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CALIFORNIA DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

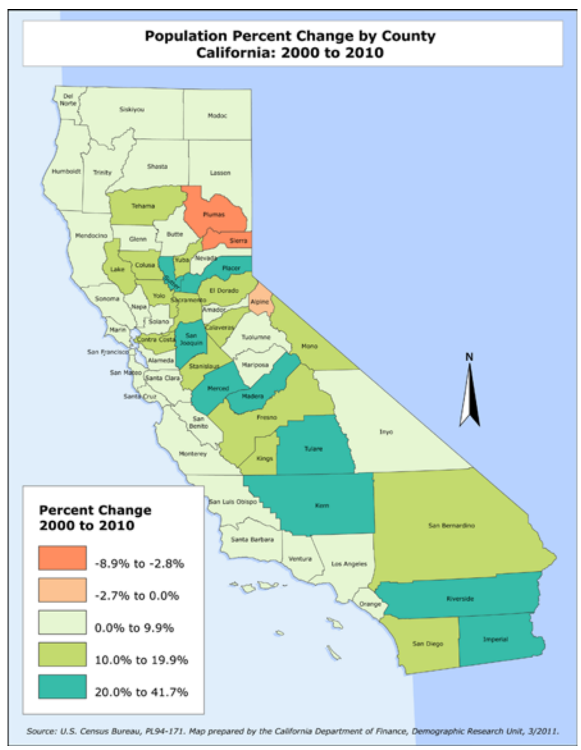
The State of Housing in California 2011: Supply and Affordability Problems Remain

Despite a steep decline in housing prices, California still lacks an adequate supply of housing, in the right locations, affordable to families, the workforce and special needs populations. Prior to the foreclosure crisis and current economic downturn (also known as the Great Recession), California had experienced decades of undersupply, contributing to significant price escalation and the affordability crisis. Research by the University of Southern California (USC) Population Dynamics Research Group found that while the recession of the early 1990s was most devastating with regard to poverty and unemployment, the housing price declines, construction declines, and foreclosures have all been worse in the Great Recession since mid 2000. This recession has worsened the effect of long term inadequate supply and affordability problems which has not been offset by record foreclosures and current depressed market conditions.

Factors contributing to California's continuing housing supply shortage and affordability problems are highlighted below:

- **California continues to experience steady and diverse population growth.** Even encompassing the recession in the early 1990s and the current downturn, California's population has still annually grown by approximately 340,000 people. Although slow by historical California standards, this annual growth amounts to the second largest numerical increase in a state population over the past decade.[1] The State is projected to experience continuing steady population gains over the next decade. Inland areas are experiencing particularly high growth rates. Despite the current market crisis, Californians continue to have babies, expand their families and, as noted below, live longer (a good thing!). These demographic trends play a central role in fueling steady future housing demand.

  California is steadily becoming more diverse. Regardless of what happens in the future, the State demographic has already been shaped. The 2010 Census shows the most significant growth in the State occurred in the Hispanic and Asian population, at 28 percent and over 31 percent, respectively, a trend that is likely to continue in the coming decade.

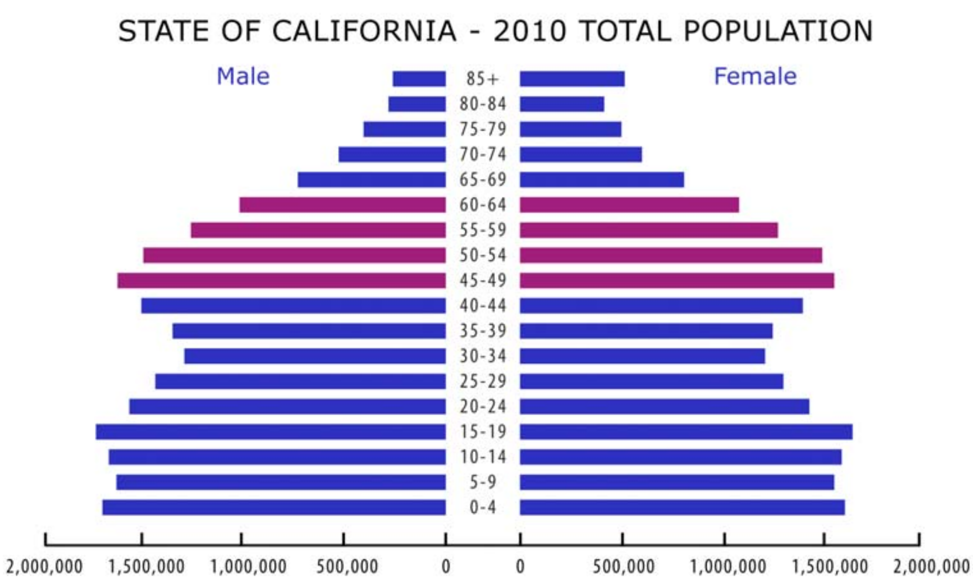


1 Department of Finance http://www.dof.ca.gov/research/demographic/state_census_data_center/census_2010

These ethnic and racial groups form households in a different manner than white non-Hispanics. For example, Hispanic households tend to have more children and are more likely to include multiple generations. According to a 2008 study by Pitkin and Myers, Hispanic households remain much more likely to locate in central cities and metropolitan areas than non-Hispanic households; housing preferences of households with foreign-born householders – an important subset of California's ethnic and racial groups, are substantially different from those of native-born, as these households are more likely to choose higher densities and multifamily structures; these differences tend to level off with time due to assimilation.[2] Nonetheless, the mix of preferences and needs for a variety of housing types and locations will be drivers for more diverse housing demand in decades to come.

- **Over the current decade, the greatest population growth is projected for residents aged 55 and over (aging baby-boomers), followed by the 25-34 age group (baby-bust generation).** This trend is dramatically different from the past decade and, combined with the shifts in ethnic and racial composition of population growth noted, can substantially affect the type and location of housing demand throughout California. For example, older Californians have the highest housing demand per 1,000 people – the result of divorces, separations and deaths. A 2009 survey by real estate advisory firm Robert Charles Lesser and Co.(RCLCO) found that 75 percent of retiring boomers want to live in mixed-age and mixed-use communities, and more urban settings. Baby–boomers are projected to dominate changes in the housing market until at least 2030, with their strong demand for active living housing, near transit and services, as well as for assisted living.[3]

  Complementing and nearly outnumbering the aging population is the baby-bust generation which is more diverse, and entering household formation ages.



The RCLCO's 2008 survey found that 77 percent of this younger generation reports wanting to live in an urban core, rather than the suburbs where they grew up, and are willing to live in smaller spaces to be able to afford their lifestyle. As such, this generation may augment the demand for apartments and smaller starter homes in urban centers over the next decade.[4]

Source: California Department of Aging

2 Pitkin, John and Myers, Dowell *"U.S. Housing Trends: Generational Changes and the Outlook to 2050"*; Prepared for Transportation Research Board, National Academy of Sciences, Washington, D.C., May 2008

3 Myers, Dowell and Ryu, SungHo, "*Aging Baby Boomers and the Generational Housing Bubble: Foresight and Mitigation of an Epic Transition*", 2007, Journal of the American Planning Association, 74:1 http://dx.doi.org/10.1080/01944360701802006

4 Joint Center for Housing Studies of Harvard University, *"State of the Nation's Housing 2010",* p .14 http://www.jchs.harvard.edu/publications/markets/son2010/son2010.pdf

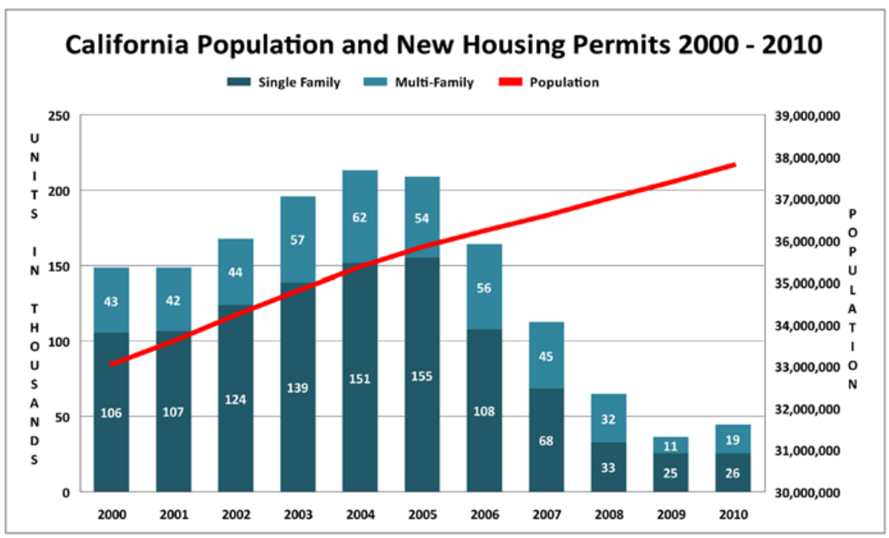
A 2010 Urban Land Institute study summarizes that four large demographic groups, facing a unique set of challenges, are driving the housing markets for the next decade:

- Older baby boomers, who will live longer than previous generations and constitute a senior population unprecedented in size;
- Younger baby boomers, many of whom may be unable to sell their current suburban homes to move to new jobs;
- Generation Y, which will be renting housing far longer than they did in past generations, partly because of high college debt;
- Immigrants and their children, who will want to move to the suburbs but may find housing there too expensive, even after the current drop in prices.[5]

Given the variety of housing preferences and needs of the State's diverse and aging population, an assortment of rental and owner options are needed to accommodate households in different stages of life and for all incomes. For example, an increase in one-person and older households is likely to continue for the next several decades, driving the need for more housing and different housing products. By 2030, one in four homes is projected to be occupied by a single-person,[6] while a growing number of homes will be occupied by empty-nesters or non-family households without children. All of these trends combined will likely result in a stronger demand for a variety of housing types, located in denser, more urban settings, closer to services and amenities.

- **New home construction, critical to California's economy, reached record lows during the recession and has been slow to rebound.** A recent study by Myers, Calnan, Jacobsen and Wheeler depicting construction trends in California since 1960, finds that permits have fluctuated dramatically in the past, following the business cycle.[7] The 1990 recession involved a prolonged downturn, with six years of depressed construction followed by a surge in construction that continued into the next decade. During the past decade, residential new construction has averaged less than 150,000 permits per year, lagging well behind the State's annual average need.

California was already behind in meeting its housing need relative to population and employment growth when residential permits in the last decade peaked in 2004 at over 212,000. Just when residential construction was approaching the average annual need to accommodate the State's population growth and mobility, the bottom fell out of the financial sector with the foreclosure crisis and recession.



5 John McIlwain, Urban Land Institute, *"Housing America. The Next Decade"* http://www.uli.org/~/media/Documents/ResearchAndPublications/Fellows/McIlwain/HousinginAmerica.ashx

6 Arthur Nelson "*America Circa 2030: The Boom To Come",* Architect Magazine, October 15, 2006. http://www.architectmagazine.com/retail-projects/america-circa-2030-the-boom-to-come.aspx

7 Dowell Myers, Ray Calnan, Anna Jacobsen and Josh Wheeler, *"California Roller Coaster-Income and Housing in Boom and Bust, 1990-2010"* April 2011, sponsored by the John Randolph and Dora Haynes Foundation, p.7 http://www.usc.edu/schools/sppd/research/popdynamics/pdf/2011_Myers-etal_California-Roller-Coaster.pdf

Residential permits spiraled down in 2009 to the lowest level of permits in 55 years of historical records to just over 35,000 (approximating a 84 percent decrease from 2004); multifamily permits decreased by 80 percent.[8] In 2010 housing production (44,925 permits) was well under a quarter of the 2004 level. The outlook for 2011 is yet dim: residential permits for the first quarter totaled 9,321, which is 10 percent lower than the same quarter of 2010. This continuous decline in new housing construction severely deepens the State's housing deficit and diminishes the economic multiplier benefits of new housing construction.

The Center for the Continuing Study of the California Economy (CCSCE) describes the devastating effect the decline of the State's housing sector has had on the overall economy.[9] From 2005 to 2009, the decline in annual building permits accounted for much of the 60 percent reduction in construction spending over that span, from nearly $100 billion in 2005 to less than $40 billion in 2009. The report added that California lost nearly 500,000 construction-related jobs during the peak recession between December 2007 and December 2009.

> **"...We will come back big time on employment when housing construction comes back."**
>
> **Warren Buffet**
> **July 8, 2011**
> **Associated Press**

The health of the housing construction industry is critical to the health of California's economy. Estimates for Fiscal Year 2009–2010 indicate that a newly built, median-priced home adds more than $375,000 in economic output for the State and creates 2.1 new jobs.[10] A 2006 report showed when the market was still strong, the homebuilding industry generated close to $273 billion in economic output and about 960,000 jobs, accounting for approximately eleven percent of all economic activity in the State.

- **The current inventory of foreclosed units does not eliminate the need for more housing.** The sustained housing deficit is not eliminated by the current stock of foreclosed homes. California had already fallen behind in its housing need relative to population and employment growth before the Great Recession started. In the 1990s, a decline in new construction directly led to dramatic price increases and increased overcrowding. By Census 2000, California had 1.7 million overcrowded households; two-thirds of these were renter households. Almost a decade later, there is no sign of improvement, as the 2009 American Community Survey shows one in every two overcrowded households are renters living in severe overcrowding conditions.

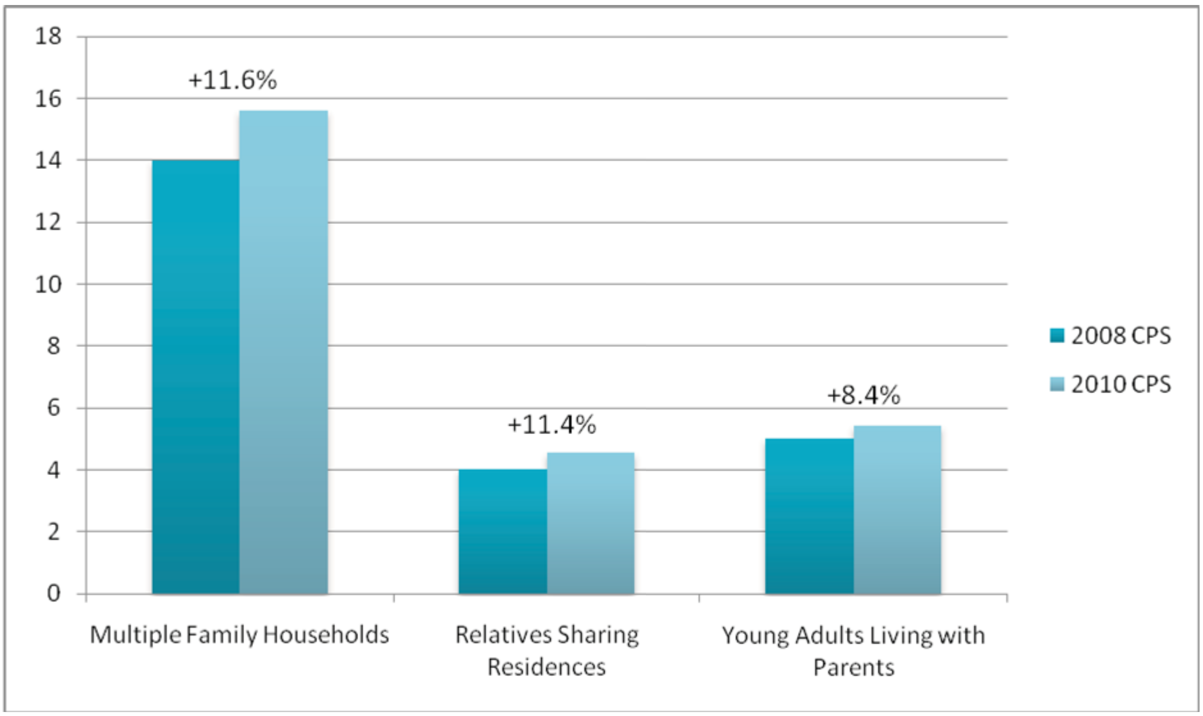
Homes going through the foreclosure process do not automatically become vacant available for occupancy, because of the length of time in working through the financial and legal systems, and are often held off the market for various reasons. Even when placed for sale, these units do not increase the overall supply, given the households vacating them must relocate, in rental units, or with family or friends in shared quarters. Recent analysis found that, between 2008 and 2009, approximately 12 percent of households that moved joined an existing household, a significant increase from 2005,

8 Construction Industry Research Board, California Construction Review, Burbank, April 2011

9 "*Why is California's Unemployment Rate so High and what does it Mean for the State's Economic Future"* by CSCCE at http://www.ccsce.com/PDF/Numbers-Sep2010-Cal-Unemployment-High.pdf .

10 Maya Brennan, Keith Wardrip "Building California's Future", June 23, 2010

suggesting that more households may be doubling-up and living in overcrowded conditions to better afford housing costs during the current economic downturn.[11] Many of these families and children living at home are expected to live on their own as soon as their economic conditions improve. This could lead to a potential jump in housing demand resulting in a boost in household formation.



Furthermore, as the Joint Center for Housing Studies of Harvard University predicts, "once the consumers perceive that a floor has formed under housing prices, their re-entry into the market could weekly burn through the lean inventory of unsold new homes and slim down the excess supply of existing homes on the market." [12]

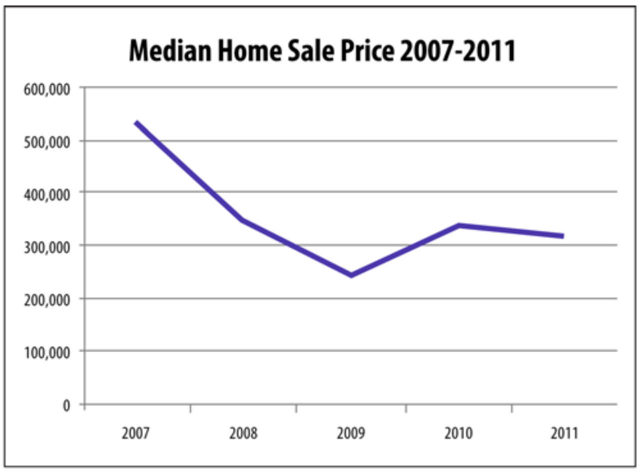
- **The State's chronic housing affordability gaps have not been eliminated despite the improved affordability of ownership housing due to the foreclosure crisis.** The Bureau of Labor Statistics reported the State's unemployment rate doubled since 2008, reaching 12 percent in March 2011. Between 2008 and 2009, California's owner households declined by 130,000. In 2000, 56.9% of households were homeowners, spiking upward to 58.4% in 2006. With the collapse of the financial market, the homeownership rate plunged 2.5 percent to 55.9 percent in 2010.

11 U.S Census Bureau, Newsroom, http://www.census.gov/newsroom/releases/pdf/09-16-10_slides.pdf

12 Joint Center for Housing Studies of Harvard University, *"The State of the Nation's Housing 2011"* available at: http://www.jchs.harvard.edu/publications/markets/son2011/index.htm

Recessionary conditions have swelled the ranks of renters, overcrowded housing units, and the homeless, with many families struggling to meet food, housing, and transportation costs.

Affordability represents the relationship between housing prices and incomes; in order for housing to become more affordable, its prices need to fall by more than the decline in income. By this standard, the USC Professor Myers' "California Roller Coaster-Income and Housing in Boom and Bust, 1990-2010" study found housing did not become more affordable, as prices did not decline enough to compensate for the loss in income.[13]



Median home prices statewide peaked at $534,300 in March 2006, and declined steeply, reaching $337,500 in 2010. By June 2011, the median sales price had decreased another 5.9 percent when compared to June 2010.[14] Falling prices also left many homeowners "underwater" in their mortgage loans, and trapped in homes worth less than the mortgage balance. The Public Policy Institute of California reported that CoreLogic, a private real estate data research firm, estimates 32 percent of mortgaged residential properties nationwide were "underwater".[15]

Source: California Association of Realtors, *"Trends",* Vol. 32, July 2011

While in some markets, homeownership has become more affordable, especially for first-time homebuyers, housing remains out of reach for many lower-income families and workers, due to unemployment, lack of available financing and tightened underwriting standards. In addition, as the Center for Public Policy suggests, others may prefer renting for reasons as varied as concerns about home price volatility, uncertainty about affording the costs of major repairs, or a desire to have greater access to job opportunities elsewhere.[16]

- **There is a mismatch between the existing housing stock and the demand for housing by type and location.** Despite vacant foreclosed units, much of this housing does not meet current consumer demands. Today's young adults have a stronger preference for urban living than their predecessors and the demand for smaller homes close to services and transit is rising. In addition, many older Californians desire or need smaller sized units, close to amenities or services. Also, many smaller homes and apartments, which account for a higher share of affordable units, are older and often substandard and may be lost to demolition, widening the gap between the supply and demand for affordable rental units. Vacant foreclosed units for sale in outlying suburban areas will not meet this need or the demand for more infill housing accessible to jobs and transit in more

13 Idem., Dowell Myers, Ray Calnan, Anna Jacobsen and Josh Wheeler, p.8

14 California Association of Realtor's, "Trends;" Vol. 32. : No. 2. March 2011, and No.7, July 2011

15 Public Policy Institute of California, *"California Housing: Planning for a Better Future"*., June 2011

16 Center for Housing Policy *"Paycheck to Paycheck 2011: Is housing affordable for Americans getting back to work?"*, Maya Brennan and Laura Williams , July 2011

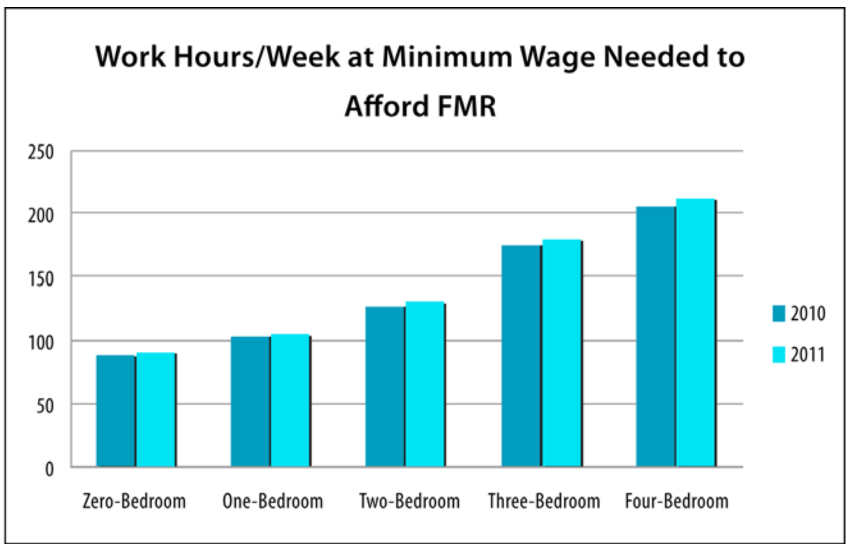
central locations, necessary to reduce the costs of energy, transportation and greenhouse gas emissions. Nor does the existing housing stock meet the need for different housing types including "greener" development, smaller homes, or mixed-use housing.

In a recent study, economists Denk, Dietz and Crowe, maintain current high vacancies are not a sign of overbuilding, but rather an indication of significant pent-up demand related to economic conditions. The study implies that recovery in the housing market will come more quickly as the economy recovers and pent-up demand becomes realized demand, absorbing vacant units in the existing stock and adding pressure for the construction of new units.[17]

- **California has a large unmet need for rental housing affordable to lower-income households.** The "Paycheck to Paycheck 2011" report by the Center for Housing Policy shows that ten of twenty least affordable rental markets in the United States are in California. One in two renters in California pay in excess of 30 percent of their income, while one in four renters pay more than half of their income toward rent.[18]

In a recent report to Congress, HUD revealed the housing needs of low-income renter households with high housing costs or occupying severely substandard housing increased more than 20 percent from 2007- 2009. Unfortunately, only a quarter of eligible households nationally actually receive tenant-based rental assistance, leaving a large proportion of renter households paying too much for housing, doubling up, or living in substandard conditions.

According to the National Low Income Housing Coalition, affordability of rental housing in California has continued to worsen: in 2007, a minimum wage renter had to work 120 hours per week to afford a two-bedroom apartment; in 2010, the number of hours increased to 128; in 2011, it reached 131 hours per week.[19]



Source: National Low Income Housing Coalition http://www.nlihc.org/oor

Furthermore, the recent California Federal Rent Assistance Facts by the Center on Budget and Policy Priorities reports that out of 5.3 million renters in California, only 466,244 low-income households are federally assisted and can afford modest housing at an affordable housing cost. Approximately 60 percent of these households are headed by people who are elderly or disabled; roughly

17 Robert Denk, Robert Dietz, Ph.D. and David Crowe, Ph.D Economics & Housing Policy , *"Pent-up Housing Demand: The Household Formation That Didn't Happen-Yet",* Special Studies, February 2, 2011

18 U.S. Census Bureau, 2005-2009 American Community Survey, http://www.census.gov/acs/

19 The National Low Income Housing Coalition (NLIHC), "*Out of Reach",* June 2010, June 2011 http://www.nlihc.org/oor

30 percent are families with children. There are, however, another 1.4 million low-income renter households that pay more than half of their monthly cash income for housing costs. On average, these households have monthly incomes of $1,291 and pay housing costs of $1,143, leaving only $148 to pay for other necessities. About 31 percent of these cost-burdened renters are elderly or people with disabilities, while 38 percent are families with children.

The foreclosure crisis exacerbated renter housing needs; an estimated 38 percent of homes in foreclosure were rentals, resulting in more than 204,000 California renters being directly affected, many of which were evicted and had to move to unstable, tenuous living situations.[20] Estimates of the 2009 American Community Survey are that three in four California households living in overcrowded conditions were renter households.

A shift in tenure due to foreclosures tightened the rental markets and will likely result in increased rents. The Joint Center for Housing Studies of Harvard University recently emphasized the renewed importance of an adequate supply of affordable rental housing, as today's economic and demographic conditions boost rental demand. It describes the diverse rental needs for what is a disproportionately large share of single–person, young and minority households concentrated at the bottom half of the income distribution, indicating that nearly three-quarter of renters have incomes below median income for all households.[21]

As the foreclosure crisis continues, the demand for rental housing will likely increase as owners of foreclosed units move into rental units and potential homebuyers, facing tighter credit and increased unemployment, postpone home buying. If this increased demand is not met with an adequate increase in rental supply, rents will rise, leading to further decline in affordability.[22]

The aforementioned Urban Land Institute study also concludes that demographic forces favor rental housing at levels unprecedented in decades. Going forward, the study projects an ongoing and robust need for housing production in the decade ahead and that the falling homeownership rate, the wave of gen-Yers deferring homeownership, and growing urbanization will increase long-term demand for rental and multifamily housing.[23]

"Improvements in affordability require both increasing renter incomes and moderating housing costs. But with persistently high unemployment, the prospects for renter income gains are dim and rising demand for rental housing may well put added pressure on rents. Moreover, global energy demand is almost certain to grow, further limiting the ability of the poorest renters to afford housing."

Joint Center for Housing Studies of Harvard University, *"America's Rental Housing : Meeting Challenges, Building on Opportunities, 2011"*

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20 Tenants Together, "*California Renters in the Foreclosure Crisis*" , Third Annual Report, January 2011, http://www.nlihc.org/detail/article.cfm?article_id=7653

21 Joint Center for Housing Studies of Harvard University, "*America's Rental Housing : Meeting Challenges, Building on Opportunities, 2011*", http://www.jchs.harvard.edu/publications/rental/rh11_americas_rental_housing/AmericasRentalHousing-2011.pdf

22 Rebecca Cohen, Keith Wardrip, and Laura Williams, "*Rental Housing Affordability -A Review of Current Research*", October 2010, http://www.nhc.org/media/files/RentalHousing.pdf

23 Idem. John McIlwain, p.23

Aggressive actions to increase the supply and affordability of housing and support the residential construction industry is critical to supporting California's competitive economic edge and improving the quality of life for its residents. This is fundamental for California to maintain its leadership role in addressing climate change and environmental quality while adequately housing workers and families.

For more information or questions, please contact Anda Draghici, Senior Housing Policy Specialist, Division of Housing Policy Development, at (916) 327-2640.

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