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Homes at a new development in Fontana, Calif. KYLE GRILLOT/ BLOOMBERG NEWS

THE COLLECTIVE FRAME, EDUARDO BALLESTEROS Modular residential construction in Norwalk, Calif.

The Great Housing Shortage Is Forcing a Search for Solutions

'Granny flats' in California and single-staircase codes in Texas: States try to fill a gap that has pushed homeownership out of reach for many

BY WILL PARKER

IT has taken many years to come to a consensus, but today few disagree: America simply doesn't have enough housing.

Too few new homes is one of the reasons home prices have outpaced incomes and general inflation. There are solutions—but they all could produce both winners and losers.

A wave of new-home construction, for instance, that lowered prices and rents would be a boon to millions of Americans who have struggled with high housing costs. But it also could mean lower returns to real-estate investors, and lower home values for millions of existing homeowners.

Still, there is wide agreement in both the industry and policy worlds that the housing shortage is too great to not take action. The public also supports policy changes that would allow more homes to be built.

Estimates vary, but the U.S. is short somewhere between one million and five million units to keep up with demand. Filling that gap is a big task. Here are some ways it could happen, and in some cases, already is:

Rethinking zoning, red tape

This is the one you hear the most about, and changes are starting to take shape.

Among the leaders is the unlikely state of California. For decades, California has been emblematic of the kind of place that make it too hard to build. Some towns adopted laws that capped the number of new homes that could be built. Housing opponents were able to delay building projects by filing a host of environmental lawsuits, including frivolous ones.

Note

New laws are starting to chip away at this, albeit slowly. The state's passage of a law allowing homeowners to build accessory dwelling units (also known as granny flats) in their backyards translated into more than 20,000 of these units being built in 2023. More recently, the state passed a law allowing developers to override local zoning to build apartment buildings up to nine stories within half a mile of public transit stations.

Other states and cities are taking similar measures, including Minneapolis and Austin, Texas, removing requirements for apartment developers to build parking lots—lowering construction costs and freeing up more land for housing units.

Smaller changes can be more arcane, but taken together, they can reduce a builder's costs. A simple example: allowing builders to use a single central staircase, instead of two, which frees up space to add larger apartment units more suitable for families. Several states, including Texas, Tennessee and Oregon, have recently passed such a staircase measure.

Cheaper construction loans

Note

Even if staircase codes become more amenable, developers won't build much if they can't obtain or afford the financing. The cost of capital has risen sharply since the Fed began increasing interest rates in 2022.

One solution could be to give the government-sponsored housing enterprises, Fannie Mae and Freddie Mac, an expanded role in lowering the price of construction loans for apartment buildings. Specifically, Fannie and Freddie would help finance mezzanine loans, which are normally expensive, at lower-than-market interest rates to reduce overall development costs. Builders have pitched something similar for single- family house construction.

By tapping Fannie or Freddie for these construction loans, apartment developers would build hundreds of thousands more units a year, according to Jim Millstein, co-chair of Guggenheim Securities, who served as President Obama's chief restructuring officer at the U.S. Treasury after the 2008 financial crisis. Twenty percent of the units could also be income-restricted affordable housing.

Not everyone is a fan. Construction is a much riskier proposition than financing buildings that already exist. In a market downturn, the housing agencies— and, possibly, taxpayers—could be left holding a bad bag if they haven't banked enough reserves.

Modular construction

One of the biggest obstacles to building new homes is that it costs a lot of money to build a house. Labor and materials prices continue to rise, but innovation to make construction cheaper has been lacking.

Modular construction for apartments, or prefabricating parts of buildings in factories and then assembling them on-site, offers a way to possibly bring down costs.

In Norwalk, Calif., Primestor Development is at work on the country's largest modular residential project, which is 374 units. Arturo Sneider, partner at the Primestor development firm, says construction should end up being 30% cheaper than if the project had been built conventionally. The savings comes from the amount of time saved by constructing part of the building in a factory (and being able to prepare the site simultaneously), as well as reducing the amount of labor needed.

Scaling modular construction into a formidable source of new housing supply has been slow, however. Some of that ties back to local codes and red tape. Requirements for construction differ greatly from town to town and state to state, making mass production tricky.

Another problem is that many investors and lenders still see the space as risky and unproven, says Tyler Pullen, a researcher at the Terner Center for Housing Innovation at the University of California, Berkeley. That's because investors are dependent on a third-party factory to build the parts, adding another layer of responsibility and another place where things could go wrong.

"No one wants to be the first mover on a new, innovative thing in housing," Pullen said. "Everyone wants to be the second adopter once they know it works."

Focus on starter homes

The gap between demand and supply of housing is especially wide when it comes to starter homes for young families.

Decades ago, starter homes, or houses of less than 1,400 square feet, accounted for more than one-third of all homes built every year. But by 2024, it was just 10%. Builders have instead focused on larger homes for higherincome customers. Part of the problem is that local governments often mandate that new homes be on very large lots, which limits the number of homes to be built—making it economical for builders to think big.

Edward Pinto, co-director of the AEI Housing Center at the American Enterprise Institute, a conservative think tank, has mapped out a way to make the market think small again. He proposes state-level policy changes that would override local ones, lowering the minimum lot size for homes, yielding a higher number of smaller homes.

Pinto and other researchers at the think tank cite Houston, which has produced more than 80,000 small-lot homes and townhouses since 2010. Home prices in Houston have still grown, though at a slower rate than many other major cities.

Washington, Kansas, Virginia and Idaho have recently passed bills allowing smaller lot sizes. Similar bills are being considered in more than a dozen states.

"We call 2026 the year of the starter home," Pinto says.

Social housing

Housing activists and landlords alike acknowledge that there is

some housing that the market has little incentive to provide. That's the lowest-income housing.

The U.S. once sought to fill this need with public housing, and later with the project-based Section 8 program. Today, the lion's share of affordable housing is built by private developers financed by the Low Income Housing Tax Credit, or LIHTC.

Progressive think tanks and politicians are pushing for the federal government to focus funding on millions more of these "social housing" units. It could be either public or nonprofit managed, targeting lower and middleincome renters and homeowners. Proponents point to European nations like France and Austria, where cities have built out such housing for a range of incomes. Some U.S. projects fitting the mold are already built with the help of state housing agencies— but the idea is to build far more.

In 2024, Sen. Tina Smith (D., Minn.) and Rep. Alexandria Ocasio- Cortez (D., N.Y.) proposed creating a national Housing Development Authority to build, acquire and preserve 1.3 million units of rental and for-sale housing that would be required to remain affordable. The House and Senate bills, called the Homes Act, died in committee. *Will Parker is a Wall Street Journal reporter focusing on commercial real estate. Email him at will.parker@wsj.com.*