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WORKING PAPER NO. 87-132

HOUSING IN SAN FRANCISCO:
SHELTER IN THE MARKET ECONOMY

BY

JOHN A. HIRD

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MICHAEL L. WISEMAN

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The University of California, Berkeley

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ABSTRACT

This paper traces the development of the San Francisco Bay Area housing market over the past forty years, and analyzes the effects of various private and public policies on land use and development. The Bay Area has grown dramatically, particularly outside of San Francisco, while problems of overcrowding and inadequate housing amenities have declined markedly over the same period. The major and growing problem afflicting the housing market is affordability. Housing prices have far outstripped consumer prices and construction costs, indicating that rising land values and the effects of Proposition 13 (which caused communities to effectively exclude low-income households) exacerbate the problem. Many government programs create substantial incentives for homeownership through indirect tax benefits and direct subsidies. As a result market forces restrain the ability of moderate income households to purchase homes, particularly in the Bay Area, at the same time that government programs bestow substantial benefits on wealthy homeowners.

HOUSING IN SAN FRANCISCO: SHELTER IN THE MARKET ECONOMY

by

John A. Hird, John M. Quigley, and Michael L. Wiseman*

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1. INTRODUCTION

Housing policy in the United States relies upon private enterprise to supply shelter for virtually all households in an allocation process realized by free markets. On the demand side, households generally receive housing in amounts and qualities consistent with their own choices, given their preferences, their overall budgets, and market prices. On the supply side, the design, construction, and financing of housing are organized by the private sector, with only limited and often indirect government involvement. Housing production is undertaken by entrepreneurs, many quite small, who construct housing in local and regional markets. This housing is distributed to citizens through markets in which prices are determined by supply and demand. Housing finance is governed not by direct political or parliamentary decisions, but rather by those of private financial intermediaries who offer a variety of long-and short-term financing mechanisms depending upon market conditions.

All of these statements require considerable qualification. Although housing is overwhelmingly the responsibility of the private sector in United States, all levels of the U.S. government play important roles in the determination of both housing supply and demand. In some cases, local governments build, own, and manage housing using resources provided by the federal (central) government. The financing of new construction and of mortgage obligations has been greatly influenced by the regulations and credit guarantees of the federal government. The availability of land for housing and for other urban developments is quite heavily regulated by state and local authorities, and the construction process itself is regulated at the local level. Moreover, the attractiveness of housing and residential construction is greatly influenced by the tax policies adopted by the federal government and by the systems of taxation used by local governments. Thus, it would be a mistake to conclude that because the market plays

a dominant role in the housing sector of the United States, the role of government is insignificant.

This paper provides an overview of the housing market and housing conditions in the San Francisco Bay Area of California and suggests some of the ways in which housing outcomes are related to housing policies. The essay starts by describing the characteristics of the Bay Area, its housing market, and its housing problems. Section 3 presents a general discussion of the U.S. federal and state housing assistance policies and their interaction with local housing policies in California. Bay Area regionalism and localism in land use and development is discussed in Section 4. A summary and some conclusions are presented in Section 5.

2. THE SAN FRANCISCO BAY AREA

The state of California has the largest population of any of the 50 U.S. states.¹ It ranks third among the states in area, and is roughly the size of Austria, West Germany and Hungary combined, but smaller than either Sweden or France. Situated on the long western coast of the U.S., California's massive economy (its Gross State Product of roughly \$600 billion, around 12 percent of the U.S. GNP, is larger than the combined GNP's of the Scandinavian and Benelux countries.) includes a diverse array of export products -- agriculture, electronics, entertainment, and tourism, to note merely a few. The state governor, together with the two representative legislative bodies, the State Assembly and

¹ For a more comprehensive review of the Bay Area economy, see Hoerter and Wiseman (1986).

Senate, command a taxation and spending authority commensurate with a large economy. The governor's proposed 1987 budget totalled more than \$37 billion.

The Bay Area is advantageously located on the coast of this most wealthy and populous state, about 300 miles north of Los Angeles, the third largest American city. Figure 1 shows the geographical position of the Bay Area in California. Figure 2 indicates the position of San Francisco, as well as its principal satellite cities, San Jose and Oakland, within the Bay Area.

The Bay Area includes the nine California counties surrounding the San Francisco Bay. Socially, politically, and economically, the Bay Area is dominated by the (combined) City and County of San Francisco, which is located on the peninsula that forms the southwestern side of the Bay itself. Although the city was originally settled by Spanish explorers in the early 1800s, the housing, industry and infrastructure of San Francisco and the entire region were virtually built anew after a massive earthquake in April 1906. While it is the earthquake itself that remains prominent in the minds of today's Bay Area residents, it was the ensuing fire that caused most of the property damage. This fire burned for three days and two nights and spread over more than 500 city blocks. It destroyed 28,000 houses, claiming the lives of more than 500 persons and causing property damage in excess of \$500 million. However, with the aid of \$300 million in fire insurance payments San Francisco was largely rebuilt in less than five years. The capstone of the reconstruction was the new Civic Center; the Panama-Pacific International Exposition of 1915 left the city with the existing Palace of Fine Arts and a renewed sense of pride (see Cleland, 1947).

FIGURE 1.

The San Francisco-Oakland-San Jose SCSA

FIGURE 2
The Bay Area

Because it was at first the state's only metropolis, San Francisco was long and familiarly known in California as "the City," and the Bay Area was the home of the state's only university campus in Berkeley. By the 1920s, however, Los Angeles had surpassed San Francisco in both population and industry. In part because of its great natural harbor, San Francisco remained a major military, manufacturing, and shipping center during World War II, and many who passed through the area later settled in and around San Francisco (see Hart, 1978). The San Francisco-Oakland Bay Bridge, erected in 1936, connected San Francisco with the "East Bay" (replacing a ferry system), and provided a vital transportation link for those working in San Francisco but living outside. Two years later, the Golden Gate Bridge was completed, connecting San Francisco with Marin county, and San Francisco became accessible to all areas surrounding the Bay. Prior to World War II, land use outside of San Francisco and the older cities between Oakland and Richmond was predominantly agricultural. The Veterans' Administration home loan program for returning veterans helped to finance new development outside the major cities, and the Bay Area's agricultural foundation gave way to a regional economy of some cohesion.

Today, San Francisco is both the smallest (119 sq km) and the most densely populated (5700 persons per sq km) county in California. With a population of 679,000, San Francisco ranked 13th in city size in the U.S. in 1980 (down from 9th in 1900). When compared with other similarly defined conurbations, however, the Bay Area ranks 5th among large American agglomerations in population and 6th in population density. Table 1 indicates the position of San Francisco in the U.S. urban hierarchy.

TABLE 1

Population Rank of U.S. Cities and Metropolitan Agglomerations, 1980

Rank	City	Population (thousands)	Agglomeration	Contiguous Urban Population (millions)
1	New York City	7,072	New York City- Northeastern New Jersey- Southern Connecticut	18.0
2	Chicago	3,005	Los Angeles-Long Beach- San Bernardino- Riverside	10.0
3	Los Angeles	2,967	Chicago-Northwest Indiana-Aurora- Elgin-Joliet	7.2
4	Philadelphia	1,688	Philadelphia- Wilmington-Trenton	4.8
5	Houston, Texas	1,595	<i>San Francisco-Oakland San Jose</i>	4.4
6	Detroit, Mich.	1,203	Detroit	3.8
7	Dallas, Texas	904	Boston-Brockton-Lowell- Lawrence/Haverhill	3.2
8	San Diego, Ca.	876	Miami-Fort Lauderdale- Hollywood-West Palm Beach	3.1
9	Phoenix, Ariz.	790	Washington, D.C.	2.8
10	Baltimore, Md.	787	Houston-Texas City- Lamarque	2.5
11	San Antonio, Tex.	786	Cleveland-Akron- Lorain-Elyria	2.5
12	Indianapolis	701	Dallas-Ft. Worth	2.4
13	<i>San Francisco</i>	679	St. Louis	1.8

Source: Long and DeAre (1983).

As Table 2 indicates San Francisco's population has actually declined moderately since 1950 and is up by only seven percent over the past forty years (see Table 2). In contrast, the populations of California and the rest of the Bay Area have grown dramatically over the same period. California's population increased by almost 250 percent while the population of the Bay Area (excluding San Francisco) tripled. While the share of state population located in the Bay Area declined only slightly during this period (from 25 to 22 percent), San Francisco's share of Bay Area population fell much more precipitously. As indicated in Figure 3, in 1900 the central city/county contained more than half of the region's population; San Francisco today has only slightly more than 13 percent of area population. Clearly, San Francisco is no longer the only center of population in the Bay Area, and as a result it can no longer dominate regional politics as it did in years past.

The relative importance of natural population increase and net migration in the growth of the Bay Area varies considerably by region. As indicated in Table 3, about half of all population growth in the decade 1970-1980 resulted from net migration. In the northern counties, three quarters of the increased population arose from relocations; in the East Bay it was less than one quarter.

San Francisco is one of the most ethnically diverse cities in one of the most ethnically diverse states in the U.S. While the U.S. population is over 83 percent white, California's is just 77 percent white and San Francisco is less than 60 percent white. Nearly 22 percent of San Francisco's population is Asian, from dozens of countries; over 12 percent of the population is black; and over 12 percent are of Spanish origin. For the U.S. as a whole, in 1980 the population was 1.6 percent Asian, 11.7 percent black, and 6.5 percent persons of Spanish origin. In addition, San Francisco has a higher percentage of

TABLE 2

Bay Area Population by County, 1940-1980
(Thousands)

County	1940	1950	1960	1970	1980	Percent Change 1940-1980
Alameda	513	740	908	1,073	1,105	+116%
Contra Costa	100	299	409	558	656	+553
Marin	53	86	147	206	223	+321
Napa	29	47	66	79	99	+248
San Francisco	635	775	740	716	679	+7
San Mateo	112	236	444	556	587	+425
Santa Clara	175	291	642	1,065	1,295	+640
Solano	49	105	135	170	235	+379
Sonoma	69	103	147	205	300	+334
Bay Area Total	1,734	2,681	3,639	4,628	5,180	+199
Bay Area Excl. San Francisco	1,100	1,906	2,899	3,913	4,501	+309
California	6,907	10,586	15,717	19,958	23,668	+243

Source: U.S. Census.

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TABLE 3

Natural Increase and Migration as Sources of Bay Area Growth, 1970-1980

Area/ Year	Population	Change in Population	Annual Change	Natural Increase	Net Migration
San Francisco					
1970	715,674				
1980	678,974	-36,700	-0.5%	3,789	-40,489
North Bay ^a					
1970	662,598				
1980	856,654	+194,056	+2.9	42,837	+151,219
East Bay ^b					
1970	1,628,989				
1980	1,761,764	+132,775	+0.8	102,650	+30,125
South Bay ^c					
1970	1,623,022				
1980	1,882,401	+259,379	+1.6	140,507	+118,872

Source: U.S. Census.

a "North Bay" includes Marin, Sonoma, Napa and Solano counties.

b "East Bay" includes Alameda and Contra Costa counties.

c "South Bay" includes San Mateo and Santa Clara counties.

older residents and persons living below what the federal government designates as the poverty level than does either California as a whole or the U.S.²

The demographic data for the rest of the Bay Area make a sharp contrast. As noted in Table 4, the population in the other 8 counties of the Bay Area is generally less ethnically diverse, younger, and wealthier. In the eight surrounding counties, almost 80 percent of the population is white, and less than 10 percent of the population is elderly (compared to 15 percent in the central city). The poverty rate is 13.7 percent in the city of San Francisco, yet only 8.4 percent in the rest of the Bay Area.

Table 5 provides more information on household size and relative incomes in the Bay Area. The region has somewhat smaller households, on average, than the rest of the state. By any measure, households in the region are prosperous, at least on average. The mixture of household types in the Bay Area and in San Francisco has changed, particularly since 1970. On the one hand, the number of single parent, childless married couples and single adult households has increased. By and large, this change amounts to a shift toward household types that have traditionally had lower incomes. On the other hand, the city has become especially attractive to highly educated workers in the business service sector and to homosexuals; in particular, the number of young single males, living alone or in couples, has increased. The economic consequences of this turn largely on the fact that these groups are relatively affluent, have a high

² The federal government classed a family of three as poor in 1980 if pretax family income was less than \$6,565; the threshold for a family of four was \$8,414. The corresponding standards for 1986 were \$8,570 and \$10,990, respectively.

TABLE 4

Comparative Bay Area Demographic and Income Characteristics, 1940-1980.

Category	Region	1940	1950	1960	1970	1980
<hr/>						
Percent White						
	San Francisco	95.0	89.5	90.0	71.7	59.2
	Other Counties	96.3	92.6	96.2	89.5	78.6
	California	95.5	93.7	94.4	89.5	77.0
<hr/>						
Percent Spanish						
	San Francisco	NA	NA	NA	14.2	12.4
	Other Counties	NA	NA	NA	12.5	12.2
	California	NA	NA	NA	15.5	19.2
<hr/>						
Percent Elderly						
	San Francisco	8.2	9.6	12.6	14.0	15.4
	Other Counties	8.1	7.6	7.9	7.9	9.5
	California	8.0	8.5	8.8	9.1	10.2
<hr/>						
Percent Poor						
	San Francisco	NA	NA	NA	9.9	13.7
	Other Counties	NA	NA	NA	6.6	8.4
	California	NA	NA	NA	8.4	11.4
<hr/>						
Median Age						
	San Francisco	NA	36.2	37.3	34.5	34.1
	Other Counties	NA	31.0	29.4	28.0	30.8
	California	NA	32.1	30.0	28.4	29.9
<hr/>						
Median Family Income						
(Thousands of 1980 Dollars)						
	San Francisco	NA	\$13.4	\$18.7	\$22.3	\$23.7
	Other Counties	NA	\$13.2	\$20.2	\$25.4	\$28.6
	California	NA	\$12.3	\$18.7	\$22.8	\$24.4

NA = Not Available.

Source: U.S. Census. Due to a change in definition, 1980 "Spanish" proportions are not strictly comparable to those for earlier years.

TABLE 5
Selected Income and Poverty Characteristics, 1979

Region	Average Hshld. Size	Tot.Civ. Employed Per Hshld.	Average Hshld. Income \$	Median Hshld. Income \$	Per Capita Income \$	Poverty Rate, Persons ¹	Poverty Rate, Families ²	Percent High Income ³
United States	2.74	1.21	20,306	16,841	7,400	12.4	9.6	1.4
California	2.67	1.23	22,415	18,243	8,388	11.4	8.7	2.0
Bay Area Cities	2.56	1.28	24,303	n.a.	9,483	n.a.	n.a.	n.a.
San Francisco	2.18	1.14	20,551	15,866	9,413	13.7	10.3	1.9
Oakland	2.33	1.00	17,969	13,780	7,720	18.5	16.0	1.1
San Jose	2.96	1.47	24,946	22,886	8,441	8.2	6.3	1.2
Counties								
Alameda ⁴	2.52	1.20	21,772	18,700	8,636	11.3	8.7	1.4
Contra Costa	2.69	1.26	26,538	22,870	9,863	7.6	6.1	2.6
Marin	2.43	1.32	30,757	24,554	12,673	7.0	4.9	5.2
Napa	2.54	1.17	22,616	18,887	8,891	8.1	6.0	1.7
San Francisco ⁵	2.18	1.14	20,551	15,866	9,413	13.7	10.3	1.9
San Mateo	2.58	1.39	27,640	23,172	10,730	6.1	4.5	3.2
Santa Clara ⁶	2.76	1.44	26,588	23,369	9,624	7.1	5.3	2.2
Solano	2.82	1.12	21,104	19,264	7,497	9.4	8.1	0.8
Sonoma	2.55	1.13	20,944	17,732	8,212	9.5	7.1	1.3

¹ Percent of Persons, poverty status determined.

² Families, 1979 income below poverty level, as a percent of all families.

³ Percentage of households with 1979 income greater than \$75,000.

⁴ Includes Oakland.

⁵ Coextensive with San Francisco City.

⁶ Includes San Jose.

Source: U.S. Department of Labor, Employment and Training Administration, 1980.

labor force participation rate, and have a strong preference for residing in the central city.

Housing in the Bay Area (and in California) has grown dramatically since 1940. As Table 6 shows, San Francisco's total housing stock grew by only 42 percent since 1940, while the stock of the rest of the region has more than quadrupled. In part as a result of the boom in the semiconductor industry, the housing stock in Santa Clara county, in the South Bay, increased eight-fold. Growth in housing in Contra Costa county, in the East Bay, was a close second.

As Table 7 indicates, the portion of total dwelling units occupied by owners peaked around 1960 when the "baby-boom" generation reached home-buying age; despite the ensuing decline in the proportion of owner-occupied units owner occupancy was still by 1980 remains, substantially above the levels of 1940-50. Though reliable statistics are not available for more recent years, widespread evidence of condominium conversion and the coming of age of the children of the "baby-boom" generation suggest that owner-occupied units are playing an increasing role in today's housing market.

B. Housing Conditions

By any comparative standard, Americans are on average well-housed, and San Franciscans are no exception. Table 8 indicates trends in the level of overcrowding of dwellings (defined as units with more than one person per room, kitchen excluded).

During the past forty years, the level of overcrowding in California has declined by more than 40 percent. In the Bay Area as a whole, less than 5

TABLE 6
Total Year-Round Housing Units
by County, 1940-1980
(thousands)

County	1940	1950	1960	1970	1980	Percent Change 1940-1980
Alameda	173.0	247.1	310.3	379.7	444.4	+157%
Contra Costa	31.3	90.6	124.3	178.3	251.7	+704
Marin	16.5	28.6	49.6	70.6	92.4	+461
Napa	8.8	13.7	21.2	26.8	38.4	+339
San Francisco	222.2	265.7	310.6	310.4	316.4	+42
San Mateo	37.2	76.6	141.8	190.1	232.9	+526
Santa Clara	56.4	91.7	199.9	336.2	473.5	+740
Solano	15.3	33.0	41.9	53.5	84.1	+449
Sonoma	26.8	40.0	59.8	77.2	123.7	+361
Bay Area Total	587.5	887.0	1,259.3	1,622.8	2,057.5	+250
Bay Area Excluding San Francisco	365.3	621.3	948.7	1,312.4	1,741.1	+377
California	2,340.4	3,590.7	5,465.9	6,976.3	9,220.4	+294

Source: U.S. Census.

TABLE 7

Owner-Occupied Housing Units,
1940-1980

	<u>1940</u>	<u>1950</u>	<u>1960</u>	<u>1970</u>	<u>1980</u>	Percent Change <u>1940-1980</u>
San Francisco						
Owner-Occupied Units	69,541	97,521	108,696	101,806	106,610	+53%
Total Dwelling Units	222,176	265,726	310,559	310,383	316,351	+42
% Owner Occupied	31.3	36.7	35.0	32.8	33.7	+8
Other Bay Area						
Owner-Occupied Units	186,166	360,685	616,189	786,379	1,041,802	+460
Total Dwelling Units	365,331	621,324	948,718	1,321,426	1,741,127	+337
% Owner Occupied	51.0	58.1	65.0	59.9	59.8	+17
California						
Owner-Occupied Units	936,149	1,949,728	3,192,068	3,836,944	5,154,215	+451
Total Dwelling Units	2,340,373	3,590,660	5,465,870	6,976,261	9,220,421	+294
% Owner Occupied	40.0	54.3	58.4	55.0	55.9	+40

TABLE 8
Crowded Dwellings,^a
by County (in Percent)

County	1940	1950	1960	1970	1980	Percent Change 1940-1980
Alameda	7.4	9.3	8.2	6.3	4.7	-36.1%
Contra Costa	13.1	17.6	9.1	5.5	2.9	-77.9
Marin	4.9	8.9	6.1	3.4	1.7	-65.3
Napa	5.3	8.9	7.4	5.4	3.4	-35.8
San Francisco	7.8	7.7	6.3	6.8	7.3	-6.4
San Mateo	7.3	6.2	6.2	4.9	5.1	-30.1
Santa Clara	11.0	12.3	9.0	6.4	5.3	-51.8
Solano	11.7	11.7	10.6	7.3	4.5	-61.5
Sonoma	8.4	9.9	8.9	6.5	3.3	-60.7
Bay Area Total	8.2	9.8	7.7	6.1	4.8	-41.6
Bay Area Excluding San Francisco	8.5	10.7	8.2	5.9	4.4	-48.8
California	12.9	12.3	9.5	7.7	7.4	-42.6

^a "Crowded" defined as dwellings with 1.01 or more persons per room, excluding kitchen.

Source: U.S. Census.

percent of households live in overcrowded conditions. During this period, the reduction in overcrowding was much less in San Francisco than in any of the other counties. In fact, during the 1960-1980 period, the level of overcrowding increased from 6.3 to 7.3 percent. In part, this reflects the living conditions of low-income recent immigrants, especially Southeast Asians. During this same period, utilization of dwellings with sanitary conditions (dwellings lacking toilet, bath, or running water) was virtually eliminated. By 1980, less than one percent of Bay Area dwellings were substandard on this criterion. In the central city, almost 4 percent of dwellings lack sanitary facilities (or else they are shared), down from 20 percent in 1940 (see Table 9). Table 10 reports similar changes in the fraction of dwellings lacking heat. By 1980, virtually all dwellings in the Bay Area had heat, even though the rather mild climatic conditions make such a deficiency less significant here than elsewhere.

One further measure of the quality, or at least the character, of the housing stock may be its age. Limited information is available on the year of construction of owner-occupied housing. More than half of the owner-occupied dwellings in San Francisco were built before 1939. For other parts of the region, the stock is much newer, with less than 15 percent dating from before World War II (see Table 11).

C. Housing Adequacy

Not surprisingly, given the free market orientation of the U.S. housing market, most of the substandard and low-quality dwellings noted above are also the least expensive, occupied by the lowest-income households. But as Table 12 indicates, this does not mean that the incidence of substandard housing is

TABLE 9
Occupied Dwellings Lacking Complete Plumbing for Exclusive Use,
by County (in Percent)

County	1940	1950	1960	1970	1980	Percent Change 1940-1980
Alameda	14.5%	7.8%	5.3%	1.9%	1.2%	-91.7%
Contra Costa	17.6	6.7	4.3	0.9	0.5	-97.2
Marin	13.7	4.9	3.7	0.8	0.8	-94.2
Napa	20.9	8.6	7.1	0.8	0.6	-97.1
San Francisco	19.6	8.9	13.2	6.4	3.8	-80.6
San Mateo	10.2	2.5	1.7	0.8	0.9	-91.1
Santa Clara	18.0	10.6	4.4	0.8	0.9	-95.0
Solano	20.8	7.5	6.2	0.8	0.6	-97.1
Sonoma	23.8	10.5	8.0	1.1	0.8	-96.6
Total Bay Area	17.3	7.9	6.7	2.2	1.3	-92.3
Bay Area Total Excluding San Francisco	15.9	7.4	4.6	1.1	0.9	-94.4
California	22.0	14.1	6.8	1.5	1.2	-94.5

Source: U.S. Census.

TABLE 10

Dwellings with No Heat,
by County (in Percent)

County	1950	1960	1970	1980	Percent Change 1950-1980
Alameda	1.6%	1.2%	0.4%	0.3%	-81.6%
Contra Costa	1.3	0.6	0.1	0.2	-86.4
Marin	0.9	1.0	0.1	0.2	-83.5
Napa	0.6	1.1	0.3	0.2	-65.0
San Francisco	4.8	5.3	2.4	1.1	-76.6
San Mateo	0.8	0.5	0.2	0.2	-77.5
Santa Clara	1.8	1.0	0.2	0.2	-90.9
Solano	0.8	0.9	0.1	0.2	-73.7
Sonoma	1.0	12.6	0.5	0.4	-66.0
Total Bay Area	2.4	2.1	0.7	0.4	-85.1
Bay Area Total Excluding San Francisco	1.3	1.0	0.2	0.2	-84.0
California	1.7	2.1	0.9	0.9	-47.1

Source: U.S. Census.

TABLE 11
Vintage of Owner-Occupied Housing Stock
(in Percent)

	Before 1939	1940-49	1950-59	1960-69	1970-74	1975-80
San Francisco						
CC	58.2%	22.0%	12.0%	5.2%	1.1%	1.5%
MSA	23.5	16.4	24.8	19.6	7.3	8.3
San Jose						
CC	6.6	4.4	17.1	34.8	19.3	17.8
MSA	7.2	7.4	28.1	30.5	13.0	13.7
Santa Rosa						
CC	9.8	10.2	16.0	26.2	15.7	22.1
MSA	12.9	10.1	16.8	24.3	15.9	20.0
Napa						
CC	11.6	12.5	24.5	23.2	15.6	12.6
MSA	10.1	10.9	21.2	20.0	13.2	24.7

CC = Central City.

MSA = Metropolitan Statistical Area. The San Francisco-Oakland MSA includes Marin, San Francisco, San Mateo, Alameda and Contra Costa counties. The San Jose MSA includes only Santa Clara county. The Santa Rosa MSA includes Sonoma county. The Vallejo-Fairfield-Napa MSA includes Napa and Solano counties.

Source: U.S. Census.

TABLE 12

Apartment Lacking Complete Plumbing,
by Income Class of Residents (in Percent)

		1979 Household Income (\$)																			
		<5000		5000-9999		10,000-12,499		12,500-14,999		15,000-19,999		20,000-24,999		25,000-34,999		35,000-49,999		50,000+		All Units	
San Francisco	CC	12.13	6.72	3.52	2.85	2.46	2.17	1.44	1.44	1.44	1.44	1.44	1.44	1.44	1.44	1.44	0.96	5.08			
	MSA	6.73	3.61	2.19	1.85	1.52	1.59	1.07	1.07	1.07	1.07	1.07	1.07	1.07	1.07	1.07	0.92	2.85			
San Jose	CC	3.27	1.58	2.06	1.57	1.63	1.06	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.80	1.70			
	MSA	3.19	1.71	1.83	1.46	1.55	1.18	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.87	0.51	1.56			
Santa Rosa	CC	2.18	0.25	0.51	1.73	0.29	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.71			
	MSA	3.18	1.10	1.44	1.11	0.63	0.50	0.58	0.58	0.58	0.58	0.58	0.58	0.58	0.58	0.58	1.13	1.32			
Napa	CC	2.07	1.50	0.00	1.48	0.97	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.95			
	MSA	2.05	1.51	0.91	0.61	0.77	0.13	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.00	1.03			

CC = Central City.

MSA = Metropolitan Statistical Area. The San Francisco-Oakland MSA includes Marin, San Francisco, San Mateo, Alameda and Contra Costa counties. The San Jose MSA includes only Santa Clara county. The Santa Rosa MSA includes Sonoma county. The Vallejo-Fairfield-Napa MSA includes Napa and Solano counties.

Source: U.S. Census.

particularly high, even among the poor. A similar impression is gained from data on overcrowding.

D. Housing Affordability

Housing in the Bay Area is among the most expensive in the U.S. Though this is no doubt in part due to quality differences, serious problems of housing affordability have arisen and will continue to affect the welfare of Bay Area residents.

Table 13 summarizes median gross rent and housing values for San Francisco and for the remainder of the Bay Area. Table 14 reports housing expenditures for renters, as a fraction of income, as reported by the 1980 U.S. census. These rent-to-income figures are high by international standards and are also well above the U.S. average. About 55 percent of San Francisco renters spend more than one-quarter of their incomes on rent; one-third of San Francisco renters pay rents that are above 35 percent of their incomes.

The percentage increase in San Francisco's median gross rent exceeded the increase in median income (both in constant dollars) in every decade since 1950. The same has been true for median housing prices since 1960. Most notably, however, in the 1970s the inflation-adjusted median house value in San Francisco rose by 75 percent while gross rents, population, and median incomes fell (see Table 15).

TABLE 13

Bay Area Rents and Housing Values,
by County

Median Gross Monthly Rents
(in 1980 Dollars^a)

County	1940	1950	1960	1970	1980	Percent Change 1940-1980
Alameda	\$160	\$147	\$217	\$278	\$266	+66%
Contra Costa	131	116	214	289	294	+124
Marin	157	161	270	365	373	+138
Napa	123	130	198	253	281	+128
San Francisco	176	144	203	286	285	+62
San Mateo	176	192	298	354	336	+91
Santa Clara	135	147	262	333	334	+147
Solano	153	130	203	259	246	+61
Sonoma	112	140	206	257	289	+159
Bay Area Total	163	144	223	300	299	+84
Bay Area Excluding San Francisco	151	145	235	305	304	+101
California	159	144	220	267	283	+78

Median Value of Owner-Occupied One Family Dwellings
(in 1980 Dollars^a)

County	1940	1950	1960	1970	1980	Percent Change 1940-1980
Alameda	\$24,500	\$37,100	\$41,700	\$50,300	\$ 85,300	+248%
Contra Costa	20,400	33,100	40,600	54,700	94,600	+364
Marin	25,300	42,300	56,200	71,800	151,000	+497
Napa	18,200	28,100	35,600	45,400	78,200	+329
San Francisco	29,200	40,800	48,100	59,800	104,600	+258
San Mateo	28,800	42,900	51,200	64,700	124,400	+332
Santa Clara	21,200	36,400	47,600	58,000	109,400	+415
Solano	20,500	29,900	34,500	39,800	67,500	+230
Sonoma	16,900	28,700	37,300	44,800	88,400	+423
Bay Area Total	24,800	37,400	45,100	56,000	101,600	+309
Bay Area Excluding San Francisco	23,200	36,500	44,500	55,500	101,200	+336
California	19,700	32,700	42,000	49,000	84,700	+329

^a Consumer Price Index used to convert values to 1980 dollars.
Source: U.S. Census.

TABLE 14

Average Ratio of Gross Rent to Income,
by Income Class (in Percent)

1979 Household Income (\$), Renters

All Renting
Households

		1979 Household Income (\$), Renters										All Renting Households
		5000- 9999	10,000- 12,499	12,500- 14,999	15,000- 19,999	20,000- 24,999	25,000- 34,999	35,000- 49,999	50,000+			
San Francisco	CC	50.8%	40.9%	31.5%	26.8%	22.5%	18.0%	14.4%	10.8%	7.6%	30.1%	
	MSA	52.3	42.0	32.0	27.2	22.5	18.3	14.6	11.1	7.8	30.1	
San Jose	CC	54.5	45.2	34.9	29.0	24.5	20.3	15.8	12.5	8.1	31.1	
	MSA	54.9	46.2	35.1	29.7	24.5	20.2	15.7	12.0	8.0	29.7	
Santa Rosa	CC	54.3	44.6	32.9	28.1	23.4	18.3	15.1	10.0	7.5	33.1	
	MSA	53.3	43.1	32.0	27.2	22.8	18.1	14.5	10.4	7.7	32.0	
Napa	CC	53.1	42.8	32.7	27.2	22.5	17.6	14.9	11.3	7.5	31.4	
	MSA	52.8	38.5	28.4	24.1	20.1	15.8	13.0	9.4	7.5	29.4	

CC = Central City.

MSA = Metropolitan-Statistical Area. The San Francisco-Oakland MSA includes Marin, San Francisco, San Mateo, Alameda and Contra Costa counties. The San Jose MSA includes only Santa Clara county. The Santa Rosa MSA includes Sonoma county. The Vallejo-Fairfield-Napa MSA includes Napa and Solano counties.

Source: U.S. Census.

TABLE 15

Population, Housing Value, Rent, and Income,
Bay Area, 1940-1980
(In 1980 Dollars, where applicable)

Region	Family Income	1940	1950	1960	1970	1980
San Francisco						
(Number)	Population	634,635	775,357	740,316	715,674	678,97
(Median Values)	Family Income	NA	\$13,428	\$18,689	\$22,271	\$20,91
	Housing Value	\$29,187	\$40,826	\$48,136	\$59,769	\$104,60
	Gross Rent	\$176	\$144	\$203	\$286	\$28
Other Counties						
(Number)	Population	1,099,772	1,905,965	2,898,623	3,912,525	4,500,81
(Median Values)	Family Income	NA	\$13,213	\$19,961	\$25,422	\$25,22
	Housing Value	\$23,209	\$36,509	\$44,514	\$55,471	\$101,24
	Gross Rent	\$151	\$145	\$235	\$305	\$30
			1940-1950	1950-1960	1960-1970	1970-1980
San Francisco						
(% Change)	Population		22.2%	-4.5%	-3.3%	-5.1%
	Family Income		NA	39.2	19.2	-6.1
	Housing Value		39.9	17.9	24.2	-75.0
	Gross Rent		-18.4	41.3	41.0	-0.5
Other Counties						
(% Change)	Population		-4.0%	62.1%	29.8%	15.0%
	Family Income		NA	51.1	27.4	-0.8
	Housing Value		57.3	21.9	24.6	82.5
	Gross Rent		-4.0	62.1	29.8	-0.3

Source: U.S. Census.

Note: The change in housing cost is understated since housing prices are included in the Consumer Price Index, which is used to convert values to 1980 dollars.

Note: The growth in gross rent for much of the Bay Area is understated after 1960 because of the housing rent controls in effect in Berkeley, San Francisco, Oakland, and six other Bay Area localities.

3. FEDERAL AND STATE HOUSING POLICY

A. General Overview

The United States does not have a national housing policy in the comprehensive sense in which the term is typically used in Europe. Most federal and state housing policies operate through tax and capital markets to increase the demand for housing or the supply of capital to the housing sector. At the same time the regulation of public health, safety, and welfare is undertaken by the 50 states and by the many counties, cities, and towns within them. These public health, safety, and welfare regulations may include the establishment of standards for construction and maintenance of dwellings and even the regulation of rents. Local governments are empowered to regulate existing housing and the conditions under which new housing is constructed. Even when new housing construction is funded directly by higher levels of government, it is carried out at the local level. The important aspect is that while many levels and agencies of government participate in the process that leads to the provision of housing, unlike the circumstances in many other countries no agency in the U.S. has comprehensive responsibility for the growth of the housing supply. While local governments are nominally created by the states (and are not, in fact, acknowledged in the U.S. constitution), in most states the rights of local government to housing regulation are entrenched in constitution, custom, and popular sentiment and are thus challenged only at substantial political peril.

B. Direct Expenditures

The conflict between local government activities and the broader objectives of housing policy are readily illustrated by developments in the Bay Area. In this section the attempts of federal and state governments to increase the supply of housing are discussed in four general categories. The first includes direct housing assistance and direct government subsidies for housing. The second is the relationship between housing policy and the various systems of

taxation at the federal, state, and local levels. The third section discusses mortgage insurance, credit guarantees, and credit institutions, while the final section involves secondary market operations.

1. Direct Federal Housing Assistance

Direct federal government subsidies for housing in the United States are restricted to low-income households -- generally to households with incomes that are less than half of the median income of a local area. The costs of these programs have been substantial, but the fraction of eligible households served by direct housing assistance is relatively low. Such programs are not "categorical" -- that is they do not serve all households meeting their eligibility criteria -- but rather "selective." Households who are eligible under the income guidelines of housing programs may apply for assistance; if there are sufficient units, these households are served by these programs. It is estimated that in the early 1980s, about one out of every eight low-income households who would qualify for assistance on the basis of their incomes actually received direct housing assistance from the federal government. Although there are a variety of direct housing subsidy programs currently in force in the U.S., the two principal programs are the Public Housing Program, authorized by the Public Housing Act of 1937, and the Low Income Rental Assistance Program operated under Section 8 of the U.S. Housing Act of 1974.³

³ It should be noted that a substantial amount of general welfare assistance (income support) is spent by recipients on housing, though it is omitted from this discussion of specific housing programs.

a. Public Housing

Subsidies are provided for public housing by a federal government cabinet ministry, the Department of Housing and Urban Development (HUD). Under the Public Housing Act, each community may decide for itself whether public housing is to be built. If public housing is needed in a local community, then the local government forms a Local Housing Authority (LHA), a distinct legal entity. The housing authority takes responsibility for designing, developing, owning, operating, and maintaining the public housing facilities, in addition to determining need, selecting sites, and planning and managing the housing project.

The LHA may apply to the federal government for various kinds of assistance. The most important form of assistance from the federal government comes in the form of an "annual contributions contract." Under this contract, the federal government agrees to pay the interest and the amortization of 40-year bonds issued by the local planning authority for the entire construction of a designated public housing project. While an additional form of assistance, annual federal appropriations for operating and maintenance expenditures, was introduced in the early 1970s, the annual contributions contract remains the principal form of assistance for public housing. In practice this means that the federal government is willing to bear all the capital costs of construction and only a small fraction of the operating costs. This form of subsidy encourages local authorities to reduce maintenance expenditures through overdesign, a consequence that is often reflected in the physical appearance of projects. In recent years LHA's have been encouraged to lease housing units under long-term contracts from private landlords rather than to construct facilities themselves.

In return for these federal subsidies, the local planning authority must agree to accept residents in low-income public housing under guidelines issued by the federal government. These guidelines specify that at the time of admission, tenant incomes must be quite low, and until recently also specified that the local planning authority could not charge more than 25 percent of a household's income for rent. As a consequence of the low rents charged (currently no more than 30 percent of tenants' incomes), public housing provides a substantial subsidy to those eligible households who are fortunate enough to be housed. The equity of this subsidy is questionable, however, since it is currently estimated that only about 10 percent of U.S. households eligible on income terms are actually served by low-rent public housing.

b. Section 8

The so-called "Section 8" program has higher income limits than the public housing program, but it still serves poor households.⁴ In contrast to the public housing program, the dwelling units provided under Section 8 are all owned and managed privately, not by housing authorities. Housing is supplied by private, profit-motivated owners, and by non-profit or cooperative organizations. Under this program, the owners enter into long term agreements with the U.S. Department of Housing and Urban Development. HUD agrees to pay the so-called "fair market rent" of the dwelling (certified by local surveys of market rents in the area) over an extended period of time. The owner agrees to accept low-income tenants under federal guidelines. Households participating in the program pay

⁴ Although most families participating in the program have incomes which do not exceed 50 percent of the median income of the area, some fraction of the dwelling units provided under the Section 8 program may be rented to households whose incomes are between 50 and 80 percent of the median income.

30 percent of their income towards rent, and the federal government makes up the difference between this contribution and the "fair market rent" for similar dwellings in the local market.

When originally introduced in 1974, the program was designed to stimulate construction of new facilities for occupancy by eligible households. By the mid 1970's, the program was changed to encourage the "substantial rehabilitation" of dwellings for occupancy by low-income households. Since the early 1980's, the program has been focussed on providing dwellings from the existing stock of standard housing for eligible low-income households.

Although government payments under the Section 8 program are made to landlords, the legislation incorporates many of the features of housing allowances in other countries. A principal difference remains, however: the Section 8 program is not an entitlement program for all low-income households. It is a program providing valuable housing benefits to a small fraction of eligible households.

2. Direct State Housing Assistance

U.S. states differ substantially in their activism with respect to housing policy and in the distribution of responsibilities between state and local governments. In California, direct expenditures specifically on housing or rent subsidies by the state or local government are quite small. The state does administer over a dozen loan programs that aid various segments of the population. In 1981, 135,000 households were served by state loan programs. Currently, the state has about \$3.2 billion in outstanding loans; loans to war veterans account for nearly 80 percent of the total.

3. Local Housing Authorities

The 100 local housing authorities (LHA) in California are authorized by the Health and Safety Code to provide housing for "persons or families who lack the amount of income necessary...to enable them to live in decent, safe and sanitary dwellings." Housing authorities receive financial assistance from public or private sources; they prepare, acquire, lease, and operate housing projects on a non-profit basis. They provide for the construction or reparation of housing projects and acquire property for constructing low-income housing. They also issue revenue bonds to finance rehabilitation, and operate leased housing, temporary housing, and farmworker housing.

California's LHA's primarily operate federal programs such as public housing and "Section 8" housing assistance programs, discussed above, though state-sponsored programs, such as those for migrants, are operated by local housing authorities as well. In California, a local election is required before a housing authority can develop, construct, or acquire a low-rent housing project.

Local housing authorities in California serve an ethnically-diverse population. The largest ethnic group served is white (38 percent), followed by black (32 percent), and Hispanic (24 percent). Thirty-nine percent of the households served are elderly, and about one in twelve units were occupied by disabled persons. Most of the units under LHA management are one or two bedroom units (70.6 percent), while less than one-fourth are three or more bedroom units. The remaining 5 percent are one-room units.

As Table 16 illustrates, the growth of Section 8 units since the mid-1970's has been substantial, while conventional public housing assistance has grown only modestly. Over time the share of publicly-provided low-income housing in all housing has grown, but such units still amount to less than 2 percent of the total stock.

Table 17 summarizes the distribution of programs under LHA control in the nine Bay Area counties as of 1983. Most county programs reflect the statewide dominance of Section 8 LHA units over conventional public housing; however, nearly 75 percent of San Francisco's LHA units are funded by public housing expenditures, while fewer than one-fourth are financed by Section 8 monies. Most striking, however, is that fewer than 44,000 Bay Area units are financed directly through LHA's by federal and state programs, compared with over 2 million year-round units in the Bay Area. Thus, like the rest of the state, less than 2 percent of all Bay Area households receive direct federal or state assistance.

C. Taxation and Housing Policy

By far the largest subsidies to housing from both the federal and state governments in the United States arise indirectly through the operation of the federal and state income tax systems. These subsidies arise from the tax treatment of owner-occupied housing and the special regulations that cover the expenses associated with investment in rental housing.

TABLE 16
California Trends in Major Locally-Administered Programs,
Thousands of Units, 1969-1983

Program	1969	1972	1976	1978	1980	1983
Conventional	30.9	33.4	35.1	35.5	36.8	38.6
Section 23*	10.3	28.5	31.6	21.8	9.5	1.1
Section 8	---	---	21.2	70.2	98.6	120.4
Totals	41.2	61.8	87.8	127.5	144.8	160.1
Estimated Total California Dwelling Units	7,711.5	8,139.0	8,709.0	8,994.0	9,279.0	9,633.2
LHA Housing As % of All Units	0.5%	0.8%	1.0%	1.4%	1.6%	1.7%

Sources: *California Housing Authorities: Summary of 1983 Activities*, California Department of Housing and Community Development, Tables 4 and 7; and California Housing Finance Agency.

* The Housing and Community Development Act of 1974 created the Section 8 program and began phasing out the Section 23 program.

TABLE 17

Units Under Local Housing Authority Management,
by Type of Government Program, 1983.

County	Section 8	Conventional Public Housing	Other ^a	Total LHA Managed	Total Dwellings (1980)
Alameda	9,359	3,751	305	13,415	444,422
Contra Costa	4,703	1,882	105	6,690	251,721
Marin	921	500	49	1,470	92,357
Napa	533	- -	11	544	38,405
San Francisco	2,208	6,933	145	9,286	316,351
San Mateo	2,515	230	97	2,842	232,917
Santa Clara	5,808	275	175	6,258	473,523
Solano	1,698	75	205	1,978	84,073
Sonoma	817	- -	46	863	123,709
Bay Area Total	28,562	13,646	1,138	43,346	2,057,478
California Total	120,394	38,636	10,576	169,606	9,220,421

Sources: *California Housing Authorities: Summary of 1983 Activities*, California Department of Housing and Community Development, September, 1986, Appendix pp. 13-17; and U.S. Census.

^a "Other" includes Section 23 (now terminated), FMHA 514/516, State Migrant, Aftercare, and all other programs.

Under the federal Internal Revenue Code (IRC), an investment in owner-occupied housing is treated differently from an investment in other assets in the calculation of the personal income tax liabilities of individuals. If one owns rental property, the net income earned⁵ is taxable at the household's marginal tax rate.⁶ If, instead of renting property, the household "rents to itself," the implicit rent need not be reported as income, but the household can still deduct interest and tax payments as personal expenses. This difference in the treatment of otherwise similar transactions is substantial. The tax subsidy increases with income, since both home values and marginal tax rates increase as households become better off. The regressivity of the subsidy is enhanced by the fact that it is only available to homeowners, since in the U.S. homeowners are generally wealthier than renters. The cost of this subsidy of homeownership to the federal government is quite large; it is expected to increase from about \$31 billion dollars in 1981 to \$83 billion in 1986.⁷

In addition to the provisions associated with net rental income, several other aspects of the tax code subsidize owner-occupancy. Capital gains on housing can be deferred with the purchase of another dwelling, and at age 55 households qualify for a one-time exclusion of \$125,000 in capital gains from

⁵ Net rental income is the gross rent earned by the property minus expenditures on maintenance and depreciation, interest payments, and taxes paid on that property.

⁶ Until the Tax Reform Act of 1986, the highest federal marginal tax rate was 50 percent; this marginal tax rate will be reduced under the Act to a high of 27 percent by 1990.

⁷ U.S. Congressional Budget Office, *The Tax Treatment of Home Ownership: Issues and Options*, September 1981, p.7.

owner-occupied housing. This means that for all practical purposes, capital gains on owner-occupied housing escape taxation. In addition, there are provisions, discussed below, which permit agencies of state and local governments to issue tax-exempt bonds whose revenues are ultimately used to subsidize owner-occupied housing.

While renters receive no direct concessions in the federal tax code, owners of rental properties do. It has long been possible for landlords to depreciate the value of investment in rental properties much more rapidly for tax purposes than the rate at which true economic depreciation occurs. When this is done, properties often show negative profits for tax purposes at the same time cash flow -- that is rents minus expenses other than depreciation -- is positive. These "losses" can then be used to offset taxes that would otherwise be levied on other income. Until the 1986 reform of the tax laws, an investor could often deduct for tax purposes losses from investment that exceed the amount the investor actually had "at risk" in an investment activity.

The Tax Reform Act of 1986 changed these regulations, increasing the period for which investments in real property may be depreciated for tax purposes and reducing deductions to the amount which an investor actually has at risk. Nevertheless, it is still true that the depreciation schedules for real property investment are considerably shorter than the expected economic life of the investment. The value of this subsidy is substantial. While it initially accrues to the owners of the investment property, in a competitive market some fraction of the subsidy is passed on to the renters of those properties.

2. State and Local Tax Expenditures

In California, the state personal income tax accounts for over 40 percent of the total state taxes collected. In 1984, the personal income tax yielded \$11.1 billion (from 11.6 million personal income tax returns), while \$9.8 billion was raised through retail sales and use taxes; banks and corporations paid \$3.8 billion. Local governments in California are financed largely by ad valorem taxes on real property, including owner-occupied and rental housing. Property tax revenues account for 40 percent of the own source revenue of local governments in the state. The importance of income and property taxes for state and local government means that tax policy and housing policy are inextricably linked.

California follows the federal law in the tax treatment of owner-occupied housing; the net income from owner-occupancy is not recorded, but interest payments are deductible from income. In 1984, \$20.9 billion was subtracted from personal income tax returns using this deduction alone. Predictably, most of the benefits of the deduction accrue to higher income households for whom the tax deduction is the most valuable; nearly three-fourths of the deductions were made by households with an adjusted gross income (AGI) of over \$30,000, one-third by those with AGI's over \$55,000, and 12.5 percent (\$2.6 billion) to those with AGI's in excess of \$90,000. For those with AGI's over \$1 million in 1984, the average deduction was over \$37,000, while those making between \$29,000 and \$30,000 annually (roughly the median state income) received an average mortgage interest deduction of \$4,600.

In order to compensate renters who do not qualify for mortgage interest deductions, a renter's tax credit^a is allowed in California. In 1984, the renter's credit amounted to \$474 million for 4.8 million persons, or about \$100 per claimant. These benefits accrue directly to middle- and low-income renters.

The state government provides property tax relief to households both through the income tax and by manipulating the operation of the property tax. Senior citizens, the disabled, and low-income homeowners are reimbursed for a fraction of the property taxes they pay on personal residences. The amount reimbursed varies with income and ranges between 4 and 96 percent of total taxes paid. Each renter is assumed to pay \$250 per year in property taxes; tax relief is based on income. Totally disabled veterans and totally blind persons are exempted from property tax obligations. The first \$7,000 in home value is exempted from property taxation for all homeowners; local governments are directly compensated for this loss by the state. Table 18 reports the direct payments made by the state to Bay Area households under this program.

Taken together, these tax adjustments constitute by far the most expensive housing policies of the state. Table 19 summarizes the value of housing-related tax expenditures in 1981. In that year the mortgage interest deduction alone cost the state \$825 million; permitting taxpayers to deduct property taxes from income before calculating state tax liability cost \$160 million; compensation of local governments through the homeowner assessment exemption cost \$334, and

^a A "credit" is subtracted directly from personal tax liability, while a "deduction" is subtracted from income before computing taxes. Thus, the numbers that follow concerning the renter's credit do not compare directly with those of the mortgage interest deduction since the former is a direct benefit, and does not depend on one's income.

TABLE 18

California Franchise Tax Board
Homeowner and Renter Property Tax Assistance, 1985

a. Homeowners

County	Number of Claimants	Amount of Assistance	Average Assistance
Alameda	3,582	\$369,369	\$103
Contra Costa	2,075	192,039	93
Marin	393	47,420	121
Napa	290	25,436	88
San Francisco	2,105	220,160	105
San Mateo	1,572	176,120	112
Santa Clara	2,511	261,291	104
Solano	508	40,277	79
Sonoma	1,011	91,238	90
Bay Area Total	14,047	\$1,423,350	\$101
California Total	68,985	\$6,206,936	\$90

b. Renters

County	Number of Claimants	Amount of Assistance	Average Assistance
Alameda	10,272	\$1,320,337	\$129
Contra Costa	4,652	588,198	126
Marin	753	92,007	122
Napa	814	88,442	109
San Francisco	14,373	1,825,609	127
San Mateo	2,501	299,971	120
Santa Clara	6,353	774,611	122
Solano	1,991	245,314	123
Sonoma	2,525	295,060	117
Bay Area Total	44,234	\$5,529,549	\$125
California Total	224,883	\$28,274,851	\$126

Source: California Franchise Tax Board, 1985 *Annual Report*, pp. 90, 95.

TABLE 19
Summary of California Housing-Related Tax Expenditures^a

Tax Expenditures of the Federal Government in California	Public Cost (Millions of 1981 Dollars)
Mortgage Interest Deduction	\$3,505
Real Property Tax Deduction	680
Energy-related Tax Credits	53
CHFA Mortgage Revenue Bonds	23
Total	\$4,261
Tax Expenditures of the California State Government	
Mortgage Interest Deduction	\$825
Real Property Tax Deduction	160
Real Property Tax Exemption	334
Renters Income Tax Credit	407
Property Tax Credit for Elderly, Disabled Owners	19
Tax Credit for Elderly, Disabled Renters	48
Property Tax Postponement for Elderly Owners	2
Property Tax Exemption for Disabled Veterans	1
Energy-related Tax Credits	58
CHFA Mortgage Revenue Bonds	5
Total	\$1,859

^a Foregone government revenues.

Source: Furry, 1983.

so on. In sum, housing-related state tax expenditures totaled \$1.86 billion in 1981. Estimated total federal tax expenditures in California during the same year were \$4.24 billion, more than twice the state cost.

3. Tax Exemptions: Mortgage Revenue Bonds and the California Housing Finance Agency

Tax subsidies to selected home buyers are available through state mortgage revenue bond (MRB) programs, used by over a half-million U.S. households since 1982. Interest paid to holders of these bonds is exempt from federal and most state (including California) taxes, and thus the bonds can be sold to investors at lower interest rates. The bonds, authorized by the U.S. Revenue and Expenditure Control Act of 1968, may be used for acquiring residential property (and a variety of other private pursuits), and considerable controversy has surrounded the unrestricted use of private-purpose bonds by state and local governments (See Durning, 1986).

In California, state MRB's are issued by the Housing Finance Agency (CHFA), created in 1975 to assist in providing affordable housing to low- and moderate-income persons and families. The agency passes the savings from below-market interest rates on to home buyers and rental tenants.

The CHFA is a self-supporting state agency, relying on the spread between CHFA loan interest rates and the tax-free bond interest rates to cover its administrative expenses. Direct tax dollars are not used, and the subsidy arises

from income taxes foregone. The value of MRB loans to prospective home-buyers, however, can be substantial.⁹

Figure 4 shows the growth of lending activity sponsored by the CHFA since 1976. The Agency has financed nearly 35,000 units and has assets in excess of \$2.8 billion. In 1981, the total cost of California's CHFA Mortgage Revenue Bonds was \$21.6 million to the federal government and \$4.8 million to the state. The difference reflects the higher federal marginal tax rates (see Table 21).¹⁰

To ensure that mortgage money is channelled to low-income residents, the state of California has required that any multi-family project financed with tax-exempt bond proceeds set aside 10 percent of the units for very-low income tenants (those with incomes less than 50 percent of the county median income) and another 10 percent for households which were slightly better off (less than 80 percent of the median county income).¹¹ Many of the low-income tenants in

⁹ The average mortgage amount of a CHFA loan is roughly \$75,000. When market interest rates were 10.5 percent, the monthly payment for a 30-year mortgage was \$686. At this time, a CHFA bond issue made mortgages available at an interest rate of about 8.5 percent or monthly payments of \$577, a savings of \$109 per month to the recipient.

¹⁰ It should be noted that local mortgage revenue bond activity has far outstripped that of the state. Between 1976 and 1983, local governments issued \$7.4 billion in tax-exempt bonds, over 80 percent of all such sales during that time. The legislation permitting local governments (which includes local housing authorities and redevelopment agencies) to issue mortgage revenue bonds imposes a ceiling on the total amount of bonds that can be sold in any one year. (Wong, 1986)

¹¹ Federal law had only required a 20 percent set aside for low-income tenants.

FIGURE 4
CHFA Cumulative Lending Data, 1975-1986

CHFA Lending Data
1975-76 To 1985-86

Economic Impact of CHFA Programs
1985-86

	Rental	Single Family
State taxes (Dollars in Millions):		
Fiscal year	\$ 3.8	\$ 9.6
Cumulative	\$ 36.2	\$ 75.0
Local taxes (Dollars in Millions):		
Fiscal year	\$ 1.7	\$ 2.9
Cumulative	\$ 10.7	\$ 22.9
Total taxes (Dollars in Millions):		
Fiscal year	\$ 5.0	\$ 12.5
Cumulative	\$ 47.3	\$ 97.9
Employment (Person Years):		
Fiscal year	3,650	7,200
Cumulative	34,550	75,100
Wages and salary (Dollars in Millions):		
Fiscal year	\$ 53	\$ 132
Cumulative	\$ 503	\$ 1,040
Total business (Dollars in Millions):		
Fiscal year	\$ 163	\$ 402
Cumulative	\$ 1,523	\$ 3,152

these projects pay part of their rent with the aid of the federal Section 8 program, discussed above. Almost 80 percent of units in completed projects (currently 9,661 rent-assisted or regulated units in 158 developments) for which permanent financing has been approved by CHFA are occupied by elderly persons or families with very low incomes.

CHFA's single-family programs operate under less restrictive distributional rules. Of the more than 10,000 units financed by CHFA's Home Mortgage and Ownership Program, 82 percent of the mortgages were made to households earning \$25,000 annually or more, and nearly one-fourth to those earning in excess of \$35,000. In contrast, less than 1 percent of CHFA single-family mortgages were channelled to persons earning \$15,000 or less. The sales price of most houses (64 percent) was between \$60,000 and \$90,000, but about 6 percent of CHFA-financed houses cost more than \$110,000.¹²

Table 20 shows the CHFA's cumulative lending activity for each Bay Area county for multi-family rental housing and single-family housing. More than one-fourth (27.4 percent) of all CHFA loans go to Bay Area residents.

Though the magnitude of the effect is as yet unclear, the U.S. Tax Reform Act of 1986 will most surely curtail the use of mortgage revenue bonds, particularly for multi-family dwellings. The tax revision includes several pro-

In any case, the remaining 80 percent of the units may be rented to tenants at market rates. (CHFA 1985-86 *Annual Report*, p.15.)

¹² (CHFA 1985-86 *Annual Report Supplement*, p.27) Since figures reported are summaries for a number of years and are not adjusted for inflation, housing prices are actually more expensive (in current dollars) than indicated, and state-financed mortgages are channelled to households with higher incomes than shown. The extent of the bias is unknown.

TABLE 20

California Housing Finance Agency Lending Activity
Cumulative Loans by Type: June 30, 1986

Loan Amount (thousands of 1986 dollars)

County	Rental Housing	Single Family	Total
Alameda	\$45,241	\$67,742	\$112,982
Contra Costa	21,173	77,839	99,012
Marin	0	3,209	3,209
Napa	4,802	2,793	7,595
San Francisco	38,919	18,197	57,116
San Mateo	9,867	11,536	21,403
Santa Clara	16,797	74,957	91,753
Solano	17,894	25,260	43,154
Sonoma	9,399	37,249	46,648
Bay Area Total	\$164,092	\$318,782	\$482,872
California	\$555,078	\$1,205,596	\$1,760,674

Note: Figures may not sum to total due to rounding.

Source: California Housing Finance Agency, *1985-86 Annual Report Supplement*, Table II, pp. 3-4.

visions related to MRB's, including a limitation on the volume of bonds issued by each state. This limitation will substantially reduce MRB activity in California.

4. Proposition 13

The rapid increase in property values during the 1970s (see Section 2) interacted with the system of property taxes and the efficient tax collection mechanisms in the state to produce a crisis. As real capital values rose substantially, tax bills increased dramatically even though tax rates remained relatively constant. Citizens came to resent the taxation of unrealized capital gains; the result was Proposition 13.

The California state constitution allows citizens to directly pass laws and amend the constitution through a process of petition-gathering and popular vote. Proposition 13 was one of a series of citizen-initiated measures intended to reduce tax bills. The initiative received an overwhelming majority of votes in the 1978 general election amidst a tide of resentment over big government, inflated property values, and correspondingly high property taxes. Proposition 13 restricted both property tax rates and the growth of the property tax base in the state. Property taxes were limited by the initiative to 1 percent of assessed value. Growth of the base was restricted by a shift from annual assessment of all properties based on estimated market value to a system in which assessments are restored to market value only on transfer of ownership. Until transfer occurs, assessments may increase by at most 2 percent per year regardless of actual increase in property value. Since property taxes are the preeminent source of local government revenues, the ability of localities to generate revenues was greatly impaired.

One effect of Proposition 13 was that many communities were forced either to restrict their community services sharply or else to find other sources of revenue to make up for reduced property tax revenues. Not surprisingly, both occurred. Many towns, including those in the Bay Area, have stepped up efforts to attract new businesses in order to broaden their tax bases.

The commensurate need for new residential single-family housing, however, has not been met. After Proposition 13, localities have been reluctant to zone for such housing because the new development would not pay, in terms of additional property taxes generated, for the cost of public services required for their occupants. As a result, affordable housing near employment centers has become scarce, and communities try to import their labor force from neighboring jurisdictions. Since some development inevitably must occur, local officials have been more likely to permit the construction of apartment complexes with small units; this tends to discourage young families with children, whose demand for public schools is high.

A second and related effect of Proposition 13 has been the imposition of service fees. For example, the city of Fremont levies a one-time school impact fee on all new development as a result of Proposition 13. In Fremont and other growing localities that were attractive to developers, builders and developers have been forced to provide infrastructure -- streets, sidewalks, utility lines, and so on. In Concord, new developers have financed the extension of sewer lines in order to gain local approval; other cities have required the developer to provide parkland or additions to the infrastructure. In addition, housing permit charges and application fees have risen dramatically since 1978. It is now commonplace for communities to conduct cost-revenue assessments, estimating whether the tax revenue generated will pay for the increased public services

required by new residents. Concern shifted from development that would enhance the physical character of the community to that which could pay its own way. Not surprisingly, the added scrutiny has also lengthened the time required to gain acceptance of a new development project, and has increased construction costs. (See Dowall, 1983, for more detail).

Simultaneously, Proposition 13 has become a weapon of slow-growth advocates who wish to curtail the spread of the "suburban sprawl" and to preserve environmentally-sensitive areas. Groups such as the Bay Area's People for Open Space and the Sierra Club consistently oppose measures that expand the amount of developable land, and instead support more clustered development at higher densities.

D. Mortgage Insurance, Credit Guarantees, and Credit Institutions

The federal government undertakes a number of programs designed to help purchasers borrow funds for home mortgages on favorable terms. The largest and most important are the programs of mortgage insurance of the Federal Housing Administration (FHA) and the system of loan guarantees administered by the Veterans' Administration (VA). Both of these programs protect private lenders against losses from default by borrowers. The basic FHA mortgage insurance program is designed¹³ to be financially self-supporting, that is, it operates principally to pool risks and, on average, fees paid by homeowners cover default risk. In contrast, the VA guarantee program provides modest subsidies to eli-

¹³ The guidelines for the FHA program include a maximum mortgage amount and maximum interest rate. The maximum amount means that upper middle income households buying more expensive dwellings generally do not qualify for FHA insurance.

gible veterans. Both programs transfer loss risk from the lender to the government.

One consequence of these federal programs has been a broader and more liberal set of terms throughout the mortgage market. Terms for a typical home mortgage have changed radically since the FHA began insuring default risk, with higher loan-to-value ratios and lengthier repayment periods than previously. It has been argued that the principal effect of the FHA has been to cause banks to understand that it is in their self-interest to offer more liberal terms for all residential mortgages, including those that are not covered by FHA insurance.

Since the 1970s, the importance of private mortgage insurance companies has increased substantially. By 1981 they accounted for some 36 percent of the market.

The sources of finance for housing include savings banks, commercial banks, and savings and loan associations (S & L's). Historically, about 40 percent of mortgages originated in any year have been provided by savings and loan associations, another 30 percent by mortgage banks, 20 percent by commercial banks, and the remainder by savings banks and other agencies. Savings and loan associations are similar in many respects to the building associations of Britain and the Commonwealth. Until the 1970s, housing finance was rather straightforward: loans were made for a fixed term at a fixed rate of interest by S & L's, savings banks, or commercial banks. The interest rate charges varied with monetary conditions, but long-term rates were generally low. The sources of loanable funds were individual savers, in the case of savings and

loan associations and savings banks, or corporate investors, in the case of commercial banks.

Until as late as 1980, S & L's were subject to a variety of legal restrictions.¹⁴ In return for an advantage in attracting the deposits of small savers, S & L's were legally required to invest a fixed percentage of their assets in home mortgages. This notion, which was a part of the original Federal Home Loan Bank Act of 1932, was to channel money into the housing market at favorable interest rates to promote home ownership.

The period of rapidly rising interest rates in the late 1970s and early 1980s caused a real crisis among S & L's, who found themselves caught in a position of borrowing short (issuing passbooks) and lending long (issuing 30-year mortgages). When market interest rates exceeded the regulated interest rate on deposits, S & L's quickly lost deposits at the same time that the real value of their mortgage holdings declined. The Monetary Reform and Decontrol Act of 1980 was intended to remedy some of these problems and to permit S & L's to compete more fully for funds. The act permitted S & L's to issue longer maturity savings certificates, removed regulated deposit rate ceilings for savers, and permitted S & L's to diversify their investments.

Higher and more volatile interest rates in the early 1980s also led to the introduction of new mortgage instruments in the United States. Adjustable interest rate mortgages (ARMs), under which the mortgage interest rate varies with

¹⁴ They were allowed to issue only certain types of deposits, essentially passbook time deposits, at interest rates which were controlled by the federal government. These interest rates were set slightly higher than the interest rate paid by commercial banks on time deposits.

market conditions, were one such innovation. Often variable interest rate mortgages call for level monthly payments and make up the difference by adjusting the amortization period of the mortgage itself. This protects the lending institution from some of the interest rate risk and presumably lowers costs to borrowers. In addition to these ARMs, other financing instruments, such as shared equity arrangements, began to flourish. Under shared equity arrangements, a third party agrees to pay some part of the monthly mortgage payments, and perhaps part of the down payment, in return for a fraction of the capital gain at the time of the sale of the house. Use of these alternative mortgage instruments was widespread in the early 1980s, but with the return of rather stable interest rates by 1984 the fraction of the market devoted to alternative mortgages declined substantially.

E. Secondary Market Operations

The distinguishing feature of the housing finance system of the United States is the existence of a thriving secondary market for mortgages. A large fraction of the mortgages originated by S & L's, commercial banks, and mortgage bankers are sold to investors on a secondary market. This secondary market developed initially for FHA and VA loans, since the guarantee by the federal government made the mortgages highly liquid. A logical next step was the formation of mortgage pools which could be sold in shares. The Federal National Mortgage Association¹⁵ (FNMA or "Fanny Mae") has been the largest purchaser of mortgages in this secondary market.

¹⁵ Fanny Mae is a rather unusual corporation. It was initially wholly-owned by the federal government but, in the late 1960s, shares were sold and it became a privately-owned corporation.

Fannie Mae borrows money in the capital markets by issuing bonds which are then used to purchase mortgages from lending institutions. Profitability depends upon the spread between the interest income on its mortgage portfolio and the cost of borrowing. Initially, Fannie Mae purchased only FHA and VA mortgage loans, but since the early 1970s it has purchased "conventional" (that is privately insured and uninsured) mortgage loans. These now account for an increasingly large fraction of its activity. Fanny Mae also sells mortgage-backed securities, that is, securities backed by its own portfolio of loans.

The Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac"), created by Congress in 1970, was charged with developing and maintaining a nationwide secondary market for conventional mortgages. This corporation purchases loans, both traditional fixed rate loans and also the more recent ARM's, from S & L's and other institutions. It then resells these loans in a variety of securities.¹⁶

These government-sponsored institutions have substantially changed the circumstances of mortgage finance in the United States. In the 1930s, S & L's collected the savings of local residents and pooled them to provide mortgage money for other local consumers in the manner of traditional building societies. By the 1980s, financial institutions were permitting sophisticated investors to invest in shares backed by large mortgage pools -- including mortgage contracts made by residents thousands of miles away, in many different local mar-

¹⁶ For example, Freddie Mac sells mortgage participation certificates (PCs), representing an undivided interest in a specific pool of mortgages. As the secondary mortgage market has increased in importance in the last few years, the Freddie Mac corporation has grown substantially. Freddie Mac has been able to structure PCs to minimize interest rate risks, buying and selling loans with a positive spread rather than holding them in its own portfolio.

kets -- whose identities are unknown to the investors themselves. The increase in the liquidity of the residential mortgage market has been remarkable, especially in the last decade.

4. Regionalism and Localism in Bay Area Land Use and Development

A. Local and Regional Regulation

The San Francisco Bay Area is an identifiably regional economy which developed and spread from the older cities near the Bay (such as San Francisco and Oakland) out to the once-rural areas where new cities now stand. Nonetheless, planning and land-use policies are largely a result of local governance, not comprehensive regional or state planning. With nine counties, over 100 municipalities, and several hundred school districts and special districts, governance in the Bay Area is an extremely complicated process involving both public and private actors. To be sure, federal and state policies play a large role in determining the location of the new development projects which they sponsor. However, as we have seen, the bulk of new development does not utilize direct state or federal support, and local jurisdictions have the final word. This reflects both a federalist attitude -- that localities should make land-use decisions for themselves -- and a long-standing Bay Area tradition of "home rule." Local governments control development through a variety of land-use planning, zoning, building standards, and rent control policies.

In order to increase local cooperation in land-use practices, the Association of Bay Area Governments (ABAG) was established in 1961 as a voluntary association of local governments. ABAG was originally an advisory organization that studied problems and recommended solutions, but it did not institute programs.

ABAG was not created to dictate policy, but rather to prevent the imposition of a strong regional authority that could usurp traditional local political power.¹⁷ However, the 1960s saw increasing interest and emphasis upon regional planning. Despite the original intention, in 1964 ABAG began preparing a comprehensive regional development plan. In addition, a federal program enabled ABAG to become a regional clearinghouse with the right to review and comment upon local government applications for federal funds for development projects. At that time, however, ABAG received only modest federal grant monies earmarked for planning activities. With the assistance of state legislators, ABAG continued to press for regional control, but in 1968 the agency was beset by an embezzlement scandal¹⁸ that weakened its efforts to secure authority and power from the state legislature.

Despite its inability to obtain state statutory authority, ABAG enjoyed increasing federal support for regional planning. By 1977, ABAG had a budget of \$3.4 million and a staff of over 100 who reviewed applications for federal aid and were completing a large-scale regional Environmental Management Plan. It was supported by the dues of its voluntary local government members, and had won support as an association of local governments helping to achieve regional goals, not a regional government trying to usurp authority from its member jurisdictions.

¹⁷ Several single-purpose regional agencies with real authority were also established during this period, most notably the Metropolitan Transportation Commission (MTC) and the Bay Conservation and Development Commission (BCDC).

¹⁸ It was discovered that ABAG's assistant director had embezzled \$500,000, soon thereafter causing the resignation of its executive director.

ABAG's prosperity came to an abrupt end when, two weeks after the passage of Proposition 13, member governments cut their ABAG dues by 70 percent. It was quite apparent that ABAG was not seen as a high priority when money was tight. In addition, ABAG's role as a regional clearinghouse ended when federal resources for planning assistance were eliminated in 1982. By 1984, ABAG's budget was only \$1.8 million, a decline of 47 percent over seven years; the staff decreased commensurately, from 109 in 1977 to only 33 by 1984. The rapid decline in funding and staff illuminated ABAG's inherent difficulties: because it has no statutory authority, it must rely on voluntary local government member contributions for financial and political support. Consequently, ABAG's present role is, just as it was 20 years ago, merely to advise local governments in planning decisions and to provide information such as land-use projections to localities, often on a fee-for-service basis.

The Metropolitan Transportation Commission (MTC), on the other hand, maintains broad responsibility for regional transportation planning, and must approve all applications for state and federal funding for highway construction and for transit agencies. Unlike ABAG, the commission can rely on revenues from Bay Area bridge tolls for financial support. Its chief influence on local planning and land use is through the siting of new highways and in approving additions to the Bay Area Rapid Transit (BART) system. In addition, the MTC has the powerful role of allocating funds from a portion of the sales tax expressly reserved for support of local and regional transit.

In addition to these and smaller regional authorities, the state of California monitors land-use development through "housing elements," which are 5-year development plans created by, and required of, all jurisdictions. Each jurisdiction must show how it intends to provide for anticipated population

increases, and for low-income and elderly residents; zoning and other subdivisions must also conform to the local housing element. Each plan must be approved by the state Department of Housing and Community Development. However, the state has no enforcement mechanism to compel localities to comply with their own plans. For jurisdictions grossly out of compliance, the state must rely on individuals to sue the locality in court in order to force the adoption of a legally-adequate general plan for development. Typically, larger jurisdictions, which are often closely monitored by citizen groups, must conform to state guidelines and regulations, but smaller jurisdictions may be able to sidestep them.

As noted above, localities have asserted their autonomy in implementing growth controls, partly as a backlash against growth in the Bay Area and partly for environmental or fiscal reasons. In the wake of encroachment upon vineyards by developers, in 1977 the city of Petaluma (in Sonoma county) implemented the first growth management plan in the state by limiting new building permits to 500 per year. This was a radical departure from traditional land-use planning, not only because it did not accommodate orderly growth but also because it was so overt. The "Petaluma Plan" was the subject of considerable regional and national controversy and spawned a variety of growth management plans in other Bay Area cities and towns. The competition between jurisdictions changed from one of attracting residential development in the 1960s to one of widespread resistance to development.

In apparent contrast to Petaluma and its imitators, in 1980 voters in San Francisco passed by referendum a declaration that it should be city policy to encourage the development of 20,000 new housing units by 1985. However, through a combination of high land costs, a lengthy permitting procedure, and restric-

tive development controls, the actual growth of housing was at most 15 percent of this goal. The city has attempted since 1981 to link the booming growth of its downtown business area to housing construction by taxing new office developments. The city's "Downtown Plan", adopted in 1984, requires developers of office space to construct 386 low-income housing units or contribute \$5.34 million for every million square feet of office space constructed to a city program offering assistance to first-time home buyers.¹⁹ It is too early to assess the impact of these programs, though their consequence clearly depends upon continued construction in the downtown area. Critics claim that imposition of such charges weakens the city in competition for office location with suburban communities.

Both Petaluma's and San Francisco's policies illustrate the competitive nature of interjurisdictional relationships and also the power localities have in making essentially regional decisions for themselves. This competition has many perverse consequences. Residential growth of any kind is restrained, and communities universally discourage housing for poor families with children, since such housing typically adds substantially to service costs and little to tax rolls. Communities generally encourage economic development, especially when such development involves retail trade and the sales tax proceeds that accompany it. But obviously all jurisdictions in the Bay Area cannot enjoy expanding employment without additional housing. Eventually the shortage of housing is certain to retard growth of employment. While this is obvious to many people, individual communities are caught in a "prisoner's dilemma." If they adopt a permissive stance toward housing construction, their neighbors may

¹⁹ San Francisco Board of Supervisors, *Office Affordable Housing Production Program*. Ordinance 358-85, August 18, 1985.

choose not to do so. Indeed if one community allows housing construction, the pressures upon its neighbors to do so are reduced.

Communities in the Bay Area are likely to continue to pursue independent land-use policies unless the state legislature imposes a regional agency with the authority to bring about significant change. Given the strong Californian predisposition toward decentralized government, this change seems unlikely in the near future. Nonetheless, it is important to emphasize that the overwhelming importance of local decision-making as a determinant of regional housing policy is not the necessary result of the constitutional structure of American government. Rather it is the consequence of the failure of the state to exercise authority.

In addition to controls on land use and building design, communities in California have the authority to impose rent control. Currently a total of 15 local jurisdictions in the state (out of 428 municipalities statewide) impose some form of rent control or price regulation. While this number is small, the communities account for a sizable proportion (22%) of the state's population. Nine of these jurisdictions are found within the San Francisco Bay Area, including the central cities of San Francisco, Oakland, and San Jose, the city of Berkeley, and the suburbs of Hayward, East Palo Alto, Los Gatos, Cotati and Campbell. These rent regulations vary widely in content and intensity. On one extreme, Berkeley's rent control board has never permitted general annual rent increases as large as the increase in consumer prices, does not allow rent adjustment on vacancy and exempts only buildings with one or two rental units. On the other hand, San Jose's ordinance limits rent increases to 8 percent per year, allows general rent adjustments when apartments become vacant, and allows most increases in operating costs to be passed through to tenants.

Assessing the consequences of these controls for housing costs and supply is difficult due to their variety of suitable sites without rent control for comparison. Evidence exists, however, that controls have reduced housing supply, particularly in cities such as Berkeley where programs appear exceptionally stringent. As with other types of local regulation, rent control has effects which spread beyond the boundaries of the controlling jurisdiction; Berkeley's law affects the demand for and supply of housing in all surrounding jurisdictions. Here again the state has authority to regulate the design and application of rent control systems in ways that recognize the regional consequences of such policies. To date, however, the state government has been unwilling to do so.

B. Effects on Local Housing Development

There are many reasons for the housing affordability/availability problems described at the beginning of this essay. Both demand and supply factors are involved. Demand side influences include changes in population and demography, high levels of employment, and personal investment behavior. Supply side factors include the shortage of developable land, reduced support of general infrastructure, laws protecting the environment, and the local building limitations discussed in the previous section. Since changes in these factors will determine the future course of housing costs and affordability, it is important to review them all. Our conclusion is, however, that the most significant factor in the future outlook is government regulation.

Population increase alone has assured a surge in the demand for housing. Between 1960 and 1980, the population in the nine-county Bay Area grew by 42 percent. However, the effect of this change on housing demand involves more than just total numbers. As a result of the post-World War II "baby boom," in the 1970s a sizable cohort reached the age at which people typically purchase housing. Between 1960 and 1980, the number of persons in the Bay Area over 20 years old nearly doubled, rising from roughly 2.2 million to over 4 million, while over the same time period average household size shrunk from 3.1 to 2.6 persons per household. The population is expected to continue to grow, but the decline in household size has ceased and households likely to purchase homes should decline as a proportion of total population, even with the arrival in the housing market of the second generation of the baby boom.

The Bay Area also witnessed unusually strong employment growth between 1975 and 1980, when more than 560,000 new jobs were added to the economy. Almost half of these new jobs were located in and about the Silicon Valley. This drew residents to the Bay Area, increased the adult population, and also reoriented much new demand toward the south. The outlook for future Bay Area employment growth is uncertain, in part because at least in the south it will depend significantly upon the availability of housing.

To understand the origins of the demand influences on Bay Area housing costs it is necessary to look beyond demographic factors to motivation for housing investment. Over the 1970s the interaction of general inflation, rising real income, and the tax treatment of owner-occupied housing described above all strengthened the attractiveness of housing as an investment. Broadly speaking, the cost of use of owner-occupied housing has three components: (1) the cost of the capital required for the investment, (2) the cost of depreciation, and

(3) gains from value appreciation. During the late 1970s and early 1980s both inflation and interest rates were high. In the absence of special tax treatment of housing investment, the two factors might cancel out -- interest rates would raise user costs, but the loss would be offset by the inflation-driven appreciation in housing value. However, mortgage interest payments are deducted from income before computation of tax liability, while capital gains on housing are untaxed. This means that in an inflationary environment, the user cost of owner-occupied housing can fall even when interest rates increase by the expected inflation rates and housing prices go up only at the general rate of inflation. Thus, demand for housing during this era gained impetus from the consequences of inflation for the perceived user cost of housing. Ironically, the high interest rates of the early 1980s made owner-occupied housing less "affordable" (since monthly payments at higher interest rates were greater) at the same time that the true economic costs of owner-occupancy were lower. This suggests that the "affordability crisis" in owner-occupied housing in part arose from the liquidity constraints of households and the capital constraints imposed by lenders, rather than increases in the price of housing services themselves.

Both declining rates of inflation and reductions in tax rates have reduced the attractiveness of housing as an investment. Thus, while continued (and interdependent) economic and population growth will expand housing demand, nothing as unusual as the recent housing cost inflation is likely to be repeated. This does not mean that the Bay Area has solved the affordability problem. Rather, it indicates that the source of the problem lies not with demand, but with supply.

The first point to be made about housing supply in the San Francisco Bay Area is that construction costs are not a source of exceptional inflationary pressure. Figure 5 compares the course of consumer prices in the Bay Area with the estimated costs of constructing a standard, three-bedroom home. These construction costs do *not* include the cost of the site upon which it is constructed. As the figure indicates, construction costs increased more rapidly than general inflation in the late 1970s and less rapidly in the early 1980s. Over the decade as a whole, construction costs increased at about the same rate as other prices. However, the increase in housing prices, particularly in San Francisco but also in the entire Bay Area, far outstripped construction costs and consumer prices. Thus, the extraordinary rate of change in new home prices must be traced to other influences.

The first of these is the physical configuration of the Bay Area itself, with a significant portion of the land in both the East and West Bay physically unsuited for development because of irregular terrain, unstable soil, or other factors.

Development in other areas is constrained by environmental concerns. Much of the coastline adjoining San Francisco is protected by the California Coastal Act of 1975, which all but prohibits any new development within 1000 meters of the coastline. This eliminates thousands of hectares of highly desirable land near San Francisco for housing development, but it preserves the unique Pacific coastline for the enjoyment of local residents and for the booming tourist industry. Increasing awareness of environmental degradation in the 1970s led to the passage of the California Environmental Quality Act and other laws which, through systematic scrutiny of new development plans, also slowed the pace of new development and added to housing costs.

FIGURE 5

Price Indices and Construction Costs In The San Francisco Bay Area, 1975-86

As already discussed, reduced local government support in the wake of Proposition 13 and the federal cutbacks in grants for local services have made the expansion of the infrastructure and public services necessary for housing development difficult to finance. Because communities could not increase property taxes enough to pay for local services needed by new residents (schools, sewers, etc.), fees were imposed on new housing development, increasing housing prices. As a result, much of the new development excluded housing that could serve low-income persons. New construction approved at the local level tended to be small units that would cater to older couples (who use relatively few local services) and discouraged housing for young families (who use many public services, particularly schools.) The problems created by Proposition 13 are unresolved; in consequence local governments are likely to continue to resist rapid development of housing.

In addition to these direct causes of high housing prices, there are a number of indirect market effects that influence the local market. Important among these are bottlenecks and monopoly power (see Dowall, 1984). Bottlenecks occur when housing demand exceeds supply and either prices do not rise sufficiently to clear the market (e.g., rent controls) or local land-use controls do not permit expanding supply. The result is the low vacancy rates that exist in many Bay Area communities. In others, high housing prices have forced out low-income residents.

Monopoly power can be exercised by developers through the use of restrictive land-use regulation, which limits the amount of land available for development and makes controlling local land markets easier. The use of complex administrative procedures, lengthy application periods, and other measures that typify Bay Area local development policies can induce monopolistic control of local

land markets. One study of developers in San Jose found that their excess profits were largely attributable to constrained housing supply and the lack of competition. In other areas, such as Marin and Napa counties, the lack of developable land and high development fees have given dominant control of the housing market to a few large developers (see Dowall, 1984, pp.140-1).

These indirect effects may exert a powerful influence over local land use and development. Any policies hoping to improve the present housing conditions in the Bay Area must recognize these important, though subtle consequences of such policies. Environmentalism and local land-use regulations preventing rapid growth are supported by many Bay Area residents, and attempts to change this pattern are not likely to be initiated by local governments.

6. SUMMARY AND CONCLUSIONS

As we have seen, the Bay Area housing market is characterized by a complex weave of the public and private sectors. Public activity in the market comes in the form of direct subsidies (e.g., the construction of low-income housing units) and indirect subsidies (e.g., tax exemptions and mortgage guarantees) from federal, state, and local governments. In the Bay Area, and indeed throughout the U.S., housing assistance is predominantly indirect. While direct housing assistance is primarily aimed at low-income or otherwise disadvantaged groups, indirect subsidies are often decidedly regressive, serving wealthy homeowners more than poorer homeowners or renters. One major study of California housing policies concluded that the consequence of this combination was that the poor and the wealthy received the bulk of the assistance, while middle-class residents received the least (see Furry, 1983). Due to the size and scope of indirect benefits to homeowners, it is unlikely that attempts to

redress the balance will be met with much success.²⁰ The predominance of indirect benefits also eliminates much of the federal and state control over local development that follows with direct benefits. Individuals and localities essentially determine growth patterns regardless of the potentially negative regional impacts.

With the relative paucity of direct housing assistance in the U.S., it is not surprising that mortgage revenue bonds and other market-based credit instruments have increasingly dominated housing policy. Politically, it is much easier to "spend" an untaxed dollar through tax expenditures than to transfer directly money through "tax-and-spend" policies.

By far the largest provision of housing in the U.S., however, is simply through the decentralized market mechanism and, as a result, housing quality and price differences are larger than in most European countries where the provision of housing is more highly centralized. The average standard of housing consumption is quite high, and the variety of housing available is broad. However, with the exceptions noted above, housing is allocated on the basis of willingness to pay, and housing consumption represents a larger fraction of households' budgets than in many other societies.²¹

²⁰ For example, attempts made during the major revisions of the U.S. Tax Code in 1986 to eliminate the mortgage interest deduction were met with substantial resistance and were later abandoned.

²¹ Though of course individual tax rates are substantially lower as well.

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