<u>Overview of housing issues in California</u>

(updated November 2013)

Economics 101 teaches us that prices are a function of supply and demand. It is no great wonder, then, that if population growth and increases in disposable income significantly stimulate housing demand but supply increases only modestly, the result is higher housing costs. California currently has 13 of the 14 least affordable metropolitan areas for homeownership in the nation. California also has the second highest rate of renter households paying more than 30% of their income for housing at 52%.

The lack of supply is the primary factor underlying California's housing crunch. The state Department of Housing and Community Development (HCD) estimates that California needs to build 220,000 new homes a year to keep up with population growth. During the decade of the 1990's California averaged only 110,000 new housing units per year. During the first decade of the 2000s, production increased significantly, reaching a peak of 212,000 units in 2004 before plummeting to historic lows during the recession. Housing production is starting to recover in 2013 but is still well below average and even farther below the need based on population growth. The fact is that California has underproduced housing every single year since 1989.

This serious shortage of supply directly affects the future health of California's economy. It hinders the efforts of businesses to attract and retain qualified employees. But it is not just the economy that is negatively impacted by the housing shortage. It affects the health and education of our children, the environment, and our overall quality of life. Long commutes increase freeway congestion, emissions, and time away from family. Substandard and unaffordable housing threatens the health of our children. Health impacts and the need to move frequently to maintain affordable housing also severely impact educational performance. In sum, our communities are less prosperous, less healthy, less educated, and less livable because affordable housing is simply not available or affordable to a large segment of our society.

Why does California continually underproduce housing, and what can we do about it? Three fundamental structural problems severely constrain the ability of California to meet its housing needs:

- First, many local governments believe that housing does not pay for itself under the current tax structure, making them hesitant to embrace new residential development.
- Second, the land use entitlement process responds to public antipathy to development generally, to high-density development more specifically, and to rental housing and affordable housing in particular.
- Third, many families are simply not able to pay market rates for adequate housing, and public investment is insufficient to cover this gap.

The first two constraints effectively place barriers in front of private developers as they attempt to increase the state's housing stock. The latter constraint means that the private market cannot meet the housing needs of lower-income households without adequate subsidy.

Creating the right fiscal incentives for local governments

The concept of the "fiscalization of land use" is familiar to many. The problem, however, is not that land use decisions are "fiscalized" (Econ 101 also teaches us that rational actors always respond to fiscal considerations) but that the incentives all favor outcomes that are biased against housing development. Ever since the passage of Proposition 13 in 1978, property taxes have constituted a diminishing source of revenue for governments. This situation was exacerbated in the early 1990s when the state effectively commandeered local property tax revenues to meets its obligation to the public schools through the Education Revenue Augmentation Fund (ERAF). In many cases, the additional revenues a local government now earns from each new housing unit are insufficient to cover the added expense of providing services to the new residents of that home. Some of the fixed costs of infrastructure can be recouped through fees (which, of course, reduce the affordability of the home), but the on-going service costs remain at issue. Thus, a city council deciding the fate of a new housing development faces the unenviable dilemma of denying needed housing or reducing services to existing constituents. As one might expect, the choice often is made in favor of the existing constituents.

At the same time, when a city council considers an alternate proposal to develop a parcel of land as a retail center, the fiscal incentives strongly support approval. Local governments receive a large portion of all sales tax revenue generated within their borders. The additional revenue received from a large retail facility, such as a big-box retailer or a car dealer, easily outweighs the costs of providing services to the facility. Local government can use these surplus revenues to enhance services to its constituents. As a result, housing is subject to a double whammy. Not only can it be difficult to get approval for a new housing development on residentially-zoned land, but more land is zoned commercial in the hope that retail establishments can be attracted. The only real fiscal incentive local governments have to approve housing is so that there are enough residents to support the retailers.

The passage of Proposition 1A of 2004, which both protected local government revenues and locked in sales and property tax formulas for local governments, has made it very difficult to alter these fiscal incentives. In thinking about possible reforms, however, it is important to keep in mind that any revenue distribution that is based on a per-capita formula is the most housing-friendly. The only way a local government can increase its revenue under per-capita formulas is to increase its population, which means more housing. Reforms that increase the percentage of property tax revenue maintained by cities and counties can also be helpful. While housing is not the only type of development that increases property values, and high-end housing provides more revenue than entry-level housing, the development of new housing does bring in additional property tax revenue. The least housing-friendly formula is the one that distributes sales tax revenue based on where the sales occurred, because shoppers can easily be drawn from other jurisdictions.

Addressing public opposition to higher-density development

Political pundits have noted that the only thing the public seems to dislike more than sprawl is high density development. Moreover, there remains in many communities a stigma against rental housing generally and affordable housing in particular. Though largely debunked by evidence and experience, fears of blight, increased crime, and decreased property values fuel these biases. These views manifest themselves in the political arena when communities create their zoning ordinances and when multi-family housing developments are forced to go through the local land use entitlement process. Bowing to political pressure, local planning commissioners and elected officials often seek to limit residential zoning densities and to deny or significantly scale back proposals for affordable housing developments. In the meantime, California's population continues to grow and housing prices spiral out of reach of an ever larger number of households.

If we are to provide safe and decent housing for all Californians, we must ensure that the local land use process balances the views of the community with the larger regional and statewide housing need. Current housing element law requires local governments to plan for their fair share of the region's housing needs. In order to comply with state law, a housing element must identify adequate sites that are appropriately zoned to facilitate the development of housing affordable to all income segments of the community.

One limitation of housing element law is that it lacks teeth. While the large majority of cities and counties in the state have adopted adequate housing elements, a significant percentage of the state's local jurisdictions have failed to comply with the law. Enforcement depends on private developers or non-profit lawyers suing cities and counties that are in non-compliance. In instances where the court does find cities or counties out of compliance, remedies are limited. The court may order the jurisdiction to adopt an adequate housing element and may halt development in the community in the meantime. For local governments that do not have major commercial or industrial projects pending, this is equivalent to no remedy at all. Ultimately, there must be stronger consequences for local governments that fail to comply with the law.

A second limitation of housing element law is that it requires only planning, not production. A city or county that zones enough land at the correct densities to accommodate its housing needs has complied with the law, regardless of whether any units are ever built on these sites. Because local governments do not control housing production, it is unfair to hold them accountable for production. Therefore, encouraging production must be done with incentives. Recently, the Jobs Housing Balance Improvement Program, the Workforce Housing Reward Program, and the Housing-Related Parks Program have all provided such incentives, rewarding local governments with cash for community amenities for approving additional housing or affordable housing. On-going funding for these types of incentives remains a concern.

Ultimately, public opposition to higher-density affordable housing must be balanced politically as well as legally and financially. If the business community, housing advocates, environmentalists, and others show up at city council meetings and board of supervisors meetings to support higher density zoning and individual housing developments, neighborhood opposition often can be overcome. This model has been demonstrated successfully in the Bay Area where the broad-based Housing Action Coalition organized by the Silicon Valley Manufacturing Group has won approval of 133 out of 152 housing developments it has endorsed. Many local leaders understand the dire need for housing and want to do the right thing. Political support is often necessary for them to act accordingly.

Filling market gaps

Some families are simply unable to afford market rates to rent or own a home. Naturally, the private market cannot be expected to serve these households without some form of financial assistance. In recognition of the role the state must play to provide housing opportunities for families of modest means, the Legislature has enacted and the voters have approved general obligation housing bonds. Proposition 46 of 2002 provided $2.1 billion for a variety of affordable housing programs, and Proposition 1C of 2006 provided an additional $2.85 billion.

As important as housing bonds are, they are a short-term strategy. Both Prop 46 and Prop 1C provided roughly 4-5 years worth of funding, and the state's Department of Housing and Community Development has awarded just about all of these funds. Ultimately, the state must dedicate a permanent source of revenue to fund programs on a consistent basis that provide housing and homeownership opportunities for those families not served by the market. SB 391 (DeSaulnier) of the 2013-14 session would create such a permanent source by imposing a fee of $75 on the recordation of each real estate document, except those related to a sale. As of December 2013, the Senate has passed SB 391, and the bill is pending in the Assembly.

Conclusion

Addressing each of these constraints presents a daunting challenge. Revising local fiscal incentives and strengthening housing element law are politically difficult. Finding funds for local incentives and affordable housing programs is never easy. If California is to meet its housing need and maintain its long-term prosperity, however, these constraints will have to be addressed.