

The dynamic law and economics of housing affordability

La ley dinámica y la economía de la asequibilidad de la vivienda

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ABSTRACT

This article discusses, from a legal and economic perspective, housing affordability as a key global issue for well-being, economic growth, and political stability. It looks at the misalignment of supply and demand between urban and rural areas as well as the scant legal remedies for price increases. It recommends the implementation of fiscal interventions to redirect demand through teleworking.

Keywords: housing, land use, economic regulation, household consumption expenditure, human capital accumulation.

RESUMEN

Desde un punto de vista jurídico-económico, el documento discute la asequibilidad de la vivienda como problema global clave para el bienestar, crecimiento económico y estabilidad política. Analiza respuestas legales limitadas contra el alza de precios, enfocándose en impuestos y desajuste espacial oferta-demanda urbano-rural. Sugiere intervenciones fiscales para redirigir demanda con teletrabajo.

Palabras clave: vivienda, uso del suelo, regulación económica, gasto de consumo de los hogares, acumulación de capital humano.

1. Introduction

It is difficult to overstate the economic importance of housing, and even to take stock of all the ways it affects economic growth, development, and individual wellbeing. Housing is the single largest household consumption expenditure, making up 33.4% of household budgets in the United States, for example (BLS, 2025). But access to high-quality, stable housing is not only a source of pleasure and enjoyment like

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other forms of consumption; it also influences psychological stress and individual health more generally (Ellen et al., 2002), affecting long-term human capital accumulation and labor productivity. In this sense, quality housing is also an investment in the future labor force.

Because no one can work where they do not have a place to live, housing also plays an important role in structuring the national labor market and the geographic location of economic activity. The last six decades have been characterized by mass urbanization (Ritchie et al., 2025), the relocation of people from rural areas to towns and cities. The economic benefits of these centers of agglomeration, arising from economies of scale and greater specialization, are well known and can yield enormous gains in labor productivity and wages. The ability of labor—just like capital—to move to where it is most highly valued is an essential determinant of economic efficiency and growth. The individual freedom to move is also valuable, as an exercise of autonomy and self-determination.

At the same time, high rents and a lack of affordable housing in major urban centers limit economic growth in cities and discourage workers from migrating to places where they can earn the highest wages and find the greatest opportunities. Recent research shows that cities can be both relatively expensive for low-income workers and relatively cheap for high-income workers, due to housing costs and differences in the bundles of goods consumed by the rich and the poor (Handbury, 2021). In this way, high housing costs can present an intimidating obstacle to moving to places with greater economic opportunity, leading to a misallocation of labor (Hsieh & Moretti, 2021).

Housing can be a barrier to labor mobility for other reasons as well. And the costs of moving are themselves high. Moreover, when homeowners are underwater on their mortgage—owing more on their home loan than the property is worth—homeowners often find themselves economically locked into their current home because moving would require raising cash to pay off the difference. Thus, the way that housing is financed, as well as the overall cost of housing, can limit labor market mobility.

Housing construction itself is an economically important industry that requires costly investments of labor, capital, and land. In 2024, home construction accounted for roughly 4.5% of GDP (BEA, 2025), and it has employed more than 950,000 people in the early months of 2025 (BLS CES2023610001, 2025). And the spillover effects of home construction on the environment are also large, both in operational carbon emissions and in those embodied in the materials used to manufacture housing (Kayaçetin et al., 2020).

In addition to the effects of housing on household consumption, investment in human capital, and labor market frictions, there is also the enormous significance of housing as investment property. For most households, their principal residence is far and away the single largest investment in their portfolio. Home mortgages in the United States were roughly \$13.07 trillion in late 2025 (Federal Reserve Bank of New York - FRBNY, 2025), and one need only to go back as far as 2008 to remember the dramatic effects of housing market downturns on the entire global financial system.

Given the many ways residential real estate is entangled with labor and capital markets, and the economic properties of housing—high fixed costs, concentrated risk, immobility—identifying optimal housing policy is an incredibly complex task that involves balancing competing interests. Of necessity, then, we will consider only one aspect of this complex problem: a summary of the numerous overlapping legal regimes that affect the cost and location of residential housing construction.

And we will highlight the persistent and systematic inability of housing markets to clear because of mismatches in the location and form of housing supply with the location and forms of demand. We will

focus on the legal landscape in the United States, recognizing that there are important similarities but also significant differences in housing economics across countries.

2. Housing Supply

Most residential housing still requires substantial capital and labor investments, making it relatively costly compared with other goods in the economy. Although many sectors of the global economy have seen significant productivity gains over the last century, in the United States at least, construction has conspicuously been left behind.

The Federal Reserve Bank of Richmond reports that labor productivity in the construction sector *fell* by 30% while U.S. economic productivity overall doubled in the last fifty years (Yeh, 2025). This stunning divergence between productivity gains in the United States as a whole and in U.S. construction specifically is almost certainly a large part of the explanation for increased housing costs over time.

There are probably several reasons for declining construction productivity during this time, including the price of materials and labor, but there is growing evidence that regulation is an important driver of the cost of housing.

2.1 Regulatory Costs

In the United States, land-use regulation is primarily under the control of local governments rather than federal or state authorities. The regulations can take many forms. In some places, zoning restrictions limit the kinds of structures and property uses that are allowed in certain areas.

Building height limitations, minimum lot sizes, and restrictions on the number of people who can reside at an address all help reduce housing density and favor large single-family residences. When the only homes that can be built are large single-family homes, lower-income households are unable to afford homeownership, and households that would prefer to live in smaller homes in more desirable areas cannot find them.

Housing experts in the United States have also begun to scrutinize the effects on construction costs of labor, environmental, and labor-market regulation, as well as the often-burdensome procedural hurdles that must be cleared to engage in property development (Klein & Thompson, 2025).

New residential developments often require community consultations and multiple layers of administrative review, which can dramatically extend the time to project completion and increase development costs. Of course, these other regulatory regimes have their own laudable objectives—environmental protection, labor standards, and democratic participation, for example—but given the current shortage of affordable housing, it is urgent to ensure that the costs and benefits of these other regulatory regimes are being properly weighed against the benefits of increased housing production.

2.2 Taxation

In the United States, there are significant tax incentives for housing, but they tend to favor homeownership over renting, and they are poorly suited to the goals of a dynamic, flexible, responsive housing market that can meet the needs of a changing economy.

2.2.1. Incomes Taxes

The U.S. national income tax is the single largest source of federal revenue and is also a key tool for policy and economic planning. Many states have income taxes of their own, but they tend to conform very closely to the federal income tax base (Mason, 2012), taxing mostly the same income and providing the same deductions. In the housing context, the two most significant federal regulatory interventions from the income tax target the use of mortgage debt to finance homeownership and the exclusion of gains from the sale of homes.

Under U.S. federal income tax law, most interest on debt used for personal consumption is not deductible. However, there is an exception for mortgage debt used to buy a principal residence or a single vacation home. This naturally creates an incentive to invest in housing with debt and to purchase—not only a home but also a vacation property—rather than rent. Moreover, the deduction tends to provide greater benefits to higher-income taxpayers because deductions are more valuable to people facing higher tax rates.

The mortgage interest deduction is a poor instrument of housing policy for two reasons. First, empirical evidence shows that the primary effect of the deduction is not to increase the number of people who own their own homes (the purported justification), but to increase the size of the homes people buy (Hanson, 2012).

Thus, it subsidizes greater housing consumption for people who would own their homes anyway (Glaeser & Shapiro, 2003), diverting resources toward building larger homes rather than more homes. Second, the deduction is available for both vacation homes and primary residences. Again, the deduction subsidizes greater housing consumption for those who benefit from it—generally higher-income households—concentrating land and property ownership in fewer hands.

The second significant federal income tax benefit for homeowners is that the gain on the sale of a home—up to \$500,000—is not subject to tax. Again, this tax benefit is more valuable to higher-income households because they face a higher tax rate. This tax benefit encourages selling a home as the gain on the property approaches the \$500,000 limit, leading to more rapid turnover in the housing market.

The exclusion of gain may benefit investments in larger and more valuable properties, since a given rate of return will be larger in dollar terms on a more valuable home, allowing homeowners to more rapidly realize the gains from the exclusion, providing yet another incentive to invest in larger homes rather than more homes.

The mortgage interest deduction and the exclusion of gain on the sale of a principal residence are both tax benefits that target the purchaser/owner of real estate. That is, they are, in a sense, demand factors rather than supply factors.

But supply follows demand, and developers' interest in producing large single-family residences can also be understood as a response to households' demand for such homes. In this way, government tax interventions in the housing market have likely skewed the supply of housing.

2.2.2 Real Property Taxes

Real property taxes are the single largest source of tax revenue for local governments in the United States (Tax Policy Center - TPC, 2024). The tax base for real property taxes is generally the property's assessed value, calculated as the value of the land and the value of improvements.

Despite this seeming simplicity, the tax calculation is typically quite complex, because local jurisdictions often provide a variety of special property tax benefits designed to reduce year-to-year fluctuations in property tax liabilities (Hayashi, 2014), or to favor homeowners, disabled and low-income residents, and other select groups that are deemed worthy of lower property taxes.

In many of the most attractive metro regions in the United States, large rental properties face higher effective tax rates than single-family residences. This skews local land use away from dense rental housing toward single-family homes and condominiums that are unaffordable for many.

For example, in New York City, the effective property tax rate on the smallest residential properties in 2011 was roughly 0.67% while large rental properties face an effective tax rate of 3.31% (Furman Center, 2012).

It is conventional for a real estate tax to impose the same rate of tax on both the value of the underlying land and on the value of any improvements on that land. This means that building larger structures that allow for greater density is just as costly as acquiring additional land, encouraging sprawl.

An alternative to this approach would be to tax land value at a higher rate than the improvements, a so-called "split-rate" property tax system. The extreme end of this approach is to exclude the value of improvements altogether and tax only the value of land. The idea of a land tax has a long history, generally traced in the United States to the writings of Henry George (George, 1884), but actual experiments with land taxation have been relatively rare.

One exception is the state of Pennsylvania, which has long allowed local governments to tax land at a higher rate than improvements. The city of Detroit, Michigan, is currently set to be the first major city to implement land value taxation in the United States (Clanton, 2023).

If this implementation is deemed a success, it may inspire other cities to adopt land taxes as well. But at the current moment, most localities tax improvements, thereby discouraging housing density.

3. Housing Demand

Demand for residential real estate comes from buyers who value the housing as a consumption good because they plan to live on the property, and those who value it simply as investment property. Sometimes these are the same people, but increasingly they are not. For owner-occupants, there are a variety of income and property tax incentives, discussed in the previous section, that increase demand for residential real estate.

Also, as discussed above, the demand tends to be expressed through the purchase of larger homes rather than through the sale of homes to more people. Limiting these tax incentives by raising property tax rates for owner-occupants or by eliminating the mortgage interest deduction and the exclusion of gain on the sale of a principal residence is one way the tax law could be reformed to bring down home prices.

The popularity of real estate as an investment class means that fluctuations in other classes—bonds and equities, for example—can spill over into fluctuations in demand for real estate. In the United States, the seemingly unquenchable demand for dollar-denominated assets, particularly during times of global instability, can drive increased purchases of U.S.-situs real estate and drive-up costs for U.S. residents.

These fluctuations depend on global economic trends and dynamics that are largely beyond the control of individual countries seeking to stabilize home prices. Nevertheless, there are options: capital controls and regulation of foreign investment may be helpful in this regard. A few U.S. states place restrictions on foreign investment in agricultural land, and superstar cities around the globe have adopted rules such as higher property tax rates or outright bans on foreign ownership (Hayashi & Hynes, 2020).

4. Supply and Demand Mismatches

Housing is capital-intensive, immobile, and durable. These economic factors create persistent mismatches between housing supply and demand against the backdrop of changing population demographics and centers of economic activity. Housing built in one location for a particular segment of the housing market—consider, for example, housing built on the coast for a single-family of four—may rapidly become unsuitable when economic patterns, environmental conditions, or demographic-driven demands change over time.

Since housing is durable, the capital and land deployed for one type of housing cannot be quickly redeployed when economic conditions change. In this section, I summarize three forms of mismatch between housing supply and demand.

4.1 Spatial Mismatch

The first form of mismatch is between the geographic location of existing housing and the area where it is in highest demand. One of the most important social phenomena of at least the last 60 years is the well-documented process of urbanization, such that more than half of the world's population now lives in urban areas (Ritchie et al., 2018).

The dramatic increase in the share of the population living in urban areas is most pronounced in upper- and upper-middle-income countries, but the trend away from rural areas toward cities also occurs in lower-income countries (Ritchie et al., 2018). People move more easily than buildings, of course, and so a rapid process of urbanization creates at least a temporary mismatch in the supply and demand for housing, as demand for housing in rural areas falls and demand in urban areas increases.

The same dynamic arises naturally outside the context of mass population movements such as urbanization, with the ordinary rise and fall of the fortunes of specific cities and regions as the economy evolves.

When the industry in one city booms while the industry in another city contracts, households moving to the first city from the second in search of economic opportunity create a mismatch in the supply and demand for housing across regions that can take time—even under the best of circumstances—to reach equilibrium.

4.2 Environmental Mismatch

Another form of mismatch arises from changes in environmental conditions. This is most salient in the case of climate change and the increasing threats to low-lying areas at greater risk of flooding, as well as areas more prone to fire. Areas that were previously in high demand because of proximity to water or forests now face higher insurance costs and a greater risk of property damage from environmental disasters.

Changing environmental risks create not only spatial mismatches but also mismatches in the form and structure of housing supplied and demanded. Over time, we should expect greater demand for homes built from materials that are more resilient to extreme temperatures, water, and other climatic conditions, as well as more efficient in terms of operational energy use.

4.3 Demographic Mismatch

A third form of mismatch arises from the slowly adapting nature of the housing stock and the dynamism of demographic change. Large single-family homes may be suitable for families with multiple children or inter-generational households. But the average household size has declined in most countries over the last 50 years (United Nations - UN, 2019), with well-documented declines in birth rates and an increase in single-person households, so demand for larger homes should also decline.

Trends in immigration can exacerbate or alleviate the mismatch between the supply of homes of different sizes and demand. Immigration of larger households into the housing markets of higher-income countries with a surplus of larger, single-family properties can mitigate the mismatch problem. In contrast, immigration of individuals or smaller households into expensive urban areas can magnify it. There is not much evidence that the global backlash against immigration in high-income countries distinguishes between the effects of these two kinds of migration.

4.4 Policy Responses

What can be done about the supply and demand mismatches that arise from the durable and immobile nature of housing and the economic, environmental, and demographic dynamism that led to more rapid fluctuations and trends in demand for housing?

One category of policy responses that have obtained greater popularity in the United States in recent years is place-based subsidies. Government investments in particular regions—rather than targeted at particular people—that increase wages and quality of life can attract population and redirect housing demand to those regions and away from urban areas that are bursting at the seams.

A second aspect of the spatial mismatch problem can be addressed by making work—rather than people—more mobile. Technological innovations since the COVID pandemic have dramatically increased the feasibility of remote work, allowing for the possibility that a company's employees need not cluster in the same geographic location anymore and shifting housing demand away from the locations of employers to the places where employees would most like to live, and where housing prices may be more affordable. Ensuring that remote work arrangements do not result in increased tax burdens or regulatory costs should be a priority.

A third area for legal innovation involves creating regulatory permission, if not explicit subsidies, for a more flexible housing stock. In terms of adapting to changing demographics, this would mean loosening

zoning and other restrictions on property subdivision and allowing homeowners to rent out portions of their homes without excessive regulatory burdens. In terms of materials and housing construction, this would mean encouraging investment in resilient, adaptable materials, ensuring that insurance markets are sufficiently robust to incentivize the use of new technologies, and conducting research into forms that are robust to changing environmental conditions.

A final challenge to housing affordability arises from housing as an investment category. The free flow of capital into the housing sector is a mixed blessing. To the extent that price signals from rising rents and home prices in high-cost areas can attract greater investment for new construction, the global market for housing is a blessing. At the same time, the variety of restrictions on new construction that inhibit supply-side responses may mean that capital inflows simply bid up prices.

The ideal policy response is to lower regulatory barriers to easier building, but if there are compelling reasons for retaining those barriers or it is infeasible, then there may be a role for protectionist measures as a second-best alternative. Several countries, for example, have adopted taxes and other measures designed to keep foreign investors out of local housing markets (Hayashi & Hynes, 2020).

5. Conclusions

Housing affordability is a global concern with enormous economic implications. The lack of quality, safe, affordable housing is a barrier to economic growth, efficiency, and justice. The fundamental problem with housing affordability is a mismatch between the immobile, fixed, durable nature of housing and the dynamism of a global economy that has only accelerated in recent decades. People move; capital moves; populations age; the natural environment changes; but the housing stock is slow to adjust.

Some of the problems of housing affordability arise from the very real costs of materials and labor required to build quality housing. Only technological innovation can drive down these costs. But legal rules and tax policy often exacerbate the problems of a housing stock that is slow to respond to changing economic conditions. Housing law and policy need to evolve to make housing more adaptable, resilient, and easier to build, while labor and industrial law can alleviate pressure on home prices in urban centers by reducing the powerful incentives to migrate.

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