

Houston Business

A Perspective on the Houston Economy

Thinking Hard About Zoning: What Can It Do for Houston?

Houston has long been the only large city in America without zoning. In early 1991, however, the city council passed an ordinance to implement "Houston-style" zoning on a three-year schedule.

As Houston loses its unzoned status, it is important to note that the city is hardly unplanned. For example, it has a planning department and a tough billboard law. Many of Houston's residential areas are subject to deed restrictions. The location of sexually oriented businesses is strictly regulated, and traffic controls limit the means of entrance or exit to any building on public streets.

All these controls, some substituting for the missing zoning law, leave Houston looking remarkably like other American cities. A zoning proposal is simply one more tool for the control of the local land market. This article presents a brief analysis of the costs and benefits zoning might bring to Houston.

Zoning is the arrangement of economic activity within a community into districts that separate non-conforming uses. Zoning prevents the spillover into residential areas of noise, pollution, traffic and other intrusions from industry and commerce. If these intrusions are not controlled, they can damage the urban land market and divert land to inefficient uses. The economic rationale for zoning is to protect the urban land market and to restore free enterprise as an effective guiding force. Zoning joins other land-use controls (such as building and housing codes, nuisance laws, street ordinances and architectural controls) as one of many tools available to protect the land market.

The perspective offered here is that of an economist. The concept of zoning as a means to

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restore power to the urban land market will be foreign to most planners. City planners are more likely to view zoning as a tool for implementing a comprehensive plan to subjugate untidy entrepreneurial activity in the land market. There is already a chorus of complaints that Houston zoning is proceeding without such a plan. This article assumes Houston-style zoning benefits from less planning and an improved and functioning land market.

AN EXAMPLE

This example may help bring important issues into focus. A landowner is offered \$50,000 for land located near a residential neighborhood. A developer wants to build an 11-story office tower on the land. The only alternative use for the land would be as single-family lots valued at \$20,000. If the office tower is constructed, the value of 15 nearby homes will drop \$1,000 each because of unsightliness, increased traffic and related effects.

How is the law written? Must the developer seek community permission? If so, the homeowners will initially block construction. However, suppose the landowner offers compensation, such as a park, greenbelt or new community center worth \$15,000. With homeowners compensated for losses, the deal goes forward; the \$30,000 profit on the land parcel is effectively split between landowner and homeowners. Alternatively, does the law favor unrestricted development? If so, the office tower simply goes up, and the landowner pockets a \$30,000 profit, with homeowners uncompensated for their losses.

There are three lessons here. First, the most efficient outcome would be to build the office tower (\$30,000 land profit–\$15,000 homeowner losses). No matter how the law is written, the efficient use wins and the tower does go up. If we were to change the homeowner losses to, say, \$3,000 each, the efficient outcome is *not* to build; based on our assumptions, construction is stopped under either legal arrangement.

Second, the allocation of development rights between landowner and homeowner determines the division of gains and losses between landowner and homeowner. In fact, law and custom strongly favor development rights vested in the community, and—with or without zoning—the legal rules governing development will typically favor the homeowner.

Third, note how the project benefits the landowner in the form of profit. The focus of zoning and other land use regulation on simply preventing homeowner property losses can forestall valuable projects.

DOES ZONING MATTER?

The conventional wisdom in economics concerning the effect of zoning is that zoning doesn't matter. Although the conclusion is generally simplistic and often rendered too quickly, there is good reason to question the value of creating broad zones to separate nonconforming uses. Most of the effects that zoning seeks to cure are geographically focused at neighborhood levels. Also, once the analysis moves to the neighborhood level, we find that nonconforming uses often create both bad and good effects; zoning's broad emphasis on simply preventing the bad may often throw the baby out with the bath water.

A common feature of most zoning studies is the hedonic price index that assumes the value of a house can be represented as the sum of its characteristics, such that

$$\begin{aligned} \text{house value} = & a(\text{number of rooms}) \\ & + b(\text{lot size}) \\ & + c(\text{miles to employment}) \\ & + d(\text{how zoned}). \end{aligned}$$

This is a simple example, and actual studies include far more detailed characteristics, such as garages, flooring, exterior-type and proximity to schools and shopping. If $a = \$5,000$, it simply means that an additional room adds \$5,000 to the value of the house. The coefficients are estimated using standard statistical techniques and data on local housing.

The coefficient d has been the focus of a number of studies. If zoning "protects property values" as its proponents claim, then the coefficient d should be larger for highly restricted zones. Many cities implement *cumulative zoning*, with a hierarchy of land uses from highest (single-family residential) to lowest (heavy industrial), with intermediate categories, such as apartments and commerce variously ranked between. Higher uses are also allowed to intermingle with uses of lower value. So, we can find single-family housing in commercial or industrial zones. If zoning works, housing in exclusive zones should be worth more than housing mixed with nonconforming uses, and $d > 0$. Surprisingly, $d = 0$ in studies of Pittsburgh, New Haven, Vancouver and Rochester. The New

Haven study encompassed 16 different case studies of nonconforming uses—commercial strips, industry, apartments and others—and researchers were forced to conclude that these nonconforming neighbors had no systematic effect on nearby housing prices.

Conflicting results arise, often in suburban area studies, that find $d > 0$. The conclusion that zoning is irrelevant to housing values is often drawn too quickly. Still, there are lessons to be learned from asking why these urban studies fail to detect zoning effects.

Lesson One: A sorting process may occur among residents so that those less sensitive to a nonconforming use locate nearby. This is probably most true in urban neighborhoods: an urbanite who owns no auto and a suburban homeowner will take different views of a grocery store to be built nearby.

Lesson Two: Many of the externalities zoning seeks to cure are highly localized, not pervasive. One study of participation in zoning hearings in suburban Chicago found the probability that a resident would participate fell sharply with distance, and fell by half for every 80 feet of distance from the nonconforming use. Many such localized differences will be resolved through negotiations in situations similar to our office-tower example. There, property losses arose from the nonconforming use but were offset by compensation in the form of a park or greenbelt. This compensation is capitalized in the housing value.

Lesson Three: Consider the case of an actual 11-story office tower built in North Dallas near a small residential neighborhood. A study of the effect on the neighborhood indicated losses in property values for homes located 1,000 meters or less from the building, with losses declining quickly with distance. Less expected were the *increases* in property values for homes 1,000 to 2,500 meters away; the proximity of a significant, nearby employment center enhanced their value. In fact, for the affected area as a whole, property values rose 1.2 percent. Similar positive externalities are frequently found in conjunction with such nonconforming uses as shopping centers and freeways.

In effect, the negative effects of nonconforming uses are often offset by a process of selection, by neighborhood mediation and by often-overlooked positive benefits from nonconforming uses. With those micro-neighborhood effects at work, the creation of broad zones may become counter-productive or irrelevant.

ZONING AS A LEGAL RULE

Our example showed the distribution of gains and losses from land development affected by how land development is legally governed. The possibility of unrestricted development, in which large, uncompensated losses are inflicted on nearby homeowners, will not sit well with most readers. Also, the example raises the possibility that landowners and developers could extort money from homeowners simply by threatening to build nonconforming uses nearby. Because of these problems, both the legal and the economic literature fall squarely on the side of community and homeowner control of the development process.

Taking control of land development does not require zoning, however. Nuisance laws, building codes and deed covenants can fill a similar role. If adopted, however, zoning does hand a great deal of power to the community. Zoning is a partial taking of property. Property rights include the control of property, the right to income from property and the right to sell the property. Zoning withdraws part of the control of the property and passes it to the community. Under the typical zoning ordinance, the property owner is not entitled to compensation; the zoning rule must show only a reasonable link to public health, safety, morals and general welfare; constitutionality is presumed, and most courts are very reluctant to review a zoning decision.

How well does the community use this power to zone? Zoning's history in America suggests that zoning is difficult to control. Because zoning creates value, it is susceptible to corruption and political abuse. New York City was the first major city to implement zoning, and it soon became the home of the first major zoning scandal. Further, zoning tends to create a bureaucracy with a vested interest in the perpetuation and expansion of the practice.

Zoning inherently brings a middle-class perspective to urban problems, as it passes power to the median voter. The result is far less intensive land development with larger lots, more single-family housing, and less room for the poor or disadvantaged. Planned communities like the Woodlands, Friendswood and Kingwood are wonderful places to live; they are completely inadequate, however, as a model for urban diversity.

Employment data continue to show that Houston's growth is stagnant. Job losses among local oil and gas businesses bottomed out in recent months, and the pace of announced layoffs among both energy and nonenergy companies has slowed. There is still no stimulus from national markets, however, to get Houston back on a positive track.

RETAIL AND AUTO SALES

Back-to-school sales were described as meeting expectations but little more. Otherwise, the retail business is very lethargic, with most retailers fortunate to be matching last year's performance. The axiom in retailing is that Christmas sales are a reflection of the year leading up to it, and the flat economy is probably weighing on preparations for the holiday season.

Auto sales turned a little weaker in August, after a very strong showing in July. The August sales fell 3 percent behind those of last year, but year-to-date sales are still running 5 percent ahead of last year. Houston's sales of vans, light trucks and sport utility vehicles account for almost all the 20-percent increase posted in year-to-date sales. Fleet sales have remained typical of past years.

ENERGY PRICES

The recent surge in natural gas prices has been dramatic, as spot prices of \$1.05 per thousand cubic feet last February have been replaced by an October futures contract that shot well above \$2.50. The strong price response to Hurricane Andrew has revived hopes that the natural gas glut may be ending; weather-related factors still dominate the price situation, however.

West Texas Intermediate crude, which averaged \$21 per barrel through the second quarter, is now slightly higher, and some respondents think \$23 to \$24 per barrel is possible in the fourth quarter. Strains on OPEC will grow next year, with or without Iraqi production on the market, as Kuwait and Iran add new production capacity. Prices seem likely to drift lower in 1993.

The rig count has improved in recent months but has sustained little more than normal seasonal increases from a very low level of activity.

Natural gas drilling has moved to the forefront of drilling activity, with as many as 150 rigs now drilling for tax subsidies in tight sands formations. Respondents from oil service companies seem to feel that the bottom has passed and next year will be better.

DOWNSTREAM ENERGY

Gasoline inventories were at record highs when Andrew struck, and little impact was felt on prices. Low gasoline prices and flat input prices have left margins weak. Price increases of 3 cents to 5 cents per gallon can be expected in the fall as oxygenated fuels are mandated for 40 cities.

Chemicals volumes are reported to be off, particularly for propylene. Sales of propylene, a heavily exported chemical, were hurt in August by the normal vacation season in Europe plus very weak sales to the Far East. Prices remain weak, and the normal seasonal increase of feedstock prices came early this year. The result is continued poor margins for commodity petrochemicals.

PAPER AND LUMBER

Demand for corrugated boxes remains very strong. Building products were helped by Hurricane Andrew, but nice gains were evident before the storm. Respondents said shortages of roofing plywood were delaying construction and roofing repair throughout the Houston area.

SINGLE-FAMILY HOMES

Listings of existing homes this August ran even with those in August of last year, after running well ahead of last year earlier in the summer. Year-to-date listings are still nearly 3 percent higher than last year. Many of the new listings are not vacant, and many contingent sales are reported, both indicating that lower interest rates may have interested homeowners in moving up. Refinancing is reported to be tailing off at local title companies.

For the first eight months of the year, starts and sales of new homes are within a percentage point of last year. The market has improved since weakening in early summer. Completed speculative homes on the ground have fallen all year, from 800 early in the year to only 500 at midyear.

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