings. They force landlords to pay relocation fees to tenants leaving a building. The result is a cluster of interventions and a highly regulated environment.

Owners of rental units do not want to operate in a market that restricts their price, so they may try to convert their apartments to condominiums. Once again, government officials are compelled to act to prevent low-cost rental units from disappearing altogether.

They place restrictions on, or outlaw, condo conversions. The long-term result is that new building and renovation are curtailed. New entry is practically non-existent. No one wants to construct apartments when their authority over the resource is restricted, divided, and subject to numerous uncertainties.

The intervention dynamic can be seen at work in the housing market in Silicon Valley. By placing limitations on the market for housing, communities have prevented developers from responding spontaneously to the need for housing. Because of government restrictions, there isn't enough housing to supply the market, so government attempts to artificially supply the market with the kind of housing that government officials think residents would like to see. Like a dog chasing its tail, detrimental government intervention begets detrimental government intervention in the housing market.

What is to be done?

The solution to the housing problem is simple: liberalize the housing market and allow suppliers to provide the kind of housing people want. Secure property rights and freedom of contract allow property owners and developers to use their property in a manner as they see fit. In this setting, traditional common law tort remedies will prevent property owners from using their property in a way that injures surrounding property owners, avoiding nuisances. Tort remedies will prevent the kind of negative effects the government hopes to avoid by its interventions, so by allowing the tort system to function, the entire intervention dynamic can be avoided.

Not only does liberalizing the housing market avoid the intervention dynamic, it also avoids the problem of regulatory takings on the part of the government. The Fifth Amendment to the Constitution states “. . . nor shall private property be taken for public use without just compensation.” Clearly this applies to cases where the government physically takes title to a piece of land, but it also applies when government action removes part of the value of a property. In his book, *Takings: Private Property and the Power of Eminent Domain*, Richard Epstein looks at government regulation as a partial taking of private

property (see Appendix B for a more detailed analysis of legal issues relating to the takings clause) (Epstein 1985, 191). When the government can restrict one's voluntary and peaceful use of one's own property, people feel insecure and uncertain in their freedoms. Such insecurity makes it difficult to plan, so individuals cannot use their talents and resources to their full potential (Epstein 1985, 3). By restricting fruitful exchange and creating clusters of intervention, government intervention shrinks the size of the pie; people are not as productive as they would be if they were secure in their freedoms.

The city of Houston, Texas has significantly less regulation in its housing market than Silicon Valley. People in Houston secure their property rights against nuisance caused by neighboring property owners, as well as from government taking by regulation, by restrictive covenants built into the title of property rather than by relying on zoning restrictions. Houston has experienced fast population growth yet only a fraction of the housing-price increase seen in California (Johnson 1982, 14-15). In fact, Houston has actually suffered periods of overbuilding, with vacancy rates rising from a normal 7 percent up to 13 percent in the late 1970s (Turpin 1980, 46).

What about the Poor?

The free market can effectively provide housing, responding to increases in demand that many suggest cause high prices. Also, contrary to the beliefs of many advocates for the homeless and poor, the free market can provide housing for the poor as well. A phenomenon known as the housing ladder explains how low-cost housing spontaneously becomes available to low-income persons (Husock 1996, 6).

People of similar incomes tend to congregate together, creating neighborhoods with homes of similar sizes and values. Homeowners tend to want to move up the housing ladder, and when they purchase a new home on the next rung up, they leave behind a vacant home for someone to fill. The person who eventually occupies that house also leaves a vacancy on the rung below. This "vacancy chain" continues until it reaches a person who did not leave a vacancy behind, such as when a youth moves out of the parents' home. In

this manner, neighborhoods such as Harlem and Watts, which were originally built to serve the middle class, can house the poor. All grades of housing function in an integrated market, so building middle-class houses is part of a complex system helping to make housing available to lower income persons.

John Lansing, C. Clifton, and J. Morgan of the Institute for Social Research and the University of Michigan tested the theory of the housing ladder by randomly identifying 1,000 new homes built in 1965-66 in 17 U.S. metropolitan areas (Tucker 1990, 84-87). They interviewed the residents of these houses and asked for their previous address. They then went to the former residence and interviewed the people who just moved in, inquired about their previous address as well. They continued until they reached the end of the vacancy chain. The 1,000 new homes led to 2,545 additional vacancies, an average of over 2.5 new vacancies for each of the new homes. Of these additional vacancies, 333 units, or roughly 9 percent of the total number of vacancies (3,545), went to families below the poverty line. Clearly, the housing ladder functions well to provide housing for the poor. Furthermore, houses (especially the more expensive houses) led to more housing vacancies for the poor than did apartments (Tucker 1990, 86).

The important difference between housing and, say, food is that when food is used it is used up. Fancy restaurants catering to the rich won't help those who can't afford the fare. Not so for housing. New expensive homes do help the poor. Housing is very durable. As new units are added at any rung of the housing ladder there are more units to go around, so housing is less scarce. The price of housing declines all the way down the ladder. Those concerned about affordable housing ought to favor augmentations to the housing stock, even at the high rungs.

Chapter Three

What Gives Rise to Restrictions?

The Motivations behind Public Policy

If restrictive policies are preventing suppliers from meeting the demand for housing in the Silicon Valley, why do local governments enact policies that cause steep housing prices? Part of the answer lies in simple intellectual error. Voters, journalists, and policymakers very often do not foresee the effects of restrictive policies on housing availability and housing prices. Political economy is a complex and difficult body of knowledge. People tend to take economic processes for granted, and assume that those processes will go on unaltered even once well-intentioned government restrictions have been imposed. Only by seeing consequences that are unintended and hard to see can policymakers really serve the public.

Intellectual error is usually related, however, to one's incentives to believe errors or to correct erroneous beliefs. Hence, part of the answer lies in the interests of several groups: current homeowners, public officials themselves, and environmental activists. Each group gets some sort of benefit from restrictive policies. The costs to society may, on the whole, greatly outweigh any benefits to interest groups from restrictive policies, but the benefits are significantly more concentrated than the costs. Those bearing the brunt of the costs may not even be aware of their cause, while those receiving the benefits have a stake in implementing and maintaining heavy restrictions. The values of the few prevail over the values of the many when government intervention is allowed.

The judiciary also plays a major role in determining what types of development policies will be implemented; court decisions determine which regulations will be upheld and which struck down. California courts in the past few decades have become increasingly accepting of regulation, and this precedence invites even more restrictions.

Homeowners and the General Public

In 1972, growth restrictions in the city of Petaluma, north of San Francisco, marked the beginning of an era of extensive restrictions in the state of California. In the 1960s, the widening of Highway 101 made commuting from Petaluma to San Francisco easier, and, as a result, many San Francisco employees looked to Petaluma for inexpensive housing, spacious residential lots, and good schools (Dowall 1984, 29). The new growth put financial strain on the city in terms of providing services such as water, electricity, and sewer lines to new homes. The growth also caused significant traffic congestions on the city streets, and long-time residents worried that this growth, as well as increased future growth, would destroy Petaluma's small-town character.

In response to this sentiment, the city adopted the "Petaluma Plan." Housing starts were restricted to 500 per year, significantly below the expected would-be quantity (Fischel 1995, 222). The newcomers denied spilled over into the nearby city of Santa Rosa (Downs 1994, 4). When one city restricts growth, nearby cities find themselves accommodating not only their own natural growth, but much of that of their restrictive neighbors as well. Increased growth causes residents to put more pressure on the city to enact anti-growth measures, and soon enough there is a large cluster of communities, each with its own growth restrictions.

As was the case in Petaluma, homeowners are often the strongest supporters of government restrictions on residential development. According to Michael Percy, principal planner for the city of Mountain View, one of the most common sources of delay in the building permit process is controversy among residents at public hearings addressing proposed development projects (Percy). There are several reasons current residents might want to prevent further development in their area.

Homeowners have an interest in limiting growth to protect the value of their own home. Often, a home is the biggest investment an individual has; it makes sense that

homeowners would want to keep home prices high. The surest way to boost price is to limit or even destroy supply. When Petaluma first implemented its restrictions, home prices jumped nine percent (Downs 1994, 36). Essentially, homeowners are suppliers of housing. If they can convince government agencies to restrict others from supplying housing, they can reduce competition in the market and raise the value of their own home.

In the James Bond film *Goldfinger*, the villain, Goldfinger, schemes to enrich himself by committing a great crime. The scheme is not to steal from others, however. Goldfinger owns a great deal of gold. He plans to detonate a nuclear bomb in Fort Knox, the site of enormous inventories of gold, thereby eliminating a significant part of the world's stock of gold. Gold would become scarcer, the supply curve would shift back, and the price would rise, enriching Goldfinger. The villain seeks to destroy the property of his competitors. Restrictions on housing do essentially the same thing. An external power sees to it that others are not allowed to compete with the local "Goldfingers," by destroying or restricting private property.

Homeowners also work hard to protect the quality of their neighborhood by preventing what are known as locally undesirable land uses (LULUs) such as expressways, airports, landfills, or other uses that are valuable for society but might expose residents to noise, unpleasant odor, or traffic (Downs 1994, 12). In *The Death and Life of Great American Cities*, Jane Jacobs, who prizes diversity as one of the key factors of a thriving city, uses the glue factory and, as a more modern example, the mortuary, as catchwords for the kind of thing that people do not want in their neighborhood (Jacobs 1961, 232). The city of San Jose recently dealt with just this issue. The recently proposed construction of a crematorium in a residential neighborhood, right across the street from a school, caused much public controversy. Although the area was zoned for industrial use, residences had been constructed in the area (Russell). Ultimately, land use permits were denied to A.A. Cremation Services based on environmental issues brought up by Coalition for a Better Community, a local neighborhood group (Russell). Homeowners' desire to prevent LULUs has its own name: NIMBYism, for Not In My Back Yard. This well known acronym nicely captures the problem with how those who favor restrictions think about these issues: they

regard other people's property as their own backyard, and consequently trample property rights without shame.

NIMBYism applies not only to non-residential land uses such as LULUs, though. Often what people do not want "in their back yard" is residential development that is not of the correct sort. Often, homeowners use regulations to keep out minorities or low-income groups (Saltzman 1996, 16). Although sympathetic to the plight of the poor, most homeowners will attempt to keep any kind of low-income development out of their neighborhood. Also, residents generally want to limit any kind of development that is out of character with the rest of the neighborhood, for example, "monster" houses. One of the biggest development issues in the cities of Sunnyvale and Campbell is individuals purchasing a home in a neighborhood of older, smaller houses, razing it, and erecting an extremely large house on the lot, completely out of character with the rest of the block (Ordonez, Schmidt, Callahan 2001).

Whether the motivation to restrict growth is to protect the homeowners' investment and keep housing prices high or to protect the neighborhood from having the "wrong kind of people" living next door, the result is the same. Residents (especially homeowners) of neighboring towns find themselves in what social scientists call a "prisoner's dilemma" (Dowall 1984, 32).

Figure 5: Both towns restrict, even though the outcome is bad overall.

		Homeowners/Voters in Town 1	
		allow entry	restrict
Homeowners/Voters in Town 2	allow entry	3 3	4 1
	restrict	1 4	2 2

The prisoner’s dilemma is illustrated by Figure 5. The payoffs for homeowners/voters in Town 1 are given in the upper right hand corner of each cell; the payoffs for Town 2 are in the lower left hand corner of each cell. The best outcome overall is the upper left hand cell, the outcome when both towns favoring free entry. The collective payoff (found by adding the towns’ individual payoffs) is 6, higher than any other cell in the matrix. However, each town’s homeowners find themselves better off, no matter what the other town does, if it restricts growth. For example, if Town 1 allows entry, Town 2 will receive a payoff of 3 if it allows entry and 4 if it restricts growth, so it would be better off restricting. If Town 1 restricts growth, Town 2 will get a payoff of 1 if it allows entry and 2 if it restricts growth, so again it will be better off restricting. The situation for Town 1 is the same. The result is for both cities to restrict growth, the lower right corner of the matrix that yields a collective payoff of only 4. Residents in both cities would be better off if they cooperated and loosened growth restrictions.

To restrict supply and prevent LULUs, homeowners often band together in neighborhood associations or local homeowners associations such as the San Antonio Hills Homeowner’s Association (SAHHA) in Los Altos Hills or the Almaden Valley

Community Association (AVCA) in San Jose. Because homeowners make up the majority of any political jurisdiction, it is relatively easy for them to influence local government. City officials have little choice but to succumb to interest group pressure or face trouble in upcoming elections.

Owners could increase the value of their home by remodeling and making improvements, but this is very costly. If they lobby government to restrict growth, they will get the same effect of real improvement, but it will not cost much. Since they already own a home, when prices go up, they benefit. It is potential newcomers who are harmed most by local growth restrictions.

Essentially, homeowners and homeowners associations are using a Goldfinger tactic; they want to increase the value of their investment at no cost to themselves by eliminating through coercive channels some of their competition. Once a person owns a home in a region, he or she is perfectly accepting of growth controls. Said Arthur Kondrup, former mayor of Freehold, New Jersey, “The last guy to move into a town often wants to be just that—the last guy. Two months in town and he’s already attending the planning board meetings trying to stop anyone else” (quoted in Tucker 1990, 144).

Political Culture

Politicians and government officials also have a stake in restricting residential growth. Not only do they face a fiscal responsibility to their municipality, they also feel some responsibility for ensuring that the town is a nice place to live, which may mean clearing out “undesirable” forms of housing.

City services are funded by taxes, whether it be property taxes or sales taxes. Planners must find ways to pay for services provided, such as schools, street repair, park maintenance, and sewage disposal. The combination of politics and finance leads to manipulation of policies in order to get the greatest amount of revenue while spending the least amount on public services. The “fiscalization of land use,” as it is called, means

thwarting residential development in favor of other types of development (Bay Area Futures).

Jacking up property taxes on homes is not politically appealing. Homeowners are one of the biggest blocks of municipal voters and officials had better keep them happy to keep their jobs. One way to do this is by keeping their property assessments low. Following the Property Tax Reform Act of 1966, it was discovered that city assessors in the state of California generally assessed residential properties at 70-90 percent of their true value (Aaron 1975, 60). Clearly this made homeowners' property taxes lower than they might have been, but this deficit was made up by assessing commercial and industrial properties at up to 140 percent of their true value and railroad and utilities at up to 150 percent of their value. Unlike homeowners, these industries do not vote, and railroads and utilities have no real ability to exit.

Besides paying less, residences consume more city services than other kinds of development (Tucker 1990, 133). Single-family, detached houses in a suburban setting require creation and maintenance of an extensive road and sewer systems as well as police and fire services. In addition, single-family detached homes are likely to mean an increase in school-aged children, placing a greater burden on the school system.

City officials prefer apartments to single-family detached housing. Apartment residents are more likely to be either elderly people or young couples without children, neither of which place a burden on the schools (Danielson 1976, 58-9). Two- or three-bedroom apartments, however, can accommodate families—often of lower incomes. In consequence, local governments use zoning to discourage larger apartments. Although not as costly as detached suburbs, apartments may require significant city expenditures. For example, a high rise may require a new hook and ladder fire truck. A building constructed in an undeveloped area will require that the city construct new roads and sewers.

Cities are more likely to encourage the development of what they call “good ratables”—stores, business, and industry that pay high property taxes but do not require much in the way of city services (Tucker 1990, 132). The ideal good ratable is a light industry that is clean, non-polluting, staffed by white-collar workers, and does not generate

much traffic. Suburban governments look for office parks, corporate headquarters, laboratories, and insurance companies. It is no accident that this type of development is burgeoning in Silicon Valley; not only has light industry in the area contributed to the economic boom, it provides a great deal of revenue at little cost to the city.

The fiscal politics of development may be seen as another manifestation of the intervention dynamic. The privately supplied services to new homes, such as lawn care and maintenance, do not enter into the politics of new development. But schooling, fire service, parks, and roads, *because they are governmentally provided*, become factors in housing politics. Having intervened deeply in these services, governments are compelled to intervene again in housing affairs. (Economic research establishes that the private sector can well provide schools, fire service, parks, and roads.)

City officials do not seek merely to run “in the black;” they seek prominence for the “downtown,” even at the expense of surrounding areas (O’Toole 2000, 512). City planners seem to believe that money is the key to rehabilitating a city. Pouring money into an urban renewal project, however, does not guarantee success, as has been seen in the case of downtown San Jose. The San Jose Redevelopment Agency has spent over \$1 billion improving the downtown, adding an arena, a convention center, museums, theaters, hotels, office buildings, and upscale housing (Martin 1998, 11; Bartindale 1998). But the money spent on redevelopment did not do the trick. Rather than draw people to shop and generate sales tax revenue for the city, the downtown lost sales to a competing shopping center, Valley Fair Mall, three miles down the road. When a new \$250 million dollar mixed-use project proposed across the street from Valley Fair, including 1,200 new housing units, threatened further competition for the downtown, Frank Taylor, the executive redevelopment director, urged the city to reject the project rather than admit that the rehabilitation of the downtown had failed (Martin 1998, 12; Bartindale 1998).

For many city officials, rehabilitation does not end with refurbishing the downtown, it means eliminating any slum areas of the city that do not meet their standards of decency. Often there is a feeling that everyone is entitled to some standard quality of housing. This movement is represented by the famous early muckraker Jacob Riis who, in *How the Other*

Half Lives (1890), detailed the horrible conditions of urban slums. Certainly slum conditions are not pleasant to live in, and it is only natural that one would want to ensure that no one has to endure them. Riis' solution to the problem of urban slums is simply to tear them down. Of course, tearing down the slums does not necessarily mean decent housing will be available to those displaced. After all, occupying a rat-infested flat may be better than sleeping under a bridge or in a bus station. City officials see this as a failing of the free market to provide housing for low-income people (even though they removed the housing provided by the market). They must then step in to provide "adequate" housing for the poor in the form of public housing projects or "affordable" housing—manifesting the intervention dynamic.

Environmentalism Elitism

Another motive behind growth restriction is concern for the environment. Preserving open space, farmland, natural habitats, species, air, and water quality are major concerns of environmental groups and are supported by journalists. In turn, these have become concerns of government officials and the public in general and have been used to justify many restrictions on growth.

The Association of Bay Area Governments (ABAG), an association of the nine counties (including Santa Clara County) in the San Francisco Bay Area, has identified six objectives of development in the Bay Area pertaining to environmental issues (Regional Planning):

1. Preserve environmental resources in order to maintain and enhance ecological health and diversity of plant and animal communities.
2. Preserve economically productive lands and waterways, including crop and grazing land, forests, and fisheries.
3. Ensure availability of open lands for public purposes, including recreation and watershed protection.

4. Create and enhance community identity through protection of community separators, hillsides, ridge lines and viewsheds, riparian corridors and key landscape features.
5. Use conservation of open land to guide needed and anticipated new development into areas where it is best provided for, avoiding areas with high risk of landslide, flood, fire or other natural hazard.
6. Preserve and enhance air and water quality.

These objectives have been promoted by policies of national, state, and local governments. Now, *over half of the Bay Area's 850,000 acres of forest and wetlands are protected public lands or are specifically designated as open space* (Bay Area Futures). When governments effectively lock up hundreds of thousands of acres of land, it is no great mystery that the poor cannot afford housing.

As Silicon Valley continues to prosper and grow, many expect that the environmental impact will become more extreme. As more people enter Santa Clara County, increased traffic congestion and waste threatens the air, water, and land quality (Projections '99). In 1998, the U.S. Environmental Protection Agency (EPA) revoked the Bay Area's clean air status because the region failed to meet national ozone standards in both 1995 and 1996. Fine particulate matter in the air has also been increasing due to congestion. Santa Clara County bears the brunt of increased pollution because the prevailing winds in the region sweep pollution into the valley (Projections '99). Residential waste is also one of the top polluters of the area's water supply. Improperly disposed of household chemicals, excess fertilizers, particles swept from roads and lawns by rainwater into storm drains all run into creeks that feed into the aquifer of the Santa Clara Valley Water Basin (Projections '99).

The answer that environmentalists advocate to alleviate the problems caused by rapidly increasing population has been "smart growth" (Holcombe 2000, 6). Smart growth tries to induce urban areas to become denser by restricting growth on their outer edges and emphasizing mass transit, walking, and bicycling in new development strategies (O'Toole 2000, 502). These policies are meant to limit traffic congestion by encouraging alternative

modes of transportation as well as prevent new development in undeveloped areas. Metropolitan areas all over the country are adopting smart growth policies, perhaps in part because the EPA threatens to deny federal funds to cities that do not.

It is questionable, however, that smart growth is the answer to environmental problems and population growth. The problems that smart growth tries to attack -- depletion of undeveloped land and leapfrog development -- are not as sinister as they appear. For example, the idea that we are running out of undeveloped land cannot be supported. The amount of developed land in comparison to undeveloped land is miniscule (Holcombe 2000, 7). Also, leapfrog, strip, or ribbon development tends to promote efficient development. Leapfrog development creates higher initial infrastructure costs, so it is clear why local governments do not like it, but in the long run leap frog development spawns higher density infill and shorter commute times (Holcombe 2000, 28). What smart growth has managed to do is put a new name on the same old policies planners have been using for generations and given the current crop of planners the idea that they can fix what their predecessors got wrong (O'Toole 2000, 501-2). Smart growth goes against the trends towards automobile transportation and large homes, trends that reflect peoples' preferences (O'Toole 2000, 502).

Some environmentalists also seem to have the idea that, unless we protect agricultural land, we will not be able to feed our growing population. This belief is mistaken. As population increases, the demand for food will grow and farmers will increase production to meet demand. Currently in the U.S. there is about 10 times as much farmland as developed land in the U.S. Much of the land currently designated as agricultural is not even under cultivation. Because productivity in agriculture has increased so much, acreage under cultivation has been declining rapidly (Holcombe 2000, 11).

Chapter Four

Policy Issues

Policies Intended to Preserve the Quality of Neighborhoods

Zoning

One of the first things a developer must contend with in constructing housing, whether single home or large development, is zoning. In the 1920s, zoning ordinances began to be created to preserve order within a town. Grouping heavy industries together in an industrial area, commercial into commercial, and residential into residential, seemed sensible in terms of convenience for residence and business owners. Zoning would make sure smoke and fumes from a factory do not cause a nuisance in peoples' homes. Modern zoning ordinances go much farther than simply separating commercial, industrial, and residential districts. In fact, there are usually a number of different classifications within "residential," including specifications for minimum lot size, height, length, width, setback limits, maximum occupancy, and permissible uses.

Zoning that specifies how residences may be constructed on lots and how buildings must be used is often referred to as exclusionary zoning. Zoning ordinances set minimum quality requirements and thus minimum costs of production. Those that cannot afford the standards set by the city's ordinances are excluded from the housing market. Zoning excludes two categories of people from the housing market: would-be tenants and would-be landlords. It is often cost effective for a low-income person to rent an empty room from a family. Families may purchase a home in the expectation of renting the empty rooms and using that rental income to pay the mortgage. When zoning prohibits this kind of arrangement, not only do renters lose out on rooms, but families may be precluded from owning a home (Husock 1997, 66).

Zoning that limits the density of development is pervasive in Silicon Valley. Virtually all of the cities in Santa Clara County have minimum lots sizes and strict regulations on subdivisions. There seems to be an understanding among local governments that higher density development is needed in order to meet the demand for housing and bring prices to a more reasonable level, but no residents want high density development in their neighborhood. NIMBYism and pressure on local governments from residents keep areas zoned for low-density development.

Neighborhood associations such as SAHHA in Los Altos Hills play a big role in keeping neighborhoods low density. In May of 1998, SAHHA managed to get the Santa Clara County Board of Supervisors to declare a building moratorium on new house construction in Los Altos Hills; the groups felt that developers should not be able to buy large lots in the city and subdivide them for multiple homes (Domingue 1998). It's no wonder Los Altos Hills has the highest mean home price in the county at \$1,325,000 in 1998 (California Association of Realtors).

Los Gatos residents have had similar success in limiting density. Builder Ron Griffen attempted to get several of his properties rezoned in order to construct high-rise apartments, which builders say is generally the most efficient way to provide housing. Although it may be efficient, nearby residents generally protest it. In Los Gatos, construction over 30 feet high is prohibited. Mayor Randy Attaway said, "To get (housing values) down to affordable levels you have to go three or four stories, and that is not the quality of life we are looking for in Los Gatos" (Cromwell 7/3/96). The crucial word is "we": would-be residents are without voice and without housing. They are not included in "we." Los Gatos residents who attended public hearings on Griffen's rezoning proposal stated that they preferred zoning for only five to twelve units per acre, preferably freestanding, single-family homes. The neighborhood's pressure on the city council was so strong and made Griffen's battle to rezone so costly that he eventually gave up (Cromwell 2/19/97).

Building Codes

Like zoning, housing codes set a minimum quality of housing within the city. By specifying appropriate building materials and techniques, housing codes set a standard minimum quality of housing. Those who cannot afford such artificially high-priced housing must go without. Housing codes not only raise average housing prices by eliminating the lowest rungs on the housing ladder; they prevent builders from experimenting with new materials and techniques that may improve the quality of housing and reduce costs. Rather than specifying performance standards in order to ensure quality, building codes usually specify materials that they feel will meet certain performance standards. As a result, builders cannot use innovative new materials that might achieve the same quality (Frieden 1970, 203).

Campbell's San Tomas Area has extensive building codes pertaining not just to quality and safety, but to housing appearance. In 1991, the Campbell City Council authorized the San Tomas Study, which resulted in the creation of the San Tomas Area Neighborhood Plan, to review land use and transportation in the San Tomas Area (San Tomas Area Neighborhood Plan, 2). The Plan was developed with the joint involvement of neighborhood residents, the city council, and the planning commission to develop policies and goals for the neighborhood. The policies they created included low-density zoning, larger than average minimum lot sizes, and specific esthetic building guidelines.

Both zoning and housing codes prevent homeowners and landowners from using their property as they see fit. Although the Supreme Court has been sympathetic to zoning ordinances since the *Euclid* decision in 1926, zoning laws and housing codes do diminish the value of a property by limiting its use. These are takings; they should be compensated or ended. Contracts and covenants between landowners can achieve the same ends as restrictive zoning. With zoning laws, residents can impose their preferences on developers without paying for them. They can tell other people what they can do with their property, though they run the risk of being told what to do with their own. However, with covenants, homeowners are paying for more than just the value of their home, they are paying for their preferences. If they value living in a low-density neighborhood more than developers value their right to build high-rise apartments, then they can pay developers to enter into a

covenant preventing that type of development. If developers value their right to build the apartments more than neighbors value low-density development, they will not enter into a covenant. In this manner, the land is likely to be put to a more socially beneficial use. Covenants are self-restrictions, entered into voluntarily, at the expense of everyone involved, whereas zoning restrictions are coercive restrictions imposed by one group on another group, at the expense of the restricted group and the people they would trade with.

Houston, Texas, uses covenants to assist landowners in maintaining their preferred neighborhood. In Houston, there is no zoning. Although Houston is one of the country's largest urban areas, housing and rental prices have remained surprisingly low. In 1990, Houston's density was 3,020.2 ppn/mi², similar to the density of Gilroy, but the average cost of a home there was \$58,000 and the average rental payment was \$390, much lower than Gilroy or anywhere else in the Valley (Martin 1998, 9).

Property Taxes and Development Fees

There are a number of reasons city officials might favor commercial development over residential. In San Jose's 1992 General Plan Update, officials noted that residential housing was an economic burden to the city:

[I]t is generally true, given similar existing service capacities, that commercial/office/industrial uses have generally more positive fiscal characteristics than residential uses. This is true in large part because non-residential uses demand less of the most expensive services—police and fire protection (Martin 1998, 23; Economic & Planning Systems, Inc. 1993, v).

City officials are clearly aware of the relative benefits of commercial development, although they would probably deny that commercial and industrial development receive preferred treatment. City planning departments actively encourage commercial and industrial development by providing a "fast track" in the permitting process. One of the main costs of development is obtaining building permits and use permits. Normally this process is bureaucratic, uncertain, and prolonged. Fast tracking significantly reduces much of the red

tape and time in the process. According to Joseph Horwedel, San Jose's Deputy Director of Planning, fast tracking is intended for projects of "significant economic importance" to the city, which are generally commercial or industrial projects that create jobs and tax revenue (Martin 1998, 23; Home Builders Association).

The city's concern with developing land in a financially beneficial manner can be seen in the case of two as yet undeveloped San Jose urban reserves, Coyote Valley and the Almaden Reserve, encompassing nearly 3,000 acres (Greenbelt Alliance). Part of the rationale in keeping these areas undeveloped is the preservation of open space, which will be discussed in the next section. In 1990, the city charged the Horizon 2000 General Plan Task Force with the task of creating recommendations for the development of the reserves. The Task Force found that expanding residential development into the reserves would increase service costs and cause net losses for the city. The Task Force recommended that the city not allow development in the areas until certain criteria were met. The criteria for the Almaden Reserve were as follows:

- allocation of funding for Route 85 in order to avoid increased congestion
- expected creation of 17,500 new jobs in the area, based on building permits issued

The criteria for Coyote Valley were a bit more extensive:

- expected creation of 25,000 new jobs in the area, based on building permits issued
- creation of 89,000 new jobs city wide
- issuance of building permits for 37,800 new dwelling units citywide
- widening of Highway 101 to at least six lanes between San Jose International Airport and Bailey Avenue

- allocation of funding for Route 85 to avoid increased congestion

When, in 1992, the Route 85 and Highway 101 criteria were close to being met and building permits for Coyote Valley had been issued, the city assembled a new task force to come up with further recommendations (Martin 1998, 25; Economic & Planning Systems, Inc. 1993, 7). The city seems to be making a great effort to ensure that these areas are not open to residential development.

Residential growth is further inhibited by tax incentives that are common to most cities and counties in California. In 1978, California passed Proposition 13, which limited property taxes to only one percent of the property's value (an unusually low rate), rolled back property assessments to their 1975-76 level, and limited increases to only two percent per year. Proposition 13 significantly reduced property taxes and shifted the burden of funding schools to the state level. Anyone who bought a home after 1978, however, would be assessed at the current market rate; this was essentially an institutionalized "welcome, stranger" assessment.

The effect of Proposition 13 was to reduce city tax revenues. In response to decreased revenues, cities throughout the state have adopted "developer pays" strategies to help cover the costs of government involvement in the building process as well as of maintenance of infrastructure such as roads and sewers (Dowall 1984, 78). Cities charge thousands of dollars for building permits, rezoning fees, subdivision fees, plan reviews, and a number of other government interventions in housing. Several city planning departments were surveyed as to how these fees changed as a result of Proposition 13. Most were unclear as to the exact impact of the proposition, and even though they admitted that fees have certainly gone up since 1978, they attribute it to inflation and general increases in real estate values rather than changes in property tax law. However, UC Berkeley's Institute for Economic Analysis found that development fees increased by an average of 70 percent between 1976 and 1979 (Dowall 1984, 130).

Developers often are required to construct sidewalks, roads, and sewer hook-ups themselves and then “dedicate” them to the city. This trend began in California after the passage of Proposition 13 and has spread throughout the country. Over the years, local governments have required more and more from developers, asking builders to dedicate things that will service the community, but may not really correspond to burdens borne by the city because of the new development. Such tribute adds thousands of dollars to the cost of building a home, and these costs are passed on to consumers in the form of higher prices. Requiring developers to dedicate sewers, roads, and other infrastructure also serves to increase price by restricting supply; some builders may decide to forgo a project because of the added requirements.

Proposition 13 creates a tax advantage to staying put; it encourages people to remain in their homes much longer than they otherwise would (this effect is much like rent control with vacancy allowances). A couple with a large house whose children have grown and moved out may be tempted to hang on to the home, even though several rooms are unused, because property taxes on a new, smaller home will be based on market value and thus will be much higher. The tax rules, therefore, lead to underutilization of existing housing capacity.

Programs Aimed at Protecting the Environment

Environmental Impact Reports

In 1970, the National Environmental Policy Act (NEPA) was passed, marking the beginning of a period of increased environmental concern on the part of the public (Fischel 1995, 246). NEPA held that any federal government-sponsored project must provide an adequate environmental impact report. Although NEPA did not apply to states or private building projects, California was quick to enact similar legislation. In 1970, it passed the California Environmental Quality Act (CEQA). Like its federal counterpart, CEQA applied only to government-sponsored projects. However, in 1972, the California Supreme Court ruled in *Friends of Mammoth v. Mono County* that the provisions of CEQA applied to any

sizeable development, public or private (Dowall 1984, 3; Fischel 1995, 247). The decision pulled almost all private development within the scope of the statute.

The official goal of CEQA is to develop and maintain a high-quality environment now and in the future by identifying the significant environmental effects of development and avoiding or mitigating adverse effects where feasible (California Resources Agency). CEQA requires that, if a project requires approval of a government agency before commencement, that agency must conduct a study to identify the likely impact a project will have on the environment. The agency must then file a report with a Negative Declaration if no impact is found, a Mitigated Negative Declaration if significant impacts are found but the project is modified to avoid them, or an Environmental Impact Report (EIR) if significant impacts are found (California Resource Agency).

The EIRs required by the state introduce political wild cards into what would otherwise be a normal business initiative. Local politics, numerous environmental trip wires, junk science and legal wrangling all await the builder and enshroud any building project in a cascade of uncertainties. The EIRs are costly to the builder, and in turn to potential consumers. Providing EIRs causes lengthy delays in the permitting process. In the city of Santa Rosa, EIRs caused delays of up to 530 days for project approval in 1978, due to the sheer number of projects being reviewed and the increased detail necessary in reports according to statute (Dowall 1984, 92). In addition, the cost of producing the report is borne solely by the applicant -- that is, the developer, who will pass this cost on to the buyer (Dowall 1984, 130).

Urban Growth Boundaries

In addition to the state and national environmental legislation that all of the cities in Silicon Valley must follow, many have their own environmental and open space laws. Many cities use urban growth boundaries (UGB), also known as greenlines, to prevent development. This type of legislation is not used in all of Silicon Valley's cities, as many such as Sunnyvale and Campbell, are completely surrounded by other cities and have little peripheral open space.

The city of San Jose has used a greenline to designate over 100,000 acres as urban reserve prohibited from development (Greenbelt Alliance). This area includes the Almaden Reserve and the Coyote Valley, as well as foothills surrounding the city near the Silver Creek area. In early 1998, landowners beyond the UGB who want to develop their land filed a lawsuit against the city council. The council won, and former mayor Susan Hammer claimed the policy was one of the best implemented since she had been elected, ensuring “long-term health, prosperity, and quality of life” (Kurtzman 1998). Yet she does not understand the impact of her decision on all the people clinging to the lower rungs of the housing ladder.

Evelyn Richmond, whose family farm operates at a loss every year because the city forbids her from developing her own land, does not agree with Hammer’s assessment of the situation. The Richmond family and the owners of the Young Ranch, also outside of the UGB and forbidden to develop, circulated a petition to put an initiative loosening greenline restrictions in San Jose on the November 2000 ballot. Although they claim to have enough signatures to put the initiative on the ballot, the landowners have decided to sideline it until the following election, pointing to a number of touchy issues on November’s ballot that they would like to see the outcome on before moving forward (Levey 2000). Instead, the ballot will feature a referendum sponsored by mayor Ron Gonzales and the city council to tighten restrictions on the UGB. In response to the landowners’ decision not to seek a spot on the ballot, Autumn Bernstein of the Greenbelt Alliance, a local environmental group, said, “The landowners must have realized that the residents of San Jose are not as foolish as they thought.” If the landowners’ initiative passed, it would have allowed them to build nearly 2,500 homes (Levey 2000).

Landowners affected by the boundary were not the only ones opposed to the city’s policy to limit growth. Council member Frank Fiscalini was the only one of the city’s 10 council members to vote against the boundary, claiming it would violate property owners’ rights. John Landis, professor of planning at the University of California-Berkeley, also objected to the boundary, saying it was drawn too tightly around the city and that planners ignored the realities of the housing market by assuming developers would build up instead of out. The city council even received a letter from the state Department of Housing and

Community Development advising them that the boundary would contribute to the Valley's housing crisis (Martin 1998, 26; Kurtzman 1998).

Superfund

In addition, Santa Clara County has prohibited development in "Superfund" sites. These are areas deemed to have been excessively contaminated by toxic waste (Projections '99). The EPA runs a competitive grant program to provide funding and technical assistance to communities for the purchase and clean-up of such sites. The Superfund program was created by the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) in 1980 in response to concern over nationally publicized hazardous waste disasters such as Love Canal in 1978 (Wildavsky 1995, 154). The program focuses on aging and abandoned waste sites containing substances that are flammable, corrosive, reactive, toxic, or in other ways potentially harmful to humans. It is not clear that these Superfund clean-ups really accomplish anything, however.

After 1980, scientists began studying hazardous waste sites to determine just how harmful they are. In 1986, a group of 40 academic scientists, under the direction of the Universities Associated for Research and Education in Pathology, undertook comprehensive studies of 21 different waste sites and concluded that evidence of causal association between waste sites and disease was weak (Grisham 1986, 344). An independent study of 15 waste sites conducted by Gary Marsh and Richard Caplan of the University of Pittsburgh also found that the connection between exposure and health risks was weak and inconclusive (Marsh 1987, 256). The hazardous waste sites targeted as Superfund sites are not the public health threat public discussion of events like Love Canal have made them appear to be. Yet the EPA has spent over \$10 billion to finance clean-up efforts, matched by at least as much contributed by the private sector, on more than 1,200 sites nationwide (Wildavsky 1995, 153). Santa Clara County has 29 Superfund sites, more than any other county in the United States (Projections '99). These sites occupy more than 3000 acres (EPA).

Programs Aimed at Providing High-Quality, Low-Income Housing

Many ordinary citizens and government officials have a vision of what kind of housing people should have. There is a sense that, regardless of how much a person can afford, they are entitled to a certain base quality of housing. In 1937, the U.S. Housing Act was written to guarantee “decent, safe and sanitary dwellings for families of low income.” Since then, the same building codes homeowners use to keep their property values up and their neighborhoods looking presentable have been used to ensure that builders do not construct homes of lesser quality. Building codes require builders to work within certain guidelines on everything from wall thickness to hallway width to smoke detectors.

Perhaps these regulations have prevented the construction of low quality housing that some would find objectionable. However, they have also raised costs for suppliers, who in turn raise prices for consumers. A poor family might prefer a home of less than superb quality simply because they can afford it, while they cannot afford something nicer.

Today, the market is not providing housing for low-income people because government regulations do not allow it. The result is a “Cadillac effect.” The analogy, suggested by Milton Friedman in *Capitalism and Freedom* (1962, 153), goes like this: the government, disgusted with the quality of cheap cars the automobile industry is producing, mandates that all cars be built to Cadillac standards. But this does not mean that everyone will get a Cadillac. Those that can afford only something less expensive will be forced to go without any car at all. Similarly, consumers in the Silicon Valley housing market either purchase a high quality, high-priced product, or none at all.

Some, including Charles Hoch and Robert A. Slayton, argue that regulations restricting low quality housing cause homelessness. In *New Homelessness and Old*, Hoch and Slayton specifically address the disappearance of the single-room occupancy hotel (SRO) and its contribution to homelessness. Their study focused on Chicago’s SROs, which served to house single people with low incomes. Many of the SROs in Chicago were poor quality and unsanitary, but many were not. In fact, most SRO residents made an active choice to live there, citing convenience, location, and social networks as well as low rent (Hoch & Slayton 1989, 130). Unfortunately, many SROs fell victim to urban renewal and

were torn down in the name of helping the poor. Reformer claimed that “flophouses” did not promote middle-class values of home, family, and community (73). Many of those without money or a support network to fall back on were forced onto the streets.

There is evidence that something similar is happening here in Silicon Valley. The Mountain View Hotel, a low-priced hotel on Castro Street in the city of Mountain View, was rezoned by the city several years ago. A number of people had been using the hotel as a residence and were displaced, although it is unclear if the majority became homeless or found other residence. The hotel has remained vacant for over five years now, according to realtor Ron Ikebe (Ikebe).

Redevelopment Agencies

Since regulations basically remove any chance that low-income persons will be able to afford housing, the government feels impelled to find some way to provide shelter for them. Urban renewal, one of the very forces behind the destruction of many SROs, is one of the city’s main tools for fighting so-called urban blight and providing the less fortunate with quality housing. Usually facilitated by a city redevelopment agency (RDA), urban renewal aims at wiping out slum areas and replacing them with development the city considers more wholesome and valuable. RDAs were authorized by the California state legislature in the California Community Redevelopment Act of 1945, and since then more than three-quarters of the cities in the state have established RDAs (Dardia, 11). More than half of these were established after the passage of Proposition 13 in 1978, which limited the property taxes cities could collect.

In addition, RDAs use the government’s power of eminent domain to carry out redevelopment projects (Jacobs 1961, 311). Residents are inevitably displaced, and new housing projects often are not large enough to accommodate all of those displaced. Although RDAs compensate property owners with market value for what they take, what they are acquiring is not of very high value (it is a slum), and the amount of money received

by each property owner is not enough to find substitute housing in an increasingly government controlled market.

Furthermore, redevelopment projects are often not located in blighted areas. Although about 25 percent of RDA funding comes from federal grants, the majority of the funding for RDAs comes from what is called tax increment financing (Dardia 1998, 15). Property taxes increase when the value of a property increases. Under tax increment financing, the RDA gets to keep whatever revenue is gained from the project area through subsequent increases in property taxes in the project area for as long as the project remains in existence, whether increases in property values resulted from the efforts of the RDA or from other factors such as general land value increases in the area. County and state governments thus essentially subsidize the RDA by giving up property taxes to them (Dardia 1998, 28). RDAs have an incentive to define blight very broadly in order to capture property tax revenues. Also, a significant number of project areas contain more than 50 percent vacant land, which suggests development rather than redevelopment (Dardia 1998, xii).

A number of cities in Santa Clara County have redevelopment agencies, including Sunnyvale, Mountain View, Morgan Hill, San Jose, Campbell, and others. We have already seen that San Jose's RDA was not successful at revitalizing the downtown. San Jose is also making an attempt to provide funding for low-income housing. A reporter says, however, that only one out of five redevelopment dollars goes to housing (Levey 2000). The city recently approved over \$150 million to build 2,056 new "affordable" homes (Levey, "San Jose to finance affordable housing," 2000). Affordable homes are defined as units that, on an annual basis, cost no more than 30 percent of a family's household income, which means that for many people in Silicon Valley, a home must be sold at below-market prices in order for it to be deemed affordable. If the example of Morgan Hill is any indication, San Jose's efforts will not be nearly enough to accommodate those displaced. Morgan Hill recently removed a blighted building that provided "squalid" housing for more than 50 tenants in order to create 3,500 square feet of commercial space and 13 studio apartments (SVMG, 23). The building may have been squalid, but it was home to over 50 people, only some of

which could be accommodated by the new development. It appears that the redevelopment agencies, like most government agencies, are actively advancing the intervention dynamic.

Mandatory Affordable Housing

Another measure cities use to create affordable housing is to mandate that developers sell a certain percentage, usually between 10 to 15 percent, of their units at below-market prices deemed affordable to low-income families. Sunnyvale, Campbell, Los Gatos, Mountain View, Morgan Hill, Palo Alto, and Cupertino have such ordinances. Here again, the law of unintended consequences rules. Forced to sell a portion of their housing at a loss, builders will continue building only if they can make up for this loss on other units. The net effect is thus to *raise* average housing prices for all but the few low-income people lucky enough to obtain the specially designated units. Overall, housing becomes *less* affordable and less available, especially for middle-class families, who neither qualify for subsidies nor can afford premium priced housing.

Rent Control

Yet another example of a regulation intended to ensure affordable housing to the poor is rent control. Rent control ordinances essentially set the rent of an apartment or dwelling and prevent the owner from raising rents. Upheld by the Supreme Court in *Block V. Hirsh* just after World War I, rent control statutes were originally seen by Justice Holmes, writing for the majority, as a proper exercise of government power during wartime conditions (Epstein 1985, 176). Today, despite the absence of war, rent controls are common practice in many Bay Area cities, including San Jose.

When governments impose rent control, they essentially create three related markets for apartments: the rent controlled market, the black market, and the non-controlled market. As with affordable housing, rents will be much higher in the unregulated market and in black markets for those who cannot obtain rent-controlled units, because the excess demand from the rent controlled market will spill over, increasing demand in the unregulated and black markets (Tucker 1990, 162).

In *The Excluded Americans*, William Tucker uses the city of Berkeley, CA, which instituted rent control in 1971, to illustrate the effects of rent control. His interpretation of the evidence shows that the theoretically anticipated consequences of rent control can be seen in Berkeley. Condo conversions were happening all over the city until they were made illegal, and an estimated 9,000 rental units were simply removed from the market between 1980 and 1988 (Tucker 1990, 163).

The only city in Santa Clara County that currently has rent control is San Jose. The city's rent control ordinance was put in place in 1979, and it applies only to renters in apartments built before that year (Rodriguez 6/30/2000). San Jose's ordinance is a modest one, allowing rent increases of up to 8 percent per year (stricter ones allow only 2-3 percent increases). Because (unregulated) rents in Santa Clara County have gone up as much as 70 percent in the past seven years, Joe Rodriguez, a columnist for the *San Jose Mercury News*, advocates rent control like San Jose's all over the county. His argument: landlords are greedy. Numerous apartment managers have explained to Mr. Rodriguez that supply and the market sets the rent in Silicon Valley (Rodriguez 7/16/2000). He does not seem to want to accept that explanation, unconvinced that "the cruel forces of supply and demand in Silicon Valley" can arrive at a fair rental price (Rodriguez 7/5/2000).

Mr. Rodriguez fails to appreciate the fact that apartment owners are not charities. They do not rent properties out of the goodness of their hearts, they do it to make a profit. In fact, they are more likely to do a good job because there is profit involved. Adam Smith, author of *The Wealth of Nations*, explains how people's needs and wants are met by satisfying the needs and wants of others:

Give me that which I want, and you shall have this which you want. . . and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of. It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages (Smith 1976, 71).

Although the principles of self interest are utilized and seem successful in other markets, for some reason they are not expected to be successful in the rental market, or in the market for low-income housing.

Chapter Five

Conclusion

Today, many housing regulations are aimed specifically at providing affordable housing and relieving the housing shortage. City planners seem to have the best intentions in ensuring reasonably priced housing for all. Unfortunately, good intentions are not enough to resolve the housing problem. The extreme scarcity of housing in Silicon Valley endures because of heavy restrictions placed on the market. Adding more regulation in order to alleviate the problem only adds fuel to the fire. Without a sound understanding of economics, good intentions may end up paving a road to hell.

An intervention dynamic has snowballed in Silicon Valley. Homeowners use zoning and housing codes to limit development in order to keep their own property values high and protect the quality of their neighborhood. Yet the controls limit developers' ability to build new, affordable homes. Since Proposition 13 has diverted most property taxes to the state, the tax system in California is also a hindrance to developers. Because it is not cost effective, local governments discourage residential developments. An intervention dynamic within itself, local governments pass laws requiring developers to contribute to the city's infrastructure by dedicating sewer lines, sidewalks, and roads, increasing the cost of constructing homes. Restrictions aimed at protecting the environment also prevent builders from supplying housing. Greenlines prevent developments in new areas and environmental impact reports are costly and introduce significant uncertainty.

All of these factors have contributed to the inability of developers in Silicon Valley to provide affordable housing, and local governments have intervened again to try to make sure affordable housing is available to all. By requiring developers to sell a certain percentage of housing units at below-market levels and even instituting rent control, governments have tried to make sure the poor can afford to live in Santa Clara County. The California Department of Housing and Community Development (HCD) has even stepped in

and required that each city provide its “fair share” of housing; using census data, HCD determines how many dwellings in each price range a city should have and requires the city to try and meet this goal (Martin 1998, 29). The city of Los Gatos is currently not in compliance and may be prohibited from issuing building permits (Cromwell 11/20/96). Local governments are so concerned with the housing problem that they are now interfering in other markets in an attempt to fix the housing shortage. In Palo Alto, planners have proposed clearing out an office park filled with doctors, dentists, and other medical practitioners to construct housing (Khanh 2000).

These attempts to provide affordable housing may have good intentions behind them, but unfortunately good intentions are not sufficient to resolve the housing shortage. The housing shortage in Silicon Valley is a consequence of development controls and housing regulations that violate property rights. Rather than repeal the restrictions that create the housing problem, governments at various levels continue to try to alleviate the problem with still more government regulations.

Concerned citizens need to cultivate a new attitude: Owners of land and buildings should be allowed to use them as they see fit, provided they do not generate tangible nuisances for neighbors. Although the Bay Area is predominantly Democratic, concerned citizens ought to promote the idea that property rights and free enterprise are good for society and especially the poor. When Adam Smith wrote *The Wealth of Nations*, he set out to show that the government’s best way to raise the living standards of ordinary people was with few exceptions to allow free enterprise. Economic research has repeatedly borne out that he was right. It is time for Bay Area leaders and citizens to take Smith’s ideas seriously.

Contrary to popular opinion, high demand is not the cause of extraordinary housing prices in Silicon Valley. High demand for lettuce does not, in the long run, lead to high lettuce prices. What is exceptional is the extent of regulations that restrict landowners and developers, making it impossible for suppliers to meet Silicon Valley’s demand for housing. The result is high prices.

APPENDIX A

Home Price Comparisons

To test the idea that Silicon Valley home prices are rising because we are running out of room, I have compared 1990 home prices in 12 of the 15 cities in Santa Clara County to all cities around the country with comparable densities (measured in population per square mile). (I did not make the comparisons for Los Altos Hills, Monte Sereno, and Morgan Hill because the source book included only cities with 1990 populations of 25,000 or more.) Cities with similar density are defined as cities whose density is within plus or minus one percent of the Silicon Valley city being examined. Density data was gathered from the U.S. Bureau of the Census website using a computer search that identified all cities nationwide within the plus-or-minus-one-percent band. Median home values were gathered from *1998 County and City Extra* (Gaquin and Littman 1998). The findings of this Appendix are summarized in table 1 in Chapter One.

Campbell: Californian and Out-of-State Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Campbell	CA	6,427	\$276,700	\$743
Buena Park	CA	6,483	206,000	727
Cypress	CA	6,447	252,700	811
Torrance	CA	6,486	340,000	795
Dover Base Housing	DE	6,429	88,700	470
Lauderdale-by-the-Sea	FL	6,405	79,600	544
Ferndale	MI	6,473	38,400	467
St. Louis	MO	6,406	50,700	342
Rochester	NY	6,473	65,200	442
Harrisburg	PA	6,459	38,400	363
Non-SCC California Average:			\$266,233	\$778
Out-of-State Average:			\$60,167	\$438

Cupertino: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Cupertino	CA	3,908	\$328,900	\$788
Longmont	CO	3,923	85,900	466
Tamarac	FL	3,901	77,600	633
Jamestown	NY	3,916	43,300	311
Chester Township	PA	3,897	38,400	392
South Ogden	UT	3,882	54,700	330
Charlottesville	VA	3,932	85,600	469
Out-of-State Average:			\$60,167	\$438

Gilroy: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Gilroy	CA	3,069	\$243,300	\$659
Escondido	CA	3,048	169,500	621
Encinitas	CA	3,086	285,700	796
Rancho Palos Verdes	CA	3,049	500,001	1001
Denver	CO	3,051	79,000	386
Lakewood	CO	3,100	91,400	465
Boynton Beach	FL	3,051	79,400	632
Plantation	FL	3,066	130,100	705
Belleville	IL	3,061	58,500	393
Mishawaka	IN	3,068	46,800	363
Raytown	MO	3,089	63,900	427
Hamilton	OH	3,073	53,700	363
Gresham	OR	3,093	71,100	446
Oshkosh	WI	3,066	53,800	379
Non-SCC California Average:			\$318,400	\$806
Out-of-State Average:			72,770	456

Los Altos: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Los Altos	CA	4,130	\$500,001	\$1,001
Altamonte Springs	FL	4,093	90,000	553
Oakland Park	FL	4,138	89,200	541
Elmhurst	IL	4,142	135,600	605
Flint	MI	4,160	33,900	375
Muskegon Heights	MI	4,159	32,400	338
Westland	MI	4,141	63,400	512
Canton	OH	4,162	37,700	298
Toledo	OH	4,132	48,900	578
Lynnwood	WA	4,119	122,400	529
Out-of-State Average:			\$72,611	\$481

Los Gatos: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Los Gatos	CA	2,636	\$439,900	\$849
Porterville	CA	2,630	71,500	407
Mesa	AZ	2,653	86,500	470
Warner Robins	GA	2,620	56,000	405
Kaneohe Station	HI	2,658	242,700	845
Nampa	ID	2,627	45,600	308
Twin Falls	ID	2,617	51,600	313
Carbondale	IL	2,649	54,800	319
Granite	IL	2,628	42,700	351
Peoria Heights	IL	2,631	49,200	360
Marion	IN	2,615	34,500	317
Wichita	KS	2,640	56,700	395
Wyoming	MI	2,630	57,700	429
Findlay	OH	2,633	62,700	363
Cranston	RI	2,662	129,700	534
Haltom City	TX	2,661	52,300	390
Richardson	TX	2,649	110,000	597
Longview	WA	2,622	61,100	352
Wausau	WI	2,630	51,000	360
Cheyenne	WY	2,662	68,700	365
Non-SCC California Average:			\$71,500	\$407
Out-of-State Average:			\$72,972	\$415

Milpitas: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Milpitas	CA	3,685	\$255,600	\$869
Santa Cruz	CA	3,679	263,200	707
Orange Cove	CA	3,656	248,700	766
Boulder	CO	3,694	122,700	521
Pembroke Park	FL	3,679	93,800	685
Riviera Beach	FL	3,690	61,600	495
Addison	IL	3,717	126,000	531
Chicago Heights	IL	3,662	62,500	402
Wheeling	IL	3,696	113,400	679
Hammond	IN	3,671	45,500	377
Rockville	MD	3,696	180,900	798
Dearborn	MI	3,664	69,600	465
Bethlehem	PA	3,708	90,600	453
West Warwick	RI	3,690	116,600	570
Manassas Park	VA	3,676	150,700	695
Burlington	VT	3,709	113,500	493
Tacoma	WA	3,677	66,200	413
Yakima	WA	3,666	56,700	346
Huntington	WV	3,681	46,700	311
Non-SCC California Average:			\$255,950	\$737
Out-of-State Average:			\$94,813	\$515

Mountain View: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Mountain View	CA	5,606	\$347,000	\$760
Beverly Hills	CA	5,632	500,001	925
Montclair	CA	5,632	134,700	613
New Britain	CT	5,660	139,200	512
Poughkeepsie	NY	5,606	128,700	522
North Lindenhurst	NY	5,590	156,800	737
West Allis	WI	5,580	63,100	446
Non-SCC California Average:			\$317,351	\$769
Out-of-State Average:			\$121,950	\$554

Palo Alto: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Palo Alto	CA	2,361	\$457,800	\$851
San Clemente	CA	2,353	308,500	774
Phoenix	AZ	2,342	77,100	442
Biloxi	MS	2,359	55,400	331
Massillon	OH	2,350	43,600	345
Eules	TX	2,378	76,300	484
Mesquite	TX	2,369	68,700	469
Bellingham	WA	2,370	89,100	426
Everett	WA	2,341	98,000	484
Non-SCC California Average:			\$308,500	\$774
Out-of-State Average:			\$72,600	\$426

San Jose: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
San Jose	CA	4,568	\$259,100	\$755
Azusa	CA	4,592	150,800	650
Santa Barbara	CA	4,529	346,900	715
Buffalo Grove	IL	4,560	163,600	754
Streamwood	IL	4,571	107,100	891
Newton	MA	4,572	293,400	884
Waltham	MA	4,558	191,100	707
Elmira	NY	4,600	43,600	343
Non-SCC California Average:			\$248,850	\$683
Out-of-State Average:			\$159,760	\$716

Santa Clara: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Santa Clara	CA	5,115	\$270,400	\$779
Fullerton	CA	5,159	234,600	706
La Mirada	CA	5,153	209,700	791
New London	CT	5,152	131,600	526
Lake Worth	FL	5,087	66,900	453
Orland Hills	IL	5,070	152,700	620
St. Paul	MN	5,157	70,900	424
Binghamton	NY	5,106	71,500	361
Euclid	OH	5,122	65,000	434
Parma Heights	OH	5,109	78,700	510
Non-SCC California Average:			\$222,150	\$749
Out-of-State Average:			\$91,043	\$475

Saratoga: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Saratoga	CA	2,344	\$500,001	\$1,001
San Clemente	CA	2,353	308,500	774
San Joaquin	CA	2,324	77,100	442
Tulare	CA	2,335	70,300	427
Jacksonville Beach	FL	2,324	63,400	431
Port St. Lucie	FL	2,341	79,800	639
Gary	IN	2,322	31,700	335
Coon Rapids	MN	2,322	82,500	556
Biloxi	MS	2,359	55,400	331
Chapel Hill	NC	2,342	141,100	489
Reno	NV	2,328	109,600	492
Massillon	OH	2,350	43,600	345
Greenville	SC	2,322	68,700	367
Carrollton	TX	2,364	99,700	542
Everett	WA	2,341	98,000	484
Non-SCC California Average:			\$151967	\$548
Out-of-State Average:			\$79409	\$456

Sunnyvale: Californian and Out-of-Sate Comparisons

City	State	Density (ppn/sq.mi.)	Median Home Price	Median Rent
Sunnyvale	CA	5,354	\$332,700	\$784
Burbank	CA	5,398	262,500	677
Kaneohe	HI	5,393	242,700	845
East Lansing	MI	5,339	97,000	451
Altoona	PA	5,316	31,600	285
Non-SCC California Average:			\$262,500	\$677
Out-of-State Average:			\$123,767	\$527

APPENDIX B

Constitutional Law and the Takings Issue

The Fifth Amendment to the Constitution was intended to protect citizens from government seizure of property. It reads: “. . . nor shall private property be taken for public use without just compensation.” This does not prohibit the government’s ability to seize property all together. There is economic justification for the government to use eminent domain power to take property for providing public goods. For example, if the government were to build a highway, it would need a long corridor of continuous land. This land may be owned by many separate parties, any one of whom might hold out for a large sum of money if the government lacked the power to coerce exchanges with landowners. Such “monopoly holdouts” could cause extreme difficulties (or transactions costs), so such government takings are permissible, provided fair compensation is paid.

Property ownership consists of more than just title to a piece of land, though; property ownership also consists of a bundle of rights, including the right to use, exclude, and transfer title to the property. In *United States v. Causby* (1946), the Supreme Court found that title to a piece of land does not have to be transferred in order to be considered taken under the eminent domain clause. Actions that cause an owner’s use of his property to be restricted in such a way as to decrease the land’s value must be compensated as well. In *Causby*, the operations of a chicken farm (owned by the Causby family) were disrupted by the an airport constructed on a nearby piece of land for the purpose of landing World War II bombers. The noise from the planes made the chickens unable to lay eggs, which rendered the farm virtually useless. Because the actions of the airport removed all value from Causby’s property, the Court ruled they were entitled to compensation.

Similarly, value can be removed from property by laws restricting the use of property. Many restrictive ordinances in Silicon Valley would fall into this category. In *Pennsylvania Coal v. Mahon* (1922), the Supreme Court found that government regulation that removed value from property was essentially an eminent domain taking, and thus required compensation. In 1921, the Pennsylvania legislature passed the Kohler Act, which

outlawed any coal mining that caused damage to surface structures, which effectively prevented mining underneath urban areas. The ownership deeds of surface owners above areas that were being mined, however, had clauses i specifying that mining companies were not responsible for surface damage. The Kohler act transferred value from the coal company and transferred it to the surface owner. Justice Oliver Wendell Holmes, writing for the majority, noted that the Kohler Act was an improper use of police power.

Holmes' interpretation of police power versus eminent domain power in *Pennsylvania Coal* was the correct one. Eminent domain power is used to provide a public good and requires compensation for the taking. Police power, on the other hand, is used to prevent a public bad and does not require compensation. In *Pennsylvania Coal*, there is not a public bad being avoided, so compensation is required.

In later decisions, the court did not necessarily see the distinction between eminent domain and police power; the nine justices became much more accepting of government regulation as police power. Just a few years after *Pennsylvania Coal*, the Court ruled in *Euclid v. Ambler Realty* (1926) that removing value of property through zoning was not a compensable taking. The Court upheld the law, which down-zoned Ambler's industrial property to residential uses only, on the grounds that industry in the area would have been a nuisance to nearby residential property. Traditionally under common law, the kind of nuisances that zoning was designed to prevent in *Euclid* were handled through contracts, covenants, and, in the worst case, litigation between property owners.

In the 1978 case *Penn Central Transportation v. New York*, the Supreme Court upheld a city regulation similar to *Euclid* that forbid Penn Central Transportation from selling the right to erect a skyscraper atop of Grand Central Terminal, which was a relatively low structure compared to surrounding buildings (Fischel 1995, 49). The city's Landmark Preservation Committee designated the structure as a landmark and forbade modifications, and the New York court as well the Supreme Court affirmed their power to do so. Finally, in a case very similar to *Pennsylvania Coal*, the Supreme Court rendered the complete opposite decision. The Court upheld a modern version of the Kohler act in *Keystone*

Bituminous Coal Association v. DeBenedictis (1987).² These decisions demonstrate the Supreme Court's continuing willingness to accept government regulation restricting the use of property.

² The dissenters in the 5-4 decision pointed out that the facts closely paralleled *Pennsylvania Coal*; some suspect that the reason for the differing decisions in such similar cases was the fact that a strike made coal much more valuable in the 1920s, favoring the coal company (Fischel, 28).

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