CURRENT STATE OF THE CALIFORNIA HOUSING MARKET

A COMPARATIVE ANALYSIS

MARCH 2016

NEXT 10

Next 10 is an independent nonpartisan organization that educates, engages and empowers Californians to improve the state's future.

Next 10 is focused on innovation and the intersection between the economy, the environment, and quality of life issues for all Californians. We provide critical data to help inform the state's efforts to grow the economy and reduce greenhouse gas emissions. Next 10 was founded in 2003 by businessman and philanthropist F. Noel Perry.

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Overview

California's current housing market suffers from a shortage of supply and the lingering effects of the housing crash and the Great Recession.

- Homeownership rates, which have historically been low compared to rates in other states, have been declining throughout California, as many residents - especially those with recent foreclosures on record - remain unqualified for mortgage loans. In 2014, California ranked 49th in terms of homeownership, as only 53.8% of homes were owner-occupied[1].
- Housing costs are high relative to incomes and have been increasing in recent years for both homeowners and renters. California's average homeowners spent 25.4% of their household income on housing costs in 2014, more than homeowners in any other state.
- Housing remains overcrowded as the proportion of renter-occupied housing units with more than one person per bedroom grew from 12.7% in 2007 to 13.2% in 2014.
- Home prices are more expensive than in all other states, particularly in major metropolitan areas. Diminishing levels of affordability have already driven many low-income and middle-income households to migrate to more affordable states.
- Housing remains in short supply, placing upward pressure on home prices and reducing levels of affordability. From 2005 to 2015, permits for only 21.5 housing units were filed for every new 100 residents in California, less than any other state except Alaska.

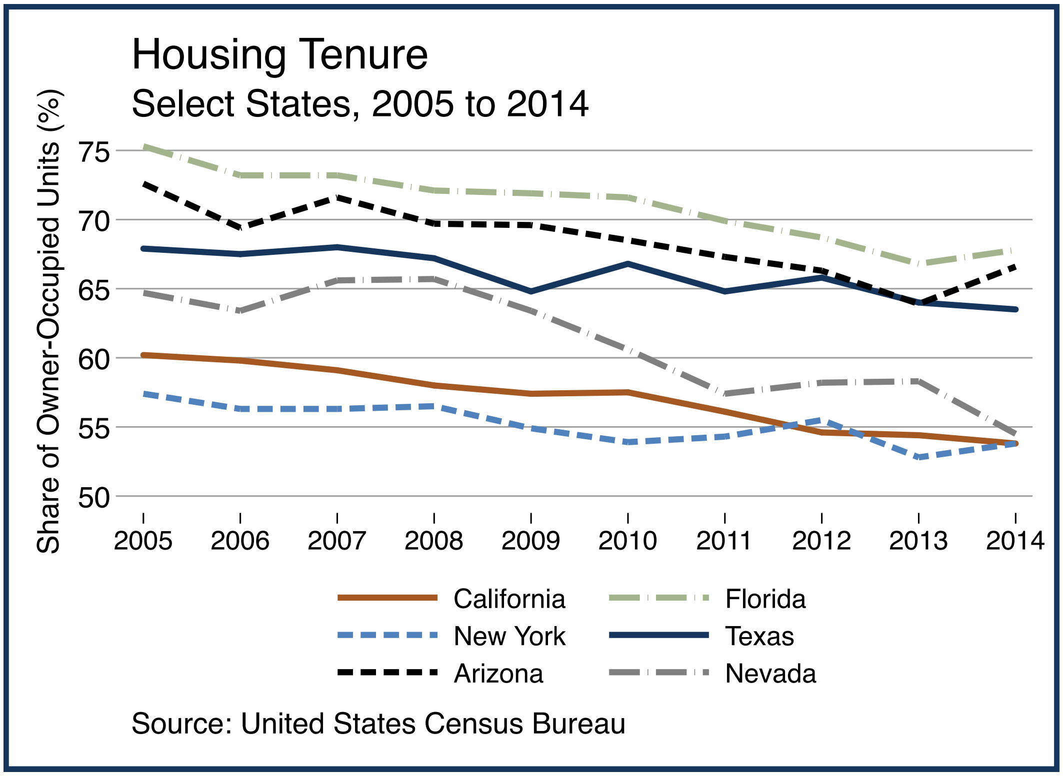
Indeed, California currently ranks near the bottom in terms of its supply of housing relative to population growth. Add that to the increasing demand to live near the coast, to be close to tech hubs, and to be near downtowns, and it's not too surprising that home prices throughout the state continue to rise. In the years to come, the dearth of new homes could exacerbate the problem, making housing even less affordable for many of California's residents.

The cost of development and stringent regulations imposed on developers has contributed to the lack of homebuilding in California. Tough environmental and zoning laws sometimes create an obstacle for homebuilders that are seeking approval for development activities, especially along California's coastal cities. Although these laws reflect good intentions and were enacted to preserve the state's

[1] Unless otherwise noted, all statistics in this report are attributed to the U.S. Census.

natural land, they are well past due to be reevaluated, as they are often poorly implemented and abused.[2]

This report will provide further evidence that California's residential real estate market needs more housing by showing how the state stacks up against other states. Taken together, these key housing trends explain the economic fundamentals of the housing market and why housing is becoming too expensive for many California residents, laying the groundwork for the decisions and policy changes that need to be made to improve the lives of those living in the Golden State.



[2] A few examples include the Sacramento Senior Homes in the City of Berkeley (2001), the East County Transitional Living Center in the City of El Cajon (2003), the Wagon Wheel Village in the City of Oxnard (2009), and the Parkmerced Development Project in the City of San Francisco (2014).

Structure of Housing Occupancy

Many households in the state rent rather than own. This is common in states like New York and Massachusetts, where major metropolitan areas attract young professionals who prefer to live near their jobs rather than own homes in more affordable suburbs. Areas like San Francisco, the South Bay, Los Angeles, and San Diego have been attracting more young professionals from out of state in recent years. Migration patterns from 2007 to 2014 indicate that over 52,700 persons over 25 years of age with bachelor's degrees moved to California from other states on net. In contrast, 469,800 persons without bachelor's degrees moved out of California on net.

Housing Affordability in Select Metropolitan Areas

MSA	Housing Affordability Index 2014	Housing Affordability Index Rank	Median Home Price($)
Youngstown, OH	369.0	1	78,600
Toledo, OH	368.1	2	87,200
Rockford, IL	353.5	3	86,300
Decatur, IL	343.5	4	89,700
Elmira, NY	320.0	5	100,800
Cleveland, OH	285.5	18	122,600
Cincinnati, OH	257.4	33	140,500
Amarillo, TX	230.2	58	144,500
Atlanta, GA	221.7	70	159,500
Tampa, FL	205.6	85	151,500
Dallas, TX	197.7	92	188,300
Chicago, OH	190.3	103	205,900
Albuquerque, NM	182.3	118	177,600
San Antonio, TX	180.4	120	182,100
Houston, TX	180.4	121	198,400
Austin, TX	169.9	134	240,700
Tucson, AZ	169.6	135	175,800
El Paso, TX	168.9	136	140,800
Orlando, FL	168.8	137	180,000
Phoenix, AZ	166.7	140	198,500
Las Vegas, NV	158.8	144	198,000
Washington, DC	147.1	154	383,800
Sacramento, CA	**136.9**	**157**	**268,700**
Denver, CO	135.9	158	310,200
Portland, OR	134.7	160	286,000
Seattle, WA	125.3	163	355,800
Boston, MA	125.3	164	389,800
Inland Empire, CA	**117.9**	**165**	**273,900**
Miami, FL	111.8	167	266,000
New York, NY	108.2	168	1,984,000
San Diego, CA	**77.6**	**171**	**497,900**
Los Angeles, CA	**73.0**	**172**	**449,500**
San Francisco, CA	**70.5**	**173**	**737,600**
Honolulu, HI	67.7	174	682,800
Orange County, CA	**65.0**	**175**	**687,900**
South Bay, CA	**64.3**	**176**	**860,000**

Source: National Association of Realtors
Based on 176 Metropolitan Statistical Areas

In 2014, California ranked 49th among all states in homeownership. Proposition 13 has had a negative effect on the homeownership rate because it encourages properties to remain under the same ownership for longer periods of time, making it difficult for new homeowners to enter the market. Move-up buyers can rent out their prior homes and maintain the lower costs associated with the lower assessed values, in comparison to the costs and assessed values for would-be owners were they to sell their homes.

Not only is the homeownership rate in California low, it has also been falling over the last ten years for various reasons related to the economic cycle. California residents suffered greatly during the housing crash, and the effects of the crash continue to linger. Subprime mortgages were very prevalent in inland regions throughout the state, which caused massive numbers of foreclosures in these areas. An overcorrection of home prices between 2009 and 2013 created bargains for investors, providing them an advantage further fueled by the lack of competition from the many traditional buyers who held foreclosures on record. Many investors converted these homes to rentals and will benefit from low tax rates due to Proposition 13 until they decide to sell.

With few distressed properties now available on the market, residents in middle-income households, many of whom were subprime borrowers during the downturn, are finding it increasingly difficult to become homeowners. In addition to the introduction of much tighter lending standards, metropolitan areas in both the Bay Area and Southern California continue to rank at the bottom in terms of affordability when compared to metropolitan areas throughout the nation. Even inland metropolitan areas such as Sacramento and the Inland Empire are estimated to be less affordable than metropolitan areas in other states, such as Las Vegas, Phoenix, Chicago, Washington, D.C., San Antonio, and Houston.

CoreLogic estimates that 11.4% and 8.7% of homeowners with mortgages in the Inland Empire and Sacramento region, respectively, were still underwater, with negative equity, as of the third quarter of 2015. Housing costs in the Golden State continue to remain elevated for both homeowners and renters when compared to housing costs in other states. Approximately 40.6% of households living in owner-occupied housing units with a mortgage spend 30% or more of their income on housing. Apartment renters in California are also struggling, as 56.8% of households living in rental units spend 30% or more of their income on housing- second only to Florida (57.9%).

Average Percentage of Household Income Spent on Housing

	Owner-Occupied				Renter-Occupied			
State	Income Spent (%)		Rank		Income Spent (%)		Rank	
	2000	2014	2000	2014	2000	2014	2000	2014
Texas	18.0	19.3	16	24	25.0	30.3	15	15
Arizona	21.0	20.4	40	33	27.2	30.9	42	19
Nevada	22.6	21.6	48	39	26.8	30.0	38	13
Florida	21.4	22.4	43	43	28.8	35.5	50	46
New York	21.7	23.0	45	46	28.0	36.4	47	49
California	23.8	25.4	50	50	28.1	36.0	48	48

Source: U.S. Census Bureau

Indeed, California continues to have expensive apartment rental rates as well. In 2014, the average apartment rental rate was 35.7% above the national average. In comparison, the State of New York, despite the significantly high rental rates in Manhattan, has an average apartment rental rate that is only 22.9% above the national average.

The high cost of housing has contributed to two notable trends among California households. First, household sizes, which were steeply declining prior to the recession, started to grow larger over the last five years as young adults are living with their parents for longer periods of time. This trend made national headlines during the recession because it affected every state. However, the issue continues to affect California households even as the economy is expanding, particularly with respect to renter-occupied housing units. California had the highest share of renter-occupied housing units with more than one resident per bedroom in 2014 (13.2%).

Proportion of Homes with More than 1 Resident per Bedroom

	Owner-Occupied				Renter-Occupied			
State	2000 (%)	2007 (%)	2014 (%)	2014 Rank	2000 (%)	2007 (%)	2014 (%)	2014 Rank
Florida	3.7	1.3	1.6	37	12.9	5.2	5.5	40
New York	2.6	1.7	2.0	43	13.6	7.6	8.5	48
Nevada	4.7	1.8	2.2	44	14.5	5.6	6.4	43
Arizona	5.4	3.0	2.4	45	15.4	7.7	7.6	46
Texas	6.3	3.2	3.2	47	15.0	7.3	7.3	45
California	8.6	4.1	3.9	48	23.9	12.7	13.2	50

Source: U.S. Census Bureau

The second notable trend stemming from the high cost of housing is a trend in domestic out-migration: more residents are leaving California than are moving in from other states. An analysis of California's aggregate domestic net migration between 2007 and 2014 shows a net outflow of approximately 625,000 residents (excluding migrants who are enrolled in college and universities, as they may be only temporary residents). This is compared to net positive domestic migration for Texas (975,700), Arizona (261,400), Florida (558,500), and Nevada (102,000) over the same time span. New York also experienced a net domestic out-migration, with a net outflow of 967,400 residents.

Net Domestic Migration, 2007–2014 (in thousands)

Component	California	Arizona	Florida	Nevada	New York	Texas
Total	-625.0	261.4	558.5	102.0	-967.4	975.7
By Household Income Group						
Under $50,000	-563.0	157.5	294.3	73.2	-476.5	432.0
$50,000 to $99,999	-138.9	70.0	175.5	15.2	-292.0	312.6
$100,000 to $149,999	-3.3	15.6	54.5	20.9	-105.2	149.3
$150,000 and Over	80.1	18.3	34.3	-7.3	-93.7	81.8
By Age Group						
Under 36	-292.6	38.5	45.2	37.0	-484.7	641.3
36 to 65	-309.8	138.7	324.8	47.3	-361.6	276.7
Over 65	-22.6	84.1	188.5	17.8	-121.1	57.7
By Education (25 Years and Over)						
Less than Bachelor's Degree	-469.8	169.3	324.5	54.6	-480.4	407.3
Bachelor's Degree or Higher	52.7	72.2	163.5	11.0	-204.6	196.9

Source: U.S. Census Bureau

Migration patterns confirm that middle-income households are being driven out of the local housing market. Persons in households with incomes of between $50,000 and $100,000 constituted 22.2% of domestic migrants leaving California between 2007 and 2014. Meanwhile, in other states, such as Arizona, Florida, and Nevada, households in this income group represented a high share of the positive net domestic migration over the same period. And while more middle-income households are leaving the state, the opposite can be said about high-income households. Net domestic migration of persons in households with incomes of more than $150,000 was 80,100 persons between 2007 and 2014.

Further declines in homeownership and levels of home affordability could carry serious consequences and affect the future economic growth of the State of California. Homeowners are more likely to invest in their homes and communities than renters, an important reason to encourage homeownership. Furthermore, households that spend high proportions of their incomes on housing will spend less on goods and services. High costs for housing increase the likelihood that lower-income households will be reliant on government welfare, which in turn puts undue fiscal pressure on state and local governments. Yet these concerns only exist because homes are in short supply.

Owner-Occupied Housing Statistics, 2014

Component	California	Texas	Arizona	Florida	Nevada	New York
Total Persons Living in Owner-Occupied Housing	6,855,688	5,674,241	1,484,857	4,693,821	547,905	3,857,906
Share of Owner-Occupied Households (%):						
With Income of less than $50,000	28.1	35.4	40.0	43.2	36.4	29.2
With Income of $150,000 or More	22.6	15.3	11.8	10.7	10.8	20.1
With Householder in Retirement Age	30.1	25.9	35.3	39.0	31.4	29.7
Whose Householder has a Bachelor's Degree	42.5	35.3	36.0	35.1	31.8	42.0

Source: U.S. Census Bureau

Housing Supply Constraints

California ranks near the bottom in terms of the number of residential permits issued on a per capita basis. From 2005 to 2015, only 21.5 new units have been permitted for every 100 new residents, compared to 33.4 new units nationwide. Housing statewide has favored multifamily structures more than single-family structures, a trend that sets California apart from many other states. From 2005 to 2015, only 59.1% of housing units permitted were for single-family homes, a category in which California ranks 46th. While the city centers of the largest cities in the state are fairly built out, and thus mainly receive permits for multiunit properties, construction of new single-family homes in suburban areas has lacked significant growth.

Permitting by State, 2005-2015

Rank	State	Permits per 100 New Residents
1	Michigan	166.0
2	Rhode Island	92.2
3	Maine	74.2
4	Vermont	69.7
5	Louisiana	58.6
6	Ohio	56.3
7	New Hampshire	53.7
8	Illinois	47.6
9	Mississippi	47.2
10	North Dakota	46.8
11	South Dakota	46.5
12	Wisconsin	45.3
13	Iowa	42.8
14	New York	42.3
15	New Jersey	40.7
16	Nebraska	40.2
17	South Carolina	39.8
18	Delaware	37.4
19	Alabama	37.4
20	North Carolina	36.7
21	Indiana	36.1
22	Idaho	36.1
23	Pennsylvania	36.0
24	Florida	35.3
25	Kansas	34.7
26	Tennessee	34.7
27	Missouri	34.6
28	Minnesota	34.5
29	Oregon	33.3
30	Washington	33.1
31	Georgia	33.0
32	Nevada	32.0
33	Arizona	31.5
34	Virginia	31.2
35	Arkansas	31.2
36	West Virginia	31.1
37	Maryland	30.7
38	Utah	30.0
39	Colorado	29.9
40	Texas	29.4
41	Kentucky	29.2
42	Massachusetts	28.9
43	Montana	28.5
44	New Mexico	28.5
45	Connecticut	27.9
46	Oklahoma	27.6
47	Wyoming	25.3
48	Hawaii	25.1
49	**California**	**21.5**
50	Alaska	16.2
	United States	**33.4**

Source: U.S. Census Bureau

The deficient amount of homebuilding in California is in part the result of a number of regulatory changes. Among these regulatory factors is the California Environmental Quality Act (CEQA). Following CEQA, local governments require new developments (either residential or nonresidential) to conduct environmental reviews for potential environmental effects, which may lead to either limiting developments or stopping them altogether. According to the 2012 Annual Planning Survey Results published by California's Governor's Office of Planning and Research, 21% of respondents indicated that the primary barrier to implementing infill projects was community opposition/CEQA/lawsuits, while another 24% of respondents attributed a lack of funding/high costs, which can be impacted by the fear of a CEQA lawsuit.[3]

[3] State of California, Governor's Office of Planning and Research, "Annual Planning Survey Results, 2012". Available at https://www.opr.ca.gov/docs/2012_APSR.pdf

The scarcity of developable land has also made any form of homebuilding along the coast difficult. The Legislative Analyst's Office (LAO) reports that just under two-thirds of the area surrounding urban centers on California's coast is undevelopable due to mountains, hills, ocean, and other water.[4] The 1976 passing of the California Coastal Act, which was enacted to protect and maintain the overall quality of the coastal zone environment, has played a role in limiting how much coastal land can be developed for residential construction.[5]

On multiple occasions, local communities have blocked homebuilding by utilizing land use authority to either slow or stop projects. The resistance to new developments often stems from the desire to maintain current home values or from the perception that the land should not be developed for various reasons.

Also concerning to developers, especially those that handle fewer properties, are the costs associated with tearing down existing buildings and addressing the environmental concerns that may arise during the redevelopment phase. The State of California has some of the toughest zoning laws in the country, requiring developers to adhere to multiple state and local ordinances. The fees associated with development also put more financial strain on homebuilders, resulting in these fees being passed along to homebuyers. These fees include the building permit, utility connection, environmental impact assessment, and zoning and subdivision fees. These items were all key issues discussed at a recent House L.A. 2015 Summit hosted by the Building Industry Association's Los Angeles and Ventura Chapter, which featured a number of local and national developers along with local political representatives.[6]

Some developers assert that many local governments have favored commercial projects over residential, as these projects provide a larger financial upside than residential projects. Cities and counties are aware that sales taxes collected by potential commercial and retail establishments far outweigh the property taxes homeowners would pay. Some local governments have also remained cautious toward homebuilding because the accompanying population growth is sometimes costly, leading to an increased need for funding to facilitate infrastructure development and for policing.

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[4] Mac Taylor, *California's High Housing Costs, Causes and Consequences*, Legislative Analyst's Office, March 2015, available at www.lao.ca.gov/reports/2015/finance/housing-costs/housing-costs.pdf.

[5] See the 2003 State of California General Plan Guidelines, p. 174.

[6] For more information, see www.bialav.org.

Conclusion

California's current housing climate is not able to support its growing population. The low levels of residential construction could result in further increases in home prices, such that fewer and fewer California residents will be able to afford homes. It is true that home prices have increased throughout the country, but California remains the most expensive state for purchasing a home. Rental rates have also continued to climb, and residents who usually flock to the rental market to avoid unaffordable home prices find little relief. The state's lower-income residents suffer the most; they are burdened with having to spend a higher proportion of their incomes on housing and are forced to cut back on other discretionary, but oftentimes necessary, purchases. However, diminishing levels of affordability are also reducing the ability for middle-income residents to own a home, which is discouraging for residents of both low-income and middle-income categories. Indeed, the current state of housing has led many to leave California in the hope of finding more affordable living circumstances elsewhere.

To alleviate the housing affordability crisis that plagues low-income and middle-income households in the state, more housing construction needs to take place. Homebuilders should be encouraged to build in California. One such way would be by streamlining the permitting processes and finding a way to reduce concerns about environmental protection policies. The LAO report references a few solutions that may help alleviate the housing affordability crisis that California currently faces, including encouraging more residential development along California coastal cities and, if possible, an increase in the residential density for such developments.