PPIC

Housing

CALIFORNIA'S FUTURE

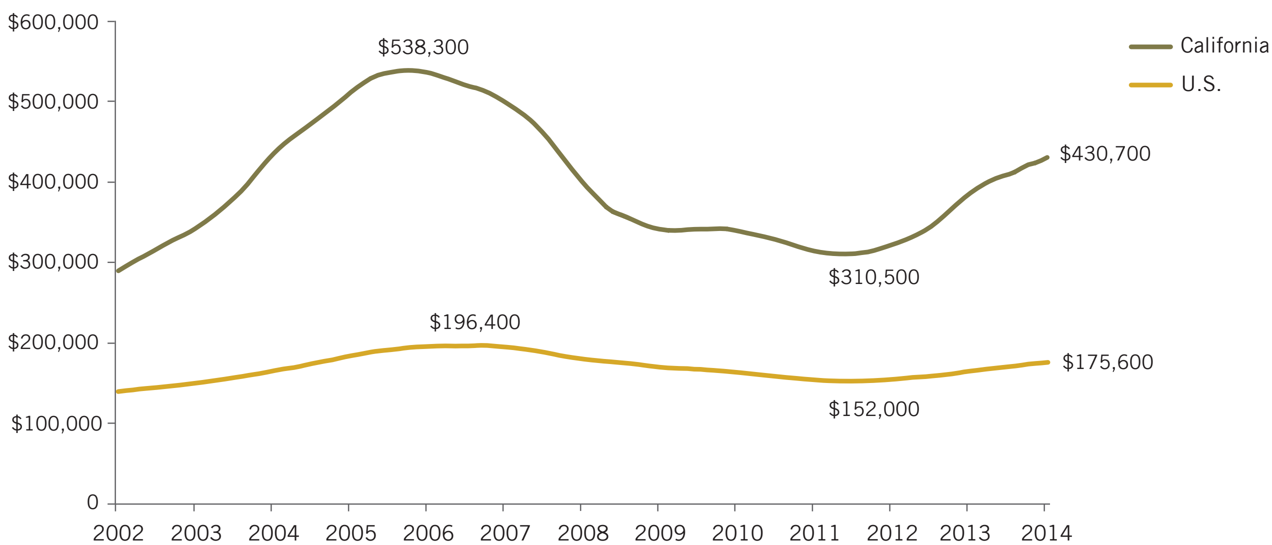
FEBRUARY 2015

THE RECOVERY CONTINUES—AND SO DO CALIFORNIA'S HOUSING CHALLENGES

California's housing market is on the mend. Although home values in most of the state remain lower than they were at the peak of the housing boom, values have increased substantially since the nadir of the housing bust. Statewide, median home values have increased 39 percent to $430,700 (as of August 2014) from their post-boom low of $310,500 in January 2012 (according to Zillow). Moreover, vacancy rates are low compared to the rest of the United States, and rents have continued to increase. Finally, the pace of new housing construction continues to pick up, although levels remain far lower than during other recoveries.

Despite the recovery, California is still experiencing the aftereffects of the most recent housing bust, and the long-term challenges of housing California's population haven't gone away. The housing bubble, which popped in 2008, left the state with a foreclosure problem and large losses of construction jobs. About 652,000 California homeowners remain "underwater"—their mortgages are higher than the market value of their homes (CoreLogic, 2014 second quarter). Paradoxically, a housing recovery for some is a housing problem for others, as high rents and increasing prices place housing out of reach for many Californians.

MEDIAN HOME VALUES: BOOM, BUST, AND RECOVERY



SOURCE: Zillow.

NOTE: Values are in nominal dollars from August 2002 to August 2014.

In both the short and the long term, California's economic performance and livability depend on its housing market. The perennially high cost of housing in coastal California reflects the fact that people and businesses are willing to pay more to be there, but it is also a consequence of geographic and policy-related barriers to building new housing in those regions. In the state's inland areas, continued economic recovery could further ameliorate the foreclosure problem. Throughout the state, balancing new housing construction with environmental goals will be a challenge.

THE HOUSING RECOVERY IS WELL UNDER WAY

- **Home values are rising throughout California.**
  Gains have been uneven across the state, but all of the most populous counties have experienced increases of at least 28 percent from their lows during the housing bust. Some of the sharpest increases have occurred in counties that experienced the worst busts, including San Joaquin (57%), San Bernardino (51%), Sacramento (50%), and Riverside (49%). Even with these remarkable increases, values in these counties remain lower than they were at the peak of the housing boom. Other counties, all in the Bay Area, have experienced sharp increases even though their housing busts were less severe. In three of those counties (San Francisco, San Mateo, and Santa Clara), home values are now higher than they were during the previous boom.

MEDIAN HOUSING VALUES HAVE RISEN IN CALIFORNIA'S MOST POPULOUS COUNTIES

	Peak (2006 or 2007)	Low (2011 or 2012)	Current (August 2014)	Peak to current	Low to current
Alameda	$637,200	$403,300	$607,000	-5%	51%
Contra Costa	$623,200	$308,800	$469,500	-25%	52%
Fresno	$295,500	$134,400	$181,500	-39%	35%
Kern	$272,500	$119,600	$163,800	-40%	37%
Los Angeles	$568,500	$360,500	$485,500	-15%	35%
Orange	$721,300	$485,000	$625,900	-13%	29%
Riverside	$422,700	$200,100	$298,800	-29%	49%
Sacramento	$402,000	$187,300	$281,300	-30%	50%
San Bernardino	$379,900	$171,100	$258,600	-32%	51%
San Diego	$538,500	$347,000	$471,400	-12%	36%
San Francisco	$822,600	$667,700	$993,100	21%	49%
San Joaquin	$415,100	$148,500	$233,800	-44%	57%
San Mateo	$819,600	$614,200	$864,100	5%	41%
Santa Clara	$747,600	$565,700	$821,300	10%	45%
Ventura	$638,000	$381,900	$488,500	-23%	28%
California	$538,300	$310,500	$430,700	-20%	39%

SOURCE: Zillow.

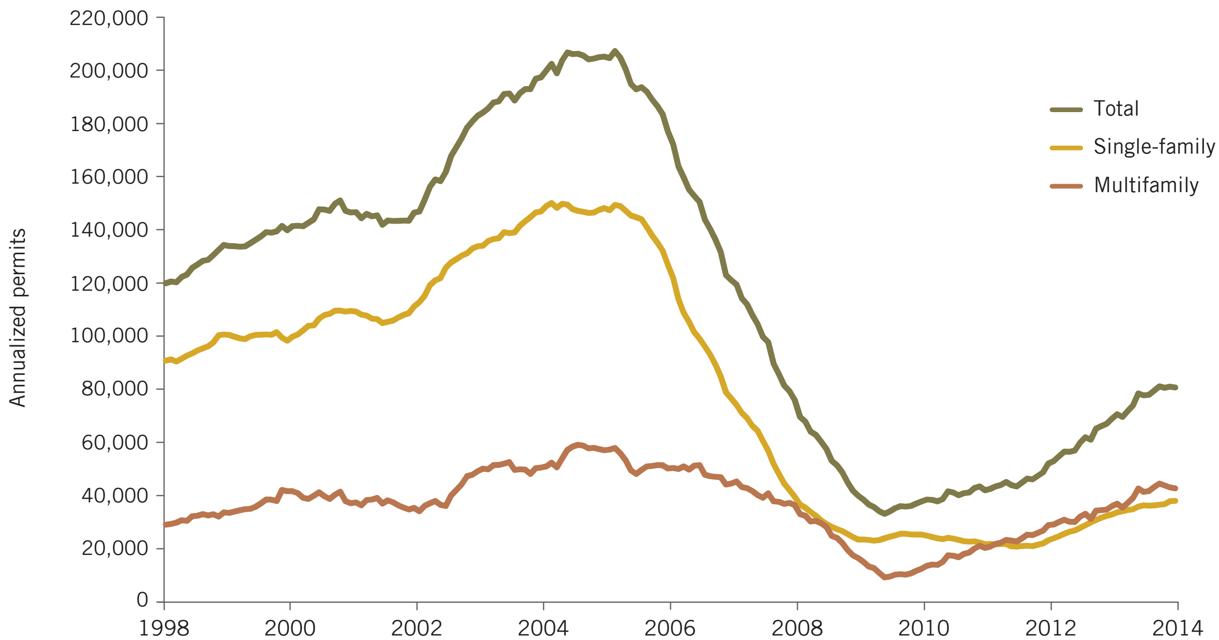
NOTE: Housing values are in nominal dollars. For most counties, the boom peak occurred in 2006 or 2007, and the bust low occurred in 2011 or 2012. Counties listed are the 15 most populated counties in the state.

- **The number of homeowners with negative equity has declined sharply.**
  According to CoreLogic, 11.2 percent of California homeowners with mortgages were underwater in the first quarter of 2014. This represents a dramatic decline since the fourth quarter of 2009, when 37 percent of mortgaged homeowners were underwater. For the first time since the housing bust, California's rate is actually lower than the rate in the rest of the nation (12.7%).

- **Foreclosure rates have fallen to the lowest level in years.**
  California appears to be over the worst of the foreclosure crisis. The number of foreclosures has declined by 67 percent over the past two years (August 2012 to August 2014, according to RealtyTrac). The total number of foreclosures is lower than it has been in at least six years.

- **New home construction is increasing.**
  Low vacancy rates, rising prices, and low interest rates are leading to increases in housing starts. New residential construction permits are on a pace to reach more than 80,000 this year, up from only 33,000 in 2009 but still far lower than the 200,000 new units built annually from 2003 to 2005 (according to the U.S. Census Bureau). For the first time in more than 25 years, permits for multifamily units exceed those for single-family units. Over the past three years, construction employment has grown much faster than employment in most other sectors. Between August 2011 and August 2014, construction employment grew at an average annualized rate of 5.8 percent, while total nonfarm employment grew at 2.4 percent.

AFTER A SHARP DECLINE, NEW HOME CONSTRUCTION IS RECOVERING



SOURCE: U.S. Census Bureau, Building Permits Database.
NOTE: Data extends from August 1998 to August 2014.

- **Housing is more affordable in inland areas.**
  Despite recent price increases, overall employment gains and low interest rates make housing affordable in many inland areas of California, home to one-third of the state's population. In the second quarter of 2014, more than 60 percent of households could afford the median-priced home in the metropolitan areas of Hanford-Corcoran, Madera, Chico, and Redding. In the Inland Empire and Sacramento, about half of households could afford the median-priced home (NAHB Wells Fargo).

HOUSING REMAINS EXPENSIVE FOR MOST OWNERS AND RENTERS

- **Californians spend disproportionate shares of their incomes on housing.**
  Monthly housing costs are substantially higher in California than in the nation as a whole. For homeowners with mortgages, median monthly housing costs are 43.4 percent higher than nationwide, and, for renters, median rents are 35.2 percent higher than nationwide. Yet household incomes in California are only 14 percent higher than incomes nationwide, according to the 2013 American Community Survey (ACS). This means that the share of Californians with excessive housing costs is quite high: 32.6 percent of mortgaged homeowners and 47.7 percent of renters spend more than 35 percent of their total household incomes on housing (compared with 24.1% and 42.5%, respectively, nationwide).

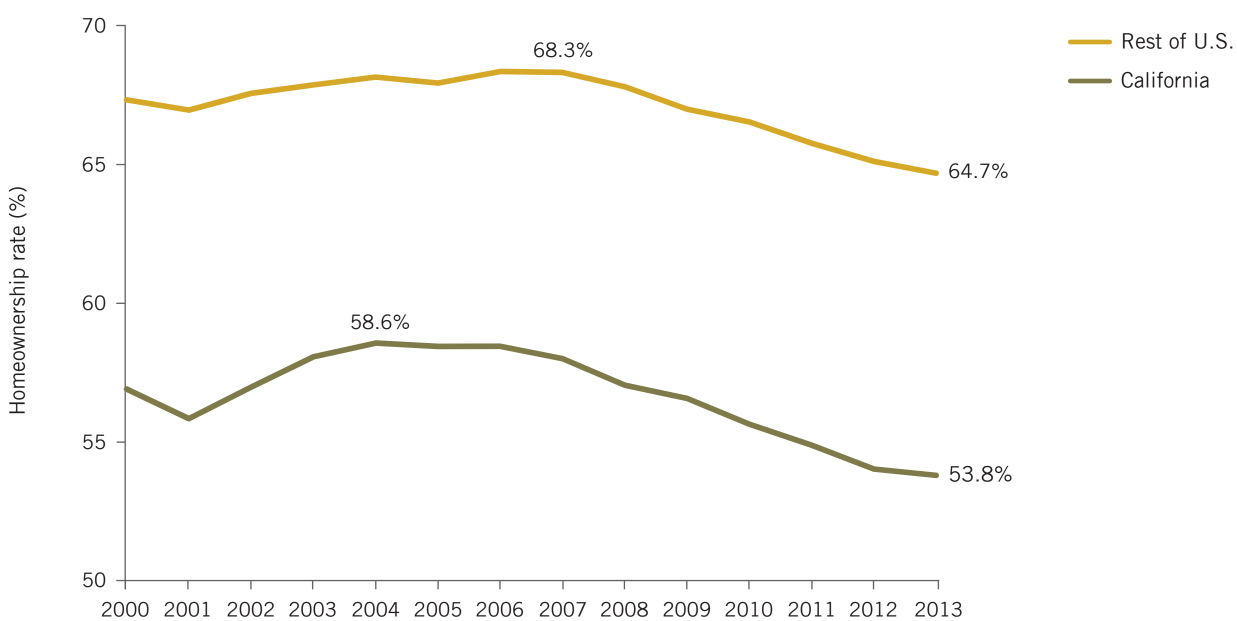
- **Housing is especially unaffordable in coastal areas, where two-thirds of California's population lives.**
  For a seventh consecutive quarter, the San Francisco metropolitan area (San Francisco, San Mateo, and Marin Counties) was the nation's least affordable major housing market. The coastal metropolitan areas of Orange County, Los Angeles, and San Jose were also among the six least affordable nationwide. In the second quarter of 2014, less than one-fifth of households could afford the median-priced home in these areas (NAHB Wells Fargo). The five most unaffordable small housing markets in the nation were all in California: Santa Cruz–Watsonville tops the list, followed by Napa, Salinas, Santa Rosa–Petaluma, and San Luis Obispo–Paso Robles.

- **Rents are high and rising.**
  According to the Department of Housing and Urban Development (HUD), six of the 12 most expensive large metropolitan rental markets in the U.S. are in California: San Francisco is most expensive, followed by San Jose, Oakland, Orange County, Los Angeles, and San Diego. In these expensive metropolitan areas, HUD's estimated median rent for a two-bedroom apartment ranges from $1,512 in San Diego to $2,263 in San Francisco. And, unlike housing prices, typical rents were higher in 2014 than in 2006 in nearly all metropolitan areas, in nominal terms.

- **Vacancies are low, relative to most states.**
  Despite sharply falling prices in recent years and increases in vacancy rates, the residential vacancy rate in California remains among the lowest in the country. In 2013, the homeowner vacancy rate was 1.3 percent in California and 1.9 percent nationwide. Meanwhile, the rental vacancy rate in California was 4.2 percent versus 6.5 percent nationwide. In many states, foreclosure often leads to abandonment, whereas in California it often means turnover. (Vacancy rate data are from ACS.)

- **Homeownership rates have fallen.**
  Between 2006 and 2013, homeownership rates, already much lower in California than in the rest of the nation, have declined more sharply in the state than elsewhere in the country, falling to 53.8 percent of all occupied housing units in 2013 (compared to 64.7% in the rest of the nation). The number of owner-occupied housing units fell by almost 300,000 in California, while the number rented increased by about 800,000. Much of the increase in rental units has occurred among formerly owned single-family detached housing units. By 2013, California's homeownership rate was at its lowest level in more than a dozen years.

HOMEOWNERSHIP RATES HAVE FALLEN SHARPLY IN CALIFORNIA



SOURCE: American Community Survey.

LOOKING AHEAD

Demand for housing in California appears to be on the upswing. The Great Recession and ensuing economic uncertainty lowered household-formation rates, especially among younger adults, many of whom are now living with their parents rather than on their own. By inducing a drop in domestic and international migration, the recession also led to slower population growth. But household formation among younger age groups is likely to recover as more jobs are added to the economy, unleashing a significant amount of pent-up demand. In the future, as residents form new households and as the state's population grows, housing demand will continue to increase. Because the "echo boomers" are much more racially and ethnically diverse than previous generations, a larger share of tomorrow's young households will be Latinos and Asians. The biggest unknown is the contribution of migration to overall population growth.

An increase in housing demand will require an increase in the supply of new housing. California needs to address both immediate and long-term housing challenges with policies that improve affordability, remove unnecessary barriers to expanding the supply of housing in high-cost areas, and meet the state's environmental goals.

- **The state and local authorities should pursue policies that increase the supply of affordable housing.**
  The construction of affordable housing in California is funded partly through state housing bonds, but the state has not passed a housing bond in eight years. The elimination of redevelopment areas has also led to a reduction in the development of low-cost housing. To encourage construction of affordable housing, state and local governments need to establish funding mechanisms and policies—possibly including new housing bonds, development fees, and inclusionary zoning—that lead directly to more affordable housing.

- **State and local governments should look carefully at regulations that contribute to high prices.**
  The supply of new housing is often constrained by geography, as most of populated California is nestled against natural barriers to construction—ocean, bay, and mountains. But it is also a result of policy choices and regulations. The state and many local governments have strong land-use and building regulations that curtail construction and keep prices high. Height restrictions, setback requirements, parking requirements, and outdated zoning that discourages new housing all serve to limit supplies and increase costs. Some argue that inclusionary zoning and rent control also restrict the supply of new housing.

- **Balancing environmental goals with housing development will be a challenge.**
  As part of its ambitious plan to reduce greenhouse gases, California has passed legislation to encourage local land-use planning that reduces the need to drive. The goal is to coordinate new housing development with current and planned transportation networks so that emissions (especially from cars) are reduced. Infill (new construction in built-up areas) is one way to achieve this goal, but there is a trade-off. In the past, much of California's most affordable new housing was built on vacant land at the edge of urbanized areas. Infill housing is often more expensive and of smaller magnitude (in terms of units built) than exurban development.

Contact a PPIC expert:

Hans Johnson
johnson@ppic.org

Marisol Cuellar Mejia
cuellar@ppic.org

Read more:

- CLIMATE CHANGE
- CORRECTIONS
- ECONOMY
- HEALTH CARE
- HIGHER EDUCATION
- HOUSING
- K–12 EDUCATION
- POLITICAL LANDSCAPE
- POPULATION
- SOCIAL SAFETY NET
- WATER

This series is funded by PPIC's Donor Circle and the S. D. Bechtel, Jr. Foundation.

PPIC PUBLIC POLICY INSTITUTE OF CALIFORNIA

Public Policy Institute of California
500 Washington Street, Suite 600
San Francisco, CA 94111
T 415 291 4400   F 415 291 4401
ppic.org

PPIC Sacramento Center
Senator Office Building
1121 L Street, Suite 801
Sacramento, CA 95814
T 916 440 1120   F 916 440 1121