# OVERVIEW OF HOUSING ISSUES IN CALIFORNIA

## Introduction

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; it also has the second highest rate of renter households paying more than 30% of their income for housing at 52%. Further, according to a 2020 study by the California Housing Partnership Corporation, California needs 1.3 million more affordable rental homes to meet current demand.

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 1990's California averaged only 110,000 new housing units per year. During the early 2000s, production increased significantly, reaching a peak of 212,000 units in 2004 before plummeting to historic lows during the recession. Unfortunately the downward trend continues; in June 2019, residential permits were down 38% compared to June 2018, and continued that trend in 2020. California recorded only 7,909 housing permits in June 2020, down 12% from June 2019. While this was the most permits the state has recorded since March, it was the lowest June total since 2014, showing the continued impact of the COVID-19 pandemic. The multifamily housing permit total of 2,745 was the lowest figure yet in 2020 and less than half the June average over the previous five years. The fact is that California has under-produced housing every single year since 1989.

This serious shortage of supply, and, in particular, supply of housing affordable to lower-income families, directly affects the health of California's economy. It hinders the efforts of businesses to attract and retain qualified employees. The housing shortage also negatively impacts the health and education of our children, the environment, and our overall quality of life. Long commutes increase freeway congestion, reduce air quality, and increase time away from family. Substandard and unaffordable housing threatens the health and educational performance of our children. In sum, our communities are less prosperous, less healthy, less educated, and less livable because housing is simply not available or affordable to a large segment of our society.

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

1) Many local governments believe that housing does not pay for itself under the current tax structure, making them hesitant to embrace new residential development.
2) 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.
3) 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.

**Fiscal incentives do not favor housing**

The concept of the "fiscalization of land use" is familiar to many. 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, add to the cost 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, new housing developments tend to be the loser.

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, online distribution center, 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 to ensure 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.

## Higher density developments tend to generate public opposition

Political pundits have noted that the only thing the public seems to dislike more than sprawl is high density development. Moreover, many communities stigmatize 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.

Recent reports point to the permitting and approval processes as a major factor preventing more housing construction. Local governments control most of the decisions about where, when, and how to build new housing. Cities and counties often require multiple layers of approval for new housing projects and commonly include review by multiple departments within the city (such as the building department, fire department, and health department), a design review board, the planning commission, and the city council or board of supervisors. Many of these reviews must be conducted at public hearings, providing venues for residents that oppose development to make their voices heard. More complicated projects require even more approvals and procedural steps, and thus, more opportunities to slow down or stall development.

Most projects that require an approval where a local government exercises discretion must also complete California Environmental Quality Act (CEQA) review, which can entail complicated analyses of dozens of aspects of the environment upon which a development may have a significant impact, such as land, air, water, minerals, flora, fauna, ambient noise levels, and objects of historic or aesthetic significance. Development opponents can appeal many of these individual decisions to the planning commission and to the city council or board of supervisors. Finally, litigation over approvals is also common. The building industry also points to environmental reviews and other permitting hurdles as a hindrance to housing development. They argue that the high cost of building and delays in the approval process reduce builders' incentives to develop housing. [1]

Some housing projects can be permitted by city or county planning staff ministerially or without further approval from elected officials. Projects reviewed ministerially require only an administrative review designed to ensure they are consistent with existing general plan and zoning rules, as well as meet standards for building quality, health, and safety. Most large housing projects, however, are not allowed ministerial review. Instead, these projects are vetted through both public hearings and administrative review. Most housing projects that require discretionary review and approval are subject to review under CEQA while projects permitted ministerially generally are not.

[1] For more details about how local governments add barriers to housing, please review this background document for the November 16th, 2018 hearing by the Senate Committees on Governance and Finance and Transportation and Housing: [https://shou.senate.ca.gov/sites/shou.senate.ca.gov/files/nov_16_background_paper_draft_v4_joint_w_gf.pdf].

Over the last several years, the Legislature has taken steps to update state housing element law, created more oversight and transparency over the regional housing needs allocation process, and established processes for streamlining the approval of housing developments.[2] More specifically, SB 35 (Wiener, Chapter 366, Statutes of 2017) requires local jurisdictions that have not met their housing production requirements to streamline the approval of certain infill housing developments; AB 2162 (Chiu, Chapter 753, Statutes of 2018) requires streamlined approval of supportive housing developments; AB 101 (Committee on Budget, Chapter 159, Statutes of 2019) creates a streamlined, ministerial approval process for high-quality, low-barrier navigation centers; SB 9 (Atkins, Chapter 162, Statutes of 2021) requires streamlined approval of a housing development of no more than two units in a single-family zone (duplex), the subdivision of a parcel zoned for residential use into two parcels (lot split), or both; AB 2011 (Wicks, Chapter 647, Statutes of 2022) creates a by-right approval process for affordable housing and mixed-income developments in commercial corridors; and SB 6 (Caballero, Chapter 659, Statutes of 2022) authorizes housing developments in otherwise commercial areas to be subject to SB 35 streamlining. These streamlined approval processes reduce opportunities for opposition groups to slow-down or stall developments from receiving necessary permits.

Combined, these reforms will result in more sites available for housing development and therefore more opportunities for streamlined approvals to take place; however, the full effects of the changes described above will likely take years to be fully realized. This is because local governments are only just beginning their new housing element planning process for the next eight year planning period, which means there may not be sufficient sites available in all jurisdictions due to the prior, likely lower regional housing needs allocation. Additionally, developments typically take several years to build. Lastly, local governments may continue to create other barriers to building denser housing.

**The market does not serve the lowest-income households**

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. The expenditure of bond funds from Proposition 46 (2002) and Proposition 1C (2006) combined with the loss of redevelopment funds for affordable housing, has resulted in the loss of $1.5-1.7 billion per year in dedicated funds for housing.

Over the last several years, California has made significant investments in low- and moderate-income housing[3]. The primary sources of funding:

- Low Income Housing Tax Credits (LIHTC), administered by the California Tax Credit Allocation Committee;
- Greenhouse Gas Reduction Fund monies allocated to the Affordable Housing and Sustainable Communities Strategies Program (AHSC), administered by the Strategic Growth Council;

[2] For more details on recent changes to state housing element law, please review this document: [https://shou.senate.ca.gov/sites/shou.senate.ca.gov/files/RHNA%20reform%20fact%20sheet.pdf]
[3] Moderate-income households are those members earning 80-120% AMI.

- The Veterans Housing and Homeless Prevention (VHHP) Bond Act of 2014, allocated to programs administered by HCD in coordination with the California Housing Finance Agency (CalHFA) and California Veterans Department (CalVet);
- Revenues generated through the Building Homes and Jobs Act[4] (SB 2, Atkins, Chapter 364, Statutes of 2017), allocated through HCD and CalHFA;
- The Veterans and Affordable Housing Bond Act of 2018[5] (Proposition 1), allocated to a program administered by HCD and CalHFA;
- The No Place Like Home Program (established by Proposition 2, 2018), administered by HCD;
- Several affordable housing programs administered by HCD, including the Multifamily Housing Program, Joe Serna Jr. Farmworker Housing Program, CalHome, and the Housing Accelerator Program.
- Budget appropriations to the Homeless Emergency Aid Program (HEAP) and the Homeless Housing, Assistance, and Prevention Program (HHAP), administered by the Homeless Financing and Coordinating Council (HCFC);

It should be noted that of these investments, only funds from AHSC, LIHTCs, and funds from SB 2, are ongoing sources of funding. While the state has invested substantial amounts of one-time funding in recent years, advocates state that more predictable, significant, and permanent investments are necessary to address the substantial underproduction and ongoing needs for California's lowest-income and working families.[6]

**Conclusion**

Addressing each of these constraints presents a daunting challenge. Revising local fiscal incentives and increasing state control over traditionally local functions are politically challenging. Finding funds for ongoing local incentives and affordable housing programs, is not easy, particularly when proposing additional taxes or fees. If California is to meet its housing need and maintain its long-term prosperity, however, these constraints will have to be addressed and all communities across the state must do their part.

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[4] SB 2 established a permanent source of funding for the construction of housing affordable to lower- and moderate-income households, as well as for homebuyer assistance, support for local planning documents, and housing for the homeless. In year 1, 50% of funds went to address homelessness through the California Emergency Solutions and Housing Program at HCD, and 50% went to planning grants issued by HCD. In year 2 and beyond, 70% are allocated by formula directly to local jurisdictions, 15% are administered to CalHFA for the Mixed-Income Program (MIP), 10% fund farmworker housing, and 5% fund incentives to locals for permitting new housing.

[5] Proposition 1 of 2018 allocated $1 billion to the Cal-Vet Farm and Home Loan Program at CalVet; $1.5 billion to the Multifamily Housing Program under HCD, $150 million to the Transit-Oriented Development program (TOD) under HCD, $300 million to the Infill Infrastructure Grant program under HCD, $300 to the Joe Serna, Jr. Farmworker Housing Grant program under HCD, $300 million to the Local Housing Trust Fund Matching Grant program under HCD, $300 million to the CalHome Program at HCD, and $150 million to the Home Purchase Assistance Program under CalHFA.

[6] For more information about specific funding programs, please see this background on California Housing Finance Programs: [https://shou.senate.ca.gov/sites/shou.senate.ca.gov/files/Housing%20Finance%2009.2020_0.pdf]