

# Removing Regulatory Barriers: One City's Experience

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Despite the recent boom in housing construction in the United States, affordability concerns continue to multiply. In 2005, the National Association of Homebuilders reported that overall housing affordability had reached the lowest level since its Housing Opportunity Index was created in 1992, with only 43.2% of all new and existing homes sold in the country being affordable to median income families (NAHB 2005). Among renters, particularly low and moderate income families, the numbers are even more grim. In 2003, 24% of all renters paid more than half of their incomes for housing (U.S. Bureau of the Census 2005).

In addition to the stagnant incomes experienced by many American households, one of the major contributors to unaffordable housing is government regulation. While no precise number exists, a variety of studies suggest that unnecessary government regulation adds between 10% and 25% to the cost of housing construction in the United States (Schill 2005). Among the regulations that are the greatest contributors to high housing costs are stringent zoning laws, cumbersome environmental reviews and unnecessary building code requirements. Making this problem worse is the fact that as the complexity and stringency of government regulations increase, so typically does the time required to administer the rules and the opportunities for government corruption.

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<sup>1</sup> As will become apparent to the reader, the author of this paper is not merely a disinterested observer. From 1999 until 2004, I was a participant in efforts to promote deregulation in New York City in my role as Director of NYU's Furman Center for Real Estate and Urban Policy and as a member of a variety of government task forces and nonprofit housing organizations.

This paper discusses one city’s efforts to reduce regulatory barriers. The difficulty of developing housing in New York City is as legendary as its cost. The city has had a vacancy rate under 5% — the legislative threshold defining a housing “emergency”—for more than 55 years. More than one commission or blue ribbon panel has identified government regulation as one of the primary causes of the housing problem. Since 2000, however, an opportunity presented itself to finally make some progress in reducing the cost of housing construction. Removing regulatory barriers to housing development caught the interest of two mayors—Rudolph Giuliani and Michael Bloomberg—and their respective housing commissioners.

New York’s experience over the past five years is instructive to cities around the nation. In some respects—such as the rezoning of land for residential uses—major progress has been made. In others—such as the reform of local building codes—reform has been slower to achieve. New York City’s experience also shows that deregulation does not follow a linear pattern. Instead, as development increases, a backlash could well set in. In New York, the same mayor who trumpeted the removal of regulatory barriers has supported new zoning restrictions that will have the effect of reducing or eliminating the possibility of new housing construction in several neighborhoods.

### New York’s Housing Demographics

New York City is a city of renters. According to the 2002 Housing and Vacancy Survey, 67% of all New Yorkers are tenants. The rental market is a tight one with the current vacancy rate lower than 3%. The median rent-to-income ratio for all renters in

the city is 26.5%, a statistic that is not terribly out of line with other large American cities. What is somewhat surprising, however, is that the number is not lower than most cities. For years, New York City has been at the forefront of American cities in intervening in the housing market. The city's stock of public housing is, by far, the largest in the nation, exceeding 180,000 units. Tens of thousands of additional units receive subsidies under various federal programs such as Section 8, Section 236, or the Low Income Housing Tax Credit, and 102,000 households are subsidized with housing vouchers. Furthermore, the city spent well over 5.2 billion dollars between 1987 and 2001 building or rehabilitating over 200,000 units of housing, primarily for low and moderate income households. Finally, over 156,000 units of housing are rent-regulated.

Some have argued that this intervention in the housing market, itself, has caused the persistent housing shortage in New York City (Salins 1999, Salins and Mildner 1992). While this assertion may have been accurate twenty or thirty years ago, it is hard to believe it is true today. Following World War II, New York retained a rent control ordinance that strictly capped rents at very low levels. Rent control clearly had the effect of constraining supply in two respects. First, real estate developers were fearful that although new construction was exempted from rent control, a future legislature would bring newly built dwellings within its ambit. This fear was realized in 1969 when the city enacted its rent stabilization law. Second, it is quite clear that the strict caps on rent the city enacted led to disinvestment and ultimately the abandonment of housing in the 1960s and 1970s (Downs 1996).

It has been decades since the last expansion of rent regulation. Indeed, in 1997, the New York State Legislature actually further limited the scope of rent regulation. Old

fashioned rent control applies to an ever dwindling number of units—only 59,000 in 2002. The more recently enacted statute—rent stabilization — applies to over 1 million units and provides for regular increases in rent. Furthermore, new development is exempted from regulation. It is also unlikely that New York’s investments in housing have had the effect of driving up the cost of housing by crowding out the private sector. First, the city has experienced a tremendous increase in population over the past twenty-five years as population swelled from 7.1 million people in 1980 to an estimated 8.1 in 2003. The housing that New York subsidized satisfied only a small part of this increased demand. In addition, many of New York’s development programs actually catalyzed neighborhoods in which no market for housing existed. Today, these neighborhoods are bustling with new housing development—market rate housing as well as subsidized homes (Ellen et al 2004).

#### Removing Regulatory Barriers in New York City (1999-2000)

In 1999, NYU’s Furman Center for Real Estate and Urban Policy was approached by the New York City Partnership and Chamber of Commerce to conduct a study of why the cost of housing development was so high in New York. The Partnership is one of the city’s most important civic organizations and is composed of the leaders of most of the large financial and business institutions. Since the mid-1980s, the Partnership had been interested in housing, primarily as the sponsor of one of New York’s most innovative housing programs that built two and three family homes for purchase by moderate and middle income families (Ellen et al 2001). In 1999, the Partnership’s leadership became convinced that the future economic vitality of New York City was imperiled by spiraling

housing prices that proved unaffordable not just to low income families but to teachers, firemen and mid-level managers.

Housing policy in New York City would certainly be identified as among the most politically sensitive and volatile issues facing the city. The city is home to a number of housing advocacy groups representing both landlords and tenants. Annual battles over the establishment of rents —often with police intervention to maintain order—virtually guarantee polarization. The Furman Center was an appropriate entity for a study into this sensitive set of issues for a number of reasons. The Center is part of New York University, an educational institution with an excellent reputation in the community. The Center’s staff assiduously maintained a nonpartisan and unaligned position while at the same time it engaged in a variety of housing organizations and conferences. Finally, the Center had a successful track record of working with the city’s housing agency on major projects including the development of an early warning system for abandoned housing. The hope of the sponsors of the study as well as the researchers was that recommendations would emerge with widespread appeal and credibility.

The Cost Study, as the project was soon named, comprised two major pieces of research. The first was to assess how much more expensive it was to build in New York City than other comparable cities and why. To do this, the study’s authors—which included the director of the center, a former deputy commissioner of the city’s housing agency and a former high-level staff member for the Manhattan Borough President—collected both secondary and primary data. The secondary data was from R.S. Means and Co., a company that produces standard reference information on construction costs in major American cities. These data showed that the cost to build a 1 to 3 story building in

New York City—\$69.50 per square foot—was the highest in the nation, fully one-third more than the median for all 21 cities in the study.

Because the R.S. Means data did not provide detailed breakdowns that would permit the researchers to analyze which elements in the construction process were generating the highest costs, primary data collection was employed. New York City would be compared with a small set of “control” cities. Through a long process, three cities were selected—Los Angeles, Chicago and Dallas. The expectation was that New York would be comparable to the first two cities and significantly lower than the third because of the differential power of labor unions (Texas is a “right-to-work” state). Detailed architectural renderings of three housing types—townhouse, mid-rise and luxury high rise—were created. A cost estimator was employed to provide the cost of construction of each type in each city.

The results were roughly as expected. The cost of construction in New York City was the highest, between 3.5% and 9.5% higher than Los Angeles and between 10.2% and 10.9% more than Chicago. The cost of building in New York City was between 21.7% and 29.3% more expensive than Dallas with much of the difference, as expected, reflected in labor costs.

The second part of the research project set out to determine why the cost of construction was higher in New York City than these other cities and what might be done to reduce the cost. The method employed to obtain this information was interviews with over 100 housing developers, government officials, bankers, attorneys and academics. The final report included over 60 separate recommendations. As an afterthought, and at the behest of the then President of the New York City Partnership, an effort was made by

the authors to estimate the impact that adoption of these recommendations would have on the ultimate price of new construction. This estimate suggested that if all the proposals were adopted the cost of housing construction could be reduced by between 18.8% and 25.1%. Additional savings would accrue from increased supplies of developable land as previously unavailable sites were rezoned or brownfields remediated.

*Reducing the Cost of New Housing Construction in New York City* (Salama, Schill and Stark 1999) was released in 1999 and was featured in a front page story in the New York Times (Hevesi 1999) as well as other media. Interestingly, albeit possibly predictably, the number that was cited the most frequently was the 25% reduction in price that could be achieved by adoption of the study's recommendation. Between 1999 and 2001, the authors of the study publicized the study's recommendations by widely appearing on scores of panels and authoring op-ed columns. Meetings were held with government officials, yet months after the report's publication very little in terms of policy change had actually taken place.

In 2001, this began to change. Mayor Giuliani, nearing the end of his second term of office, had decided that he wanted to make a major financial commitment to housing. Upon coming face-to-face with the cost of this investment, the Mayor asked his housing commissioner to look at how to reduce its expense. The housing commissioner, a supporter of deregulation, brushed off the Cost Study and gave it to the mayor to read. A few weeks later, Mayor Giuliani gave his annual State of the City address (Lambert 2001). Brandishing a copy of the Cost Study in one hand, he offered the City Council a quid pro quo. If they adopted regulatory reform he would invest an additional \$600 million in housing.

Nevertheless, in the days preceding 9/11, Giuliani was a fairly unpopular lame-duck and never was able to devote the time or energy to push regulatory reform through the City Council. Despite this, the idea had gained some currency and publicity and would soon gain political support. In 2000, a citywide umbrella organization called Housing First! was created by several foundations and banks in New York City to promote housing among each of the mayoral contenders. The initial goal of the organization was to influence candidates to commit themselves to spending \$10 billion for housing. However, as the campaign season heated up Housing First! also adopted many of the proposals in the Cost Study. Ultimately, regulatory reform became part of each mayoral candidate's platform.

In November 2001, Michael Bloomberg won the mayoralty in an upset. Bloomberg, who had made a fortune in business, was no doubt comfortable with the notion that government regulations could impede markets. In his first address to the New York City Housing Conference he outlined his plans for housing, which included the rezoning of several neighborhoods, coordinated disposition of city-owned land, streamlined approvals from the Department of Buildings and adoption of a new model building code.

The remainder of this paper will examine two of the most important areas of reform to which the mayor committed himself—building code and zoning reform. The information and conclusions set forth here were largely obtained as a result of a 2005 update to the Cost Study undertaken by the Furman Center and funded in part by a grant from the Fannie Mae Foundation (Salama, Schill and Springer 2005).

## Building Code and Building Department Reform

The Cost Study identified the New York City Building Code and the New York City Department of Buildings as barriers to housing development. New York City's Building Code was characterized in the study as "stringent, voluminous, detailed, complex, cumbersome and arcane." The Code, which was first adopted in 1850, has not been substantially overhauled since 1968. New York City is one of the few large cities in the nation that does not use a uniform building code such as the International Building Code (IBC). The Cost Study identified several problems with the current code: (1) its complexity led to differing interpretations and lengthy permitting processes; (2) its idiosyncratic nature caused developers from outside New York City not to bid on jobs, thereby reducing competition and increasing the cost of construction; (3) it did not permit the use of new and efficient technologies that could significantly save money; and (4) the process utilized to approve new materials was cumbersome and politicized.

One example illustrates many of the flaws in the existing code. The current Building Code does not permit the use of plastic pipes in buildings over three stories despite the fact that they are commonly used in other jurisdictions. The reason typically given for this is that pipes might melt in a fire, giving off toxic fumes. Most observers, however, reject this argument as contrary to fact and instead believe the real reason is that plastic pipes are lighter and easier to install than metal pipes, thereby requiring fewer unionized plumbers.

The Cost Study recommended that the city adopt a uniform building code with appropriate modifications to reflect the high density nature of New York City's real

estate. Not only would the new code wipe away decades of special interest encrustations, but it would also provide a way for the code to be regularly updated by panels of experts.

The problems of the New York City Building Code contributed to and were exacerbated by flaws in the New York City Department of Buildings (“DOB”). The inefficiency of the DOB, characterized by the lack of a skilled workforce and an absence of automation, generated extremely long delays in permitting. This substantially increased the cost of building in several ways. First, time delays generated uncertainty and cost developers money as a result of mounting carrying costs. Second, many developers felt it necessary to hire expeditors to handle the paperwork and move projects through the DOB bureaucracy. Finally, the complexity of the process and the delays at the DOB contributed to a series of scandals as inspectors were prosecuted for accepting bribes. The Cost Study contained a number of proposals for DOB reform including increasing automation, improved customer service and the periodic publication of performance-based indicators such as the time it takes to obtain a building permit or certificate of occupancy.

Upon taking office in 2002, Mayor Bloomberg committed himself to overhauling the DOB and adopting a model building code. He appointed a new Commissioner who within two months of taking office was faced with a scandal involving 19 of 24 plumbing inspectors. She immediately began a reorganization of the department, invested in technology, increased manpower and circulated a code of ethics. The 2005 update to the Cost Study found that while many of these innovations have been implemented, their impact on project delays is yet to be ascertained. Problems still remain with the culture of the workforce. In many instances, although the tools exist now to expeditiously

complete inspections and grant permits, officials in the agency are reticent to make decisions for fear of making mistakes and being investigated. In addition, a lack of coordination still affects several of the divisions in the DOB.

Progress has also been made in adopting a uniform building code. In 2002, the Mayor appointed an advisory commission to consider the adoption of the IBC, together with appropriate modifications to accommodate the special needs of development in New York. The Commission ultimately decided to recommend the use of the IBC as a baseline code. Over the past three years, thirteen technical committees comprised of architects, engineers, government officials and representatives from the labor, construction and real estate communities have worked to extensively review every major provision and, in most cases, have reached consensus on modifications.

Nevertheless, the process of code adoption has unsurprisingly run into some difficulty in the City Council. At a 2004 hearing, the Commissioner was grilled by Council members on the proposed adoption of the IBC. Following her testimony, the Council heard from members of the plumber's union who were critical of the proposed code. As one of the leaders testified, "We hold in our hands a living document, passed down from those who came before us." (Vitulo-Martin 2005).

Underlying the current debate is the question of which model code the City of New York should adopt. The current administration and its advisory committee is proposing the IBC. Most members of the Council and the city's union movement support a competing code promulgated by the National Fire Protection Association (NFPA). One of the key differences between the two codes is how each would be updated. The IBC is updated every three years by the International Code Council which is comprised of code

enforcement officials. Updates to the NFPA code, on the other hand, are voted on by tradesmen and union leaders as well.

### Zoning and Land Use Reform

One of the most important contributors to the high cost of new housing construction in New York City is the cost of land. New York City is largely a built-out city; very little land is vacant and some of that land is not in areas that would be desirable for housing. Therefore, most new housing will have to be infill housing or housing built in areas that heretofore were not residential in character.

The Cost Study identified the city's zoning ordinance as a major culprit in high land costs. Like its building code, New York's zoning resolution is extremely outdated. Enacted in 1961, it is based upon principles that are no longer widely accepted, such as "towers in the park" planning and the strict separation of residential and industrial uses. As the city grew and changed, the City Planning Commission adopted special districts to create flexibility. Today, the city has over 34 special zoning districts, each with its own peculiar and difficult-to-navigate set of rules and requirements.

The second problem is one of density. Although much of New York's infrastructure is aging, it is still among the best in the nation and maybe the world. Many areas in the city are currently zoned inappropriately and could absorb higher density development. However, the process of rezoning is time-consuming and filled with uncertainty. Rather than being able to quickly meet market demand, housing developers have to run the gauntlet of certification by the Department of City Planning, possibly including the preparation of expensive environmental impact statements. Upon meeting

the requirements of the city's environmental rules, the proposed rezoning begins the Uniform Land Use Review Procedure (ULURP) in which it is considered sequentially by the appropriate Community Board, the Borough President, the City Planning Commission, the City Council and then the Mayor. Then, of course, the city's action may be challenged in court, typically on the ground that it failed to follow all of the procedures required under the law. While much of the litigation has no merit, it is effective in delaying the project—often by several years—and adding to the cost of development.

The third major shortcoming involving zoning and land use that the Cost Study identified was the strict separation of uses. Despite the fact that the New York had lost much of its manufacturing base since enacting the 1961 zoning ordinance, the proportion of land in “M” zones had not been correspondingly reduced. Much of this land remains either vacant or underutilized. Not all of the land zoned for manufacturing would be appropriate for housing. Some of it is contaminated; some needs brownfield remediation. Other areas are thriving industrial parks. Nevertheless, a significant portion of the land, particularly what could be prime land on the Brooklyn waterfront, is desirable for housing. But before this may happen the area needed to be rezoned.

The Cost Study recommended a number of changes to New York City's zoning and land use regulations and practices. First, the authors suggested that the Mayor appoint a commission to comprehensively overhaul the existing zoning resolution. Once the city's blueprint was changed to accommodate future growth, development would be able to occur “as of right,” with little or no need for rezonings and the cumbersome and costly process of land use and environmental reviews. Failing an overhaul of the zoning

resolution, the Cost Study recommended that significant parcels of land zoned for manufacturing uses—particularly along the Brooklyn waterfront—be rezoned for residential uses. Additional recommendations provided for expedited review for projects containing significant amounts of “affordable” housing.

Ultimately, the proposal for a major revision of the zoning resolution was never seriously considered by either the Mayor or the City Council. As of right zoning, while sensible in principle, would lead to a reduction in influence for members of the Council, the borough presidents and local community groups. Perhaps sensing the mood of people living in the boroughs outside of Manhattan, even the real estate industry was leery of a process that could open up areas to downzoning as well as upzoning. In addition, neither the city nor the state has seriously considered proposals to streamline environmental or land use review processes.

Instead the city continued the process of piecemeal zoning changes to the existing resolution. The most ambitious efforts involved the rezoning of manufacturing zones to permit residential uses. Certainly, the most ambitious effort took place in the contiguous neighborhoods of Williamsburg and Greenpoint on the Brooklyn waterfront. These neighborhoods, with sweeping views of Manhattan, were already the home of illegal conversions of manufacturing lofts to residential dwellings. The city proposed to rezone the areas to permit significantly higher density use.

Before the City Council approved the Williamsburg/Greenpoint rezoning it would first be necessary to reach a compromise with Mayor Bloomberg on the issue of affordable housing. The announcement of the plan to rezone the neighborhood engendered demands from neighborhood residents and their City Councilman for an

inclusionary zoning ordinance that would require housing to be reserved for low and moderate income households. The city at first opposed any use of inclusionary zoning and then relented by proposing a voluntary inclusionary zoning ordinance. Allowable densities were reduced from a 4.3 floor-to-area ratio to 3.7, with an option to increase it to 4.7 if the owner set-aside at least 20% of the units for households earning less than 80% of median income or 25% for families earning between 80% and 125% of the median.

As they have in many cities on the east and west coasts, real estate values have skyrocketed in New York City over the past five years. Partly as a result of this, the pace of new construction has increased dramatically. In 2004, 25,200 units of housing were authorized by building permits compared to only 15,020 in 2000. The number of building permits issued in the first nine months of 2005 already exceeds 23,500. Development pressures have been felt in virtually every corner of the city.

In response to these pressures and the desire of community residents and their elected representatives to preserve lower densities and reduce congestion, the Mayor has supported a surprising number of downzoning actions in the boroughs outside of Manhattan. The first downzoning occurred in Staten Island, followed by others in Morris Park, Bayside and Throgs Neck. From 2002 to October 2005, 42 rezonings “to preserve neighborhood character” have taken place involving over 3,600 blocks (Scott 2005, B1). Most of these downzonings have not accompanied by increases in densities nearby.

## New York City and the Possibility of Meaningful Reform

Removing regulatory barriers to housing is an idea that has much to recommend it. In a world of limited public subsidies for housing, there is something both logical and irresistible to the notion that government rules that impede housing construction or raise its cost are wasteful and immoral. Although careful econometric studies have not yet documented the effects of many types of regulations on the cost of housing, what we do know, primarily about zoning and land use regulations, suggests that the savings could be substantial (Schill 2005).

The federal government has found it difficult to promote reform because most of the regulations that affect housing are not promulgated in Washington but in thousands of municipalities throughout the nation. Efforts by the federal government to rein in state and local regulation have largely been of limited effectiveness. For example, in 1991, President George H. W. Bush appointed the Advisory Commission on Regulatory Barriers to Affordable Housing. The ensuing report of the Commission, aptly entitled, *Not in My Back Yard: Removing Barriers to Affordable Housing*, contained a number of useful recommendations. In particular, the Commission proposed that if states fail to adequately police their municipalities they would lose their ability to issue tax exempt bonds and allocate tax credits. Congress never adopted this recommendation and instead legislated to (1) require municipalities to prepare comprehensive housing affordability strategies that would include analyses of whether their regulations negatively affected affordability; (2) create a regulatory barriers clearinghouse where information could be exchanged and (3) provide seed money for some barrier removal initiatives.

The current Bush Administration has made removal of regulatory barriers a cornerstone of national housing policy. HUD has established a departmentwide initiative, America's Affordable Communities Initiative, to tackle the problem. Thus far, HUD has set aside funds for research on regulatory barriers and sought to build coalitions to address the problem. More tangibly, in 2004, the Department published a Federal Notice announcing its intent to include in most of its competitive fiscal year 2004 funding opportunities a series of questions on the local regulatory environment. Applicants for HUD funds have an opportunity, if they desire to respond to these questions; those applicants who meet the requisite minimum criteria for regulatory reform can receive additional "points," which can assist them in the competitive selection process. It is unclear, at this point, how much of an effect any of these efforts have had.

In recent years, a number of states and cities have shown renewed interest in the issue of regulatory barriers. For example, several jurisdictions have sponsored studies that outline strategies for barrier removal (Colorado Department of Local Affairs, 1999); Commonwealth of Massachusetts, 2000, Salama, Schill and Stark 1999). A few have even implemented proposals. For example, California, Florida and New Jersey require municipalities to plan for affordable housing. Other states have taken steps to expedite permitting procedures for affordable housing or to exempt some affordable housing projects from environmental impact requirements.

Nevertheless, most states and municipalities continue doing business as usual. Regulatory barriers abound and may even be intensifying in some jurisdictions under the banner of smart growth. The persistence of regulatory barriers in the United States, despite the prevalence of rising housing prices and extraordinary rent-to-income burdens

among many renters, can be explained by many factors. The simplest and most important of these factors is that in our federal system, states have traditionally vested the police power in municipalities. Because each city or town pursues its own parochial interest, it is not forced to consider the cumulative impact of regulation on housing in the metropolitan area or region. Indeed, each municipality has a strong fiscal incentive to erect regulatory barriers to avoid tax increases to pay for needed services. In addition, direct participation by citizens tends to be most intense and effective with respect to local governments. Many existing residents would prefer to avoid development because they want to preserve the status quo, are concerned about congestion, or want to maintain racial or economic homogeneity.

New York City's experience suggests that even a city with a pro-development mayor and which faces a perennial housing shortage may find it difficult to act consistently in removing regulatory impediments to housing. In addition to support from the business community and mayor, reform was also supported by housing advocates, a constituency that is usually oddly indifferent to discussions of regulatory barriers. There can be no denying that significant progress has been made in rezoning obsolete manufacturing sites for housing, an action that could in itself lead to the construction of thousands of units of housing. In addition, slow but steady progress has been made in reforming the Department of Buildings and the city's outdated and idiosyncratic building code. Only time will tell whether these reform efforts will bear fruit.

Ultimately, the ability of a city to reduce the regulatory barriers it has erected is largely dependent upon the particular constellation of interest groups arrayed for and against the proposed changes. In New York City, the fastest progress was made in

rezoning manufacturing areas for residential use. These were neighborhoods where very few people lived. In addition, manufacturing interests in the city had long since lost political power and sensible people had also stopped listening to community advocates who argued for years that blue collar jobs would miraculously reappear if the land were held vacant.

More fundamental zoning reform ran afoul of the powerful political forces that have an interest in the status quo. The entire concept of “as of right” zoning is anathema to a wide range of people from community and environmental activists who use regulations and the possibility of costly litigation to extract benefits from developers to politicians who want to exercise control and potentially do the same in return for their support. While New York City’s experience demonstrates that some change is possible at the local level, the modesty of its achievements reinforces the need for reinvigorated efforts by the state and nation.

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