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## Policy Solutions for Affordable Housing in Cuenca Ecuador

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## **I. Introduction**

An increase in migrant population from wealthier countries is raising concerns of displacement of less affluent local populations in less wealthy countries. This is a worldwide phenomenon (Hayes and Zaban, 2020) and is especially prevalent in Cuenca, Ecuador, which has become a regional center of retirement migrants from North America and northern Europe (Hayes, 2018).

The trend of increasing migrant population has been caused by several socio-economic factors. In North America and Northern Europe, increasing numbers of retirees are discovering that their fixed incomes can go much farther in cities which are affordable but offer high quality of life like Cuenca, Ecuador (Hayes, 2018). The rapid expansion of privileged classes in China and India has increased the presence of a global social elite which is increasingly interested in transnational mobility and private accumulation of property for the sake of lifestyles and leisure ideals. This has already led to increasingly mobile populations which is likely to accelerate once COVID-19 restrictions are lifted (Hayes and Zaban, 2020). And public-private partnerships in such cities are seizing upon these global trends, altering local regulations to increase ground rents by appealing to tourists and wealthy migrants (Garmany and Richmond, 2019).

The socio-economic impacts of these trends upon Ecuadorian locals are complex and not yet widely studied. Researchers have raised several concerns. Most importantly, the influx of approximately 10,000 retiree migrants has driven increases in costs of living (Hayes, 2019). Developments which are oriented towards wealthy migrants and tourists are generally owned by people groups which have historically benefited from colonialism. The increase in revenue from wealthy migrants has the potential to disproportionately benefit these people and perpetuate wealth inequality. And the mechanisms by which local governments improve areas for consumption by migrants often displace and marginalize the poorest Ecuadorians, and the increased population of migrants can disrupt local economic balances, feeding cycles of poverty (Garmony and Richmond, 2019, Hayes, 2018).

However, Cuencans can benefit from the increased presence of wealthier migrants because of the significant inflows of wealth they bring with them (Hayes, 2018). Wealthier migrants who are retired can also enrich the community by using their wealth and free time to provide social services to Cuencans, as they did by organizing and providing COVID relief to locals (Hayes and Zaban, 2020). Locals also benefit from the exchange of ideas and culture that can come from foreign influence: Impoverished Ecuadoreans show receptiveness to new foreign influences and perceive it as a means of achieving higher social status (Klaufus, 2012).

Policy solutions to this issue fall into three basic categories. The first is to stem the flow of wealthy foreign migrants by restricting. However, this will prevent Cuenca from benefiting from the increases in income and cultural diversity as foreign populations bring their incomes and experiences to the country. The second

is to control the behavior of migrants once they've settled. This can be done spatially, by restricting them to certain parts of the city, or by requiring a level of culture assimilation by speaking the language or attending cultural competency training. The third is to address the underlying causes of housing unaffordability in Cuenca which may be impacted by an influx of new, wealthier residents.

This paper theorizes that, with the right policy framework, Cuencans at all income levels can benefit from the increase in wealthy migrants. Middle- and lower-income local communities both desire and benefit from the improvements associated with gentrification (Hayes and Zaban, 2020), so policy should not prevent it, but rather focus on channeling new resources into improvements. For this to be possible, Cuenca policy needs to be oriented around improving social conditions, and not necessarily around increasing ground rents. It needs to foster urban communities, and not necessarily commercial surpluses. The policy solutions laid out in this paper will facilitate the healthy channeling of new resources into channels that will benefit all of Cuenca.

## **II. Literature Review**

Gentrification is defined as “the process of neighborhood change that results in the replacement of lower income residents with higher income ones” (Kennedy & Leonard, 2001). An “increase in transnational mobility helps to globalize rent gaps,” expanding the potential market for lower-income cities to an international scale (Hayes and Zaban, 2020). Middle-income groups from around the world also increasingly access cities with lower costs of living, notably in the Global South and the European periphery. This sometimes presents as an appearance of high and “middle-income groups ‘raiding’ lower income areas and undertaking upgrades that displace...low-income residents” (Hayes and Zaban, 2020). Global gentrification isn't merely a passive phenomenon but is in some cases actively encouraged by local governments and firms who pursue the “production of place for the sake of maximizing potential exchange values” which “can significantly enhance rent gaps through the travel and tourism industry” (Hayes and Zaban, 2020). Locals, too, often want to “participate in the gentrification-induced” changes in their neighborhoods and may consider the changes and potential for displacement worthwhile (Hayes and Zaban, 2020).

Cuenca is attractive to middle and high-income retirement migrants because a monthly income of only \$800 is required for a single person to obtain a residency visa in Ecuador, which is significantly less than the standard Social Security payment for Americans which is about \$1,500. Hayes estimates that middle and high-income retirement migrants inject about \$144 million into Cuenca's economy each year, which is equivalent to about 10% of the entire income from tourism for the entire country (Hayes, 2018).

The most obvious impact of middle and high-income retirement migrants in Cuenca is on pricing for housing and services. Because these migrants often pay

“gringo” pricing which is significantly higher than what locals are likely to pay, and because they tend to be older and less of a financial liability than local families with children, Cuencan landlords and service providers express preference for “gringo” migrants. Hayes shares anecdotes of taxi drivers ignoring local Cuencans in favor of “gringo” migrants, maids quitting their services for Cuencan families to obtain higher wages, and landlords raising rents by as much as 50%. Some middle and high-income retirement migrants try to minimize their impact on the local economy by bartering for lower prices and by avoiding the “gringo” premium (Hayes, 2018).

Cuenca has also experienced a high rate of internal Ecuadorian immigration, with approximately 10% of the population having immigrated between 1982 and 2010, many relocating to Cuenca (Royuela & Cuenca, 2016). Since 2000, Ecuador’s population has grown 4.5% per year (Royuela & Cuenca, 2016). Cuenca is its third largest city with a 2010 population of 329,928, after Guayaquil and Quito with populations of 2.3 million and 1.6 million respectively.

Migrants respond to push and pull factors, and disparities of opportunity and affordability between cities and countries drive migration and economic instability. The most powerful pull factor for migrants to a new city are the expected opportunities “to earn an income at the destination” and the expected differences “in terms of quality of life” (Royuela & Cuenca, 2016).

An influx of wealthy foreigners doesn’t merely have a financial impact; it also has an impact on culture, and local perceptions of self and status. Local Cuencans are influenced by relatives who live abroad as well as local foreign migrants, and integrate fashions, goods, and ideas into their lifestyles. Hearing about conditions in other countries influences their perceptions and expectations and expressing those influences in the form of architectural trends or acquisition of foreign goods functions as a means of expressing personal agency, dignity, and autonomy to counter the stigma of poverty (Klaufus, 2012).

Gentrification can be mitigated through education of the local community and policy makers on growth dynamics and their legal rights, discussing ways to capitalize on local gentrification, and adjusting local policies to influence development patterns (Kennedy & Leonard, 2001, White et al., 2016).

### **III. Criteria for a policy solution**

#### **A. Cost of implementation and economic impact**

In a post-COVID time, local resources will be limited, and the cost of any policy implementation will be an especially important factor. Because the challenges that Cuenca is facing involve an influx of wealth, the possibility that funding for any policy solution will be built in is quite strong. Wealthier migrants may be able to pay for the solution to their own impacts on Cuenca. They may pay an extra immigration fee or may pay a certain tax to cover the economic impact of their presence.

However, treating migrants as blank checks may cause solutions to backfire. Their addition of their wealth to the Cuencan economy should not be taken for

granted, and if any new taxes or fees shift the expected value of Cuenca as a retirement destination, then they may choose to take their income sources to other places. Any policy solution must facilitate an economic net-gain for Cuenca and, if it must drive away any middle and high-income retirees, it must only drive those away who will have a detrimental impact on Cuenca.

### **B. Impact on Equity**

Any policy solutions for gentrification in Cuenca must facilitate a growth of opportunity for all Cuencans. They should not perpetuate class or caste systems, and they must lead to the enrichment of life for every class. Any taxes or fees should not add a burden to lower-income Cuencans, and new revenue streams from policy solutions should be used in a way to reduce poverty and improve the prospects of Cuencans.

### **C. Impact on Cuencan Culture**

An influx of foreigners can be a frightening prospect for any city or country and is usually accompanied by cultural shifts as well as economic ones. New foreign residents in Cuenca means new languages, new traditions, new cultures, and shifts in the balance of power. This can lead to change in policy as new residents influence leaders, especially when these new residents are accompanied by wealth.

However, cultural change is not automatically a bad thing. Larger cities like Cuenca, especially, stand to benefit from increasing diversity, especially as higher-income retirees bring with them a wealth of intellectual capital that has the potential to enhance the local community. Policy solutions for Cuenca must facilitate the positive impacts of cultural change and discourage the negative impacts.

### **D. Impact on development feasibility**

Affordable market-rate housing is only possible if four local conditions are met: the availability of reasonably priced land, sufficient demand for housing at a profitable price point, access to capital, and an appropriate public policy framework (Urban Land Institute, 2016). Poorly designed policies can add unnecessary expense to housing construction. A policy which has a detrimental impact on development feasibility may backfire by disincentivizing new housing development which will constrain supply and actually accelerate gentrification (Urban Land Institute, 2016, Ramakrishman et al., 2019, Kennedy & Leonard, 2001, Jacobous, 2017, White et al., 2016). Policymakers must carefully consider the impact of their decisions on housing markets.

## **IV. Policy Analysis**

### **Option A: Incorporate rent control**

Rent control is legislation that limits rental prices and the rate at which property owners can increase from year to year. Enacting rent control could be a means of preventing displacement of Cuencans by wealthy migrants.

Rent control is most likely to be implemented in markets which are experiencing rapid rises in costs of living (Diamond et al., 2019) and provides the greatest benefit

to renters who have signed leases before substantial increases in market rental rates. The greater the disparity between market prices and controlled rent prices, the greater the benefit to the renter. However, it has a detrimental effect on landowners who are unable to capitalize on increases in market values, or who are unable to increase rents in proportion to increases in their operating costs.

As a landlord's market loss increases, he or she will alter their behavior to mitigate their losses. These changes may have a negative impact on the community. Landlords may pressure tenants in controlled apartments to vacate the unit, either by paying them to leave or by allowing the quality of the unit to decline and become less comfortable for the renter. They may remove their units from the rental market by converting them to condos. If they stay in the rental market, they may convert low- and middle-income units to high-income units or seek tenants who are likely to have high turnover instead of more stable, long-term tenants (Diamond et al., 2019).

All these impacts together can create market conditions that rapidly increase gentrification and displacement. It also locks out newcomers to the city from accessing affordable housing.

Price controls are least disruptive in rental markets that are already affordable. They cannot reverse the effects of rapid increases in rental prices. If they are to be implemented, they must be implemented along with other policy efforts to keep the availability of medium-income housing in high supply. Rent control may only benefit a few fortunate people while having an overall detrimental effect on the community. For rent control to be successful, it must provide a market benefit to the overall community that exceeds its market cost.

Because rental price controls are likely to have the long-term effect of forcing landowners to cater to wealthier people, to remove rental units from the market, and to pressure their existing tenants to leave, this will have a negative impact on equity and Cuancan culture.

### **Option B: Inclusionary zoning**

Inclusionary zoning (IZ) is a relatively new approach to preserving housing affordability. There are two main methods of implementing IZ: One way which requires developers to sell or rent a portion of their units at below market level (Ramakrishnan et al., 2019), and another method which requires developers to pay a portion of development fees to an affordable housing fund which may be used by local governments or distributed to developers in the form of subsidies (Urban Land Institute, 2016).

There is a lack of consensus on the impact of inclusionary zoning on housing markets and on city economies. Several researchers have concluded that it has a detrimental effect on housing affordability for several reasons. First, like rent control, inclusionary zoning can disincentivize new housing development by reducing the long-term profitability of these projects (Ramakrishnan et al., 2019) which constrains housing supply. It can also exacerbate class divides because

landowners must charge more for market-rate units in inclusionary zones (Urban Land Institute, 2016), raising the threshold for upward class mobility and trapping more households into dependency on public assistance. Inclusionary zoning has also been criticized for failing to provide housing for very low-income groups by instead catering to moderately low-income groups or middle-income groups (Ramakrishnan et al., 2019).

However, other researchers have criticized many of the studies which have condemned inclusionary zoning for lacking rigorous data or effective methodologies (Ramakrishnan et al., 2019). Some studies have found no evidence that IZ even has a statistically significant impact on housing affordability, while others have found that it has. Considering that another criticism of IZ stems from the lack of comprehensive research covering wide geographic regions (Ramakrishnan et al., 2019), the most likely explanation for the disparity in research conclusions is simply that IZ is effective in some situations and ineffective or even detrimental in others. Ramakrishnan et al. theorize that IZ has a positive impact on housing markets which are already stable, but actually exacerbates gentrification in areas that are seeing rapid increases in property values (Ramakrishnan et al., 2019).

Because Cuenca is seeing rapid increases in housing costs in migrant retiree neighborhoods, policy makers should be cautious about implementing IZ in these areas. However, in neighborhoods that have more stable pricing, IZ might be more effective in granting migrants to Cuenca access to better neighborhoods. Policymakers must consider the potential for rapid changes in Cuenca's economy and must be careful not to lock neighborhoods into IZ policies that can't rapidly respond to changing conditions.

- **Option C: Facilitate rapid build out of middle-income housing**

The laws of supply and demand are simple: the greater the disparity between supply and demand for a good or service, the greater the impact on price. This is true for housing as well as anything else like electricity, cars, and healthcare. A notable thing about much of the literature on gentrification is a lack of discussion about the role that increasing housing supply can lower costs, with research focusing more on subsidies and incentives than discussions about policy barriers to housing supply. Simply building more housing at a rate which keeps pace with new housing demand can have a powerful impact on housing affordability (Jacobous, 2017). Affordable market-rate housing is only possible if four conditions in the local economy are met: there must be sufficient availability of reasonably priced land, sufficient demand for housing at a profitable price point, adequate access to capital for developers, and a public policy framework which is amenable to new housing (Urban Land Institute, 2016). Policymakers can have a powerful impact on facilitating a steady supply of new housing by simply keeping policy barriers to development low (Urban Land Institute, 2016, White et al., 2016). Municipalities can do this by intelligently removing unnecessary regulations that needlessly add to costs of development.

Mandates such as design standard, parking minimums, unit limits, setbacks, and open space requirements can also reduce profitability by limiting the amount of lot space developers can use for housing. Limiting the number of units available per lot can prevent developers from developing small units that are more affordable in favor larger ones to maximize the rents they can charge. Requirements for setbacks and open space can be costly to developers as well, forcing them to set higher rental price points (White et al., 2016).

While all these requirements are necessary in some settings, policymakers must work closely with developers to ensure that their quality-of-life requirements are not leading to development costs which results in rental price points that lock out low- and middle-income residents from opportunity in their municipalities. Policymakers can also facilitate development of affordable housing by streamlining the local license and permitting processes. Researchers have found a strong correlation between length of approval processes and housing affordability (Glaeser & Gyourko, 2003). Long permitting processes are costly and create an environment of uncertainty which increases the financial risk of housing development. This incentivizes developers to focus on larger projects with higher profit margins because they can concentrate their efforts on getting them through the regulatory process.

Lengthy approval processes also prevent developers from responding effectively to changes in housing markets, leading to lagging responses to rising and falling demand. With shorter turnaround for project approvals, new units can enter markets as they are needed, and projects can be halted quickly if they become unfeasible (Urban Land Institute, 2016).

Policymakers can facilitate affordable housing by incentivizing density which leads to increased economies of scale and lower rental prices (White et al., 2016). This type of development will complement Cuenca's existing historical layout which already facilitates walkability and density.

## **V. Policy Recommendation**

Based on the criteria established in section III, Option C: Facilitate rapid build-out of middle-income housing is the best solution to addressing gentrification in Cuenca, Ecuador. However, options A and B may also be feasible in parts of Cuenca which are not seeing abnormal increases in housing costs.

### **Cost of implementation and economic impact**

Out of all the options, option C will have the highest initial cost of implementation. Depending on the city's current land use regulations, it may require significant alteration to facilitate affordable market-rate housing. Doing a comprehensive review of local land use regulations can be a complex and difficult task and coordinating changes to these regulations can require significant costs in community outreach and significant challenges in developing consensus. This can be especially challenging if entrenched interests are likely to oppose the construction of affordable housing.



However, once reforms to facilitate market-supplied affordable housing are established, the cost to the municipality is significantly less than they are through options A and B. This is because the local government is responsible only for licensing and permitting new constructions and ensuring adequate infrastructure for new developments. They will not need to spend as much on administrative costs as they would for options A and B, and they will not be liable for coordinating construction, managing properties, or managing money and resources with publicly owned affordable housing.

### **Impact on Equity**

The rapid buildout of affordable market-rate housing will have a positive impact on equity in Cuenca, because, unlike options A and B, wide availability of affordable market-rate housing keeps rents lower for all Cuencans.

Because IZ and rent control are not as widely scalable as the mass buildout of middle-income housing, only a select few lower-income residents will be able to access housing in the city, while unintentionally incentivizing developers to favor wealthier people, many of whom are likely to come from overseas. This will have a greater and arguably more detrimental impact on Cuencan culture.

With a larger population of Cuencans who are not reliant on public assisted housing means the city will have more residents who are contributing more to Cuenca's economy than they are taking, which will grow the city's wealth while improving equity.

### **Impact On Cuencan Culture**

Option C will have a positive impact on Cuencan culture because it will enable current residents to stay in their city while also allowing greater numbers of Ecuadorean migrants to compete with wealthier foreign migrants for housing. In the short term, altering regulations to allow the rapid buildout of middle-income housing may seem disruptive. But in the long term, implementing these changes will help Ecuadoreans and Cuencans balance out the cultural influence of wealthy migrants and tourists.

### **Impact on development feasibility**

Because Option C represents the lowest cost burden to developers, it also has the lowest impact on development feasibility. Not only do low barriers to housing development incentivize greater supply of housing, but higher supply of housing also means developers have less power to charge higher rents. With lower barriers to market entry, developers can afford to operate with lower profit margins and therefore can afford to charge smaller rents. Options A and B both disincentivize development by adding to the initial costs of development, and by reducing profitability of low- and middle-income projects. These forces are likely to lead to smaller housing supply and higher price points.

### **Conclusion**

As Cuenca's leadership embraces the global market, it should prepare for the

disruptive changes to its economy by setting a precedent of being pro-housing and pro-income diversity, and it can do this best by facilitating the buildout of multiple housing types.

Local land use restrictions should not exacerbate income inequality by banning the construction of affordable forms of housing. Inclusionary zoning requirements, like requiring developers to set aside a certain percentage of new units for affordable housing, can help to mitigate the impacts of housing unaffordability, but without sufficient stock of market-rate development, they will not generate significant results (Urban Land Institute, 2016).

Cuenca is well-positioned to grow its wealth by attracting higher income migrant residents. However, this growth must not come at the expense of its existing population and culture.

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