(Note: the following post was co-authored by U.C. Davis School of Law Professors ***Chris Elmendorf*** *and* ***Darien Shanske****; the white paper discussed in the post is their work product.)*

California's housing policies–a topic that for years received precious little attention from state officials–has suddenly become the Golden State's hottest political and policy issue. The California Legislature passed no fewer than 15 new housing bills in 2017, and then doubled down on that accomplishment by enacting 16 more laws in its just-concluded 2018 session. Taken together, they represent incremental (if not sweeping) progress in addressing California's chronic housing shortage.

With California Governor-elect Gavin Newsom about to take office, attention turns to if and how he will deliver on his campaign pledge to create 3.5 million new housing units by 2025. Legal Planet colleagues Ethan Elkind and Meredith Hankins have recently weighed in on the topic. Here's a slightly different take on these same housing issues, courtesy of U.C. Davis academics:

In January of 2018, California State Senator Scott Wiener shocked the political firmament with a bill that would have zoned every tract of land in the state near a bus, rail, or ferry stop for 8-10 story buildings. His bill, SB 827, was soon watered down and then defeated, but not before launching a national debate about housing costs, "NIMBYism," and the critical importance of increasing residential density near mass transit.

Though SB 827 was uniquely far-reaching, it was not a one-off. Sen. Wiener has introduced a very similar successor bill, SB 50, for the 2019-2020 legislation session, and a state senator in Washington has floated a proposal to establish density minimums around transit stations in the greater Seattle region. Out of the limelight, state housing agencies and to some extent state courts are also pressing local governments to allow denser housing.

The debate thus far about state-mandated upzoning has centered on questions about the proper balance between statewide vs. local interests. An equally if not more important question has received too little attention: what will it take to get local governments—the entities that actually issue building permits—to comply with the state's policy? SB 827 did nothing to displace local control over permitting, design standards, demolition restrictions, impact fees, affordable-housing requirements, and more. SB 50 is no different. If the bill passes, localities that don't want tall buildings near a transit station could make them incredibly difficult to

build.

The history of state efforts to make local governments allow more housing is a history of mostly minor interventions that were met, swamped, and defeated by local champions of the status quo. A bold, state-led upzoning program is unlikely to achieve very much unless it is paired with an equally bold mechanism to secure local governments' cooperation.

Two of us have just posted a new white paper proposing such a mechanism. We argue that states should confer on local governments a *right to auction* the new development rights created by upzoning pursuant to state policy. Local governments that comply with state policy (and whose upzone-plus-auction plan is approved by a state agency) would recoup the development value thereby created. This is akin to a state subsidy for local compliance, but it comes at no cost to the state's budget, and, critically, the size of the subsidy—that is, the revenue generated for the local government through the auction—would depend on the credibility of the local government's commitment to allowing development in the upzoned area. Our proposal would also facilitate state monitoring of local land-use regulation, as the price at which development-allowances trade would provide a forward-looking signal about otherwise hidden or obscure local barriers to development.

Though the notion of auctioning the right to develop housing may seem strange, our proposal has a near analogue in existing transferable development rights (TDR) programs. The principal difference is that TDR programs reallocate development value among landowners, whereas our model would reward local governments for upzoning and permit streamlining.

Our proposal also resembles California's cap-and-trade regime for greenhouse gas emissions. Just as the owner of a power plant who wishes to burn fossil fuels must purchase emissions allowances for the carbon dioxide that would be released, so too would a landowner who wishes build in the expanded zoning envelope have to acquire and redeem "development allowances." Each development allowance would permit its owner to build, say, 100 square feet of housing in excess of the baseline, up to a maximum defined by the new zoning map. To illustrate, imagine a parcel of 2500 square feet that had been zoned for a floor-to-area ratio of two, i.e., two square feet of housing for every square foot of lot size. Let us stipulate that after upzoning, the maximum floor-to-area ratio is eight. This means that the owner of the parcel, who previously could build no more than 5000 square feet, may now

construct as many as 20,000 square feet. But to obtain a permit to build 20,000 square feet, she would have to acquire and redeem 150 development allowances ([20,000 – 5000]/100 = 150).

To protect landowners' reasonable expectations, the state legislature should carefully define the development baseline—that is, the minimum level of development for which local governments *maynot*demand development allowances. A landowner who seeks only to build something similar to what most others have already built should not have to pay for the privilege. Nor should local governments make landowners pay for the density allowed under longstanding zoning classifications. Accordingly, we recommend defining the baseline as the greater of (1) the typical density of parcels that have already been developed for housing within the local government's territory, and (2) the locally permitted density for the parcel in question as of the date of the state law authorizing the auctions.

We acknowledge that courts and legal commentators have often resisted the idea of putting zoning up for sale. A generation ago, the economists William Fischel and Robert Nelson argued that local governments should have more or less unfettered discretion to sell rezoning for cash. Their proposals went nowhere. Liberals generally regard the sale of zoning as corrupt, and conservatives see it as extortionate. If local governments could profit from selling development rights, wouldn't they just ban all development everywhere to obtain maximum leverage for negotiating upzones?

Our proposal sidesteps the usual zoning-for-sale objections, because it vests authority to approve the rezoning (plus auction) in a different government than the one which profits from it. Local governments could only sell those development rights created by upzonings that advance the state's policies, and with the approval of the state's housing agency. The state policy of promoting dense development near transit would continue to be shaped by environmental, economic, and equity goals, not the prospect of filling state-budget holes with auction revenues (the state wouldn't pocket the revenues). Moreover, state lawmakers could easily allay concerns about "exploitative downzoning" by setting a development baseline that precludes local governments from requiring landowners to redeem allowances if they merely seek to develop at previously-allowed densities. In a legal challenge, the public-profit aspect of our scheme could be defended not as a way of raising revenue, but as a rational means by which the state fosters local-government compliance with its policies.

This is not to say that the right to auction development rights is an absolutely surefire bet for wrangling local governments into compliance with state housing policies. Our white paper considers various legal and policy objections. But new tools are clearly needed if existing residential neighborhoods are to be rezoned and repurposed for substantially denser housing. The development-rights auction belongs in the mix.