Choking California's Housing Supply

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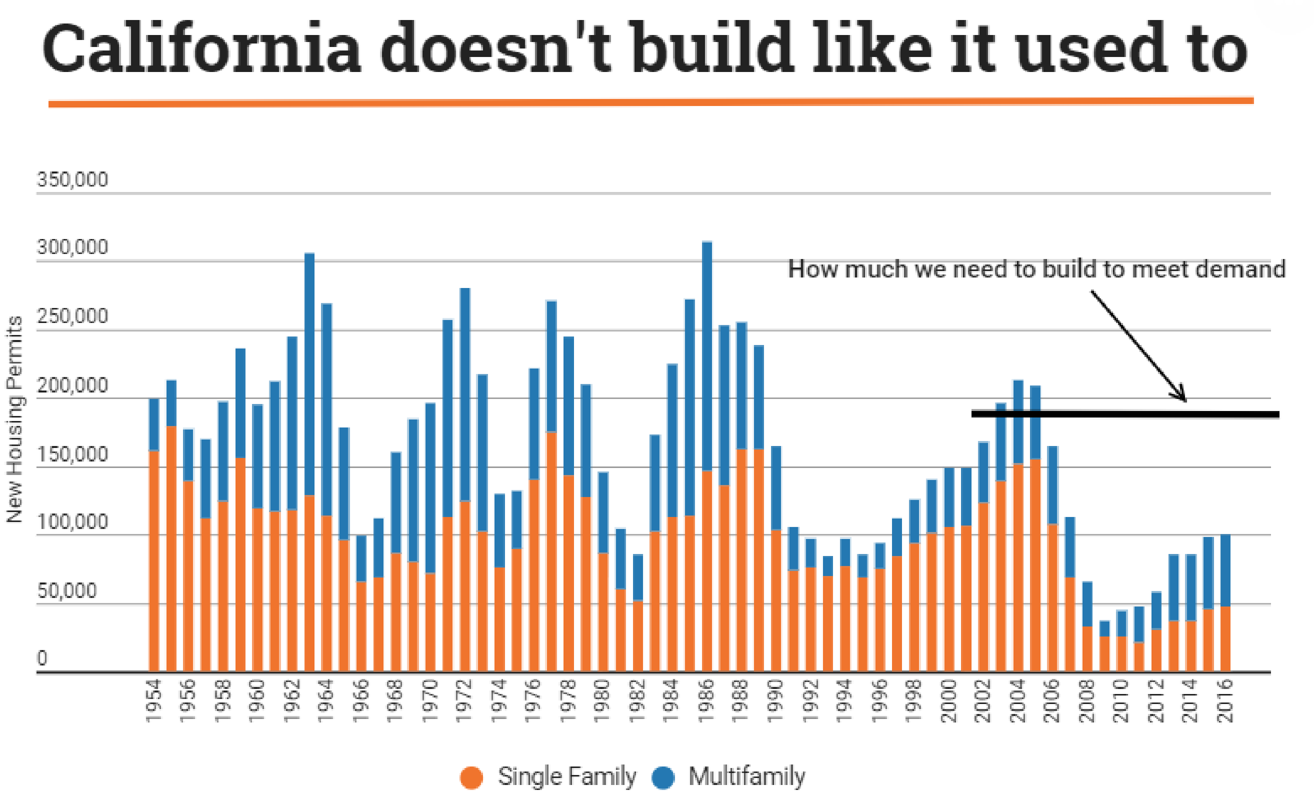
The median price of a house in California is more than double that of the rest of the country. Prices have skyrocketed as demand has outstripped supply for decades. Experts agree that California has not built enough housing for the people who live here. The California Department of Housing and Community Development estimates that the state needs to build 180,000 new housing units a year. Over the past decade, California has averaged less than half that number.

Next 10 recently published a comprehensive study on the Current State of the California Housing Market. It cites a McKinsey study showing that California has produced less housing per capita than other states. From 2005 to 2014, California built 80% less housing than New York, 29% less than Texas, and 8% less than Oregon.

Why has housing supply fallen so far behind demand? The Legislative Analyst's Office analyzed this question in "California's High Housing Costs, Causes and Consequences," published in 2015. The LAO identifies four contributing factors: community resistance, use or abuse of environmental reviews, local finance favoring nonresidential development, and limited available land to develop in the coastal areas. Although these factors play a larger role in California's coastal cities and counties than the rest of the state, their effects spillover to inland communities. As people are priced out of coastal communities and big cities, they look inland for housing. The LAO writes that "[t]his displaced demand places pressure on inland housing markets and results in higher home prices and rents here." The LAO examined the relationship between housing costs in neighboring counties throughout the country, using U.S. Census data from 1980 to 2010. That analysis found that a 10% increase in housing



Source: Matt Levin, 5 Reasons California's Housing Costs Are So High, KQED News, May 2018, based on data from the California Department of Housing and Community Development

costs in one county is associated with a roughly 5% increase in housing costs in neighboring counties.

Cities and counties generally decide how to regulate development within their jurisdictions. They prepare General Plans that shape long-term development patterns. Local zoning ordinances and building codes specify where housing can built and specify its density, quality, and style. Over two-thirds of cities and counties in California's coastal regions have adopted policies explicitly aimed at limiting housing growth. These policies are known as growth controls. Many regulate directly by capping the number of new homes that may be built in a given year. Other explicit caps may limit housing density or building heights. Indirect limits may take the form of requiring supermajorities to approve housing projects, thus making approval more difficult. The LAO cites a research study that found that each additional growth control policy a community added resulted in a 3% to 5% increase in home prices.

Cities and counties generally require housing projects to be reviewed by multiple departments prior to approval. Independent review by a building department, health department, fire department, planning commission or department, and city council are typical. The LAO notes that this process is usually slower in California's coastal communities, which take about two and a half months longer to issue building permits than most inland communities (seven months compared to four and a half). At every stage of review concerned residents can weigh in. With its long history of citizen activism, California has a high degree of voter involvement in land use decisions.

The LAO study cites CEQA as the second factor that may limit housing development in California. The

California Environmental Quality Act of 1970 requires state and local agencies to consider the environmental impact of their decisions when approving a public or private project. Cities and counties must conduct a preliminary analysis to determine whether a project may have significant adverse environmental impacts. If the preliminary analysis finds this may be the case, then the developer will be required to prepare an environmental impact report. This report details the project's likely environmental effects, ways that they might be mitigated, and alternatives to the project. Local governments are prohibited from approving projects which are found to have significant adverse environmental impacts unless one of two conditions is met. Either the project developer makes modifications that substantially lessen the adverse environmental effects or the city or county finds that economic or other project benefits override the adverse economic effects. The LAO notes only four other states have this level of environmental review for private housing development.

The CEQA process can significantly slow down building projects. The LAO reviewed CEQA documents submitted by California's ten largest cities between 2004 and 2013 and found that local agencies took, on average, two and a half years to approve housing projects that required an environmental impact statement. The process provides many opportunities for project opponents to raise concerns. The project cannot advance until all the concerns are addressed, either through mitigation or with a determination by elected officials that the project's benefits outweigh the costs. Even after a local government approves a project, opponents may file lawsuits challenging the validity of the CEQA review.

Environment attorney Jennifer Hernandez co-authored a study in 2015 that reviewed all lawsuits filed over a three-year period between 2010 and 2012. The study found widespread abuse of CEQA lawsuits for non-environmental purposes. "[T]oo often enforcement of CEQA is aimed at promoting the economic agendas of competitors and labor union leaders, or the discriminatory "Not In My Backyard" (NIMBY) agendas of those seeking to exclude housing, park, and school projects that would diversity communities by serving members of other races and economic classes." Hernandez published a follow-up study last year analyzing another three year period of CEQA lawsuits, filed 2013-2015. She found that the top lawsuit targets remained infill housing and local land use plans to increase housing densities and promote transit. This lawsuit abuse inhibits new housing construction and thus contributes to California's supply problem.

The third factor contributing to the supply problem identified by the LAO is that there is limited fiscal incentive for local governments to approve housing development. The financial benefit to California communities is often higher from commercial development than residential. Both types usually generate increased tax revenue in the form property taxes and, for commercial development, sales taxes too. Commercial developments, especially major retailer, auto malls, restaurants, and hotel, typically yield the highest net fiscal benefits. That is because the increased tax revenue often more than pays for the local government's costs to provide them with public services. These services can include things like police and fire protection and the cost of improving infrastructure like roads. Residential development, which generates less tax revenue, makes greater demands in terms of services in the form of schools.

Proposition 13 may also influence local governments to prefer non-residential development. Passed in 1978, Prop 13 capped ad valorem property tax rates at 1% of the value at the time of acquisition. Property tax increases were limited to no more than 2% per year so long as the property was not sold. At the time of a sale, the property value is reset to the new acquisition price. According to California Tax Data, prior to Prop 13, the property tax rate throughout California averaged a little less than 3% of market value. There were also no limits on increases for the tax rate or on individual ad valorem charges. Proposition 13 thus created fiscal incentives for many communities to prefer building retail stores, auto dealerships, and hotels at the expense of housing. The Legislative Analyst's Office published an analysis in 2016 of whether Prop 13 altered local government land use decisions. The study looked at two measures of city development patterns over the last decade: rezoning decisions (changes in the allowable use of land) and building permits. It found little evidence that cities with lower property tax shares set

GOVERNOR'S 2019-2020 HOUSING PROPOSALS (IN MILLIONS)

Proposal	Description	General Fund
Planning grants to local governments	Provides grants to local governments meant to accelerate meeting new short-term housing production goals	$250
Production grants to local governments	Provides general purposes funds to local governments as a reward for reaching "milestones" in their efforts to meet their short-term housing production goals	$500
State Low-Income Housing Tax Credit program	Expands existing state Low-Income Housing Tax Credit program	$300
New state housing tax credit program	Establishes new state housing tax credit program targeting households with relatively higher incomes.	$200
Mixed-Income Loan program	Expands existing program aimed at increasing middle-income housing production	$500
Total		$1,750

Source: The 2019-20 Budget: Considerations for the Governor's Housing Plan, Legislative Analyst's Office, February 2019

aside less land for housing or built less housing. It also found that cities that are more reliant on sales taxes are, at most, modestly more likely to prefer retail over other types of development.

The final factor limiting the supply of housing in California is that most of the demand is in coastal areas and there is limited land available to be developed there. This due to topography (ocean, mountains, etc.), the fact that coastal communities are already extensively developed, and many of those communities choose to put tight limits on any further development. The LAO cites a study (conducted in 2006) that found that less than 1% of land in California's coastal urban communities was developable and vacant. In principal, opportunities still exist to build housing on older and/or underutilized parcels. It may be possible to replace older, lower-density housing with new higher-density housing. These redevelopment projects, however, are difficult and costly. Builders must demolish old structures and may then have to address environmental pollutants. More importantly, proposals for higher density housing often encounter fierce opposition from existing residents.

There are many factors that contribute to the choked supply of new housing in California. Most state programs attempt to address the affordability side of the problem, rather than the supply. Governor Newsom, however, has turned his attention to the supply problem. In his State of the State speech last month Newsom called out cities that fail to meet mandated housing goals. California cities and counties are required to plan for housing for all income levels under the Regional Housing Needs Assessment instituted 50 years ago. There has never been, however, an enforcement mechanism to that process. In January, Governor Newsom, himself a former mayor, sued the city of Huntington Beach for cutting affordable housing units from their general plan. Assemblyman David Chu, chair of the Assembly housing committee, applauded this approach and mused that the lawsuit against Huntington Beach may not be the last of its kind. ♦