RESEARCH BRIEF

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How Critical Is California's Housing Shortage?

High housing prices, low vacancy rates, and low levels of new construction have convinced many observers that California is experiencing a critical housing shortage, especially in the state's largest metropolitan areas. Supporting this view is the fact that the number of persons per housing unit has increased in California even as it has declined in the rest of the nation. Other indicators, however, show that California's housing shortage is not so severe and may not even exist in many regions. For example, the real median value of a California home was lower in 2000 than in 1990, and incomes during that decade rose faster than rents or housing prices in much of the state. Moreover, high prices and rents in the state's largest metropolitan areas are not a new phenomenon. Homeowners and renters have long paid premiums for living in choice areas, and many observers attribute these premiums to high incomes and abundant local amenities rather than to shortages.

To explore these two seemingly contradictory views, Hans P. Johnson, Rosa M. Moller, and Michael Dardia conducted a study of California's housing market during the 1990s. Their report, *In Short Supply? Cycles and Trends in California Housing*, notes that the production of new housing units in California lagged that of previous business cycles and did not keep pace with demand. They find, however, that the actual housing shortfall is much smaller than previous estimates, especially when key demographic and macroeconomic factors are taken into account. They also find that almost the entire housing shortfall was confined to the Bay Area, San Diego, and coastal Los Angeles (including Los Angeles and Orange Counties). The authors find little evidence of housing shortages in other regions, although affordability problems were common to many of them.

Measuring the Housing Shortage

General housing indicators show substantial variation across the state but point to several common patterns. Population growth outstripped new housing; indeed, new housing production declined from 2.1 million units in the 1980s to 1.1 million units in the 1990s. Already-low vacancy rates in many counties declined even further in the 1990s, especially for rental units; real prices increased in most counties in the 1990s; and households generally became more crowded. The authors note, however, that many of these trends—for example, housing price and rent increases—were less notable in the 1990s than in the 1980s.

With these general trends in mind, the authors examine the effects of macroeconomic and demographic factors on the housing markets in ten regions and for the state as a whole. To do so, they construct an econometric model that considers key factors in the housing market, including interest and unemployment rates, incomes, and prices. The results indicate that the recession of the early 1990s, which hit California especially hard, put significant downward pressure on new housing supply. The authors also construct a model for householder rates—that is, the likelihood that members of various demographic groups will form new households—to see how population changes influenced the demand for housing in California. Using these models, the authors estimate a statewide housing shortage of around 138,000 units. This figure is far lower than the estimates often cited in the media, many of which simply compare production rates from the 1980s to those of the 1990s.

Why Was Housing Production Sluggish?

According to the authors, a few demographic and macroeconomic factors explain the anemic production of new housing during the 1990s. For example, California is home to a relatively large population of immigrants and children, and both groups grew faster in the 1990s than in the 1980s. Both groups also consume less housing than others; children do not form their own households, and immigrants often live in large ones, even where housing prices are relatively low. Once the authors controlled for such demographic differences, California resembled the nation in terms of household formation.

Another demographic factor that affected California's housing market was a slowdown in overall population growth during the 1990s. Adjusting for census undercounts, California's population grew by 3.8 million people in the 1990s, but this was far smaller than the 6.2 million increase in the 1980s. Much of the slower population growth during the 1990s was due to unprecedented flows of domestic migrants out of California. Along with the shifting composition of California's population, this slowdown helps account for low levels of construction during the 1990s, when builders and developers scaled back their construction plans in response to these trends.

Yet another demographic factor was the aging of the baby boomers. During the 1980s, Californians born between 1946 and 1964 entered the prime age for household formation. During the 1990s, however, household formation rates declined for this particular group, which represents one-quarter of the state's population. The much smaller cohort that followed formed far fewer households, thereby weakening demand for new housing.

Developments in the financial markets also dampened new home construction. Expected returns on housing construction decreased relative to stock investments, and more money was shifted away from residential development and to financial markets. Federal monetary policy—for example, the Federal Reserve's commitment to low inflation during this time—may have lowered profit expectations among builders and developers as well.

Policy Implications

Although these findings do not point to a large *statewide* crisis in housing production, the authors acknowledge that other legitimate concerns about housing—including affordability in some regions, the condition of rental housing, and overcrowding—may still exist. For example, previous research shows that overcrowding occurs more frequently in California than in the rest of the United States. However, that research also shows that such overcrowding is prevalent in areas with inexpensive housing.

Although housing shortfalls in the Bay Area, coastal Los Angeles, and San Diego are cause for concern, the authors note that these areas are the least receptive to new construction, and other research has indicated that restrictive land-use policies in these regions exacerbated the shortages. Because opposition to new housing often grows from concerns about the effects of new development on the environment and existing infrastructure, policies that address these concerns might diminish that opposition. In some cases, too, educating the public about the consequences of *not* allowing for new housing could change local opinion. The state's housing markets vary significantly, and the authors therefore suggest that any policies designed to address housing shortages should focus on challenges in specific regions.

Finally, policies could be enacted to encourage job growth in areas with relatively abundant housing, perhaps by providing infrastructure in less developed areas adjacent to existing job centers.

This research brief summarizes a report by Hans P. Johnson, Rosa M. Moller, and Michael Dardia, In Short Supply? Cycles and Trends in California Housing *(2004, 145 pp., $12.00, ISBN 1-58213-079-5). The report may be ordered by phone at (800) 232-5343 [U.S. mainland] or (415) 291-4400 [Canada, Hawaii, overseas]. A copy of the full text is also available on the Internet (www.ppic.org). The Public Policy Institute of California is a private, nonprofit organization dedicated to independent, objective, nonpartisan research on economic, social, and political issues affecting California.*

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