Title
Raising the Roof: California Housing Development Projections and Constraints, 1997-2020

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Publication Date
2000-07-01

Reprint 2000-01

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The following is a reprint of Chapter One's Introduction/Summary from the California Department of Housing and Community Development's May 2000 report, "Raising the Roof: California Housing Development Projections and Constraints, 1997–2020."

Please refer to page 2 to obtain a copy of the above-cited report in its entirety. The report may also be viewed on the California Department of Housing and Community Development website at http://www.hcd.ca.gov.

Institute of Urban and Regional Development
University of California at Berkeley

Raising the Roof:

California Housing Development
Projections and Constraints, 1997-2020

Statewide Housing Plan Update

State of California
Gray Davis, Governor

Business Transportation and Housing Agency
Maria Contreras-Sweet, Secretary

Department of Housing and Community Development (HCD)
Julie Bornstein, Director
Cathy E. Creswell, Acting Deputy Director

Prepared by University of California, Berkeley
Institute of Urban and Regional Development in
collaboration with HCD; additional support provided by the
Fisher Center for Real Estate and Urban Economics

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May 2000

Acknowledgments

This update was prepared under an interagency agreement with the Institute of Urban and Regional Development (IURD) with support from the Fisher Center for Real Estate and Urban Economics, at the University of California, Berkeley. Principal author John D. Landis, assisted by Michael Smith-Heimer. The project was managed by Linda Wheaton of HCD's Housing Policy Development Division, with support from Mario Angel, Rebecca Hoepcke, Therese Weather-Reyes, and Marjana Jackson. The researchers are appreciative of the many California city and county planning departments which assisted by responding to surveys on local growth controls and permit processing, and to the planners and developers who reviewed the descriptions of the permit processing case studies.

CHAPTER 1 INTRODUCTION

> *The availability of housing is of vital statewide importance, and the early attainment of decent housing and a suitable living environment for every Californian, including farmworkers, is a priority of the highest order.*
>
> (Government Code Section 65580)

This publication represents an update of the California Statewide Housing Plan (CSHP), undertaken to facilitate efforts addressing this State housing goal. Updates of the CSHP are published by the Department of Housing and Community Development (HCD) pursuant to Health and Safety Code Section 50450 et. seq., in phases. This update and the prior one provide perspective on the State's housing needs for subsequent policy development.

The most recent prior update, California Housing Markets 1990 – 1997, published in January 1999, assessed the State's housing conditions and market performance during much of the 1990's. Key issues identified included high housing cost burdens, overcrowding, assisted rental housing at risk of conversion, farmworker housing needs, and homelessness.

This update takes a county-by-county look at California's projected housing needs through the year 2020, the constraints to meeting those needs, and the possible consequences of not meeting them. The Summary provides an overview of the research findings.

Chapter 2 describes household and tenure projections for California counties and metropolitan areas for 2010 and 2020.

Chapter 3 includes a look at the supply of developable land in California and addresses these issues: Where is the state short of vacant land for housing? What role does land redevelopment and re-use play in meeting California's housing production needs? Why is "infill" housing so hard to produce?

Chapter 4 delves into the local regulatory process. What are California communities doing to try to control or manage development? How are local land use regulations impeding or encouraging housing production? Has the development approvals process become so cumbersome that it is adversely new housing construction?

Chapter 5 identifies capital constraints to housing production. To what extent are current constraints on the supply and use of private financing likely to limit housing production? On the public financing side, how is housing– related infrastructure being developed? And what of subsidy capital for affordable, low-income housing production?

Chapter 6 examines the implications of not producing enough housing. It begins by looking at the historical pattern of production shortfalls. Next, it considers the effects of production shortages on housing prices, rent levels, and housing cost burdens. The historical relationships between production shortfalls, reduced homeownership, lengthy commutes, overcrowding, and affordability are also explored. Would building more housing help alleviate some of these problems? The answer, based on a national analysis of housing prices and production, is a cautious *yes*.

Chapter 7 concludes with a summary of major findings; the implications of those findings for the future of housing in California; and recommendations to state and local officials, lenders, non-profit groups, and the building industry for how California can better meet its future housing needs. ❒

This publication includes a separate Appendix, published as Volume II. The Appendix contains technical reference materials, including the individual project case study descriptions of the sample of residential permit processing addressed in Chapter 4.

Given the magnitude, changing demography, and complexity of these housing issues, there is a significant need for further research on many of the topics addressed in this publication. HCD's Housing Policy Development Division encourages further research and collaboration on California's housing conditions, needs, and policy issues. Inquiries or information should be directed to:

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SUMMARY

Few issues facing California are as important as the State being able to meet its future housing needs. Between 1997 and 2020, California will likely add more than 12.5 million new residents and should form approximately 5 million new households. Almost all of this growth will occur in metropolitan areas. To meet the housing needs of California's growing population, homebuilders and developers will have to build an average of 220,000 housing units each year between now and 2020.

Housing production has significantly lagged job and population growth.

Achieving this level of production will be difficult. From 1980 to 1990, a period of tremendous housing construction throughout the State, annual production (as measured by single- and multi-family permits) averaged just over 200,000 units. Between 1990 and 1997, production averaged only 91,000 units per year. In 1999, a boom year for the housing market nationally, there were less than 140,000 residential permits.

One of the chief determinants of whether California can produce enough housing will be the State's economy. When California's economy goes into recession—as it did in 1980, 1982, and 1990— housing demand falls quickly and deeply. Economic recovery revitalizes the housing market, though expansionary peaks rarely even out the recessionary troughs. During the current expansion, which took hold in 1995, housing production lagged, rather than led, job growth.

Macroeconomic and tax policy changes notwithstanding, the principal sources of California's housing production problems are mostly found within the State. Between 1980 and 1990, housing production in California trailed demand by 660,000 units, leading to a 1990 statewide "housing deficit" equivalent to 5.9 percent of the existing stock. With the recession in 1990, this situation reversed itself, and from 1990 through 1994, housing production actually exceeded housing demand growth by 335,000 units. Relief was only temporary, however, and in 1995 the old pattern of structural housing shortages began to reassert itself—albeit to different degrees in different parts of the State. Between 1995 and 1997, housing production again trailed demand, this time by 145,000 units, statewide.

If these trends continue, California will build less than 60 percent of the new housing units needed to accommodate projected 1997-2020 population and household growth. Housing shortages have historically gone hand-in-hand with rising housing prices and rents, higher housing cost burdens, lower homeownership rates, increased crowding, and longer commutes.

If California homebuilders and apartment developers are to meet projected homeownership and rental housing demands, they will need an adequate supply of development sites and capital. They will also need to operate within a regulatory environment which makes it possible to build housing when and where it is needed, and at prices that Californians can afford.

Land for Housing

California is a huge state, and except in a few critical locations, has ample land to grow. As of 1996, the 35 metropolitan counties for which land supply data are available included 25 million acres of potentially developable raw land. Excluding sites far away from urban services, sites on steep slopes, wetlands, floodplains, prime and unique farmlands, and habitats to significant numbers of endangered species would reduce available urban raw land supplies to 8 million acres. Statewide, this amount of land would be sufficient to accommodate projected household growth through the year 2020 more than three times over.

It may be possible to accommodate much of California's growth with housing forms that consume less land than in the past.

California's raw land availability and development capacity vary by area, with several major metropolitan counties being most constrained. Allowing for appropriate reserves, Los Angeles, Orange, and Santa Clara counties will lack sufficient vacant suburban land to accommodate projected household growth through 2010. Four other counties, Alameda, Contra Costa, San Diego, and Ventura, will start running low on land soon after 2020. If development were to be further restricted by public policy, say through the comprehensive adoption of a series of urban growth boundaries (UGBs), many more counties would start running out of developable land. The constraining effects of UGBs would be most strongly felt in the Central Valley, where many cities are already bordering prime farmlands.

In fact, California's residential development capacity may be greater than these estimates indicate. Residential development densities rose significantly during the last decade, particularly in metropolitan areas. This trend suggests that it may be possible to accommodate much of California's anticipated population and household growth with housing forms that consume less land than has traditionally been the case.

Two important caveats apply to the projected relationship of land availability and development capacity. The first is that they are not based on local general plans or zoning ordinances. These findings do not consider, for example, whether or how particular jurisdictions might or might not increase their developable land supplies and zoned densities to accommodate projected housing demand. This is a critical point because in some regions, current planned residential capacity is far short of projected housing needs.

A second caveat is that, because there is currently no statewide database regarding the potential for redevelopment and land reuse, no one can definitively say how much of the State's projected household growth might be accommodated through what has come to be known as "infill" development. Assessment of infill development that has occurred, including the activity of California's local redevelopment agencies (RDAs), indicates that

If infill housing development is to play a larger role in accommodating California's housing demand, it will require more concerted analysis and more direct support.

infill housing development activity (while significant on a targeted basis), is uneven and idiosyncratic statewide, and has accounted for a small share of total housing development. If infill housing development is to play a larger role in accommodating California's housing demand, it will require more concerted analysis and direct support.

Capital for Housing

Housing development is very capital-intensive. Without a regular—and hopefully affordable—supply of equity and debt for land and infrastructure development, building construction, and long-term mortgages, housing production in California would grind to a halt. While more capital is available for housing today than at anytime in the past, it is disciplined capital. This means that the ability of a particular project or housing sector to attract equity and/or debt capital will depend foremost on its ability to generate competitive, risk-adjusted returns.

By this criteria, single-family mortgages should be readily available for the foreseeable future throughout California. The risk of lending on single-family housing remains low, even during recessionary periods. For lenders, California's long-term history of escalating home prices makes it comparatively easy to underwrite home mortgages, whether they are resold in the secondary market or remain in portfolio. The availability of mortgages to underserved homebuyer markets and households seeking to buy homes in places where prices are not rising—principally central city and rural locations—will depend on the effectiveness of governmental entities working with private lenders to expand the pool of available loan capital and mortgage products.

On the multifamily side, the picture is more muddled. Except in overheated markets like San Francisco and the Silicon Valley, average apartment rents are far below the levels required to attract new investment capital, constraining the response of the private sector. The multifamily debt market has also been in disarray. Volatility in the CMBS (Commercial Mortgage Backed Securities) market put a number of commercial mortgage conduits and mortgage REITs under financial pressure.

California cities are finding it ever more difficult to fund housing-related public facilities and infrastructure.

The availability of debt capital for public infrastructure will depend on how it is used. At the municipal level, the availability of unrestricted debt— which in California is raised through the issuance of general obligation bonds—remains limited under the two-thirds voter-approval requirement imposed by Proposition 13. Despite allegations to the contrary, most California jurisdictions are not over-indebted, and have had little trouble accessing additional public debt. Adjusted for inflation, per-capita borrowing by California city and county governments has more than tripled since the early 1980s. More significant than changes in the amount of debt are changes in its use. Continuing a long-term trend that began with Propositions 13, California cities are finding it ever more difficult to fund housing-related public facilities and infrastructure. Instead, such infrastructure is increasingly being funded through impact fees and developer exactions. In some jurisdictions, impact fees and required exactions already exceed $30,000 per unit and account for more than 15 percent of total housing production costs.

In California, the federal government provides most funding for affordable housing. In 1998, estimated federal housing assistance to California totaled approximately $1.2 billion, not including tax expenditures associated with the mortgage interest deduction. Future funding levels for some federal housing programs, such as the Low Income Housing Tax Credit program, generally look secure, and may actually increase. The future of other programs is more uncertain, and will likely depend in part on whether and how federal caps on discretionary spending are implemented. Regardless of which way the political winds blow in Washington, federal housing assistance levels to California in the future—as in the past—will be substantially inadequate when measured against the level of need.

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How great are future affordable housing needs likely to be? The number of low-income households needing some form of housing assistance could increase by 1.3 million by 2020 if, as projected, the number of California households grows to 16.2 million by 2020, and if the current percentage of households who are both low-income and are over-paying for housing remains constant. If there is no comparable increase in housing assistance levels, total unmet affordable housing needs in California will rise to about 3.7 million units in 2020. In fact, these estimates may very well be too low. Because affordable housing needs track with rents, a slowdown in rental housing production will cause rents and therefore affordable housing needs to climb.

Regulatory Constraints

California's local regulatory process is often frustrating to builders and developers, yet it is difficult to assess what exact effect it has had on housing costs and production levels. Part of the difficulty is that the approvals process is administered differently in every city and county. It is, moreover, constantly changing in response to shifting fiscal conditions and popular concerns over growth. Never overtly friendly to housing, the process has in recent years become even less accommodating.

In theory, the development approvals process in California is supposed to be plan-driven. In fact, the over-riding importance of the California Environmental Quality Act (CEQA), the ease with which general plans may be amended, and the widespread adoption of various growth management programs and alternative planning structures have all increased the discretion local governments—and thus indirectly, citizens and neighborhood groups—can exercise over private development proposals. The effect of these supplemental measures has been to elevate the importance of short-term fiscal, traffic, and environmental issues in the development approval process and to reduce the importance of long-term planning. None of these changes has favored housing.

As complicated as the entitlements process has become, some California builders and planners alike have become good at it. Based on a diverse sample of 24 single-family subdivisions and 22 multi-family developments entitled between 1995 and 1998, the average single-family development project involved 3.3 separate development reviews and was approved in just under a year. The average multi-family project was subject to 2.3 reviews, and was approved in seven months. These rates were from communities with generally strong residential permitting activity. Larger single-family projects took no longer to approve than smaller ones. Affordable multi-family projects were approved in an average of 9.8 months, versus 4.9 months for market-rate apartment projects. Projects that did not require a municipal boundary change, a zoning change, a CEQA review, or review by an extra-local agency were approved much more quickly. Based on this sample, it is clear that permit processing times vary widely. Among the projects and jurisdictions sampled, the local approvals process did not result in systematic reductions in density: most of the projects studied were approved at their requested densities.

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Almost certainly, the entitlement situation is not as benign as this picture suggests. Many of the sites covered in our analysis were previously or "pre-entitled" during the late 1980s. The sample included more pro-growth communities because of the need to have adequate single- and multi-family permit activity to assess. Some jurisdictions actively use the regulatory process to discourage development—the project-approvals process was not evaluated in those jurisdictions. Nor were the number and types of projects that become regulatory horror stories evaluated. The effects of delays and mandated project design changes on housing prices were also not considered. While our time-line analysis starts after the first permit application is submitted, many of the key activities and much of the time involved in the approvals process, occurs well before actual permit applications are filed. Finally, the cumulative effects of the regulatory process on the composition of the homebuilding industry have not been studied. The very large and well-capitalized homebuilders that remain active in California have successfully learned how to cope with the process. Many smaller and less well-capitalized builders have presumably left the California market.

The regulatory calmness of the 1994-97 period notwithstanding, new storm clouds have recently appeared on the horizon. Pushed by agriculture and open-space interests, a significant number of communities have already adopted, or are considering adopting urban growth boundaries (UGBs). Even more onerous is a series of initiatives that would require voter approval of all new housing projects above a certain minimum size.

The Costs of Underproducing Housing

What might happen should past trends continue and future housing production fall short of demand? How might future housing production shortages affect California and its residents?

California housing prices go up and down in response both to general economic conditions and to shifts in the balance of supply and demand. Between 1969 and 1999, California home prices increased at the average annual rate of 7.5 percent, resulting in a November 1999 median sales price of $221,890.[1] Prices and rents increased more and faster in supply-constrained coastal markets; and less and slower in inland markets, where production more closely matched demand. Like housing prices, California incomes are also higher. But they are not that much higher. As a result, Californians must consistently devote more of their incomes to housing than residents of other states. Among urban Californians, homeownership cost burdens are consistently two to five percentage points higher than for residents of comparable metropolitan areas outside California.

For renters, the differences are even larger. In 1995, the typical California renter living in a metropolitan area paid one-third of their income for rent. The comparable percentage for the U.S. as a whole was only 28 percent. Low-income renters suffer even more. According to the 1995 American Housing Survey (AHS), more than half of California's 2.5 million low-income renters—those with incomes less than 80 percent of the area median—paid more than 50 percent of their incomes for rent. Ominously, these differences in housing cost burdens between Californians and other U.S. residents have been growing over time.

Largely because housing costs are so high, California homeownership rates have long been below those of the rest of the country. In recent years, the gap has widened further. As of late 1999, California's homeownership rate was 55.7 percent; the homeownership rate for the U.S. in 1999 was 66.8 percent.

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The biggest impact of California's low production levels and high housing prices has been on commute times. Nationwide, according to the American Housing Survey, median commute times among recent homebuyers declined from 19.5 minutes in 1985 to 17.5 minutes in 1995. Inside California, the story was far different. Among recent homebuyers in California metropolitan areas, the median commute time increased from 20 minutes in 1985 to 25 minutes in 1995. Among first-time homebuyers—those hardest hit by rising prices—median commute times increased from 20 minutes in 1985 to 31 minutes in 1995. Ultimately, this problem will begin to take care of itself if employers follow their workers to less expensive suburban markets—a dynamic that has been occurring throughout California for more than 20 years.

Finally, overcrowding is considered. In the short term, overcrowding tracks with in-migration. In the longer term, it tracks with housing cost burdens and production shortfalls. The number of overcrowded housing units in the state's major metropolitan areas increased by 13 percent between 1989 and 1995. As with other housing indicators, these statewide figures mask important differences by tenure and location. Between 1989 and 1993, renter overcrowding increased by substantially with, severe overcrowding of renters increased by about 7.2 percent. Should California continue to under-produce new housing, renter *and* homeowner overcrowding are sure to increase.

An important question is whether and how future housing shortfalls will affect California's now-vibrant economy. Will rising housing prices and the ensuing difficulties attracting labor discourage businesses from expanding or locating in California? How many existing businesses will move their operations to less expensive locations, or perhaps leave the state entirely? Given the current strength of California's economy, these questions may seem a trifle over-dramatic. It is important to keep in mind, however, that the economic development impacts associated with high housing and living costs are most acutely felt not during the upside of the business cycle, but during the downside.

California will need more suburban housing, more infill housing, more ownership housing, more rental housing, more affordable housing, more senior housing, and more family housing.

Conclusion—Raising the Roof

Two conclusions stand out from this research above all others. The first is that California will need an unprecedented amount of new housing construction—more than 200,000 units per year through 2020—if it is to accommodate projected population and household growth and still be reasonably affordable. California will need more suburban housing, more infill housing, more ownership housing, more rental housing, more affordable housing, more senior housing, and more family housing. California will also need more diverse housing, and more diverse neighborhoods. California's high land and construction costs, coupled with the cumbersome and open-ended nature of the local entitlements process, have served to discourage innovative land planning, site design, and building design.

The second overriding conclusion is that while there are few intrinsic limitations to meeting California's future housing needs, the core of the existing housing production system is too fragmented and haphazard to produce the volume and quality of housing needed. This conclusion applies to the laws and procedures that govern housing development, the funding and lending programs, and the myriad public, private, and non-profit organizations that produce and operate housing in California. If indeed California is to remain a state where people from all backgrounds and walks of life are able to pursue the American dream of homeownership and secure housing tenure, then substantial investment and innovation in housing development policy, financing, and planning will be required. ❐