Housing Affordability, Supply, and Spatial Misallocation

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Abstract

In many cities, policymakers face a twin challenge: housing affordability and housing shortages. To combat this, cities have turned to inclusionary zoning (IZ), where subsidies and tax exemptions incentivize integration of restricted, low-income housing into market-rate buildings. How do these policies change where housing is built, and the neighborhoods they are built in? We study a long-running IZ program in Seattle, showing the trade-off between incentivizing new construction and providing affordability to residents. Policy requirements are the same across neighborhoods, but differences in neighborhood characteristics lead to varied responses to the same incentives. Using policy variation over time and rental micro-data, we show that the program provided significant rent differentials to residents while lowering nearby rental prices. We supplement these empirical findings with a quantitative urban model, where developers choose where and how much to build, and residents choose between units in new construction (both market-rate and low-income) and existing housing stock. Voluntary IZ programs can provide affordability in high-cost areas while spurring development in low-cost areas, with mixed welfare implications.

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