A Perspective on Housing in California

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Introduction

The availability of decent affordable housing is one of the most important of all needs to a society and its citizens. Apart from simply providing basic shelter, housing also significantly affects our living standards and the overall quality of our lives in many different respects depending upon its cost, location and quality. Taken together, for example, these factors help determine what the neighborhoods we live in are like, how far we must travel to our jobs, and the amount of income we have left over for nonhousing needs and expenses.

The nature of our housing also affects the public sector in many ways. Inadequate housing, for instance, can give rise to various social problems that necessitate public expenditures in such areas as public health. In addition, addressing housing needs requires effective governmental planning involving land-use policies and related subjects.

Lastly, housing conditions can influence the overall health of the state's economy, since the cost and availability of housing can affect the ability of businesses to hire and retain workers and thus their decisions to locate in California.

For all of these reasons, housing obviously is important from a public policy perspective and clearly merits the Legislature's ongoing attention.

Given the importance of housing, it is not surprising that few subjects have received as much attention in recent years in California as trends in the state's housing market. These trends have included high and rapidly rising home prices in many regions of the state, increasingly lengthy commute distances as people are living farther away from their jobs in order to find affordable housing, inadequate supplies of decent and affordable rental housing in some areas, and disturbing numbers of homeless individuals and families. California's citizens, public officials and the business community all have expressed concerns about these trends and their potential negative effects on the quality of life in California and the state economy's future prospects.

The purpose of this report is to provide the Legislature with an overview of housing in California, including information that will assist it in making decisions that will affect the future performance of the state's housing market and thus the economy generally. The report considers four specific questions:

- First, what are the ***basic characteristics*** of California's housing market?
- Second, what are the ***key challenges*** that the state's housing market faces?
- Third, what ***public programs and policies*** currently exist to help address California's housing needs?
- Fourth, ***what opportunities exist*** to improve the future performance of the state's housing market?

This report was prepared by Jon David Vasche with contributions from Joan Keegan and Marianne O'Malley. It was reviewed by Jarvio Grevious, Peter Schaafsma, Mac Taylor, David Illig, and Juliet Musso. Kathy Van Dort designed the report for publication and Jean Fernlund provided clerical support.

Executive Summary

This report provides an overview of housing in California, including information which will assist the Legislature in assessing the housing-related challenges facing the state and the ways in which it can positively influence housing performance in the future. The report focuses on the following questions:

- What are the ***basic characteristics*** of California's housing market?
- What are the ***key challenges*** relating to housing that California faces today?
- What ***public policies and programs*** can potentially be used to help address housing-related needs, and which of these are in use in California?
- Where are the Legislature's greatest ***opportunities*** for improving the housing market's future performance?

Basic Characteristics of California's Housing Market

The basic features of California's housing market include the characteristics of its households and housing units, the prices and affordability of its homes and rental units, and its current level of activity and likely future trends.

Characteristics of California's Housing Stock and Households

There are 11 million housing units in the state, about 65 percent of which are single-family homes and 35 percent are apartment-type units. Approximately 55 percent of households own their dwellings, while 45 percent are renters. Renting is relatively more common in California than nationally.

Geographic location. Housing in California is quite geographically concentrated, with about 60 percent of California's 10.3 million occupied housing units located in the Los Angeles and San Francisco Bay regions.

Age, ethnicity and household size. About two-thirds of California's households are white, 19 percent Hispanic, 8 percent black, and 8 percent Asian and "all other." Nearly 85 percent of household heads are over 30 years old, including one-quarter in the 30- to 40-year range and another quarter in the over-60 group. Average household size is 2.7 persons statewide, although size increases as one moves from white to black to Hispanic.

Household income. Median family income in 1988 was about $34,000. However, considerable differentials exist by ethnicity, with income highest for white and Asian households and lowest for blacks and Hispanics.

Housing Prices and Affordability

Throughout the early 1980s, California housing prices did not rise all that rapidly. In recent years, however, significant increases have occurred and affordability has suffered, both for buyers and renters.

Price levels. California's median statewide existing home price topped $200,000 during mid-1989, or over twice the national median price (about $95,000). And in the major metropolitan areas, where most Californians live, median prices were still higher — often in the mid-to-high $200,000s.

Why have prices risen? Housing prices have risen for a number of reasons, including demand pressures from growing urban populations, shortages of buildable land in prime residential areas and established communities, increased demand for real estate investments by both Californians and non-Californians, and, in many areas, restrictive local land use policies and growth control measures.

Affordability. There is no universally accepted definition of housing "affordability." However, there are a number of economic indicators which suggest that, regardless of the exact definition used, finding affordable housing has, in recent years, become *more of a problem* for many California homeowners and renters.

Recent Activity in California's Housing Market

During the past four years, the number of California's housing units has increased by about 1 million, or 10 percent. The strongest rates of home building have occurred in such areas as San Bernardino-Riverside and the Central Valley, largely because their housing affordability and availability have drawn population to them. This trend also has exacerbated certain imbalances between where people live and work, resulting in increased long-distance commuting for many Californians.

Future Performance of the California Housing Market

Although it is difficult to predict exactly what the housing market's performance will be in the future, two things seem very likely — namely, that the market will *expand significantly* as California's population continues to grow, and that many of the state's less densely populated areas will be *changing dramatically* as they help to absorb this growth.

What is less certain, however, is *how well* the state's anticipated future growth and its associated housing needs will be accommodated. This will largely depend upon how effectively the state addresses the various challenges that California's housing market faces.

Challenges Facing the Housing Market

There are a great many different housing-related challenges facing California today. All of these are worthy of attention if California's housing market is to successfully meet the state's needs in the future. Some, however, stand out as being particularly significant.

The Challenges Are Many and Diverse

The key challenges involve:

- Dealing with high housing costs and affordability, both for homeowners and renters.

- Locating housing and job centers sufficiently close to one another.
- Reducing noneconomic barriers to housing choice, such as ethnicity.
- Encouraging coordinated and consistent governmental housing policies.
- Maximizing the effectiveness and efficiency of state housing programs.
- Dealing with homelessness.
- Addressing the unique housing problems faced by special population groups.
- Maintaining and improving the housing stock's quality.
- Expanding the housing stock to meet future housing needs.

These factors head the list of the challenges — at least those that are evident today — that must be addressed to adequately provide for California's housing needs. They also will be the key determinants, along with governmental policy decisions in areas like health care, social services, environmental management, transportation and education, of the overall quality of life for millions of Californians in the future.

Policies and Programs to Help Address Housing Needs

Many different policies and programs have been suggested as possible ways of addressing various types of housing-related problems and issues. This list includes direct housing-related subsidy payments, various tax expenditures, loan guarantee programs, new and flexible mortgage instruments, partnerships between public entities and private nonprofit entities to provide new or rehabilitated housing, local planning and land use policies, state and local housing trust funds, public housing projects, down payment assistance programs, and employer-assisted housing programs.

What Housing Programs Currently Exist?

Housing-related programs and policies can be found at all levels of government — federal, state and local. There is no current estimate of the total dollar amount of housing-related activities and benefits to Californians associated with these programs. However, we do know that they total in the billions of dollars.

Federal programs. The federal government provides by far the largest dollar volume of government housing assistance to California, including direct expenditure programs, mortgage loan guarantee and insurance programs, and tax expenditure programs. The single largest program is the mortgage interest income tax deduction. Although direct federal spending for housing has continued to rise in recent years due to the expenditure of funds from earlier commitments, many programs have been eliminated or restricted during the 1980s. As a result, spending will eventually decline if current policies remain in effect. The future trend in federal spending is uncertain.

State programs. The state also offers a variety of programs to assist housing, although their dollar effect is much smaller than those of the federal government. State programs include:

- Direct assistance programs, such as low-interest loans and grants.

- Tax-exempt bond programs, which reduce home down payments and financing costs. (In addition to the state's existing bond programs, the *1990-91 Governor's Budget* proposes new bond authorizations to assist first-time home buyers.)
- Tax expenditures, such as the mortgage interest deduction and the new low-income housing tax credit.

The state also affects housing by adopting minimum statewide construction code standards.

Local programs. Localities affect housing in a variety of ways, such as through issuing tax-exempt housing bonds, and the actions of local housing authorities and redevelopment agencies. Probably the greatest impact localities have on housing, however, is through their regulatory decisions in such areas as local land use practices. In addition, localities may make their construction code standards more restrictive than the adopted statewide standards.

California's Statewide Housing Planning Process

One way by which California's many diverse housing-related governmental policies and programs are intended to "fit together" is through the California Statewide Housing Plan (which articulates the state's basic housing needs and objectives) and the housing elements of local general plans (which essentially represent the local "action plans" for addressing the state's basic housing needs).

The combination of a statewide plan and local housing elements to implement basic housing goals looks fine on paper. However, California's process has certain shortcomings and needs improvement. For example, no means or authority currently exist for ensuring that local housing elements are consistent with state goals and are actually implemented.

Improving Housing Market Performance— Where Do The Opportunities Lie?

Because the challenges facing the California housing market are so many in number and diverse in nature, there is no single solution to them. Rather, a *diversity* of approaches will be required to successfully meet these challenges. However, there are certain action areas which appear to be especially important in terms of improving the state's housing market performance. Thus, it is in these areas that the Legislature may wish to focus. They include:

- Improving the *effectiveness and efficiency* of government housing programs.
- Improving the *statewide housing planning process,* including the quality and implementation of local housing elements.
- Ensuring that the *public capital infrastructure* needed to accommodate housing growth is adequately provided for.
- Promoting policies that have the potential to *hold down housing costs.*
- Encouraging *public-private housing partnerships* in order to increase the financial resources directed at housing problems and broaden the range of housing needs that are addressed.
- Addressing the pressing housing needs of low-income persons, especially the *homeless.*

Some Actions Have Been Taken, But More Are Needed

Although there already have been a number of action steps taken by the Legislature in these key areas, more are needed. For example, steps are needed to ensure that local housing elements are consistent with state objectives and are actually implemented. Likewise, regarding public infrastructure needed to accommodate housing, there is a lack of comprehensive and integrated multi-year capital outlay planning at both the state and local levels. No state plan currently exists, nor is it the rule that comprehensive plans of a similar nature generally exist for local governments.

The Time for Responding Is Now

In our earlier report on the California economy (see *A Perspective on the California Economy*, December 1988), we indicated that, because California is so rapidly growing and undergoing so many other significant changes, *now* is the time for making and implementing plans for accommodating the state's future economic growth. This same sense of timeliness and focus applies to addressing California's housing challenges. This is because the future performance of the state's housing market will not only be a result, but also a determinant, of the state's future economic performance. Thus, the sooner and more effectively California's housing challenges are addressed, the better will be California's future economic performance, and the living standards and overall quality of life of its citizens.

Chapter I

California's Housing Market— What Are Its Basic Characteristics?

This chapter provides an overview of the basic features and characteristics of the California housing market — a housing market which is one of the most rapidly growing, dynamic, and challenging to policymakers that exists today. Specifically, the chapter:

- Highlights the *general characteristics* of the state's households and housing stock, including their socio-economic and geographic characteristics.
- Presents information regarding California *housing prices* and the related problem of *housing affordability*.
- Identifies *recent trends* in California housing market activity and their impacts on the state's economy.
- Discusses the *likely future prospects* for California's housing market, including its geographic aspects.

General Characteristics of California's Households and Housing Stock

The key characteristics of California's households and housing stock are presented in Figures 1 through 4. These characteristics include the number and types of housing units in existence, their geographic differences, the age and ethnic mix of household heads, whether households are homeowners or renters, and the size and income levels of the state's families.

How Large is the State's Housing Market?

Figure 1 indicates that, as of 1989, an estimated 11 million housing units existed in California. Of these, 10.3 million were occupied by either owners or renters. The remainder (about 6 percent) were vacant, either awaiting new occupants or needing improvements or renovation in order to be usable and marketable. Figure 2 shows the geographic dispersion of the state's housing units. It indicates that:

- About 60 percent of all units are accounted for by the state's two largest multi-county metropolitan regions — the Los Angeles region (38 percent of households) and the San Francisco Bay region (21 percent of households).
- By comparison, these two regions account for a relatively small portion of California's total land acreage — about 9 percent. Thus, at the present time, households and the housing stock are quite concentrated geographically.

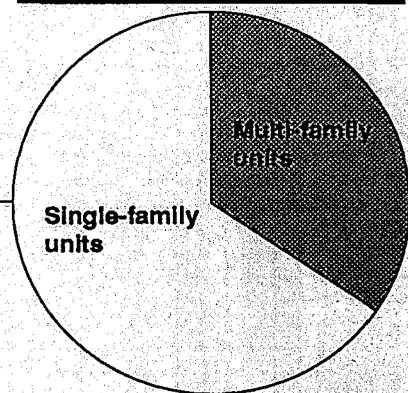
Figure 1

California Housing Units, by Type of Structure[a,b]

1989

Total Housing Units = 11 million

Single-family units (in millions)	
Detached units	6.0
Attached units[c]	0.6
Mobilehomes and other units	0.5
Total units	7.2



Multi-family units[b] (in millions)	
2-to-4 units	0.9
5-and-over units	2.9
Total units	3.8

[a] Source: California Department of Finance and California State Census Data Center. Approximately 94 percent of all housing units were occupied in 1989.

[b] Data for multi-family structures represent total units within a given multi-family structure.

[c] Includes units such as row homes and condominiums, providing that they have their own heating systems and lot lines.

What is the Mix of Housing, by Type?

Figure 1 shows that, within California, single-family housing units (primarily detached single-family homes) account for the majority — about 65 percent — of the state's total housing units. The remaining 35 percent consists primarily of multi-family units, most of which are in apartment buildings containing at least five units. It can be seen from Figure 3 that most single-family units are occupied by homeowners, which represent nearly 55 percent of all California households versus 45 percent for renters. By contrast, about 64 percent of national households own their dwellings, whereas only 36 percent are renters. Thus, renting is relatively more common in California than for the nation generally.

Figure 4 shows that the mix of different types of units exhibits considerable geographic variation. For example, detached single-family homes account for only about one-half of total units in the high-density Los Angeles region, compared to nearly two-thirds of all units in certain parts of central northern California (such as in the upper San Joaquin Valley region).

Age, Ethnicity and Size of Households

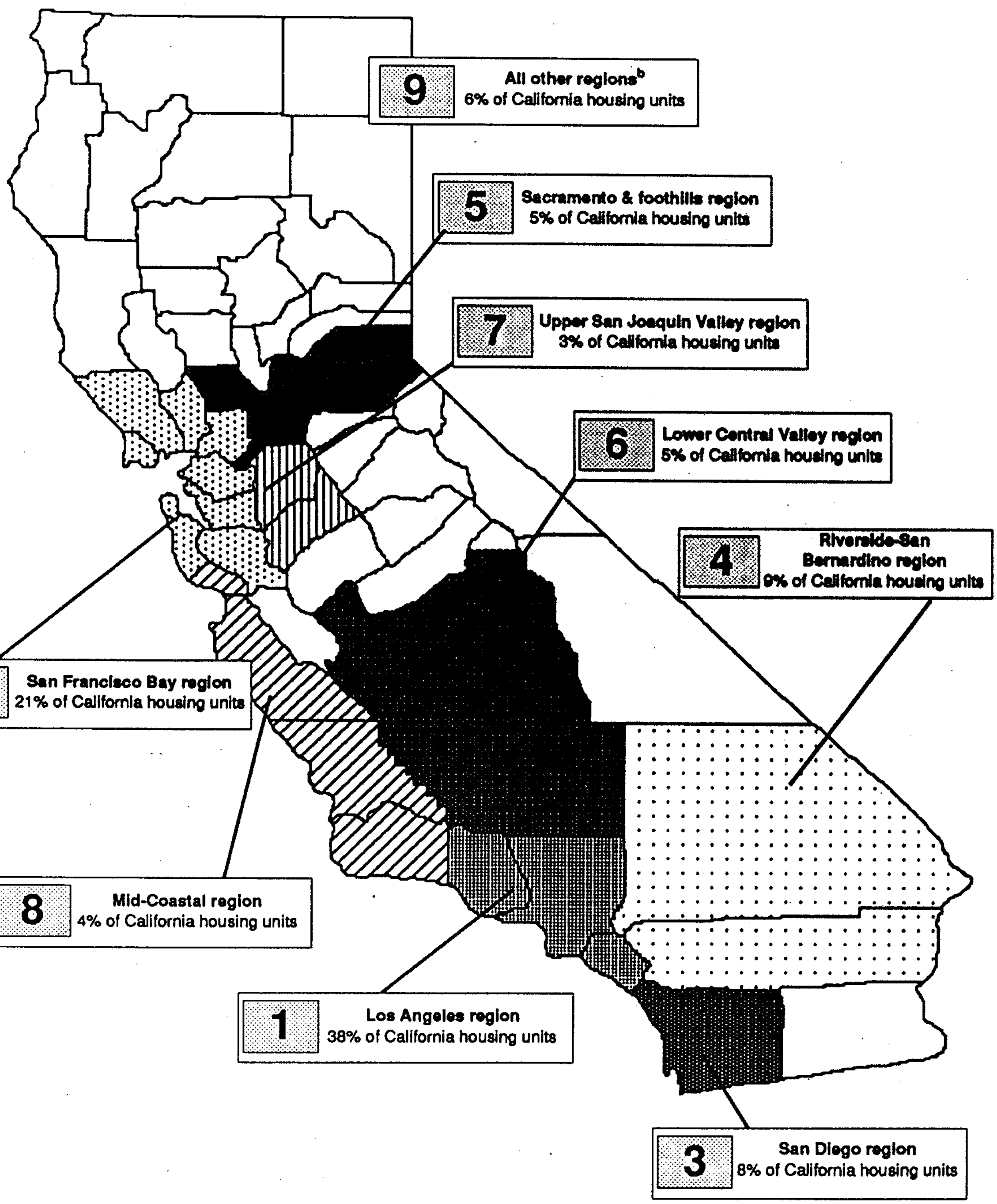
Regarding these characteristics, Figure 3 shows that:

- About two-thirds of household heads are white, followed by 19 percent Hispanic, 8 percent black, and 8 percent Asian and "all other."
- Nearly 85 percent of all household heads are over 30 years old, including one-quarter each for the 30-to-40 and over-60 age groups.

Figure 2

Geographic Distribution of California Housing Units

1989[a]



[a] *Data used are for housing units as of January 1, 1989, as estimated by the California Department of Finance and published in April 1989.*

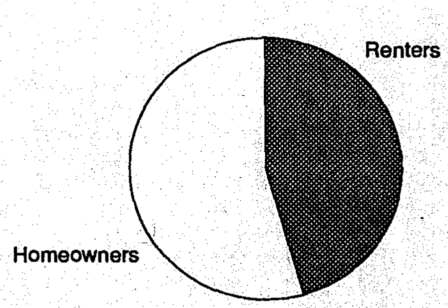
[b] *Includes housing units in unshaded areas.*

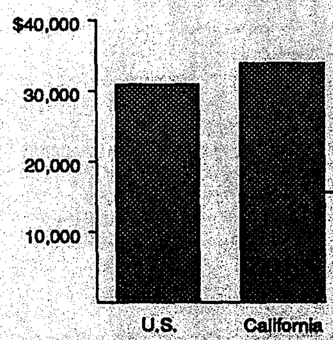
Figure 3

General Characteristics of California's Households[a]

Housing Status and Family Income

1988

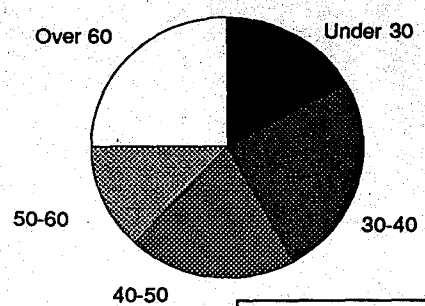


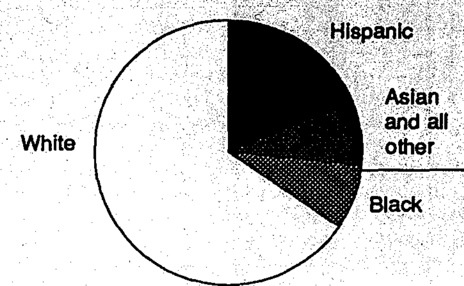


Family Ethnicity	Median Income
White	$38,600
Black	22,800
Hispanic	23,200
Asian and all other	37,700
Total California	$34,000

Age and Ethnic Mix of Household Heads

1990





Total Households 10.3 million

Average Persons Per Household	
White	2.4
Black	2.7
Hispanic	3.6
Asian and all other	3.3
All households	2.7

[a] *Source: California Department of Finance and California State Census Data Center.*

- Average household size is about 2.7 persons statewide. However, average size differs considerably by ethnicity, increasing as one moves from white to black to Asian to Hispanic.

How Much Income Do Households Earn?

As of 1988, Figure 3 indicates that the median family income in California was approximately $34,000. As with household size,

Figure 4

Different Types of Housing Units in 1989, by Region[a]

Percent Share of Different Types of Housing Units

Region	Conventional single-family units		Multi-family units		Mobile homes[b]	All units
	Detached	Attached	2-4 units	5-plus units		
1 Los Angeles	50	6	7	35	2	100
2 San Francisco Bay	53	7	11	26	2	100
3 San Diego	51	6	8	31	4	100
4 Riverside-San Bernardino	63	5	6	16	10	100
5 Sacramento and foothills	63	4	8	20	4	100
6 Lower Central Valley	64	3	9	16	8	100
7 Upper San Joaquin Valley	66	5	8	16	5	100
8 Mid-coastal	58	6	10	20	6	100
9 All other	65	2	7	12	14	100
Statewide Totals	55	6	8	27	4	100

[a] *Source: California Department of Finance. Data are based upon housing unit estimates for January 1989. Detail may not add to totals due to rounding. For description of geographic regions see Figure 2.*

[b] *Also includes a small percentage of units not otherwise classified.*

however, median family income differed considerably by ethnicity — highest for whites and Asians and lowest for blacks and Hispanics.

California Housing Costs and Housing Affordability

Few subjects have received as much publicity in recent years as has the upward movement in California housing prices and rents, and their potentially negative implications for housing affordability for both homeowners and renters.

Home Prices Have Risen Dramatically in Recent Years

Figure 5 shows the trend in median sales prices for existing single-family California homes during the 1980s. It indicates that:

- During the first half of the decade, prices were relatively stable. However, beginning in 1985 prices rose steadily, and have increased especially rapidly in the past couple of years.
- As of August 1989, the median statewide home price had reached more than $200,000, or over twice the national median price (about $95,000). And, in the major metropolitan areas where most Californians live, median prices were still higher — often in the mid-to-high $200,000s.
- In the less urbanized regions of the state, home prices are lower. Even here, however, Figure 5 shows that median prices tend to exceed $100,000 in all but the least densely populated rural areas.

Although rental costs have not inflated as rapidly as home prices in recent years, they, too, have moved upward. As of the mid-1980s, for example, the median gross monthly rent in California had reached $425, an increase of nearly 240 percent since 1970 and 50 percent higher than in 1980.

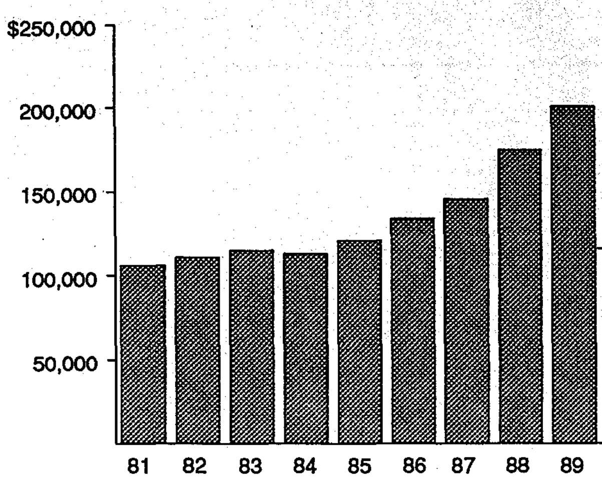
Why have housing prices risen?

There is no single factor which fully explains the significant housing price increases that California has experienced in the past few years. This is because housing prices gen-

Figure 5

Trends in California Single-Family Home Prices[a]

1981-1989



Median Home Sales Prices in Different Areas of California August 1989

Area[b]	Price
San Francisco	$272,016
Ventura	269,711
Santa Barbara	254,286
Orange County	247,641
Monterey	243,749
Los Angeles	229,618
State Median	201,026
San Diego	182,476
Northern Wine Country	164,889
Riverside/San Bernardino	129,111
Sacramento	116,967
Palm Springs/Lower Desert	114,666
Overall Central Valley	98,659
U.S. Median	94,900
High Desert	91,667
Upper Northern California	85,810

[a] Source: California Association of Realtors. Data represent the median sales prices of existing single-family detached homes in August of year shown. Data have not been adjusted to exclude the effects on prices of changes in the size or quality of homes.

[b] Areas include various cities and counties in each region. For example, the San Francisco area includes Berkeley, Contra Costa, Los Altos, Los Gatos, Saratoga, Mountain View, Sunnyvale, Marin, Palo Alto, San Jose, Southern Alameda, Oakland and San Francisco. Alternatively, the Northern California area includes data from Humboldt, Chico and Paradise, while the High Desert area includes Barstow and Victor Valley.

erally reflect a variety of differing cost components and basic supply and demand forces, all of which contribute to explaining price trends. Among the supply-side factors involved in determining housing prices, for example, are construction costs (including labor and materials), land availability combined with acquisition and development costs, construction financing charges, government fees, and overhead (including builders' profits and insurance, marketing and administrative expenses).

As shown in Figure 6, some of the state's upward median home price trend can be explained by changes over time in the qualitative attributes of new housing, such as square footage, numbers of rooms and amenities. Namely, new homes appear to have gotten "bigger and better" in recent years. (This finding also applies to some extent to the market for new rental housing.) It also is clear, however, that factors like rising residential land values have been especially important forces in recently driving up residential property values in many of the state's most populated metropolitan areas. These land value increases, as well as the increased prices of structures themselves, reflect a variety of factors. These include both demand pressures from growing urban populations for additional housing, shortages of buildable lots in desirable areas, increased demand for California residential real estate holdings by non-Californians, a certain degree of speculative investing in anticipation of continued price increases in the future, and in many localities, restrictive land use policies and growth control measures.

Are housing prices too high to be sustainable?

Many housing market observers have expressed concern that current housing prices for both owner-occupied and rental properties may be too high to be supported indefinitely by the income levels of Californians. If so, these prices may be unsustainable and could decline in the future. Such an event could trigger significant problems for California financial institutions, since housing values are the underlying security behind their mortgage loans, which in turn comprise about 30 percent of their assets. Housing price declines could also lead to mortgage delinquencies and foreclosures, given the widespread use of house-backed home equity loans to finance various consumer expenditures.

No one knows what California housing prices will be in the future, either in the near term or long term. In recent months, some softness in California home prices has indeed appeared for certain types of homes in certain geographic regions of the state — most notably, expensive dwellings in the state's costly urban coastal areas. Certain economists are predicting that, at some point in the future, *ongoing declines* in "real" (inflation adjusted) home prices will begin to emerge in the higher-priced markets of California's major metropolitan areas. They attribute this likelihood, in part, to underlying demographic trends, such as slower population growth and reduced family size. Most economic forecasters, however, *do not* believe that California housing prices are poised to decline in the foreseeable future, at least by any significant amount. For example, recent reports by such organizations as the Federal Reserve Bank of San Francisco, Wells Fargo Bank, Bank of America, and the University of California at Los Angeles (UCLA) predict that housing prices most likely will (barring an economic recession) *continue to rise* in the future due to basic supply-demand forces, though at a rate more in line with general price inflation and thus at a more subdued pace than in the recent past.

What About the Affordability Problem?

Especially in light of recent housing price trends, it generally is acknowledged that housing affordability is a major concern for

Figure 6

The Role of Quality Change in Explaining Home Price Inflation[a]

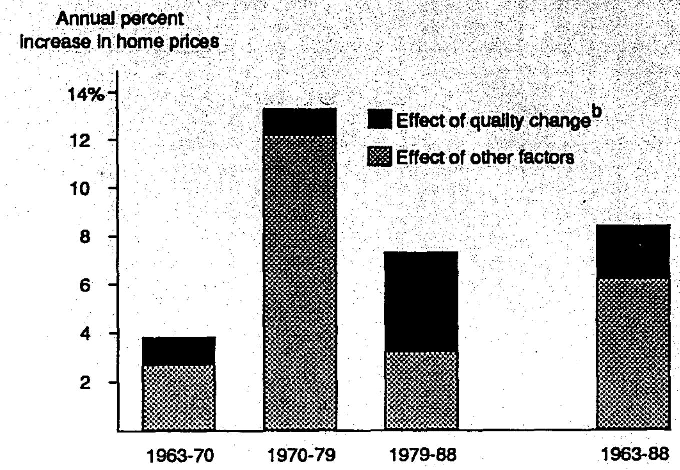
1983 and 1987

Quality Characteristics of New Single-Family Homes Built for Sale in the Western United States

	1983	1987
Average square feet	1,590	1,810
Percent with:		
2-1/2 baths or more	19%	37%
4 bedrooms or more	18	26
Fireplace	60	80
Central air conditioning	57	61

Contributions of Quality Change to Price Increases of New Single-Family Homes Built for Sale in the Western United States

1963 through 1988



[a] *Source: United States Bureau of the Census. California accounted for about 65 percent of new homes sold in the Western United States in 1987.*

[b] *Reflects lot size, house size, number of stories, number of bathrooms, geographic location, type of foundation, and presence of central air conditioning, fireplace and garage.*

many home buyers, owners and renters in California, although economists and housing analysts have differing views regarding exactly how widespread and pronounced this problem is.

Exactly what does "affordability" mean?

Housing "affordability" relates to the cost of owning or renting a housing unit relative to the amount of income one has available to pay for it. In its narrowest sense, "affordability" generally involves first one's ability to initially *acquire*, and then one's ability to *remain*, in a dwelling unit. Specifically:

- *In the case of homeownership*, affordability involves not simply a house's price per se, but rather a household's ability to make both the necessary *down payment* to acquire the home and its ongoing *monthly* house payment to stay in the home. The latter includes mortgage principal and interest payments, plus money paid into an impound account or otherwise set aside for homeowners' insurance and property taxes. The monthly payment depends primarily on one's mortgage interest rate, home purchase price, and home loan amortization schedule.
- *In the case of renting*, affordability involves being able to pay the monthly *rent*, as well as put up the initial *deposits* for damage, cleaning, and last month's rent typically required before moving into a rental unit.

In a more comprehensive and meaningful sense, however, "affordability" means not only whether one can come up with the money to acquire and stay in a dwelling, but also the financial strain and other difficulties of doing so. For example, people need to be concerned not only about their housing but also whether they have sufficient income left over to cover other basic living expenses such as adequate food, clothing, health care, and transportation.

It also should be noted that renters face a special problem regarding affordability which many homeowners do not — namely, they do not know exactly what their rent levels in the *future* will be. In contrast, homeowners who either have fixed-rate mortgages or own their homes outright do not face this type of uncertainty; and even those owners with variable-rate mortgages often have "caps" on the amount that their payments can rise, and also can have their payments fall during periods of reduced interest rates. Thus, it is often the case that renters must live with considerably more uncertainty than many homeowners regarding whether their units will be affordable at some later date, or whether they will be forced to relocate.

Given the above and the problem of standardizing for factors like changes in housing quality over time, no absolute measure of housing "affordability" has been devised that everyone agrees with. However, there exist at least some data which help indicate whether affordability is becoming more or less of a problem over time.

What do different affordability indicators suggest?

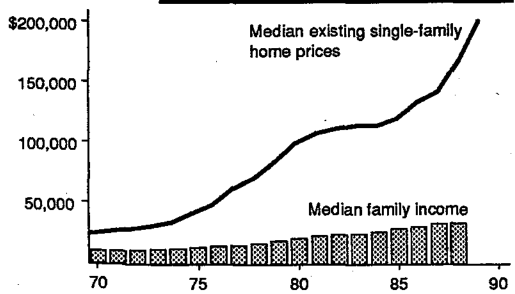
Figure 7 presents various data relating to housing affordability for California's homeowners and renters. Taken together, these data suggest that, however one chooses to define and measure housing affordability for owners and renters, the problem has gotten *worse* in recent years, not better. For example:

- *Median home prices* in California have increased *considerably faster* than median family income over the past 20 years (see upper left panel in Figure 7). During this same period, the ratio of California-to-national home prices has about doubled, meaning that California home prices have increased much faster than the nation's (see upper right panel in Figure 7).

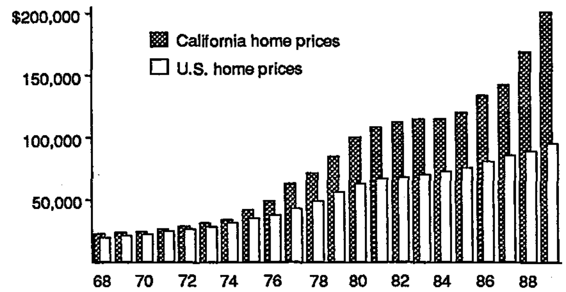
Figure 7

Indicators of California Housing Affordability

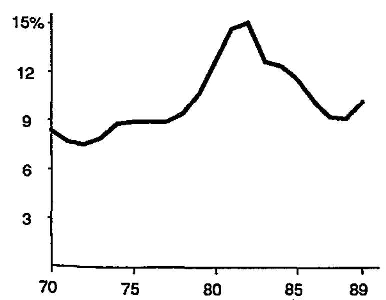
Median California Home Prices Versus Median Family Income[a]
1970 through 1989



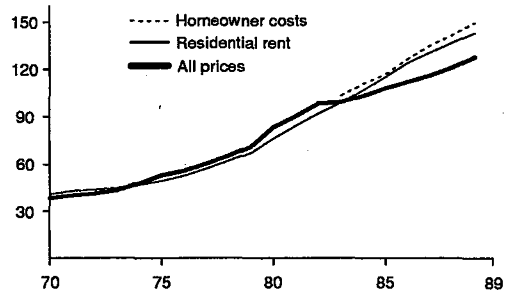
California Median Home Prices Versus U.S. Median Home Prices[a]
1968 through 1989



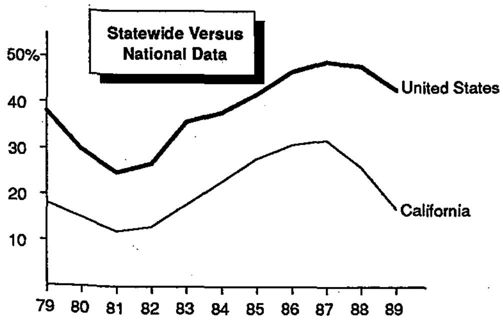
Trends in Mortgage Interest Rates[b]
1970 through 1989

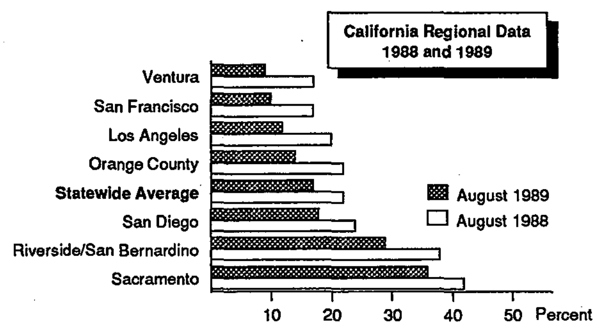


Trends in the California Consumer Price Index[c]
1970 through 1989 (1982-84 = 100)



Percent of Households Able to Purchase an Existing Median-Priced Single-Family Home with 30 Percent of Income[d]
1979 through 1989





[a] *Source: California Association of Realtors, U.S. Census Bureau and California State Census Data Center. Median family income for 1989 was unavailable from the census sources as of December 1989.*

[b] *Federal Home Loan Bank Board series. Data for 1989 is the average through August 1989.*

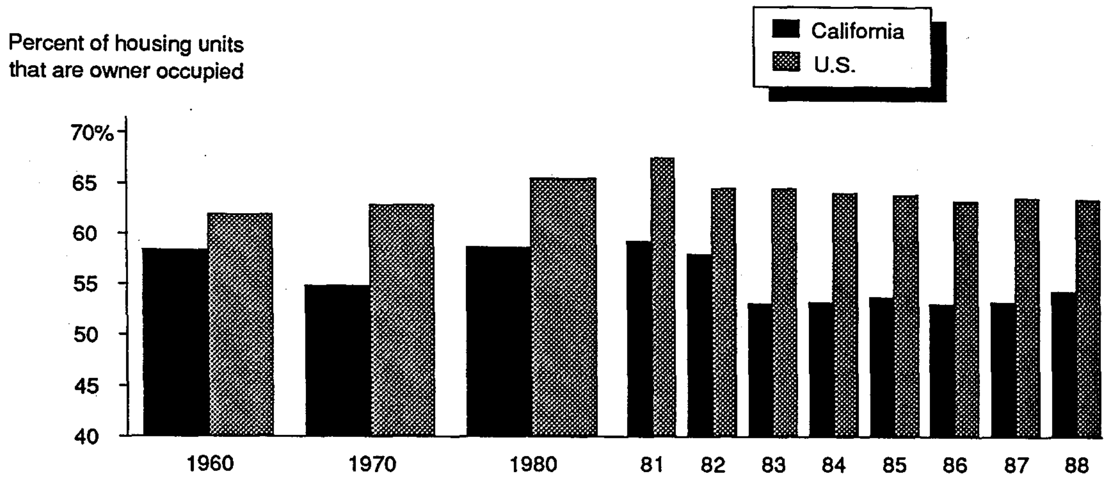
[c] *Source: U.S. Bureau of Labor Statistics. Data represent weighted averages for the Los Angeles-Long Beach and San Francisco-Oakland metropolitan areas for June of each year shown. These two areas include 15 individual counties and account for 70 percent of California's population.*

[d] *California Association of Realtors and National Association of Realtors. Data shown reflect costs for mortgage loan principal and interest payments, property taxes and insurance. They also reflect actual mortgage interest rates in effect for each year shown, and assume a 30-year mortgage with a 20-percent down payment. Data do not, however, adjust for the income tax deductibility of mortgage interest and property taxes. All data are annual averages except for 1989 data, which are for August 1989.*

Figure 8

Trends in Homeownership[a]

1960 through 1988



[a] *Source: U.S. Census Bureau and California State Census Data Center.*

- *Mortgage interest rates,* one of the principal determinants of homeowners' mortgage payments and the costs of owning rental property (and thus ultimately rent levels), still remain slightly *above* where they stood during most of the 1970s (see middle left panel in Figure 7).
- *Consumer price indexes* for both homeownership and residential rents produced by the federal government for California have inflated *faster* than overall consumer prices in recent years, even after adjusting for changes in the quality attributes of housing, like square footage and amenities (see middle right panel in Figure 7).
- *The California Association of Realtors (CAR) affordability index* — which measures the percent of California households able to purchase the state's median-priced existing single-family home with 30 percent or less of their income — declined recently to under 20 percent (see bottom left panel in Figure 7). This was its lowest level since the early 1980s, and well below the comparable national figure of over 45 percent. The lower right panel in Figure 7 shows that the CAR index is particularly low — under 15 percent — in the state's most heavily populated urban areas.
- *The percent of California households that own their homes* — shown in Figure 8 — while similar to 20 years ago, is well below the early 1980s.

Illustrative examples of affordability problems

The affordability issue is brought into clearer perspective in the case of homeownership by looking at what it actually costs to buy a house. This is illustrated in Figure 9 for differ-

Figure 9

Costs of Purchasing a Home Under Alternative Assumptions

	Down Payment Amount and Monthly Housing Payment[a]			
	10% down payment		20% down payment	
Home Price	Down payment and other fees	On-going monthly payment	Down payment and other fees	On-going monthly payment
$100,000	$12,560	$920	$22,340	$820
150,000	18,840	1,380	33,500	1,220
200,000	25,120	1,840	44,670	1,630
250,000	31,400	2,300	55,840	2,040
300,000	37,680	2,760	67,010	2,450

[a] *Monthly payment includes mortgage principal and interest payments, property taxes and homeowners' insurance. Data are rounded and assume a 30-year mortgage loan at an annual interest rate of 10 percent given a 20 percent down payment, and a 10.25 percent interest rate given a 10 percent down payment. Data also assume that one-time loan fees and closing costs are approximately 2.25 percent of loan value, annual property taxes equal 1.07 percent of home value, and annual insurance premiums are 0.3 percent of home value. Loan fees and closing costs, plus six months of property taxes, are included in the down payment amount.*

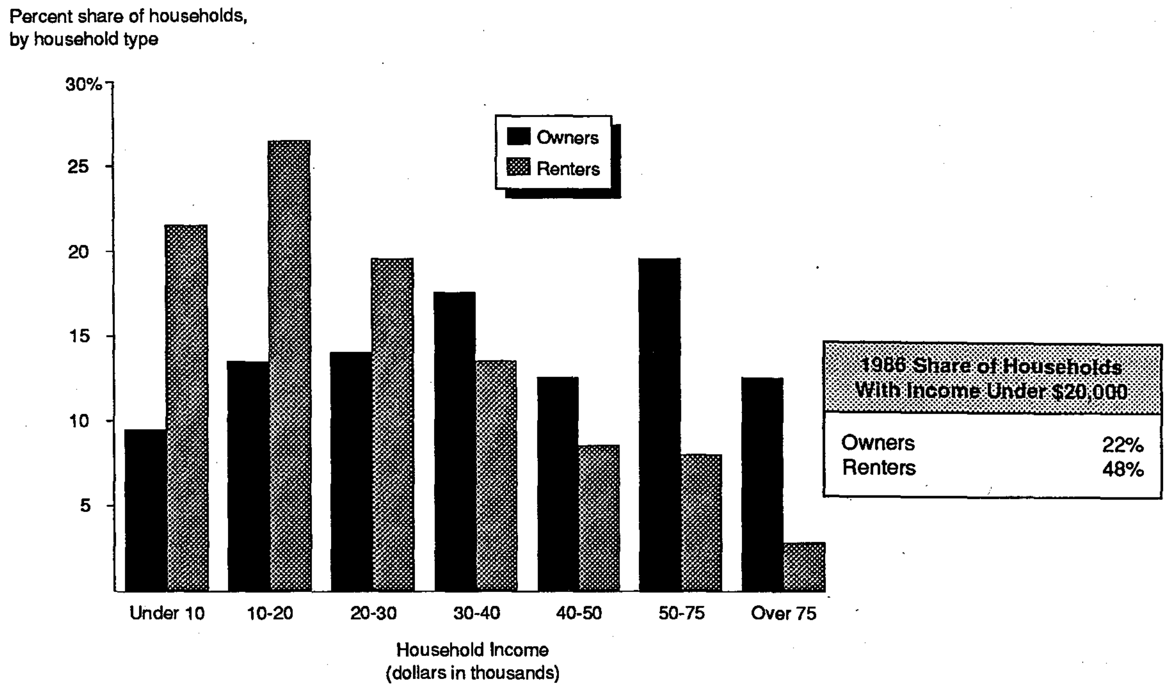
ent assumptions regarding home prices and financing terms. Specifically, the chart shows for different housing prices what the down payment amounts and monthly payments are to acquire a home, given financing terms prevalent during 1989.

The difficulty which many Californians face in buying homes is obvious, particularly for first-time home buyers, given the initial and ongoing payment requirements shown in Figure 9 in combination with household income levels. Similar problems exist for many renters, since rents ultimately relate to the prices of rental residential properties. As can be determined from Figure 10, as of 1986 only 45 percent of California homeowners had household incomes of at least $40,000, and less than one-third exceeded $50,000. Even more striking, Figure 10 also shows that only a bit over 50 percent of renting households had incomes exceeding $20,000. Although these percentages are undoubtedly higher today, the message implied from Figures 9 and 10 seems clear — housing affordability, be it ownership or renting, is a very real concern for a great many Californians.

Figure 10

Income Distribution of California's Households[a]

1986



[a] *Source: California State Census Data Center and California Association of Realtors. According to the Data Center, 1986 is the most recent year for which such data have been prepared.*

Recent Activity in California's Housing Market

Another key aspect of the housing market's performance — in addition to price trends and affordability — is the volume of home building activity that is occurring. This is important because new housing construction is the primary means by which old housing units are replaced and net additions to the housing stock are made, both of which are necessary if California is to maintain the quality of its current housing inventory plus accommodate the added housing needs of its growing population.

The level of home building activity also is important because it significantly impacts the economy's performance, given the jobs and income housing construction generates. For example, economists have estimated that every $1 billion of construction expenditures generates the equivalent of as many as 15,000 full-year jobs in construction-related activity (or an average of about 1.2 jobs per housing unit), and an equal, if not greater, number of jobs in such supportive industries as services and trade. In addition, the economic benefits of California construction activity tend to be concentrated within, as opposed to outside of, the state, given that construction activity is highly labor-intensive and reliant on in-state firms for most of its materials and supplies.

How Much Home Building Has Been Occurring?

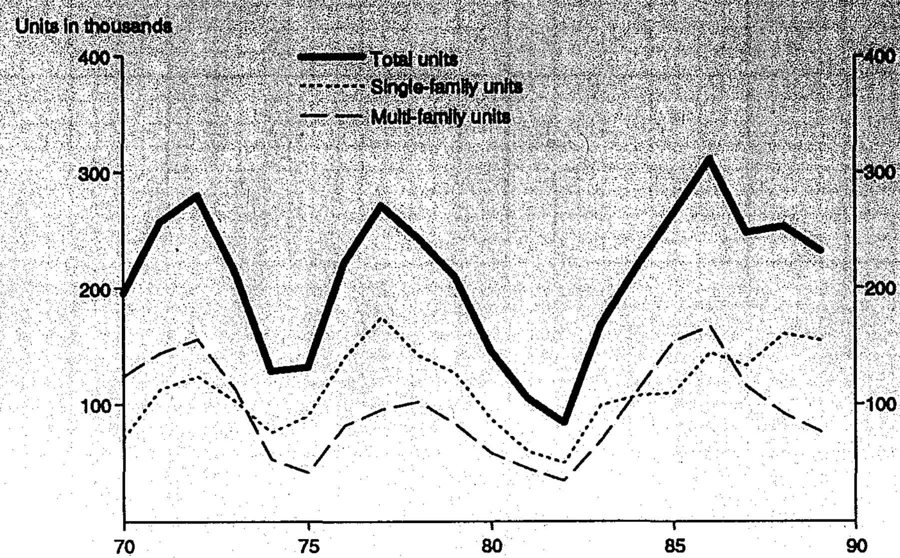
Figure 11 shows the volume of residential building permits for new housing units in California, both in the aggregate and in terms of single-family versus multi-family units. It indicates that:

- California housing activity generally has been *highly cyclical* in past years, depending on such factors as the level of mortgage interest rates, whether the economy is expanding or contracting, and the tax law provisions in force that affect the profitability of real estate investments.
- In 1989, *aggregate building permits* for new housing units totaled about 230,000. When combined with permits for housing additions and alterations, this represents about $25 billion worth of construction value.
- The 1989 number of new building permits is slightly *above* the long-term average over the past 20 years (about 210,000 units annually), and is well above the depressed levels of the early 1980s (around 100,000 units annually). However, *in per capita terms*, the recent activity level is *not* particularly strong from an historical perspective, given that California has added nearly 4 million households (more than a 50 percent increase) during the past two decades.

Figure 11

California Building Permits for New Residential Housing Units[a]

1970 through 1989

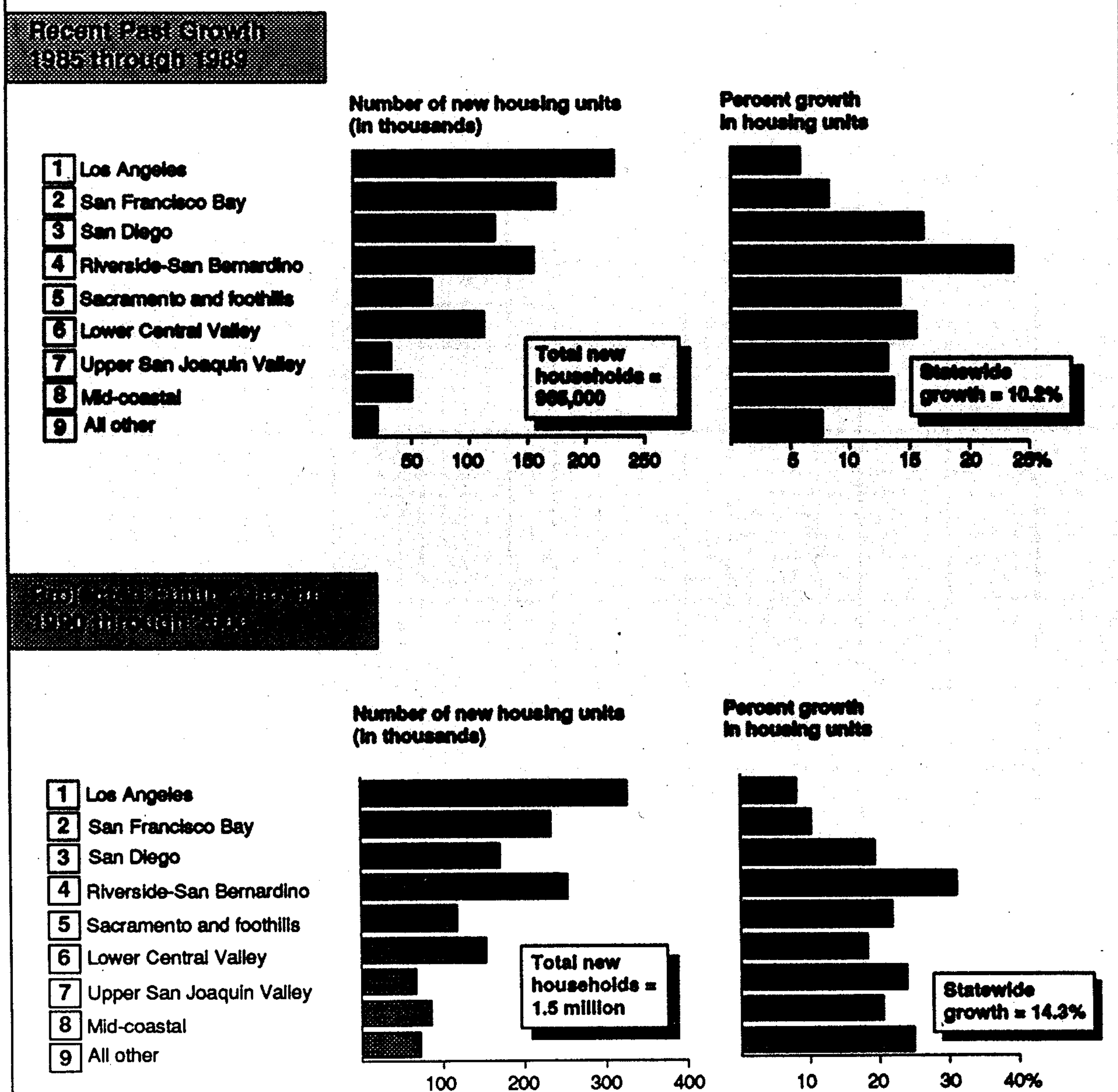


[a] *Source: California Department of Finance and U.S. Department of Commerce. Data for 1989 are Department of Finance estimates as of January 1990.*

- Total residential building activity has *dropped significantly* during the past couple of years. This reflects a sharp decline in *multi-family* construction from its record highs of 1985 and 1986 to a more historically normal level. (The 1985 and 1986 highs in part occurred because multi-family building was

Figure 12

Growth in Households in Different California Regions[a]



[a] *Source: California Department of Finance. For description of geographic regions see Figure 2. Data are for occupied housing units and therefore are equivalent to numbers of households.*

accelerated so as to take advantage of certain federal tax provisions which were due to expire.) In contrast, *single-family* construction during the past couple of years has been at its highest level in more than a decade.

Where Are the New Housing Units Being Built?

Figure 12 shows where the growth in housing units has taken place during the past five years (see upper panel). During this period there has been a net increase of nearly 1 million new housing units statewide — a growth of about 10 percent. Figure 12 indicates that over 40 percent of this gain in units occurred in the state's two largest metropolitan regions — the Los Angeles and San Francisco Bay regions. However, because these regions already accounted for about 60 percent of all households, their share of recent home building activity has been disproportionately low, and their percent growth in housing stock is below the statewide average. In contrast, such areas as San Bernardino, Riverside, Sacramento, and the San Joaquin Valley have experienced above-average growth rates, as such factors as housing affordability and availability have drawn population to them. Figure 12 (lower panel) indicates that these trends are expected to continue throughout the current decade.

Why Has Multi-Family Construction Weakened?

The recent sharp decline in multi-family housing construction shown in Figure 11 is the net result of several factors.

First, a number of significant *federal tax law changes* were made in 1986 which have negatively affected residential rental housing investments, including those changes relating to depreciation, capital gains, tax-exempt housing bonds, and restrictions on the use of real estate write-offs to reduce income tax liabilities. Although a new low-income housing tax credit also was established in 1986 that has benefited multi-family housing, its positive effects have not outweighed these negative factors. (These 1986 law changes are discussed in Chapter III.)

Second, *above-average vacancy rates* still persist in some areas of the state for rental properties, due to the high levels of multi-family construction and resulting excess supplies of such housing which emerged in some regions during the mid-1980s. (Even in these areas, however, adequate supplies of decent affordable rental housing for low-income households frequently are lacking.)

Third, multi-family home building is being *constrained* in some geographic areas by exclusionary zoning practices and other restrictive land use policies. In certain localities, for example, there is strong neighborhood opposition to allowing rental housing, especially low-income rental housing. In other areas, some housing market analysts believe that rent control is an inhibiting factor, to the extent that it interferes with the ability of property owners to earn adequate rates of return on their investments over time.

Fourth, California's recent environment of high housing prices and rapid price appreciation has made it necessary for many new rental property owners to at least temporarily absorb *negative monthly cash flows*. This is because the rent levels needed by these new owners, in order to avoid cash-flow losses, frequently are above those that the housing market can support. This, in turn, reduces the number of rental property investments which will be undertaken, since not all investors are willing or able to absorb these losses.

It is for reasons such as the above that the current level of multi-family housing activity in the state is not very strong, and, in the view of some housing experts, inadequate to satisfy the state's long-term needs.

What is the Future Outlook for California's Housing Performance?

The performance of California's housing market in future years will depend upon a wide variety of factors, including the strength of the overall economy, monetary policies that affect mortgage interest rates, state and federal income tax laws relating to residential housing expenses and investment income, demographic trends, and governmental policies and programs dealing with housing problems.

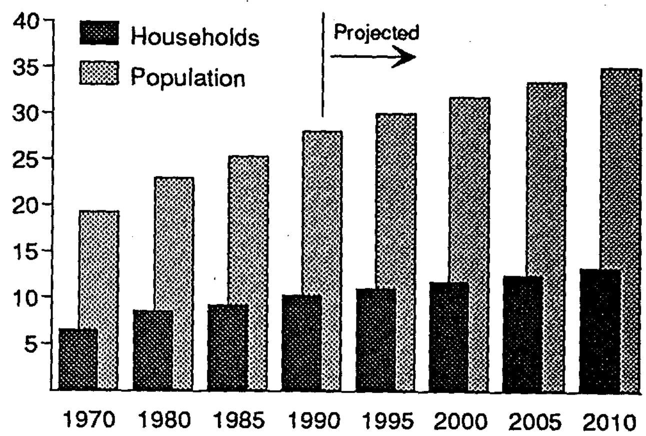
The Bottom Line — Continued Growth Expected

Much about the housing market's future performance cannot realistically be predicted at this time, such as future levels of home prices. What can be said, however, is that the California housing market can be expected to *expand significantly* in the years to come, and

Figure 13

Trends in California Population and Households[a]

1970 through 2010 (in millions)



Period	Population Growth Amount	Population Growth Percent	Growth in Households Amount	Growth in Households Percent
1970-1980	*3.7 million*	*19%*	*2.1 million*	*31%*
1980-1990	*5.1 million*	*22*	*1.8 million*	*20*
1990-2000	*3.8 million*	*14*	*1.5 million*	*14*
2000-2010	*3.3 million*	*10*	*1.6 million*	*13*

[a] *Source: California Department of Finance. Population data exclude persons living in group quarters who are not classified as household members. Comparable household data are unavailable for 1975.*

that many of the less densely populated areas of the state will be changing dramatically as they help absorb this growth. As we discussed in our earlier report entitled *A Perspective on the California Economy* (December 1988), it is the consensus view of forecasters that the state will most likely continue to experience substantial growth in population, businesses, and economic activity in the foreseeable future. This, in turn, means that the number of households and demand for new housing units also will be growing. Figure 13 shows the projected growth in California population and households during the next 20 years, and indicates that slowing though steady increases are anticipated. These projections assume, of course, that the state will not be the victim of natural catastrophes such as increasingly severe and lengthy drought spells or destructive earthquakes. They also assume that California will take the steps necessary to accommodate future economic growth, such as infrastructure investments, and not become subject to wide-spread growth controls that significantly restrict the pace of such economic growth.

But How Well Will Future Growth Be Accommodated?

What is less certain, however, is *how well* the state's anticipated future growth and its associated housing needs will be accommodated. This will largely depend upon how effectively the state addresses the various challenges that California's housing market faces. This subject — the challenges facing the housing market — is the focus of Chapter II.

Chapter II

Meeting California's Housing Needs—What are the Challenges?

This chapter discusses the major challenges which relate to California's housing market. The way these challenges are addressed, including the role played by the government, will influence not only the housing market's future performance, but also the health of the state's economy generally, and the overall quality of life for many Californians in the years to come.

Key Challenges

Naturally, there are a great many different challenges that are associated with a housing market as large and with so many diverse aspects as California's. This is especially true, given the dramatic growth and increasing urbanization the state has been experiencing in recent years. All of these challenges are worthy of attention if California's housing market is to successfully meet the state's needs in the future. Based on the information presented in Chapter I, however, some of these challenges stand out as being particularly significant. These are listed in Figure 14, without making any assumptions regarding the particular priority the Legislature might attach to them individually.

The Challenges Are Many and Diverse

The key challenges itemized in Figure 14 cover a broad spectrum, and include such diverse factors as housing affordability, homelessness, intergovernmental coordination, and ensuring the effectiveness and efficiency of housing subsidies and other programs.

In our view, it is these factors which head the list of the challenges — at least those that are evident today — that must be addressed to adequately provide for California's housing needs. They also will be the key determinants, along with governmental policy decisions in areas like health care, social services, environmental management, transportation, and education, of the overall quality of life for millions of Californians in the future.

Figure 14

Key Challenges Facing California's Housing Market

1 Homeownership costs and affordability
Can California's high home prices and the reduced affordability that accompanies them be mitigated?

2 Availability and cost of rental housing
What steps are needed to ensure that adequate supplies of decent and affordable rental housing are available, particularly for low-and-moderate income households?

3 Proximity of housing to jobs
Are there ways to bring people's homes and jobs closer together, thereby limiting or lessening the increasingly serious problem of lengthy home-to-work commute distances, which in turn can lead to such negative outcomes as increased air pollution, fuel consumption and traffic congestion?

4 Barriers to housing choice
What policies are needed to reduce noneconomic barriers to housing choice, such as occurs when households are segregated or discriminated against based on their ethnic characteristics?

5 Coordination between state and local housing policies
What steps are needed to ensure that differing governmental entities, including neighboring localities, pursue consistent and coordinated policies regarding housing and related issues like growth controls, land use, urban crowding and transportation congestion?

6 Effectiveness and efficiency of housing programs and subsidies
Are the tax dollars that currently are being spent to provide housing subsidies and other housing assistance, including grants, loans, tax-exempt bond financing and mortgage interest deductions, the most effective and efficient ways of assisting housing? Are modifications to existing programs or new approaches needed?

7 The problem of the homeless
What options exist to address the disturbing number of homeless individuals and families who lack basic shelter or, in order to have it, live as the "hidden homeless" in substandard or overcrowded units?

8 Housing needs of other special groups
What steps are needed to meet the unique housing problems faced by such groups as senior citizens, the disabled and handicapped, single-parent households, renters with children, rural households and migrant farmworkers?

9 Maintaining the quality of the housing stock
Are adequate steps being taken to provide for the rehabilitation of substandard housing units and the ongoing care of existing units needed to maintain the quality of the state's housing stock?

10 Expanding housing supply to accommodate population growth
Are actions needed to ensure that sufficient supplies of new housing will be forthcoming in the future to meet the needs of a rapidly growing and urbanizing California population?

The Challenges Involved—What Is their Specific Nature?

Given the significance of the challenges shown in Figure 14 for the future performance of California's housing market, their specific nature is discussed further below prior to considering in Chapter III the various governmental programs, policies, and strategies that are being or could be used to help address them.

Challenge One — Homeownership Costs and Affordability

The basic challenge here involves both how to keep housing prices from being unnecessarily high and facilitating people's ability to own their own residences. These are important issues because they affect the ability of many Californians to afford to live in the state, the mobility of the workforce, and the state's ability to attract new businesses.

At the outset, it is important to remember that there are certain underlying economic and demographic forces, such as population growth and land scarcity, which tend to significantly influence the determination of housing prices and thus limit direct control over them. Likewise, affordability depends not only on housing costs, but also on the incomes people can earn. The task, therefore, is to identify within the confines of these basic constraints what positive actions might be taken.

How can homeownership be facilitated?

Among the primary options for facilitating homeownership are to reduce homeowners' monthly mortgage costs and provide down payment assistance to home buyers. Another is to increase the amount of income people have for housing, such as through subsidy payments. In the case of the first option — reducing down payment amounts and monthly mortgage costs — the main approaches include reducing mortgage interest rates, lowering the size of mortgage loans, and lengthening the period over which mortgage loans must be repaid. Figure 15 shows how these alternative approaches can affect the monthly payment on a median-priced home, given typical assumptions regarding home financing. It indicates, for example, that the monthly payment drops by about $117 for each 1 percentage point drop in mortgage interest rates, and by $88 for each $10,000 drop in the required loan amount. Thus, policies that reduce the monthly payment costs homeowners face clearly can enhance affordability.

Keeping home costs down

Facilitating affordability also includes developing approaches to reduce or contain housing costs, especially for those cost components which carry the most weight. Figure 16 shows the approximate breakdown of single-family home construction and development costs in California, and indicates that, by far, the most important cost components are direct construction expenses (primarily wages and materials) and land costs (including site acquisition and development). These two components account for nearly three-fourths of total costs, and this is where the focus of cost-reducing efforts should begin. As noted in Chapter III, options for reducing these costs include various land-use policies and increased use of manufactured housing units and components. Of course, the other cost components in Figure 16 also offer many cost-reducing opportunities, such as speeding up the local land development and building permit processes to reduce construction financing costs.

Challenge Two — Adequate and Reasonably Priced Rental Housing

As shown earlier in Figure 3, almost half of all California households are renters. Of these, nearly 90 percent live in multi-family housing units. These percentages are even higher in

Figure 15

How Different Financial Assumptions Can Affect Mortgage Payments[a]

Basic financial assumptions:	Monthly mortgage payment
• $200,00 home price • 20-percent down payment • 30-year fixed rate loan at 10 percent interest	$1,404
Effect of:	**Reduction in monthly payment**
• Adding 5 years to the repayment period	$29
• Reducing the loan amount by $10,000	$88
• Reducing the interest rate by 1 percentage point	$117

[a] *All data are on a pretax basis.*

the state's major metropolitan areas and, as was discussed earlier, a large share of California's low-income households are dependent upon rental housing. In fact, *most* renters have a difficult time buying homes, a fact which is not surprising given the estimate by state housing experts that less than 10 percent of all renters could afford to purchase the median-priced California house as of 1986. In addition, many renters who work in metropolitan job centers cannot take advantage of the lower housing costs available in outlying areas, either because their incomes are insufficient to pay the required commuting costs, or they must rely on public transportation which is not always conveniently available for longer-distance commutes. For these reasons, ensuring that there exist adequate supplies of reasonably priced and conveniently located multi-family rental housing is another important challenge facing the state.

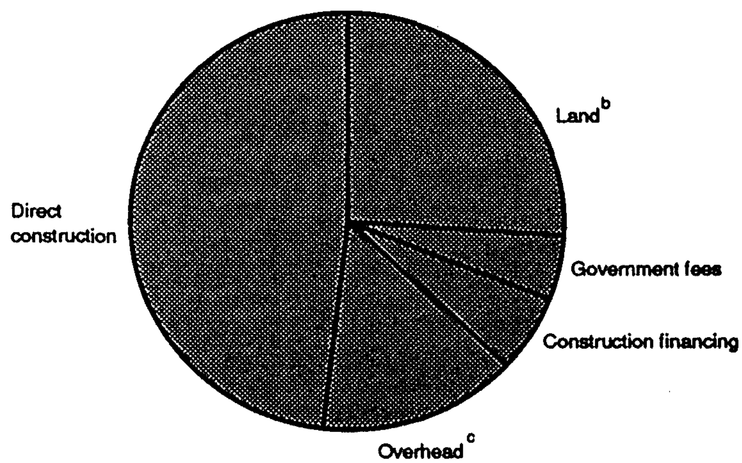
The single most common problem encountered with regard to rental housing is the extremely high percentage of their income that many households must pay for rent, especially low-income households living in major metropolitan areas. Some housing market analysts also note that multi-family rental housing frequently is the target of highly restrictive land use policies aimed at limiting or altogether excluding such housing from a geographic area. This results in a lack of adequate rental housing in the appropriate places, along with excessive rents for whatever units happen to be there.

Although some areas of the state do have adequate supplies of affordable and well situated rental housing at present, there also are many that do not, especially for low-income households. Development of adequate supplies of rental housing in the future will be especially challenging, given recent reductions in direct federal assistance and tax benefits for such housing. Many economists, for

Figure 16

Approximate Average Breakdown of Single-Family Home Construction and Development Costs in California[a]

1986



[a] Source: California Statewide Housing Plan, Phase II, California Department of Housing and Community Development, July 1988, page 32. Data represent approximate statewide medians.

[b] Includes raw land plus site development.

[c] Includes administrative costs, insurance, marketing costs and profits.

example, believe it is likely that the affordability problem for renters will increase, not decrease, during the early 1990s.

Challenge Three — Geographic Proximity of Housing and Jobs

The challenge here is to bring people's housing and jobs closer together, thereby reducing commuting distances and such related problems as traffic congestion and vehicle-related air pollution.

Significant imbalances currently exist

During recent years, significant imbalances have occurred in the mix of housing and jobs within many individual geographic areas of the state. This has happened as people working in the state's most heavily populated metropolitan centers (generally in coastal areas) have had to locate their homes in outlying areas (generally inland), largely due to a disappearance of affordable "close in" housing caused by soaring residential property values. In some cases, the problem has been exacerbated by local zoning policies and other land use decisions which have encouraged commercial and other nonresidential development at the expense of residential development. This has occurred in an effort to maximize sales and property tax revenues while minimizing the added public services that more households require, such as additional schools.

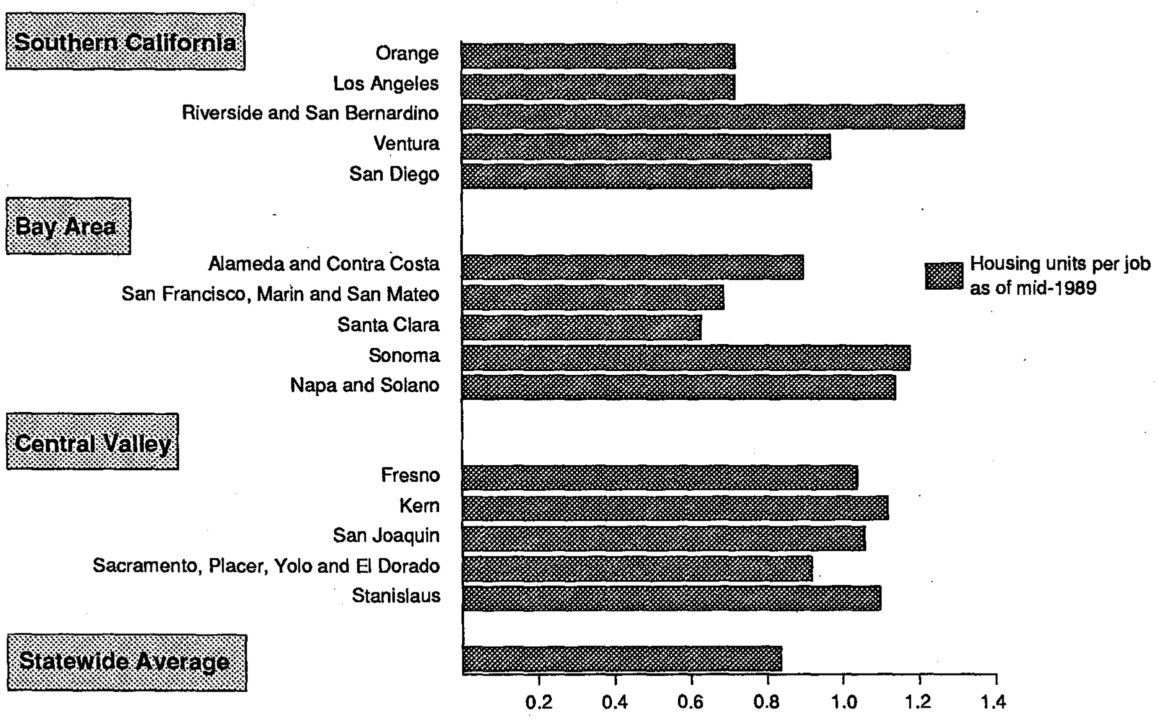
Figure 17 shows how significant these imbalances between housing and jobs are in certain regions. It indicates that:

- Counties such as Riverside, San Bernardino, Sonoma, Solano, Napa, Kern, Stanislaus, and San Joaquin have *more* housing units per job than the statewide average, as they provide *homes* for commuters. For example, Figure 17 shows that there are more than 1.2 housing units per job in the Riverside-San Bernardino region.
- Counties like Los Angeles, Santa Clara, Orange, and San Francisco have *fewer* housing units per job than the statewide average, as they provide *jobs* for commuters.

Ideally, those areas which are adding housing for commuters will eventually develop their own local economies sufficiently to produce jobs for their residents. Presently, however, significant imbalances continue. For example, from 1988 through mid-1989, the Riverside-San Bernardino area accounted for 20 percent of the state's new residential building permits but only 3 percent of the state's new jobs. Even if regional imbalances between the amounts of housing and jobs eventually disappear, the problem of extensive and entrenched "cross commuting" probably will remain.

Figure 17

Balance Between Housing and Jobs in Selected California Counties[a]



[a] *Source: California State Census Data Center, Department of Finance and Employment Development Department.*

Planning can help

One way a healthy regional balance between housing and jobs can be encouraged is for governments to use local zoning and land use plans to mix business activities in proportion to the housing stock. For example, localities should try to ensure that a mix of housing is provided which reflects the general needs of the type of labor force the businesses they attract will be hiring.

Challenge Four — Removing Barriers to Housing Choice

The challenge here is to ensure that households are not unwillingly partitioned or "cut off" from other households in terms of where they live simply because of such noneconomic factors as their ethnicity, as occurs in cases of racial discrimination. California faces a unique challenge in this regard, both because the ethnic diversity of its current population is so great, and underlying demographic trends and continuing strong in-migration from other states and nations promises to make this diversity even greater in the future.

Challenge Five — Coordinating State and Local Housing Policies

The federal, state, and local governments all are involved in housing-related matters in California, and there currently exist scores of different housing policies and programs which are overseen by different governmental entities. The challenge for California is to ensure that differing governmental entities within the state, including neighboring localities, pursue consistent and coordinated policies regarding housing and such housing-related issues as growth controls, land use, urban crowding, and transportation congestion. Without this coordination and consistency, different government programs can end up working at cross-purposes and the effectiveness of housing-related policies may be impaired. An example of this is when attempts to reduce traffic congestion and automobile-related air pollution through minimizing commuting are thwarted, by local land use policies which preclude locating the necessary amounts and types of housing near the employment centers where they are needed.

Challenge Six — Effective and Efficient Housing Subsidies

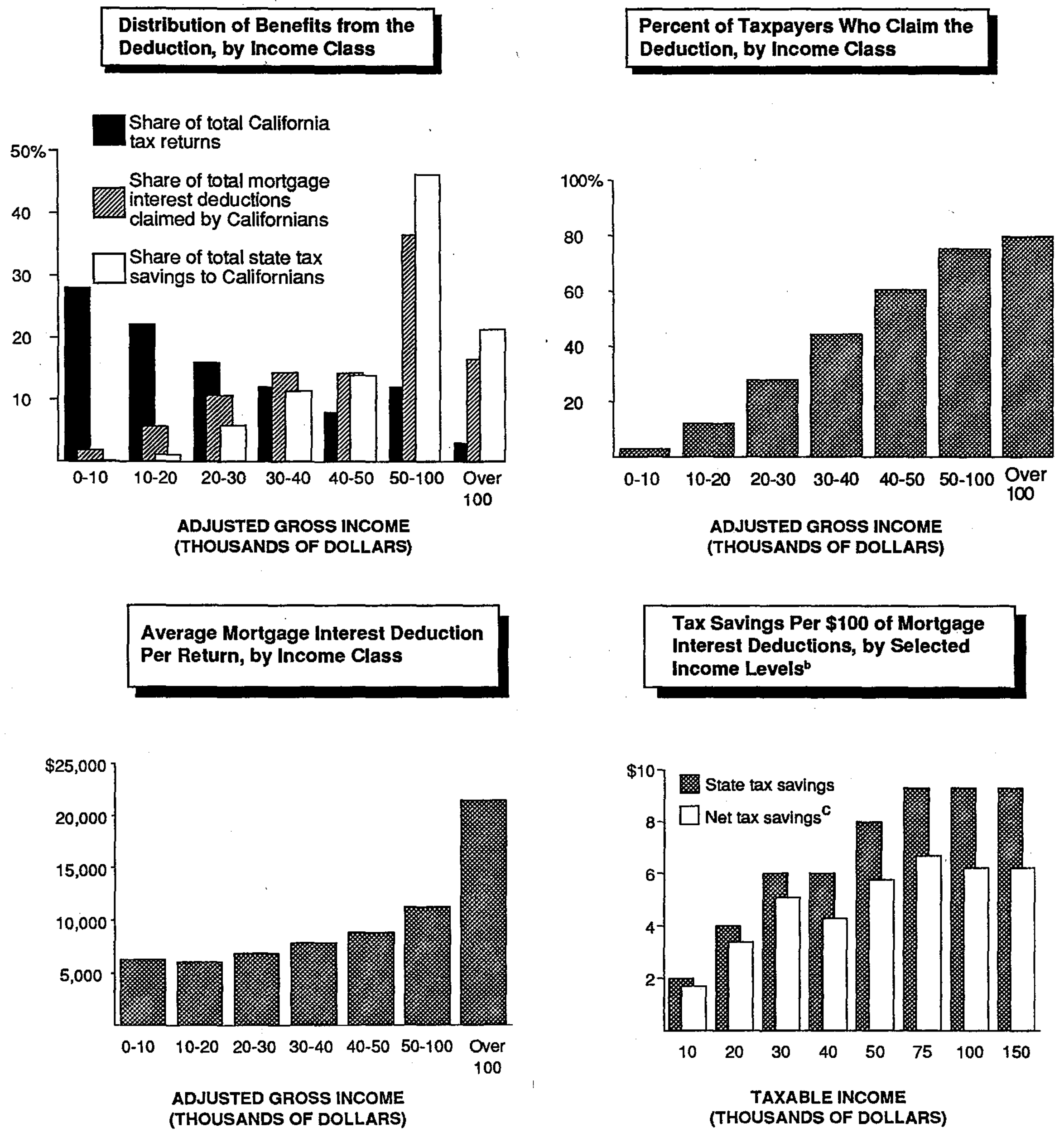
This challenge involves ensuring that the tax dollars currently being spent to provide direct housing subsidies and other forms of housing assistance (including grants, loans, tax-exempt bond programs, and other tax benefits) are (1) going to the highest priority problems and (2) the most effective and efficient ways of addressing California's housing needs and priorities. To the extent that this is not so, modifications of existing programs or entirely new programs need to be considered.

As one example, consider the mortgage interest income tax deduction. As discussed in Chapter III, this deduction represents the state's single largest housing benefit program. As shown in Figure 18, however, the benefits of this program accrue primarily to upper-middle and higher-income homeowners, and even provide a larger benefit *per dollar* of mortgage interest to high-income households than to low-income households. Also, because the "cap" on the total amount of interest which can be deducted is very high, the program encourages low-density land use and large homes, and subsidizes second and vacation homes at taxpayers' expense. Obviously, these effects are not consistent with such possible policy objectives as encouraging higher-density land use and targeting housing assistance to the basic shelter needs of low- to moderate-income households, all of which have their share of supporters. For these and other reasons, we have previously recommended that the Legislature consider modifying this program (see our *Report on the 1988-89 Tax Expenditure Budget*, December 1988, pages 26-38).

Figure 18

California's Personal Income Tax Mortgage Interest Deduction[a]

1989 Income Year



[a] *Source: California Franchise Tax Board. Data for 1989 represent estimates that have been projected using actual 1987 income-year tax return data. Figures shown exclude taxpayers with negative adjusted gross income.*

[b] *Data shown apply to joint-return taxpayers.*

[c] *Net tax savings are less than state tax savings because state tax liabilities may be claimed as an itemized deduction on federal tax returns. Thus, lower state tax liabilities result in a partially offsetting increase in federal tax liabilities. The reason why net tax savings do not follow a smooth upward trend as income rises relates to the particular shapes of the state and federal tax-bracket schedules, including the points at which their maximum marginal tax rates are reached.*

Challenge Seven — The Problem of the Homeless

This challenge involves what to do about the disturbing number of individuals and families who either lack basic shelter entirely, reside periodically in emergency shelters and motels, or live temporarily as the "hidden homeless" in overcrowded and often substandard units. (For a more detailed discussion regarding the homeless problem, see our *1988-89 Budget: Perspective and Issues*, pages 109-126.) No one knows exactly how many homeless persons there are in California, although previous estimates have been in the 50,000 to 150,000 range. The homeless are a diverse group, including low-income families and individuals, the unemployed and underemployed, runaway victims of domestic abuse, mentally ill persons not living in facilities where they can be properly cared for, and alcohol and drug abusers. Most, however, share a common problem — inadequate income to afford a decent place to live.

The *immediate need* of most of the homeless obviously is to have safe and decent shelter. The *long-term solution* to homelessness is more complex, however, because homelessness is not just a housing issue. It is true that the lack of affordable rental housing in many areas contributes to the problem. However, homelessness itself is often merely a symptom of more fundamental underlying problems. Thus, dealing with homelessness ultimately requires targeted programs that address the specific problems that *cause* people to be homeless in the first place and lack adequate incomes — such as inadequate job skills, mental and medical illnesses, drug use, and domestic breakups — as well as supportive services that are needed by these individuals.

Challenge Eight — Housing Needs of Other Special Groups

The issue here is what steps are needed to address the unique housing needs not already discussed above that pertain to such groups as senior citizens, the disabled and handicapped, large families, working single parents with children, rural households, and migrant farmworkers. The diversity of needs of these different groups means that a variety of approaches are necessary to deal with them. Focusing on these groups is important because some of the most pressing housing-related problems tend to be concentrated within them.

Challenge Nine — Maintaining the Housing Stock's Quality

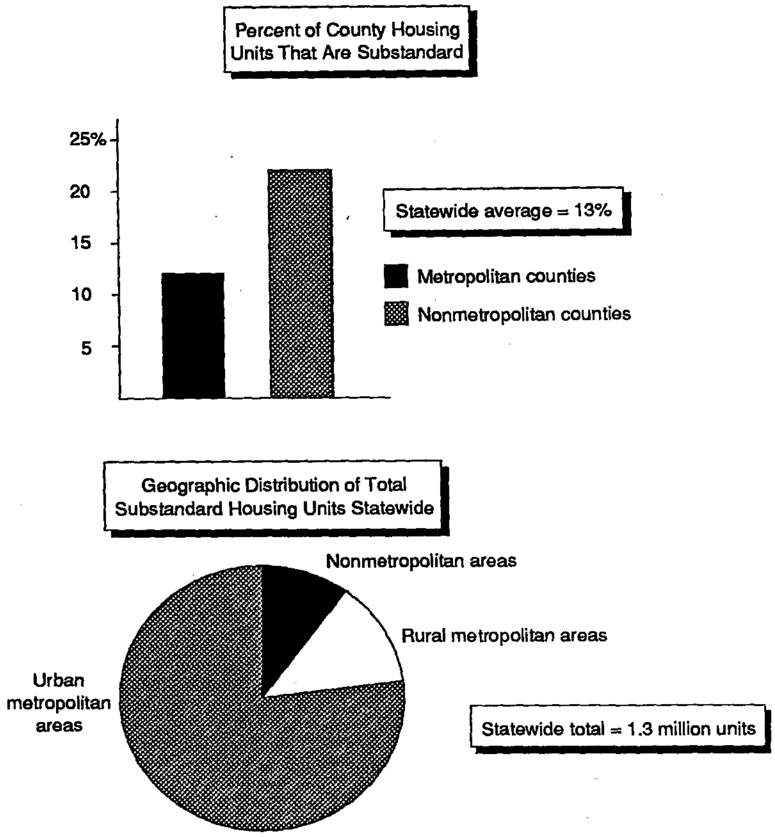
The challenge here involves the rehabilitation or replacement of substandard housing units and the ongoing care of existing units, so that the quality of California's housing stock will be maintained over time. According to the California Department of Housing and Community Development (HCD), the quality of California's housing stock is *generally good*. However, HCD also reports that, as of 1987, a *significant minority* of the stock — over 1.3 million units (or 13 percent of the total) — needed rehabilitation or removal, due to quality problems such as inoperable plumbing, inadequate roofing, and structural damage. Figure 19 indicates that it is the less densely populated rural and nonmetropolitan areas of the state which have the largest portion of their housing units classified as substandard. However, in sheer numerical terms, three-fourths of the state's total substandard units are located within the large urban metropolitan areas where most Californians live.

A lack of adequate income and financing necessary to upgrade and maintain housing units is frequently why they fall into disrepair and then remain substandard. As shown in the Appendix, there are a number of options which housing experts have identified as possible ways of dealing with these financial impediments.

Figure 19

Housing Rehabilitation and Replacement Needs in California[a]

January 1987



[a] *Source: California Statewide Housing Plan, Phase II, California Department of Housing and Community Development, July 1988.*

Challenge Ten — Expanding Housing Supply to Accommodate Growth

Significant amounts of new housing will be required in the future to accommodate the shelter needs of California's anticipated ongoing population expansion (shown earlier in Figure 13). This new housing will require billions of dollars worth of investment. The private capital market generally appears *capable* of providing the large sums of financing that this will entail, although some types of housing will find it harder to attract capital than others, such as low-income multi-family housing for the reasons cited previously.

This does *not* imply, however, that such growth will necessarily be easy to accommodate. One of the greatest growth-related housing needs will be to provide the *public infrastructure* necessary to support new housing, such as sewer systems, water delivery and treatment facilities, streets and roads, schools, and transportation facilities. In addition, as noted earlier, local land use policies will need to be designed which achieve a balance between different types of housing on the one hand and jobs, economic development, and environmental protection on the other.

A Variety of Approaches Will Be Needed

Because the challenges facing California's housing market are so diverse, there is no single solution to them. Rather, if the challenges are to be effectively addressed, a *variety* of approaches will be needed. A wide range of different options and alternatives — some old and some new — do exist. This subject — the policies and programs available to meet California's housing challenges — is the focus of Chapter III.

Chapter III
Policies That Benefit Housing—What Programs Currently Exist?

The policies and programs available to improve the housing market's performance are many in number and diverse in nature. It is beyond the scope of this report to provide a comprehensive listing of all these policies and programs, let alone discuss their characteristics, costs, and effectiveness. Rather, the purpose of this chapter simply is to provide a *general overview* of the major housing-related policies and programs that currently exist in California. Specifically, the chapter:

- Identifies the menu of *potential options* that economists and housing analysts have suggested as ways of addressing housing-related needs and problems, including the challenges discussed in Chapter II.
- Discusses the *different roles* that the federal, state and local governments play as regards housing programs and policies affecting California.
- Identifies the major housing-related programs and policies that *currently are in effect* for California, including state legislation enacted in recent years to help address housing needs.

Lastly, the chapter discusses the California Statewide Housing Plan, which, in conjunction with the housing elements of local general plans, is intended to be the cornerstone of California's housing policies.

What Is the Menu of Potential Programs and Policies?

Many different policies and programs have been suggested as possible ways of addressing the various types of housing-related problems and issues that exist today. A partial listing of this menu of options appears in the Appendix. The menu covers a diverse range and includes, among others, direct housing-related subsidy payments, various tax expenditures, loan guarantee programs, new and flexible mortgage instruments, partnerships between public entities and private nonprofit entities to provide new or rehabilitated housing, local planning and zoning policies, state and local housing trust funds, public housing projects, down payment assistance programs, and employer-assisted housing programs. Some of these alternative approaches and the others listed in the Appendix are currently being used in California, while others are being used outside of the state, and some have yet to actually be tried for any length of time.

What Programs and Policies Currently Exist?

The federal, state, and local governments all currently share in providing housing programs and setting housing-related policies for California. There is no current estimate available of the total dollar volume of such housing-related program activities or their benefits to Californians, at either the federal, state, or local governmental levels. Various data are available, however, for individual programs.

Figure 20 identifies the *largest* housing-related programs in terms of their dollar activity and/or program benefits that currently are operating in California. The programs shown generally are at least $10 million in size, and range from a high of several billion dollars in the case of the mortgage interest deduction, to the tens of millions of dollars, such as in the case of rural rental housing assistance, rental rehabilitation grants, and certain first-time home buyer assistance programs.

The Federal Role — Largest Source of Housing Assistance

The federal government provides by far the largest dollar volume of government housing assistance to Californians. This assistance takes three basic forms, including:

- *Direct expenditures* for subsidy payments and grants, such as those operated by the federal Department of Housing and Urban Development (HUD).
- *Mortgage loan guarantee and insurance programs*, such as under the Federal Housing Administration (FHA) and Veterans' Administration (VA). These programs serve to reduce both housing down payments and the interest rates that are charged on home mortgage loans.
- *Tax expenditure programs*, such as the federal income tax deduction for mortgage interest expenses. These tax expenditures provide the single largest source of federal support for housing.

Many needs still go unmet

Despite these various federal programs, the assistance needs of many households go unmet. For example, the Urban Institute has reported that fewer than 17 percent of the nation's very-low-income households received federal rent subsidies in 1988. This reflects a variety of factors, including both limitations on the amount of federal funding available and various program restrictions.

What has been the trend in federal housing assistance?

Both total direct federal spending on housing and the number of households receiving assistance have continued to expand in recent years, as has the largest indirect federal housing subsidy program — the mortgage interest deduction. However, the direct federal spending on housing that occurs in any single year primarily represents the expenditure of a portion of past appropriations for previously authorized program commitments. Because the previous commitments generally run anywhere from 5 to 50 years, they typically are spent gradually over a lengthy time period. Thus, understanding the underlying trend in direct federal housing assistance involves looking not only at direct spending in any one year, but also at the amount of new commitments being added for the future. To the extent that these new commitments slow or decline, the spending level itself will eventually slow or decline as old commitments are used up.

Figure 20

Major Housing-Related Programs Operating in California[a,b]

Programs Which Benefit:

Low and Moderate Income Homeowners

FHA mortgage insurance programs (HUD)
Mortgage revenue bond programs (CHFA and local agencies), predominately restricted to first-time homebuyers
Homeownership and rehabilitation loans (Section 502, FmHA)
Community Development Block Grant Program (HUD)
Home Purchase Assistance Program (CHFA), restricted to first-time homebuyers
Mortgage credit certificate programs (local agencies), restricted to first-time homebuyers

Low and Moderate Income Renters

Mortgage revenue bond programs (CHFA and local agencies)
Rental assistance programs (HUD—Section 8 and FmHA)
Low and Moderate Income Housing Fund programs (local redevelopment agencies)
Public housing programs (HUD)
Rental Housing Construction Program (HCD)
Community Development Block Grant Program (HUD)
Rural Rental Housing Program (Section 515, FmHA)
Low-income housing tax credits (IRS and FTB)

All Homeowners Generally

Mortgage interest income tax deductions (IRS and FTB)
Deferral of capital gains on the sale of principal residences (IRS and FTB)
Income tax deduction for taxes on real property (IRS and FTB)

Groups With Special Housing Needs

Veterans' mortgage and mobilehome loan programs (VA)
California veterans' farm and home purchase programs (DVA)
Housing loans for the elderly and handicapped (Section 202, HUD)
Farm labor housing programs (Sections 514 and 516, FmHA)

Substandard Housing

California Housing Rehabilitation Loan Program (HCD)
State Rental Housing Rehabilitation Grant Program (HUD)

[a] *Abreviations in parentheses refer to the governmental agencies which administer the housing-related programs shown. These include the U.S. Department of Housing and Urban Development (HUD), the California Housing Finance Agency (CHFA), the U.S. Farmers Home Administration (FmHA), the California Department of Housing and Community Development (HCD), the U.S. Internal Revenue Service (IRS), the California Franchise Tax Board (FTB), the U.S. Veterans Administration (VA), and the California Department of Veterans Affairs (DVA).*

[b] *Programs identified are a partial listing which generally represents the largest housing-related programs in terms of program activities or dollar benefits provided. Many other state-sponsored housing-related programs also exist, such as faculty residential mortgage revenue bonds (UC Regents), emergency shelter programs (HCD), migrant service centers (HCD), self-help housing programs (HCD and CHFA), urban predevelopment loan programs (HCD), and property tax assistance and postponement for senior citizens and blind and disabled persons. The equivalent of housing assistance also is provided under AFDC, SSI/SSP and general county assistance programs. In addition, housing is assisted through such local programs as unit "set asides" for low and moderate income families, housing trust funds financed with developer fees, density bonus programs and special zoning and other land-use policies.*

The nature of these expenditures tends to mask the basic thrust of recent federal housing activity. Specifically, growth in total housing-related budget authority and the volume of outstanding commitments has slowed, and appropriations for new long-term commitments have declined, in part reflecting both a drop in the number of new commitments and a shortening of the average number of years over which they will be in effect. A number of federal housing programs have either been eliminated, restricted or are being phased out. For example, the federal government has reduced support for new housing construction and rehabilitation of public housing. Federally subsidized housing production has declined substantially. In addition, the federal government has cut direct housing assistance to low- and moderate-income renters, reduced the number of tenants eligible to receive housing aid, and cut housing assistance to elderly and handicapped persons. Taken together, these developments have led many housing observers to conclude that the basic underlying thrust of federal housing policy in the 1980s has been to *reduce* the government's involvement in the housing area.

As shown in Figure 21, certain provisions of the federal Tax Reform Act of 1986 also had negative impacts on housing, especially those relating to depreciation, capital gains, tax-exempt housing bonds, and the use of real estate write-offs to reduce income tax liabilities. Although the act also established a new low-income housing tax credit, the act's net impact on housing — especially rental housing — was decidedly negative relative to its treatment under previous law. (This is not to say, however, that these law changes were not necessarily logical on certain other grounds, such as making depreciation periods more reflective of the actual economic life-spans of rental housing units.)

Figure 22 illustrates the type of adverse effect on a rental property's investment performance that can result from lengthening depreciation periods and eliminating accelerated depreciation, both of which the act did. It shows, for example, that these federal changes both reduce the rate of return on an investment and lengthen the period it takes for it to break even (that is, its "payback period").

Will future federal support for housing increase?

The administration recently unveiled plans to increase federal support over a three-year period by $6.8 billion, to assist first-time home buyers, low-income households, and the homeless. The extent to which this signifies any significant move toward increasing federal support for housing in the future will depend on actions by Congress and the administration later this year.

The State and Local Role — Increased Importance in Recent Years

During the 1980s, there generally have been increased housing-related activities by states and localities, as well as by community groups, nonprofit corporations, and private charitable foundations. Figure 23, for example, lists some of the state housing-related legislation that recently has been enacted in California.

State-Level Programs — What Types Are There?

The state has a number of housing programs, although their dollar impact is small relative to the federal programs. State housing programs fall into the following three basic categories:

- Various direct assistance, loan and grant programs, administered by HCD and other state agencies.
- Both mortgage revenue bonds and general obligation bonds, which provide reduced down payments and below-market mortgage interest rates on housing-related loans. (It should be noted that, in addition to the state's existing bond programs, the *1990-91*

Figure 21

Major Housing-Related Provisions of 1986 Federal Tax Reform and Their Potential Effects on Housing

POTENTIALLY NEGATIVE EFFECTS ON HOUSING

☑ Changes in depreciation
Accelerated depreciation was eliminated and write-off periods were lengthened for rental residential housing units purchased after 1986. This reduces tax deductions, and, therefore, increases taxable income and tax burdens.

☑ Changes in capital gains taxation
Previously, individuals were taxed on only 40 percent of their capital gains. Tax reform made capital gains fully taxable, the same as ordinary income. Thus, it increased taxes owed on housing-related capital gains.

☑ Reduced marginal income tax rates
Tax reform reduced the maximum federal marginal income tax rate from 50 percent to an equivalent of 33 percent. This in turn has reduced the value of the housing subsidy associated with tax-exempt bonds and such income tax deductions as mortgage interest and property taxes.

☑ Limitations on tax-exempt housing bonds
New restrictions were placed on tax-exempt housing bonds. This has reduced the amount of housing that benefits from the tax-exempt bond subsidy.

☑ Revised alternative minimum tax (AMT)
The AMT exists to ensure that taxpayers with incomes derived from tax-sheltered investments, such as real estate, pay some minimum amount of taxes. The revised AMT can negatively affect certain housing investments because fewer deductions, including passive losses, are now deductible from the AMT calculation. Thus, the return on such housing investments is lower.

☑ Tax payments for installment sales
Under prior federal law, taxpayers who earned income on property sales, such as real estate, could spread their tax payments over several years if the buyer made installment payments. Now, this installment method only can be used if the sales price exceeds $150,000, thereby reducing the return on these investments.

☑ Passive loss limitations
Previously, investors were allowed to offset their income from other sources with losses from "passive" real estate investments in which they were not actively participating. Revised law significantly limits the deductibility of such passive losses, especially for high income investors, and thus reduces the after-tax income from certain real estate investments.

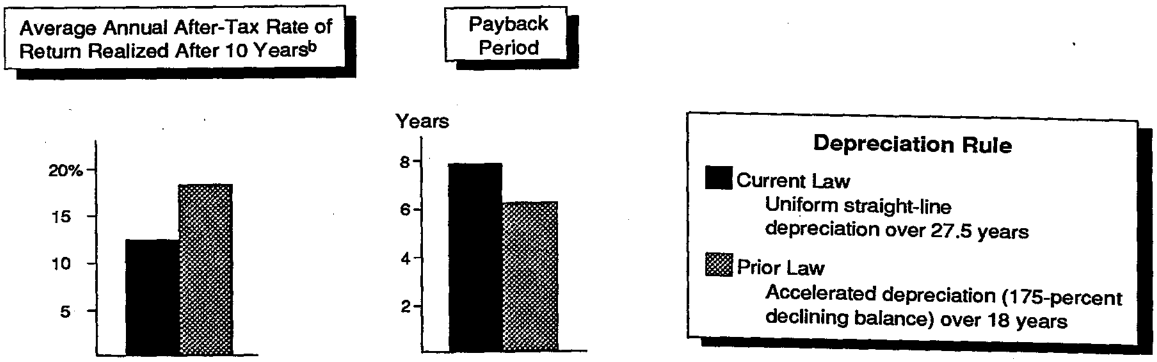
POTENTIALLY POSITIVE EFFECTS ON HOUSING

☑ Low-income housing tax credit
Tax reform established a credit to directly reduce the tax liability of investors in qualified rental housing construction and rehabilitation, thereby increasing their profitability.

☑ Interest deductibility and deferral of gains
Mortgage interest remains fully deductible (subject only to a very high "cap") for both first and second homes, gains from the sale of a principal residence remain deferable if a home of equal or greater value is bought within two years, and taxpayers over 54 years old are not taxed on the profit from selling their home unless it exceeds $125,000. These all reduce the after-tax costs of owning homes.

Figure 22

Effects of Alternative Depreciation Rules on Investment Returns for a Hypothetical Rental Property[a]



[a] *This example assumes a rental property purchased for $1 million, of which 80 percent ($800,000) is the structure's value and 20 percent ($200,000) represents land value. It also assumes a 25-percent down payment, with the remaining 75 percent financed with a 30-year loan at 10 percent interest per annum. Also assumed are a 3-percent rental vacancy rate, gross rental income of $750 monthly for each of 14 units, and an annual inflation rate of 5 percent. Cash costs include mortgage financing, property taxes, insurance and an allowance for operating and maintenance expenses. Identical depreciation rules have been uniformly applied for both federal and state tax purposes.*

[b] *Return reflects net rental income only, and does not include any unrealized accruing gains from property appreciation.*

Governor's Budget proposes new bond authorizations to assist first-time home buyers.)

- Tax expenditures.

In addition, the state affects housing by adopting minimum statewide construction code standards.

The first program category above includes many different direct assistance programs which target a wide range of housing needs, including those of farmworkers, the homeless, disabled persons, rural households, low-income households, and senior citizens. However, the latter two program categories provide by far the greatest dollar volume of housing benefits to Californians.

Tax-exempt bond programs

These programs involve the issuance of federally and state tax-exempt housing bonds by the California Housing Financing Agency (CHFA) and California Veterans Farm and Home Purchase Program (Cal-Vet). Their purpose is to provide state-subsidized reduced-interest loans for single-family and (in the case of CHFA) multi-family housing units, including their purchase, rehabilitation, and construction. The state issues both general obligation housing bonds (these are backed by the "full faith and credit" of the state) and mortgage revenue housing bonds (these are backed only by the housing units they are used to help finance). As a practical matter, nearly all of the state's housing bonds are paid off by mortgagees and thus are self-supported. However, the state does provide an indirect subsidy in the form of the state tax revenues it foregoes to make the interest on the bonds tax-exempt. There were about $920 million in bond-financed loans made during 1988-89 under these programs, and nearly

Figure 23

Selected Housing-Related Legislation Recently Enacted in California[a,b]

1987 through 1989

Tax-Related Measures

Ch 186/87 (AB 60, Elder)	Provides property tax relief to homeowners over the age of 55, who have been reluctant to move into smaller homes because of the increased property tax liability they would face due to home price inflation.
Ch 1138/87 (AB 53, Klehs) and Ch 1139/87 (SB 572, Garamendi)	Created a low-income housing tax credit (LIHTC) for California, intended to complement the federal LIHTC adopted in 1986.
Ch 1228/87 (AB 900, Polanco)	Provides an exemption from property taxes for emergency shelters and transitional housing for the homeless.
Ch 1469/87 (AB 2144, Filante)	Exempts from property taxes certain lower-income rental housing owned by nonprofit organizations.
Ch 45/89 (SB 70, L. Greene)	Requires at least 20 percent of the LIHTC to be allocated to rural areas, and allows unallocated 1987 and 1988 credits to be allocated in 1989.
Ch 1347/89 (SB 726, L. Greene)	Extends the LIHTC beyond 1990 for as long as the federal LIHTC continues.
Ch 1156/89 (SB 1290, Seymour)	Extends the LIHTC beyond 1990 for as long as the federal LIHTC continues, and allows 1989 LIHTC allocations to exceed the $35 million annual ceiling so that unallocated 1987 and 1988 credits may be allocated in 1989.

Bond Measures

Ch 27/88 (AB 2032, W. Brown)	Created the Earthquake Seismic Safety and Housing Rehabilitation Bond Act of 1988, with a general obligation bond authorization of $150 million. This bonding authorization was approved by voters in November 1988 as Proposition 77.
Ch 30/88 (SB 1692, Roberti) and Ch 48/88 (SB 1693, Roberti)	Created the Housing and Homeless Bond Act of 1988, which included a $300 million general obligation bond authorization in 1988 (approved by the voters in November 1988 as Proposition 84), and places an additional $150 million bond authorization on the June 1990 ballot.

Measures Relating to Housing Conversions

Ch 1383/87 (SB 1473, Petris)	Requires owners of certain federally assisted rental housing projects to provide six months advance notice before federal subsidies are terminated and the units are converted to charging market rents.
Ch 1451/89 (SB 1282, Seymour)	Requires localities to take potential conversions into account when determining local housing needs for purposes of their general plan housing element.

Other Measures to Assist Low-and-Moderate Income Housing

Ch 1111/87 (AB 1735, Isenberg)	Requires redevelopment agencies to repay monies deferred from their low-and-moderate income housing funds, and requires housing units created by the funds to remain affordable for at least 10 years for owner-occupied units and at least 15 years for rental units.
Ch 1353/87 (AB 1733, Isenberg)	Makes AFDC funds available to homeless families for use as rental security deposits and advance payment of the last month's rent.
Ch 1355/87 (SB 1297, Petris)	Established a nonprofit California Housing Partnership Corporation to raise equity capital for nonprofit housing development corporations involved in preserving and supplying very-low and low-income rental housing.
Ch 1400/87 (SB 1364, Rosenthal)	Established a demonstration transitional housing rental deposit program to insure the rental security of homeless families who are moving into permanent rental housing.
Ch 1565/88 (AB 4566, Polanco)	Requires more timely expenditure by redevelopment agencies of monies in their low-and-moderate income housing funds.
Ch 1140/89 (AB 2080, M. Waters)	Requires increased targeting of monies in low-and-moderate income housing funds to low-income households.
Ch 842/89 (AB 1863, Hauser)	Requires local governments to offer certain incentives to developers for setting aside a portion of their housing units for low-income renters.

[a] *Legislation shown represents partial listing of enacted measures and excludes measures adopted by the Legislature but vetoed by the Governor. This vetoed legislation included measures to strengthen current fair-share housing allocation requirements (SB 966, Bergeson), to require owners of certain federally-assisted housing to provide one-year advance notice prior to converting units to market rents (SB 1028, Petris), and to also require such owners to first offer the units for sale to tenants or nonprofit or public agencies (Clute, AB 486).*

[b] *List excludes legislation adopted to deal with housing needs caused by the Whittier-Narrows earthquake in 1987 and the Loma Prieta earthquake in 1989. These measures included funding for deferred-payment loans to reconstruct and repair damaged dwellings and provide relocation assistance.*

$6.5 billion of housing bonds currently are outstanding.

Figure 24 summarizes the types of households assisted under the state's housing-related bond programs. It indicates that:

- Although these bond programs do assist low-income households, it is *moderate-income households* that constitute the majority of beneficiaries.
- Most housing bonds have been used to assist *owner-occupied single-family housing*, as opposed to multi-family rental housing. This has become especially true following the increased federal restrictions placed on tax-exempt housing bonds that were adopted as part of the federal 1986 Tax Reform Act.

State tax expenditures — mortgage interest leads the way

As with the federal government, state tax expenditures are the single biggest source of state housing assistance. The largest state tax expenditure program is the personal income tax deduction for *mortgage interest expenses*, which provided an estimated $2.5 billion in state tax savings to homeowners in 1989 (see Figure 18 earlier). As noted in Chapter II, this program has a number of shortcomings, and we have thus previously recommended that it be modified. Other major state housing tax expenditures include the income tax deduction for residential property taxes and the deferral of capital gains on the sale of principal residences, each of which costs the state about $400 million annually.

What about the new LIHTC?

As shown in Figure 23, the most recently established major state tax expenditure program is the state's *low-income housing tax credit* (LIHTC), enacted in 1987 to complement the federal LIHTC created in 1986. This state program can distribute up to $35 million annually in tax credits to developers and builders who construct, acquire, or rehabilitate low-income housing projects. A similar volume of credits is available to California under the federal LIHTC. Both the state and federal credits are allocated to applicants by the California Mortgage Bond and Tax Credit Allocation Committee (MBTCAC), with a requirement that 10 percent be set aside for nonprofit entities. These allocations are required to be granted only for projects which would not take place without the credit, and which themselves have been prioritized according to a specified set of criteria.

Local Housing Activities — What Do They Include?

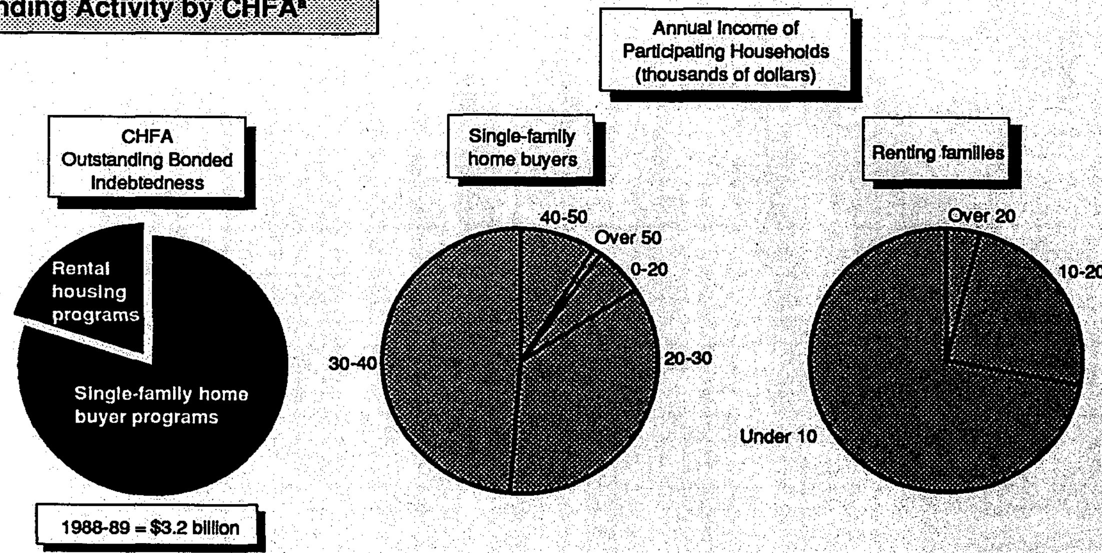
Local housing activities include both direct spending programs, indirect housing assistance programs like tax-exempt housing bonds, and various regulatory policies which affect the number, type, cost, and location of a community's housing units. Regarding these activities:

- *Local regulatory policies* are probably the single most significant means by which localities affect the housing market. These policies involve such actions as determining land development standards like grading and erosion control, minimum density and lot-size requirements, general zoning rules, allowable building materials and other building code restrictions (beyond the minimum statewide standards), developer fees, tax abatement policies, and permit-processing rules and time frames. Although these types of regulatory policies generally do not involve the direct expenditure of governmental funds, they tend to have very significant impacts on local housing markets, including the cost of housing units.
- *Mortgage revenue bonds* are issued by cities and counties to provide low-interest loans for new renter- and owner-

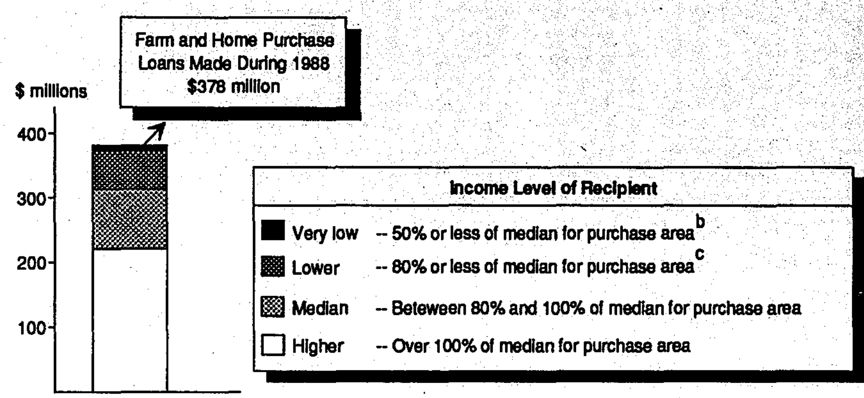
Figure 24

Home Lending Activities by the California Housing Finance Agency (CHFA) and Cal-Vet Program

Lending Activity by CHFA[a]



Cal-Vet Program Activities



[a] *Data are for fiscal years ending in years specified.*

[b] *Average of $18,100 for program participants during 1988.*

[c] *Average of $28,960 for program participants during 1988.*

occupied housing, much like the state does under the CHFA and Cal-Vet programs.

- *Redevelopment agencies,* over 300 of which exist in California, generally are required to set aside 20 percent of certain tax revenues for increasing or improving low- and moderate-income housing.

- *Local housing authorities* are local public agencies authorized by state law to help address specified housing needs. These authorities can, among other things, acquire and lease or operate housing projects on a nonprofit basis, acquire property for constructing low-income housing, issue revenue bonds for housing rehabilitation, and operate leased, temporary and farmworker housing. There also exist over 100 tax-exempt nonprofit housing development corporations (HDCs) in California which help localities meet their housing needs in various ways.

Taken together, these various local housing policies and programs are a key ingredient in the housing elements of local general plans, which in turn are a key component of California's statewide housing planning process.

California's Statewide Housing Planning Process

Understanding how California's many diverse housing-related governmental policies and programs are intended to "fit together" involves examining:

- The California Statewide Housing Plan (CSHP), which articulates the state's main housing needs and objectives.

- The housing elements of local general plans, which are supposed to contain local action plans for addressing these statewide housing needs.

What Is the California Statewide Housing Plan?

State law requires HCD to develop a CSHP in order to ensure that California's current and future housing needs are met. The plan covers a five-year period and its purpose is to:

- Provide a comprehensive description of housing conditions throughout the state and an assessment of future housing needs.
- Identify the key housing-related problems facing the state and recommendations for addressing them.

Specifically, then, the plan is intended to guide the actions of the Legislature, administration, private housing sector, and local governments in jointly addressing the state's key housing issues.

The Critical Role of Local Housing Elements

In order to translate statewide housing goals into reality, actions must be taken at the local level to accomplish them. The key step in this process involves the formulation and implementation of the *local housing elements* that, since 1969, have been required to be contained in localities' general plans. In preparing these housing elements, localities are required to assess their housing needs and identify necessary housing programs for their communities. As part of this, they must include a five-year schedule of actions for implementing the policies and goals of their housing elements, including the use of available federal and state financing and housing subsidies. Figure 25 illustrates the process involved in preparing these local housing elements and how they relate to the statewide housing plan.

Figure 25

California's Statewide Housing Planning Process and the Preparation of Local Housing Elements

Preparation of Local Housing Elements

Step One

Locality prepares a draft housing element update. State law requires each city and county to update the housing element of its general plan at least once every five years. The housing element must contain:

- An analysis and quantification of local housing needs, including the locality's share of the regional housing need.
- An inventory of resources and constraints relevant to meeting these housing needs.
- A statement of the community's goals, objectives and policies relative to the maintenance, improvement and development of housing.
- A program of specific steps that the locality will undertake to achieve its housing goals and objectives.

Step Two

Locality submits draft of its housing element to the California Department of Housing and Community Development (HCD) for *advisory* comments.

Step Three

Locality considers HCD's comments regarding its draft housing element. It may, but is *not* required to, revise the draft housing element in response to these comments.

Step Four

Locality adopts its final housing element.

Step Five

Locality submits its final adopted housing element to HCD, which has the *option of reviewing* the adopted element. HCD does *not* have authority, however, to require that the adopted element be revised or modified in any way.

Determining a Locality's Share of the Regional Housing Need

The General Process

Under state planning law, the primary responsibility for quantifying a community's existing and projected housing needs is lodged with the California Department of Housing and Community Development (HCD) and regional councils of governments (COGs). A multi-stage process is involved which includes the following steps:

- HCD, in consultation with the Department of Finance (DOF), identifies *statewide* housing needs;
- COGs (in regions where they list) or HCD develop *regional* housing needs plans;
- COGs or HCD allocate a *local share* of the regional housing need to each city and county.
- Localities incorporate this measure of housing needs into their local housing elements.

How Well Is the Process Working?

The combination of a statewide housing plan and local housing elements to implement basic housing goals sounds fine on paper. In practice, however, California's process has some *shortcomings* and could be *improved*. For example, although the HCD reviews local housing elements, the department has no mechanism or authority to ensure that locally adopted housing elements comply with state law. Moreover, the state has no means of ensuring that all the programs identified in local housing elements actually are implemented.

Improving California's statewide housing planning process thus is one of the steps necessary to improve the future performance of the California housing market.

This topic — the key action steps needed to improve the housing market's performance — is the focus of Chapter IV.

Chapter IV
Improving California's Housing Perfomance—Where Do the Opportunities Lie?

The previous chapters have provided information regarding the characteristics of California's housing market, the major challenges it faces, and the various policies and programs which are or could be used to help address these challenges. This concluding chapter considers where the Legislature's greatest opportunities lie for improving housing performance, and thus where the primary focus of its efforts should be concentrated.

Diverse Challenges Will Require Diverse Approaches

As noted earlier, because the housing-related challenges facing California are so many in number and diverse in nature, there is no single solution to them. Rather, a diversity of approaches will be required to successfully meet these challenges. Many of the alternative approaches available were identified in Chapter III and Appendix A in the menu of the potential options that have been suggested for addressing housing market problems. The preceding chapters also suggest, however, that a smaller group of particularly important action areas exist which offer especially good opportunities for improving housing in California. Thus, it is in these areas that the Legislature may wish to focus.

What Are Some Key Areas For Taking Action?

Figure 26 identifies several key housing-related action areas which appear to offer particularly good prospects for improving housing performance. They include:

- Improving the *effectiveness and efficiency* of government housing programs, including direct expenditure programs, tax-exempt bond programs, and tax expenditure programs.
- Improving the *statewide housing planning process,* including local housing elements and their implementation, so that statewide housing objectives may be achieved and the performance of local and regional economies may be enhanced.
- Ensuring that the *public capital infrastructure* needed to accommodate housing growth is adequately provided for, including such infrastructure needs as water delivery systems, solid waste disposal, sewers, and transportation.
- Supporting actions that have the potential to *hold down housing costs* for both homeowners and renters, such as ongoing reviews by localities of their

land use policies, faster processing of development and building permits, and use of cost-reducing technologies such as manufactured housing.

- Encouraging the use of economically beneficial *public-private housing partnerships*, so that as full an array as possible of financial resources may be directed toward meeting high-priority housing needs, such as ensuring adequate and affordable housing for low-income households. Housing partnerships have been successfully used throughout the nation during the 1980s to meet a number of different urban housing needs, and have typically involved voluntary collaboration between businesses, banks, city governments, community-based nonprofit development organizations, local and some national foundations, and, increasingly, state governments. It is estimated that they have provided some $400 million in new funding for low-cost urban housing by pooling together financial resources and sharing various construction and management responsibilities.
- Addressing the pressing housing needs of the *homeless*. This involves not only short-run remedies, but also considering longer-term solutions that focus both on (1) the underlying factors which contribute to homelessness, such as lack of job skills and employment opportunities, medical problems, mental illness, and drug and alcohol abuse; as well as (2) the supportive services that are needed by these individuals.

It is by focusing in key areas such as these that we believe the Legislature has particularly good opportunities for improving the performance of California's housing market.

Some Actions Have Been Taken, But More Are Needed

There already have been a number of action steps taken by the Legislature in those areas shown in Figure 26. For example, as indicated earlier in Chapter III (see Figures 20 and 23), various state programs have been established to assist both the homeless and low-income households. Likewise, regarding public-private housing partnerships, Ch 1355/87 (SB 1297, Petris) established a nonprofit corporation to raise equity capital for nonprofit housing development corporations involved in preserving and supplying very-low and low-income rental housing. These and various other actions taken by the Legislature all are steps in the right direction as regards addressing the housing challenges facing California.

Despite these accomplishments, however, more steps need to be taken in all of the action areas identified in Figure 26. For example:

- Regarding the *statewide housing planning process* and *local housing elements*, SB 966 (Bergeson) was enacted by the Legislature in 1989 to put tougher requirements on, and provide incentives to, localities to assure that the housing elements of their general plans conform to state law. The Governor, however, vetoed this measure. Consequently, the need and opportunity still exist to increase the degree of accountability and enforceability associated with local housing elements.
- Regarding *public infrastructure* needed to accommodate housing, there is a lack of comprehensive multi-year capital outlay planning at both the state and local levels. Senate Bill 2214 (Campbell), which was enacted in 1988

Figure 26

Opportunities for Improving California's Housing Performance

IMPROVE THE EFFECTIVENESS AND EFFICIENCY OF HOUSING PROGRAMS

Actions should be taken to ensure that the tax dollars currently being used to provide tax subsidies and other forms of housing assistance are the most effective and efficient means of improving the housing market's performance. This includes better targeting of housing subsidies. An example is the need to modify the mortgage interest deduction.

IMPROVE THE STATEWIDE HOUSING PLANNING PROCESS

It is important that the statewide housing planning process be improved, since it is critical to achieving California's statewide housing goals. For example, actions are needed to ensure that local housing elements are fully reflective of statewide housing priorities, and that steps are taken to implement these housing elements so that they will accomplish their objectives.

PROVIDE INFRASTRUCTURE NECESSARY TO ACCOMMODATE HOUSING GROWTH

The future performance of the housing market will be influenced by how well the infrastructure needs relating to housing are met, such as water systems, municipal waste disposal, sewers and roads. Providing for the basic infrastructure needed to accommodate California's housing and population growth is in part the responsibility of local general plans. However, the responsibility for infrastructure needs also extends beyond the local level. For this reason, both the state and localities need to develop and implement capital outlay planning processes which can help ensure that adequate infrastructure is provided.

SUPPORT POLICIES THAT CAN REDUCE OR CONTROL HOUSING COSTS

Not all factors affecting housing costs are easily controllable. However, whatever options that do exist for holding housing costs down should be encouraged, such as on-going reviews by localities of their land-use policies, greater utilization of cost-reducing technologies such as manufactured housing, and faster processing of permits for residential land development and housing construction.

ENCOURAGE PUBLIC-PRIVATE HOUSING PARTNERSHIPS

The challenges facing California's housing market are such that governmental programs alone will not completely address them. Public-private housing partnerships can help broaden the array of financial resources directed toward meeting high-priority needs, such as adequate and affordable low-income housing. These partnerships can serve to pull together such entities as state and local governments, community-based nonprofit housing development corporations, private foundations, employers, labor unions, and other entities.

ADDRESS THE NEEDS OF THE HOMELESS

A variety of approaches must be considered to deal with the needs of California's homeless population. In the short-term, these people face a need for safe and decent shelter. In the longer-term, the underlying problems leading to homelessness must be addressed, such as the need for job training, health care, and drug and alcohol rehabilitation.

by the Legislature, would have established such a process at the state level. However, this measure was vetoed by the Governor. Thus, no state plan currently exists, nor is it the rule that comprehensive plans of a similar nature generally exist for local governments.

The Time For Responding Is Now

In our report last year on the California economy, we indicated that, because California is so rapidly urbanizing and undergoing so many other significant changes, *now* is the time for making and implementing plans for accommodating the state's future economic growth. This same sense of timeliness and focus applies to addressing California's housing challenges. This is because the future performance of the state's housing market will not only be a result of, but also a determinant of, the state's future economic performance. Thus, the sooner and more effectively California's housing challenges are addressed, the better will be California's future economic performance, and the living standards and overall quality of life of its citizens.

Appendix

Partial Listing of Options Which Have Been Suggested for Addressing Various Types of Housing Problems and Needs

Options Relating to Owner-Occupied Housing

- Expanded eligibility for government-backed mortgages, including increases in maximum allowable home purchase prices and loan limits.
- Reduced insurance requirements for state home loan programs.
- Tax incentives for down payment savings plans, including IRA and Keogh-type Individual Housing Accounts (IHAs) which defer or eliminate taxation of savings for housing.
- 100 percent loan-to-value loans, supported by down payment grants and deferred-payment second mortgages.
- Down payment programs which permit individual borrowing against accruing retirement contributions.
- Emergency mortgage default assistance plans, such as crisis intervention programs to forestall foreclosures in cases of temporary income loss.
- Interest rate buydown programs.
- Deferred-payment first mortgage loans.
- Lease-purchase contracts for low-to-moderate income households, including renters seeking homeownership.
- Shared appreciation and shared equity mortgages, including subsidies to first-time homebuyers in exchange for equity recapture rights by the state, lender or builder.
- Graduated payment and variable rate mortgages.
- Sale and lease-back housing arrangements for financially troubled owners.
- Buydown programs for home purchase closing costs, and state-sponsored housing settlement loan funds to assist in covering loan origination fees and other closing costs to first-time and low-income homebuyers.
- Special mortgage insurance programs for homeowners unable to obtain federal or private mortgage insurance.
- State mortgage certificate programs.
- Direct low-interest home loans to homebuyers.
- Special second mortgage programs, including nonamortizing interest-only loans.
- Mortgage loan guarantee programs.
- Low-interest loans to homebuilders.
- Tax-recapture programs to recycle money from housing loan programs back into housing assistance.
- Employer-assisted home purchase programs, including matching down payment grants and tax-advantaged employee home ownership programs similar to employee stock ownership programs.
- Establishment of a secondary market for shared-equity and/or shared-appreciation loans, as exists for the Government National Mortgage Association (GNMA) and Federal National Mortgage Association (FNMA) mortgage instruments.
- Flexible benefit-choice packages offered by employers to employees which include homeownership assistance.

- Reverse annuity mortgages (RAMs) and special RAM insurance funds to help owners with income shortfalls keep their houses.
- Creation of state-based housing investment instruments similar to GNMA instruments and real estate mortgage investment conduits (REMICs), including state-sponsored shared appreciation securities to attract financial capital for housing.
- Special down payment mortgages for cash-poor first-time homebuyers.
- Income tax deductibility of mortgage interest and property taxes.
- Special tax incentives and insurance programs to encourage sellers to provide financing to buyers.
- Development of "sweat equity" and other types of self-help homeownership programs

Options Relating to Rental Housing

- Provision of public housing.
- Provision of low-income housing by nonprofit entities such as community-based development corporations.
- Operation by nonprofit entities of state-developed rental housing projects.
- Community development block grants for low-income rental housing.
- Urban partnerships between nonprofit entities and for-profit developers to provide rental housing.
- Low-income housing tax credits for builders.
- Up-front capital grants to subsidize rental projects.
- Rent payment guarantee programs.
- Direct rent subsidies to low-income households, including voucher programs.
- Pre-development subsidies for low-to-moderate income rental housing projects.
- Low interest loans to builders of rental housing.
- Programs to co-venture multi-family housing projects with such organizations as labor unions, community groups and nonprofit religious groups on a deferred, shared appreciation basis.
- Direct state operation and maintenance of subsidized rental properties.
- Special loan programs to assist tenant purchasers of rental housing units converting to owner-occupied units.
- Loans and insurance funds to cover security deposits and prepayments of last month's rent for low-income families.
- Resale restrictions for subsidized rental units to ensure that they will be available to low-income households in the future.
- Financial assistance to convert unused commercial space to rental housing.
- Loan programs to facilitate adequate maintenance of low-income housing units having cash-poor owners.
- Use of tax increments earned by redevelopment agencies to finance multi-family housing rehabilitation.
- Tax breaks for limited partnership syndicates investing in targeted housing projects, including low-income units and senior centers.
- Tenant management of rental housing in exchange for reduced rents.

Options Relating to Other Special Housing Needs

- Planned residential development zones for senior citizen housing.

- House-sharing programs and residential care centers for seniors.
- Home equity conversion programs for senior citizens.
- Programs to provide medical and housekeeping services to seniors so they do not have to move from their homes.
- Subsidized rents and operating subsidies for retirement facilities serving low-income seniors.
- Public contracts with private nonprofit organizations to provide shelter facilities for the homeless.
- Development of apartment structures with child care facilities for single-parent households.
- House-sharing programs for the poor.
- Emergency shelter and transitional housing for the homeless.
- Property tax postponement and/or relief for such groups as senior citizens and the disabled.

Government restrictions, regulations and other public and private policies

- Elimination of overly restrictive and cumbersome building permit processes.
- Liberalization of rent control in areas where housing stock is inadequate, including temporary exemption of new or rehabilitated housing units from rent control.
- Restrictive targeting of rent control benefits to low-income households.
- Greater flexibility in housing construction codes.
- Inclusionary zoning and density bonus zoning.
- Zoning policies that protect open space and encourage less costly housing, such as cluster homes and zero-lot lines.
- Land acquisition and donation by government entities for specific types of housing developments.
- Interest-free construction loans, including revolving loan accounts, for builders of selected types of housing.
- State housing trust funds, financed with dedicated revenue sources such as real estate transfer taxes, recording fees and developer charges.
- Nonprofit housing trust funds, financed through private contributions using mechanisms such as an income tax "check-off" system.
- Use and local acceptance of low-cost construction technologies such as modular, prefabricated and othermanufactured housing products.
- Use of public and private pension funds to invest in residential mortgages.
- Special tax benefits to financial institutions providing housing financing, including tax credits in exchange for low interest loans to targeted homebuying groups.
- Prohibition of new sewer and other utility hookups if the housing elements of local plans are not being adhered to.
- Stricter requirements for local housing elements to be consistent with actual existing local housing needs.
- Greater coordination between the housing policies of neighboring localities and consistency of these with regional housing needs.
- Greater consistency of local housing-related policies with local goals and policies regarding air and water quality, transportation and waste management.
- Revision of property tax laws so that newly constructed or purchased units do not pay a disproportionate tax burden relative to other units.