Housing

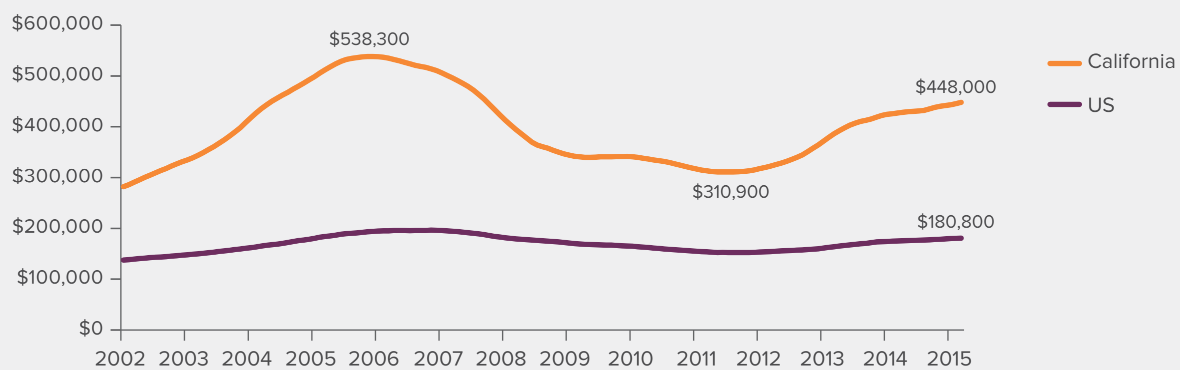
JANUARY 2016

California's housing challenges continue

California home values continue to rise but at a slower pace than in recent years. In August 2015, home values climbed 4.9 percent over the year, down from 10.6 percent in 2014 and 19.8 percent in 2013. Meanwhile, driven by exceptionally strong demand, rents continue to increase. To help meet this demand, more multifamily permits were issued in 2015 than in any year since 2005. Meanwhile, foreclosures have fallen to the lowest level in years.

Although home values have increased substantially since the nadir of the housing bust, gains have been uneven across the state and pockets of distress remain. The number of California homeowners with negative equity has dropped sharply. Still, in the second quarter of 2015, about 490,000 homeowners remained underwater, with higher mortgage amounts than the market value of their homes. At the same time, high rents and rising prices place housing out of reach for many, in some cases leading to homelessness. Affordability continues to be one of California's biggest housing challenges, aggravated by slow growth in household incomes. Almost half of California renters are paying more than 35 percent of their household income for housing.

MEDIAN HOME VALUES: BOOM, BUST, AND RECOVERY



SOURCE: Zillow.

NOTE: Values in nominal dollars from August 2002 to August 2015.

Housing values keep rising, but the pace is uneven

- **California home values have increased substantially since the housing bust.**
  The state's median home value is up 44 percent from its recent low—to $448,000, within 17 percent of the previous peak. In San Francisco, San Mateo, Santa Clara, and Alameda Counties values are now above previous highs. Some of the sharpest gains have occurred in counties that had the worst busts, including 75 percent in San Joaquin, 59 percent in Sacramento, 56 percent in San Bernardino, and 53 percent in Riverside. But values in those counties are still below peak. In 18 counties, mostly in the San Joaquin Valley and the Central Sierra, prices remain more than 30 percent below peak.

- **Fewer homeowners have negative equity.**
  Just 7.3 percent of California homeowners with mortgages were underwater in the second quarter of 2015, down dramatically from 37 percent in the fourth quarter of 2009. California's underwater rate is now lower than the 8.7 percent rate in the rest of the nation.

- **Foreclosures have dropped to the lowest level in years.**
  California's total foreclosure activity (which includes foreclosure starts, scheduled foreclosure auctions, and bank repossessions) declined 73.7 percent from August 2012 to August 2015. Foreclosure starts are at about 8 percent of their 58,858 peak in May 2009 and are below pre-crisis levels. California's foreclosure rate is 19th in the nation.

MEDIAN HOUSING VALUES HAVE RISEN IN CALIFORNIA'S 15 MOST POPULOUS COUNTIES

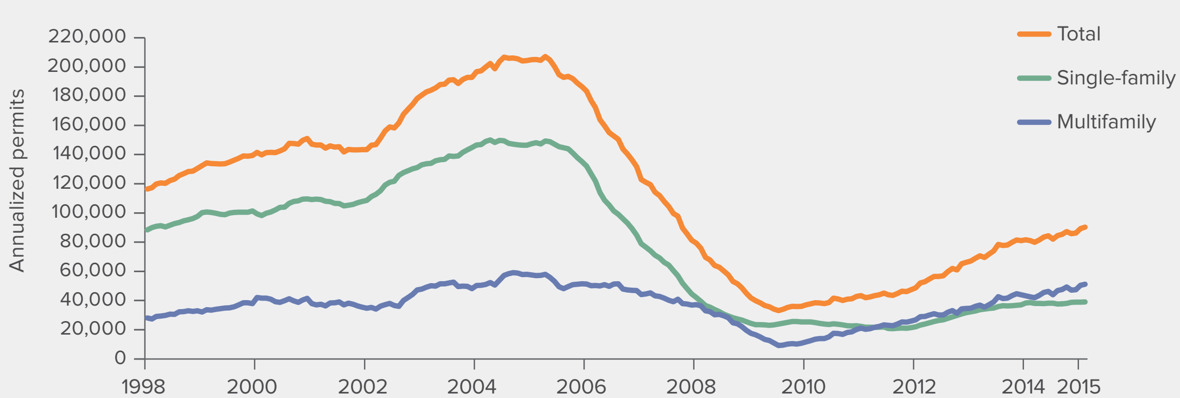
	Peak (2006 or 2007)	Low (2011 or 2012)	Current (Aug. 2015)	Peak to current	Low to current
Alameda	$637,200	$403,600	$681,700	7%	69%
Contra Costa	$623,200	$309,900	$502,700	-19%	62%
Fresno	$295,500	$134,900	$193,100	-35%	43%
Kern	$272,500	$120,000	$174,100	-36%	45%
Los Angeles	$568,500	$360,300	$503,700	-11%	40%
Orange	$721,300	$486,200	$624,500	-13%	28%
Riverside	$422,700	$200,400	$306,400	-28%	53%
Sacramento	$402,000	$187,800	$299,400	-26%	59%
San Bernardino	$379,900	$171,700	$267,000	-30%	56%
San Diego	$538,500	$347,300	$483,800	-10%	39%
San Francisco	$822,500	$667,900	$1,094,500	33%	64%
San Joaquin	$415,100	$148,800	$260,300	-37%	75%
San Mateo	$819,700	$614,500	$1,008,200	23%	64%
Santa Clara	$747,600	$564,800	$916,800	23%	62%
Ventura	$638,000	$382,400	$516,100	-19%	35%
California	**$538,300**	**$310,900**	**$448,000**	**-17%**	**44%**

SOURCE: Zillow.

NOTE: In nominal dollars. For most counties, the peak occurred in 2006 or 2007, and the low in 2011 or 2012.

- **Home construction is increasing.**
  Low vacancy rates, rising prices, and low interest rates are boosting housing starts. New residential construction permits may reach more than 90,000 in 2015—up from 33,000 in 2009, but still far below the 200,000 units built annually from 2003 to 2005. Fueled by strong rental demand, multifamily residential permits have risen 20.5 percent over the past year following strong gains each year since 2010. Meanwhile, construction jobs are growing faster than employment in most other sectors.

HOME CONSTRUCTION IS RECOVERING



SOURCE: US Census Bureau, Building Permits Database.

NOTE: July 1998 to July 2015.

Housing remains expensive for most people

- **Californians spend disproportionate shares of their incomes on housing.**
  For California homeowners with mortgages, median monthly housing costs are 4.2 percent higher than they are nationwide. California renters pay 35.8 percent above the nationwide median. Yet California's median household income is only 15.4 percent higher than the nation. This means that the share of Californians with excessive housing costs is quite high: 31.5 percent of mortgaged homeowners and 47.4 percent of renters spend more than 35 percent of their total household income on housing, compared with 23.4 percent and 42.6 percent, respectively, nationwide.

- **Housing is especially unaffordable in coastal areas, where two-thirds of Californians live.**
  In the second quarter of 2015, the San Francisco metropolitan area (San Francisco, San Mateo, and Marin Counties) was the nation's least affordable major housing market. Los Angeles, Orange County, and San Jose were among the five least affordable metropolitan areas nationwide. Less than one-fifth of households could afford the median-priced home in these areas. Santa Cruz–Watsonville, Napa, Salinas, Santa Rosa–Petaluma, and San Luis Obispo–Paso Robles were the nation's five least affordable small housing markets.

- **Rents are high and rising.**
  California has six of the nation's eleven most expensive large metropolitan rental markets: San Francisco, San Jose, Orange County, Oakland, Los Angeles, and San Diego. Estimated median rent for a two-bedroom apartment ranges from $1,512 in San Diego to $2,263 in San Francisco.

- **Vacancies are low.**
  In 2014, California's homeowner residential vacancy rate was 1.3 percent compared to 1.9 percent nationwide. Meanwhile, the rental vacancy rate was 3.9 percent, 2 percentage points lower than in 2010 and far below the 6.3 percent nationwide rate. Low vacancy rates have contributed to the tightness of the rental market.

- **Homeownership rates have fallen.**
  Between 2006 and 2014, homeownership rates, already much lower in California than in the rest of the nation, declined more sharply than elsewhere in the country, falling to 53.7 percent of occupied units in 2014, compared with 64.2 percent elsewhere. Owner-occupied units fell by almost 250,000, while rented units increased more than 850,000. Much of the increase in rental units has occurred among formerly owned single-family detached housing units. California and national homeownership rates are the lowest in more than a dozen years.

- **Homelessness is widespread.**
  About 20 percent of the nation's homeless lived in California in 2014. Some 62.7 percent of California homeless are unlikely to be found in shelters or other residential programs—the highest rate in the nation. The largest number of homeless people live in Los Angeles County, but homelessness affects most counties, even small and rural ones.

- **Housing is more affordable inland.**
  Despite price increases, housing is relatively affordable in many California inland areas. In the Hanford-Corcoran, Redding, Yuba City, and Merced metropolitan areas, families earning the area's median income could afford more than 60 percent of homes sold in the second quarter of 2015. In Sacramento and the Inland Empire, about half of homes sold were affordable to families at the median income.

Looking ahead

As the state's population grows, housing demand continues to increase. California needs short- and long-term policies that improve housing affordability and remove unnecessary barriers to expanding supply, while meeting environmental goals.

- **State and local authorities should boost the affordable housing supply.**
  Bonds help fund affordable housing, but California has not passed a general housing bond since 2006, when Proposition 1C ($2.85 billion) created almost 66,000 low-income housing units, shelter spaces, farmworker dormitory spaces, and other housing spaces. In 2014, voters authorized $600 million in bonds to provide multifamily housing to low-income veterans and supportive housing for homeless veterans. These actions are helpful but insufficient to solve California's housing problem. Meanwhile, the elimination of redevelopment areas has reduced low-cost housing development. To encourage affordable housing construction, state and local governments should establish funding mechanisms and policies, possibly including housing bonds, development fees, and inclusionary zoning.

- **California should consider expanding the housing options for the state's homeless individuals and families.** The "housing first" approach to ending homelessness provides homeless people with housing as quickly as possible and services as needed. It appears to have been implemented successfully in some California counties and in other states. Having a secure environment allows people to concentrate on getting jobs and stabilizing their lives.
- **State and local governments should reexamine regulations that contribute to high housing prices.** California's tight housing reflects not only scarce developable land but also policy choices and regulations. Some state and local land-use and building regulations—including height restrictions, setback requirements, parking rules, and outdated zoning—curtail construction and raise prices. Inclusionary zoning and rent control may also restrict housing supply. Promotion of office development, such as tax incentives for businesses that relocate, should be balanced by policies that encourage 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 driving. The goal is to coordinate new housing development with current and planned transportation networks so that emissions 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 those developments. Identifying water sources for new development is also an issue in some parts of the state.

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