GROWTH AMID DYSFUNCTION

An Analysis of Trends in Housing, Migration, and Employment

NEXT 10

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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 economy is strong. After years of growth post-recession, the state has seen job growth across all income levels.

Wages have increased and employment opportunities – especially in the Bay Area's booming tech sector – are attracting migrants from other states and countries. But a strong economy can also be dysfunctional, and not all Californians are benefitting. The state is experiencing shifting population dynamics driven by high housing costs and changes in the employment make-up of California residents. While low-wage jobs have grown more in California than in most other states, incomes for low-wage Californians have not risen on a parallel path to incomes in middle and high-wage industries in the state. The average take-home pay of a low-income earner in California isn't that far off from that of a low-income earner in other U.S. states, yet the cost of living in California is much higher. As the Golden State continues to draw more high-earning, educated migrants from other states and countries, housing development to meet the growing need is far behind. The result is an ever-increasing cost of living as low-income wages stagnate, forcing lower- and middle-income Californians to leave the state in hopes of finding more affordable housing.

To better understand some of the underlying trends shaping the state's evolving economy and population, Next 10 commissioned Beacon Economics to analyze California's housing supply, migration patterns, and employment data by income. First published as a series of briefs in 2016, this series has now been updated to provide a current look at California's deepening housing crisis and related employment and population patterns. The earlier edition of this series examined data through the fourth quarter of 2014; the new edition of the series examines data through the second quarter of 2017, unless otherwise noted.

The key findings of each brief are as follows:

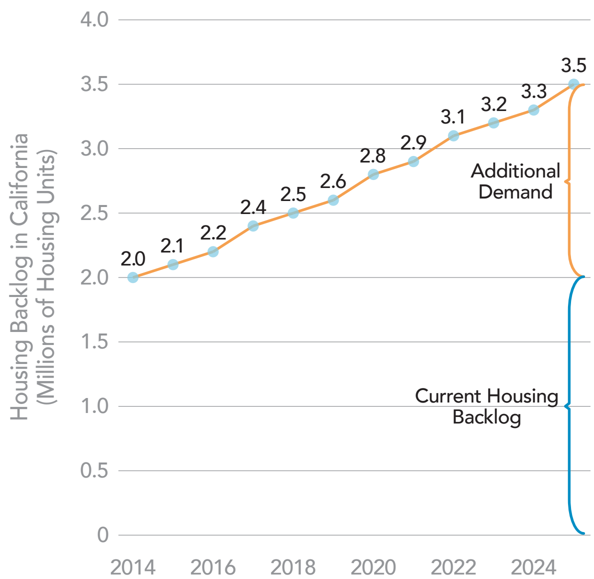
Housing

California has performed poorly relative to other states in terms of homeownership rates (second lowest), housing costs for owner households with mortgages (second worst) and renter households (third worst), rental housing over-crowdedness (worst), and new housing permits filed per 100 new residents (second lowest).

- The share of income going toward housing has dropped in California from 22.5 percent in 2014 to 21.9 percent in 2016, but it is still the second highest after New Jersey, where 22.8 percent of residents' income goes toward housing. Renters are similarly affected, as California ranks 48th in share of household income going to rental costs with 32.8 percent in 2016. Though this percentage is down slightly from 33.6 percent in 2014, it is still the third highest in the nation. Owner households without mortgages actually fared better than the U.S. average – thanks to relatively low property taxes. (See Figures 4 & 5 in *Current State of California Housing Market*).
- In 2016, the median home price in California was more than double that of the median home price in the U.S. as a whole, with a difference in cost of more than $265,000. This is down from the 2006 difference of $334,530, but still home prices remain much more expensive in California. (See Figure 6 in *Current State of California Housing Market*).
    - It's important to note that the previous home price peak came just before the housing bubble crash and the Great Recession. In the events leading up to the Great Recession, cheap and easily obtained subprime mortgage loans propped up the demand for home purchases, which drove up the median home price to an unprecedented level and proved to be ultimately unsustainable.
    - This time, however, the fundamentals of mortgage lending practices are much stronger than in the previous decade due to tightened regulations implemented following the Great Recession. Instead, housing prices are being driven by a lack of supply and a growing economy. So, it is unlikely that housing prices will be corrected by a similar crash, indicating the state may be entering unchartered territory, with sky high prices reflecting a new normal.
- New housing construction since the Great Recession has been tepid at best. From 2008 to 2017, an average of 73,000 new housing permits were issued per year – far lower than 1991 to 2007's average of 135,000 per year.
    - From 2007 to 2017, only 24.7 housing permits were filed for every 100 new residents in California – much lower than the U.S. average of 43.1 permits. (See Figure 7 *Current State of California Housing Market*).
    - By 2025, California would have a housing backlog of 3.4 million units if the trend continues. At the current pace of construction, California would add just a minimal amount of new housing – about 600,000 new housing units (net of housing unit losses due to demolition and other causes) – leaving the state with a housing gap of 2.8 million units by 2025. (See Figure 1)

- From 2011 to 2016, for every 1,000 new residents, California added just 209 new housing units (net), which is below the states that it has lost the most residents to from net out-migration: Texas (290 units), Arizona (218 units), Washington (256 units), and Oregon (221 units). Only Nevada had lower new housing units (171) per 1,000 new residents than California.
    - The situation would have been significantly worse if there was no domestic migration. Assuming nobody moved out-of-state in the U.S., California would have permitted just 171 units per 1,000 new residents, far lower than Texas (374 units), Arizona (422 units), Nevada (447 units), Oregon (495 units), and Washington (445 units). In other words, since the state has had negative net domestic migration, the new housing units per 1,000 residents are better than they would have been if those people had stayed in California.

Figure 1. California's Housing Supply Gap
2014 to 2025.



Source: McKinsey Global Institute Analysis; Tabulations by Beacon Economics

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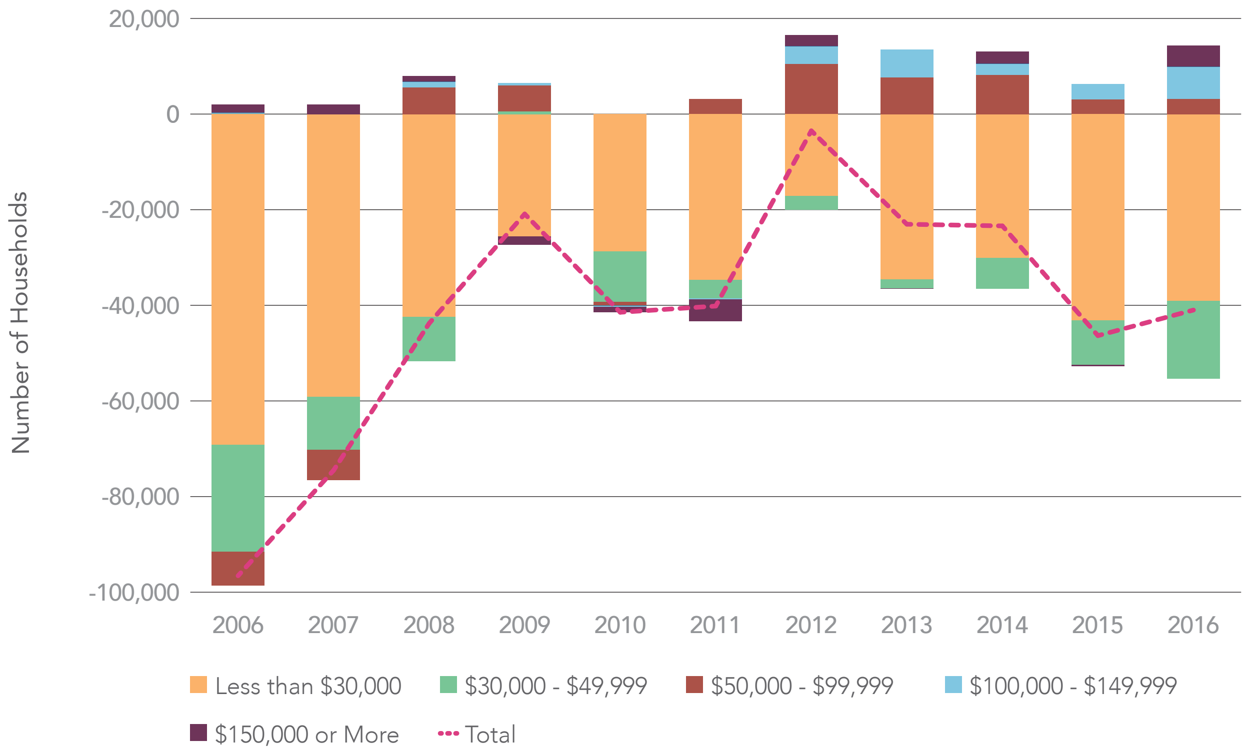
- Even though California's housing crisis is well known, so far, most jurisdictions (cities, communities, and counties) have made unsatisfactory progress toward fulfilling the housing goals set forth by the 5th cycle of Regional Housing Needs Assessment (RHNA) – a state-mandated planning process to provide allocations of housing needs at the regional level.
    - The situation is most dire in agricultural areas, namely the Central Valley and Imperial County. By 2022, Imperial County would have the highest percentage of RHNA housing allocation unfulfilled (89%), followed by the counties of Merced (85%), Stanislaus (85%), Sutter (80%) and Kings (80%). (See Map 1 in Current State of California Housing Market)

Figure 2. California Net Domestic Migration by Income, 2006 to 2016



Source: American Community Survey Public Use Microdata Sample, U.S. Census Bureau

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Net Migration

California experienced negative net domestic migration of 1,090,600 from 2006 to 2016. In other words, 1,090,600 more people moved out of California to other states than moved in from other states.

- Net out-migration in California has increased compared to a period of slowdown from 2009 to 2014 but is still not as severe as 2006 to 2007. In 2006, nearly 100,000 households left California as compared to nearly 41,000 in 2016.
    - The high cost of housing appears to be the main reason for the persistent net out-migration, as migration tends to be the highest among those at the lower-wage level. During the Recession, when the median home price dropped to nearly $275,000 in 2009, there was a similarly low level of out-migration that same year.
    - The top five outbound states for California migrants remained unchanged between 2014 and 2016: Texas, Arizona, Nevada, Oregon, and Washington.
    - New York had the greatest number of residents moving to California from 2006 to 2016 with nearly 100,000 making the move.

- Net migration trends varied considerably at sub-state level, however. Large metro areas in Southern California—the Inland Empire, Los Angeles, and San Diego—have had more people moving out of state than out-of-state people moving in to those areas. On the other hand, the Bay Area had an overall positive net migration since 2014. (See Figure 10 in *California Migration*)
  - › Given that the Bay Area had much higher percentage gains in high-wage industry sub-sector employment compared to other parts in California, this is not surprising.
  - › On the other hand, major Southern California metro areas have all gained shares of low-wage employment at the expense of losing shares of both high- and middle- wage employment. Therefore, these regions have had consistent negative net migration.
- Despite having more people leaving than people coming to the state, the Golden State remains an attractive destination for individuals with a high educational attainment, who are also more likely to be high earners.
  - › Californians 25 years and older who do not possess four-year college degrees accounted for more than 752,600 out-migrants, but the state was a net importer of nearly 43,200 people with bachelor's or higher degrees. (See Figure 7 in *California Migration*)
- Similarly, international migrants to California are increasingly more educated and have higher household incomes compared to domestic ones.
  - › From 2006 to 2016, the number of international migrants with graduate or professional degrees has increased 62 percent. Those with less than high school diplomas have decreased by about one-third. (See Figure 12 in *California Migration*)

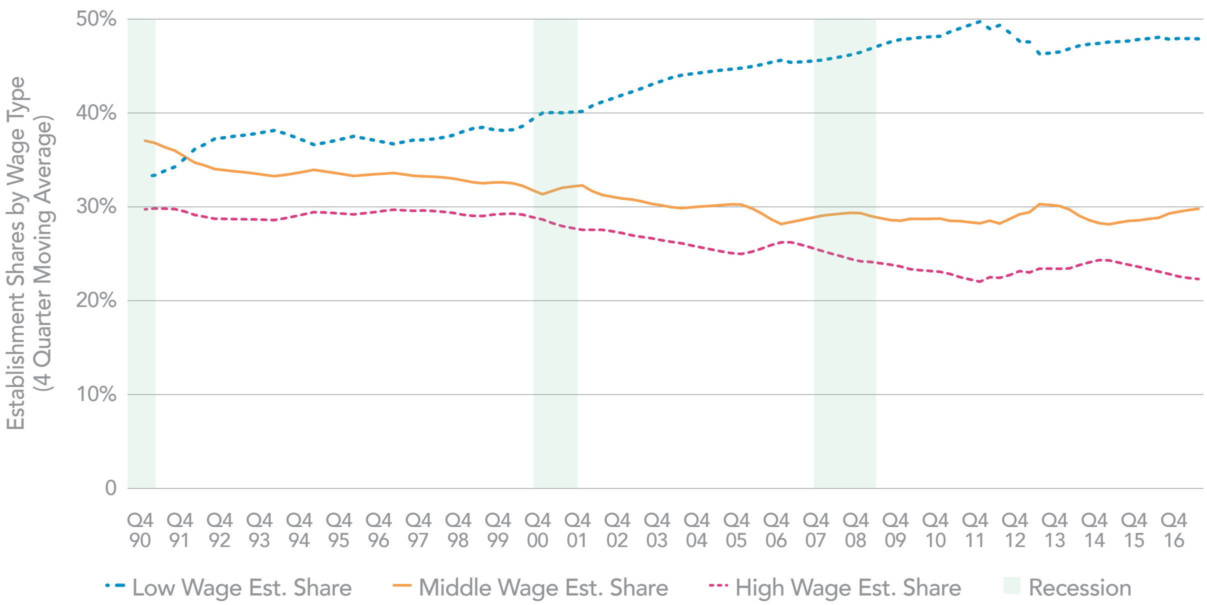
Between 2006 and 2016, immigrant households with household incomes of at least $100,000 grew 170.5 percent, while those with household incomes of less than $10,000 decreased 56.3 percent.

Employment by Income

In recent years, California as a whole saw an average increase in employment in high wage subsectors compared to other states. The Bay Area was an exception, far outpacing other regions in California due to the tech boom.

- Low-wage job growth in California during the post-recession period ranked second-highest in the nation but has dropped to the eighth-highest more recently (during the period analyzed for these briefs; Q4 2014 – Q2 2017). California is the largest state to be included in the top ten low-wage job growth states, followed by Washington. Florida and Texas, once included on the list, are no longer in the top ten. (See Table 4 in *California Employment by Income*)

Figure 3. California Establishment Shares by Wage Type
Q1 1991 to Q2 2017



Source: Quarterly Census of Employment and Wages

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- California is home to some of the leading high-wage industry subsectors in the nation, including the Professional and Technical Services industry. California fell from the 11th-highest job growth in this sector in 2014 to the 33rd in 2017. While growth in this sector may be slowing in California, the state is home to the largest base for the PTS industry in the country. Compensation in high-wage industry subsectors in California is growing more slowly than in the nation overall. (See Table 5 in *California Employment by Income*)
- Job growth in the low-wage and middle-wage industry subsectors have significantly outpaced that of high-wage industry subsectors from the fourth quarter of 2014 to the second quarter of 2017.
    - Many parts of California, including Los Angeles metropolitan statistical area (MSA), have fewer employment counts in the high-wage industry subsectors compared to ten years ago. (See Map 1 in *California Employment by Income*)
    - The Los Angeles MSA and Riverside MSAs both lost shares of employment in the high-wage industry and middle-wage industry subsectors while the San Francisco-San Jose MSA was the only region to buck the trend, with relatively stable (unchanged) shares of employment by wage type.

- While low-wage employment is found in a narrower spectrum of industry subsectors (such as Leisure and Hospitality, Retail, Health Care, and Agriculture) in California compared to middle-wage and high-wage industry subsectors, low-wage employment shares have increased from less than 25 percent in 2001 to almost 30 percent in 2016.
    - The opposite is true for high-wage employment; its shares have fallen from almost 37 percent to 33 percent over the same time period. Similarly, establishment shares in low-wage industry subsectors have made significant gains at the expense of establishments in both middle-wage and high-wage industry subsectors. (See Figure 3)

California's economy is in a state of dysfunction. While the Bay Area continues to attract well-educated workers eager to take advantage of high-paying employment opportunities, the Southern part of the state is facing rising housing prices and contracting employment opportunities. As highlighted, the simultaneous rise in low-wage employment and loss of shares of middle-and-high-wage employment paired with the rapid increase of housing prices since the Great Recession is severely limiting the ability of average Californians to maintain their quality of life, prompting an exodus. While California's economy overall is strong, it is only a matter of time before the discrepancies between wages and housing prices could begin to constrain economic growth. In order to maintain a robust economy, California will need to ensure that residents across all income and employment levels are able to afford a basic cost of living in the state. Addressing the growing housing gap is a critical piece of the equation. Policies that focus on increasing housing supply, streamlining the permitting process, and ensuring that localities meet their required levels of new housing will be crucial to ensuring that low-wage residents are able to remain in California.

To delve further into these issues, please see the complete briefs at:

- *Current State of California Housing Market*
- *California Migration*
- *California Employment by Income*