CALIFORNIA HOUSING

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CALIFORNIA FACES IMMEDIATE AND LONG-TERM HOUSING CHALLENGES

California is still experiencing the aftereffects of the most recent housing bubble, and the long-term challenges of housing California's population haven't gone away. The housing bubble, which inflated and popped over the past decade, has left the state with a foreclosure problem and large losses of construction jobs, which accounted for 6 percent of California's jobs when housing prices were at their peak (according to the California Employment Development Department).

Despite falling far below their peak, housing prices remain high in most of California. The perennially high cost of housing reflects the fact that people and businesses are willing to pay far more to be in California than almost anywhere else in the U.S.; it also reflects the barriers to building new housing in California. But the high cost of housing makes California unaffordable to many households and too expensive for many businesses, which pay rent or mortgages for their own space and also need to pay workers enough so they can afford to live here. In both the short and the long term, California's economic performance and livability depend on its housing market.

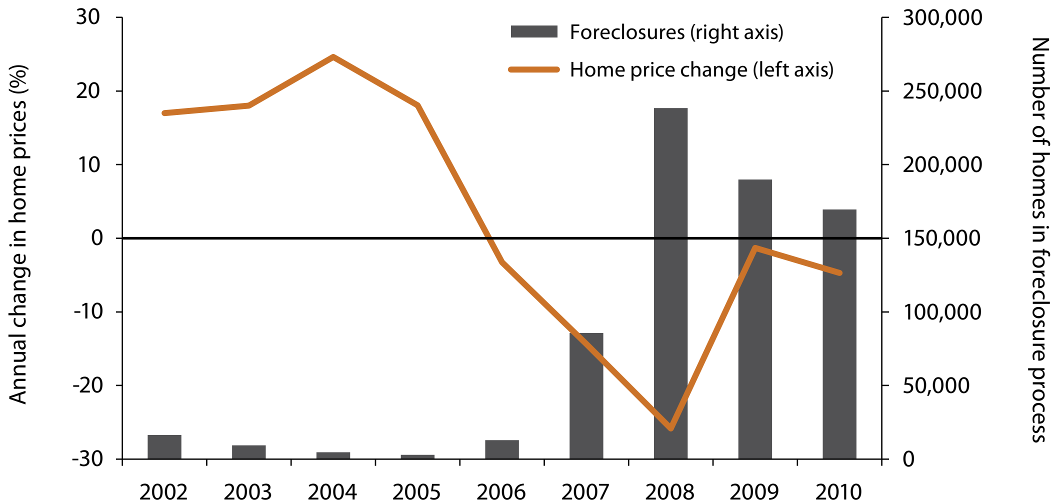
THE HOUSING BUBBLE AFTERMATH IS FAR FROM OVER

The housing price bubble and its deflation in the century's first decade helped trigger a national recession and global slowdown. Prices rose and fell more in California than in most of the country. The state is slowly emerging from the crisis, but prices remain at or near their post-bubble lows, construction remains slow, and 32 percent of mortgaged residential properties are "underwater" (worth less than the amount owed), according to CoreLogic.

- **Home prices in California are down 43 percent from their bubble-era peak.**
  After growing rapidly earlier in the decade, home prices peaked and then fell slightly in 2006, fell sharply in 2007 and 2008, and fell modestly in 2009 and 2010. At the end of 2010, the average home price in California had returned to its end-of-2002 level. Nationally, home prices have fallen 15 percent from the peak in the second quarter of 2007. California's prices are no longer falling much faster than national prices: in 2010 California's decline of 4.7 percent was only slightly worse than the national decline of 4.0 percent.

- **Foreclosures remain high, and new construction remains low.**
  Falling prices, combined with rising unemployment and resetting interest rates for adjustable mortgages, have led to very high foreclosure rates. Foreclosures skyrocketed in 2007, peaked in 2008, and have remained high in 2009 and 2010 (RAND/DataQuick and RealtyTrac). In January 2011, only Arizona and Nevada had higher foreclosure rates. Falling prices have also discouraged new construction: new residential construction permits fell from around 200,000 annually from 2003 to 2005 to tens of thousands annually from 2008 to 2010, according to Department of Housing and Urban Development (HUD) data.

AS HOME PRICES FELL, FORECLOSURES TOOK OFF



SOURCES: Federal Housing Finance Agency; RAND/DataQuick.

- **Coastal metropolitan centers have fared better than inland California.**
  During the post-bubble years, home values declined less steeply in San Francisco (18%) and San Jose (21%), as well as in Orange County (28%) and Los Angeles (29%). And in 2010 prices rose slightly or held steady in those areas. At the other extreme, prices fell 41 percent in Sacramento, 45 percent in the Inland Empire, and more than 50 percent in the Central Valley metropolitan areas of Stockton, Modesto, and Merced. Not surprisingly, foreclosure rates have been higher in these inland areas. In the Inland Empire, for instance, the foreclosure rate from 2006 to 2010 was nearly four times that of Los Angeles and Orange Counties.

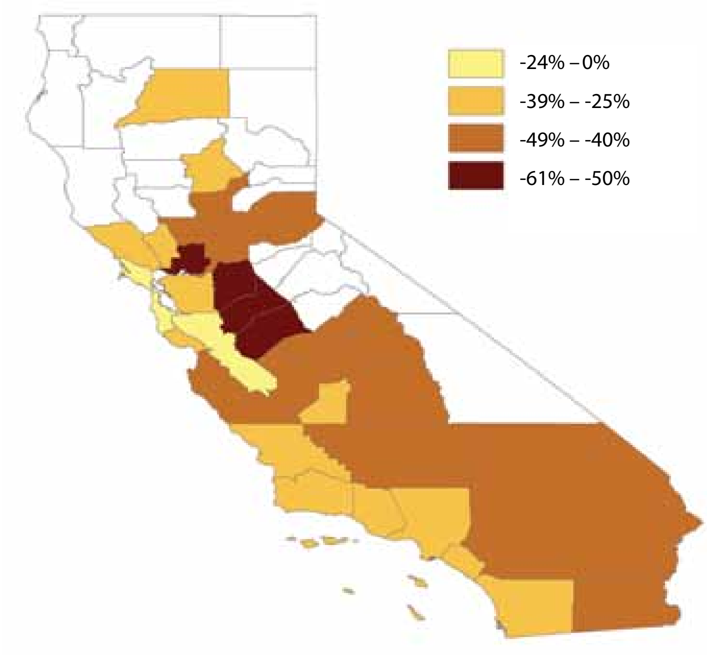
DESPITE THE BURSTING OF THE BUBBLE, HOUSING IS EXPENSIVE AND THE MARKET IS TIGHT

Falling prices make housing more affordable, but this silver lining is thin. Housing in the parts of California where most people live remains expensive by any measure, and rents have actually risen (in nominal terms) during the crisis.

- **In most of California, housing remains expensive.**
  Even after years of prices falling more in California than in the U.S., housing remains far more expensive here than elsewhere. The average home in California was 1.8 times more expensive than the U.S. average in December 2010, according to Zillow. Since 2000, average prices in California ranged from 1.6 to 2.3 times the national average. These price gaps remain even after accounting for differences in housing characteristics between California and other states.

- **Housing is dense relative to other states.**
  California is often thought of as the epitome of sprawl, but its housing density is 35 percent above the national average and rising. Census data show that the Los Angeles and San Francisco metropolitan areas have the second- and third-highest residential density in the U.S., after New York, while San Jose and San Diego are also in the top ten. High density goes hand in hand with high prices: where real estate is expensive, developers build upward and more closely together, and people are willing to live in less space. California's population density is heightened by its household structure: the typical California household has 2.1 adults and 0.7 children, as compared to the national average of 1.9 adults and 0.6 children.

HOME PRICES HAVE DECLINED MORE STEEPLY INLAND THAN ON THE COAST



SOURCE: Federal Housing Finance Agency.
NOTES: Cumulative percentage change, local price peak to fourth quarter 2010, not seasonally adjusted, from FHFA "all transactions" series. No data available for white areas.

- **Rents are high and rising.**
  Rental units account for 43 percent of California's occupied housing stock, according to the American Community Survey. According to HUD, five of the ten most expensive rental markets in the U.S. are in California: San Francisco, Orange County, San Jose, Ventura County, and Los Angeles. And, unlike housing prices, typical rents were higher in 2010 than in 2006 in nearly all metropolitan areas, in nominal terms. Even more striking, since 2006 rents have risen more in the metropolitan areas with higher foreclosure rates, even though home prices have fallen more sharply where foreclosures are more widespread.

- **Vacancies are low, relative to most states.**
  High housing prices indicate that California's housing market is tight; low vacancy rates confirm this. Despite sharply falling prices in recent years and increases in vacancy rates, the residential vacancy rate in California remains among the lowest in the country. Even in the San Joaquin Valley and Inland Empire, residential vacancy rates are near the national average. The other states with the highest foreclosure rates (Arizona, Florida, Georgia, and Nevada) have among the highest vacancy rates in the U.S. In these states, foreclosure often leads to abandonment, whereas in California foreclosure more often means turnover. (Vacancy rate data are from HUD, USPS, and American Community Survey.)

LOOKING AHEAD

Housing policy in California needs to address both immediate and long-term challenges. Policies must help resolve the foreclosure crisis, fund affordable housing construction, and remove unnecessary barriers to expanding the supply of housing.

- **With the job and housing markets recovering slowly, foreclosures will continue.**
  Foreclosures displace families and can ruin access to credit, but keeping people in homes they cannot afford risks slowing down recovery in the housing and financial markets. Most housing policy is set at the federal level, and most housing financial institutions—including Fannie Mae, Freddie Mac, and the large banks—are national. However, states strongly influence the foreclosure process, and the hardest-hit states including California have received federal money to help underwater borrowers. With these tools, the state should do what it can to help struggling homeowners who can potentially afford their homes and to speed up the foreclosure process for homeowners who can't.

- **Funding for affordable housing is threatened.**
  Affordable housing construction in California is funded partly through redevelopment agency set-asides and general obligation bonds. Redevelopment might be eliminated as part of the fiscal year 2011–12 budget, and continued state budget troubles raise the cost of borrowing and limit the scope for authorizing and issuing new general obligation bonds. If it wants to support affordable housing construction, California needs to establish new funding mechanisms.

- **Regulations help keep housing prices high.**
  Why is housing so expensive in California? Many people and industries are willing to pay a premium to be in California, keeping demand high. At the same time, the supply of new housing is constrained both by geography and regulation. Most of populated California is nestled against the ocean, the Bay, or the mountains—natural barriers to construction. And California has unusually strong land use and building regulations, especially in the major coastal cities, which curtail construction and keep prices high. California cannot move the mountains or fill the ocean, but it can tackle some of the regulations and related rules and fees that contribute to high housing prices.

We invite you to dig deeper at ppic.org.
Related PPIC resources include:
The California Economy: Housing Market Update
Housing in California
California's Newest Homeowners: Affording the Unaffordable
Urban Development Futures in the San Joaquin Valley

Contact a PPIC expert:
Jed Kolko

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PPIC | PUBLIC POLICY INSTITUTE OF CALIFORNIA

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

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

www.ppic.org

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