5 reasons California's housing costs are so high

CALmatters, by Matt Levin, May 3, 2018

Why are California housing costs so high? At its most basic level, it's a story of supply and demand; lots of people want to live here, and there aren't enough homes to go around.

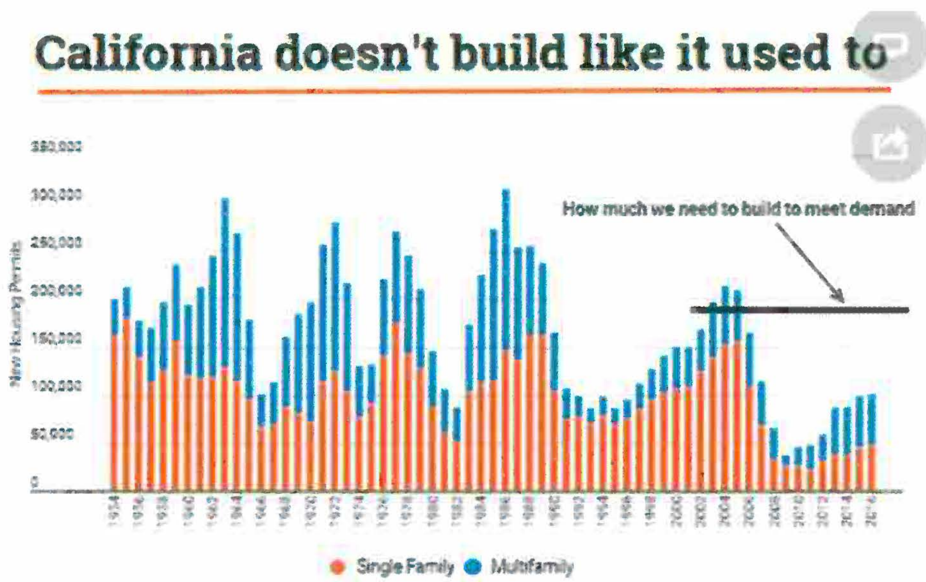
But there are lots of uniquely California factors--from the shape of our coastline to Prop 13 — that have attached a painfully expensive price tag to the California dream. The median price of a home is now well over half a million dollars — that number is about $240,000 nationally. More than 20% of Californians pay more than half their income for housing.

Here are five reasons the state's housing market got so out of whack.

1. WE HAVEN'T BUILT ENOUGH HOUSING

Experts who study California's housing crisis argue about lots of things. Is rent control good or bad? Will that new shiny high-rise going up in your neighborhood help or hurt housing costs? How much should we blame "not in my backyard" NIMBYs for our problems?

But there is one principle the vast majority of housing experts agree on: Over the past few decades, California hasn't built enough housing to keep up with the number of people who live here. The state housing department estimates that we need to build 180,000 new housing units a year to keep prices stable. Over the past ten years, we've averaged less than half of that.

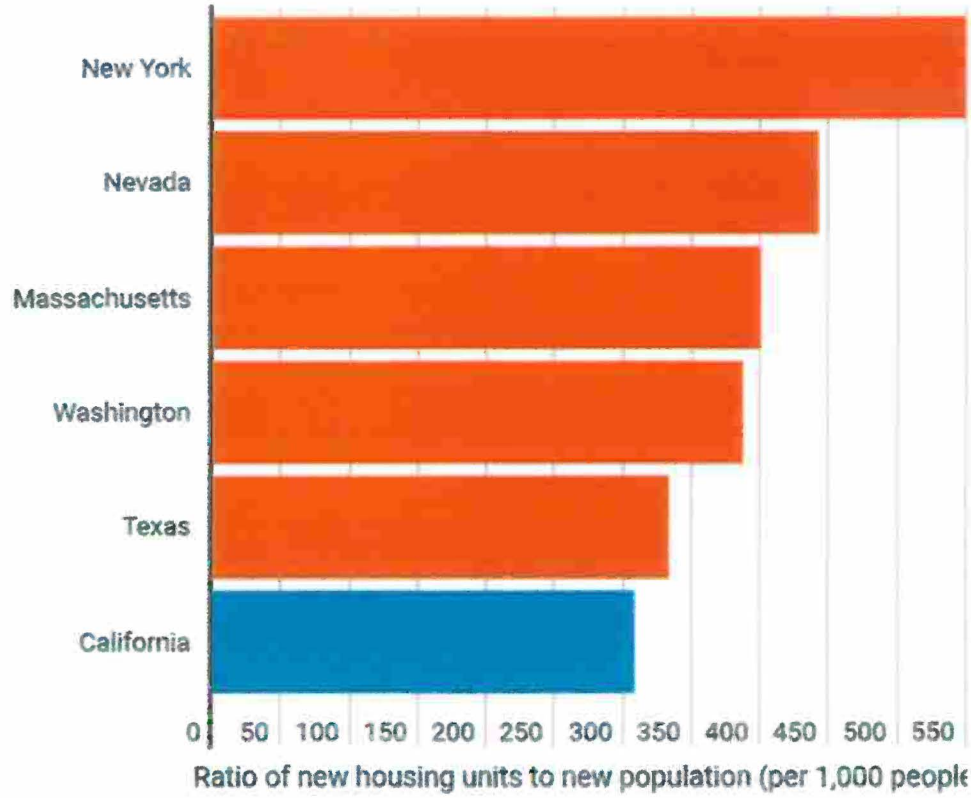


Source: California Department of Housing and Community Development

Even when new construction was booming in the early and mid 2000's, new homes and apartment buildings weren't being built in coastal cities where the vast majority of Californians work. While places like the Inland Empire and Central Valley saw a building craze, places like San Francisco and Los Angeles basically flatlined.

We're also not keeping up with other states.

Places like New York and Massachusetts have built a lot more housing per capita than we have in recent years. That hasn't made those places cheap, but it has helped to alleviate some cost pressures.

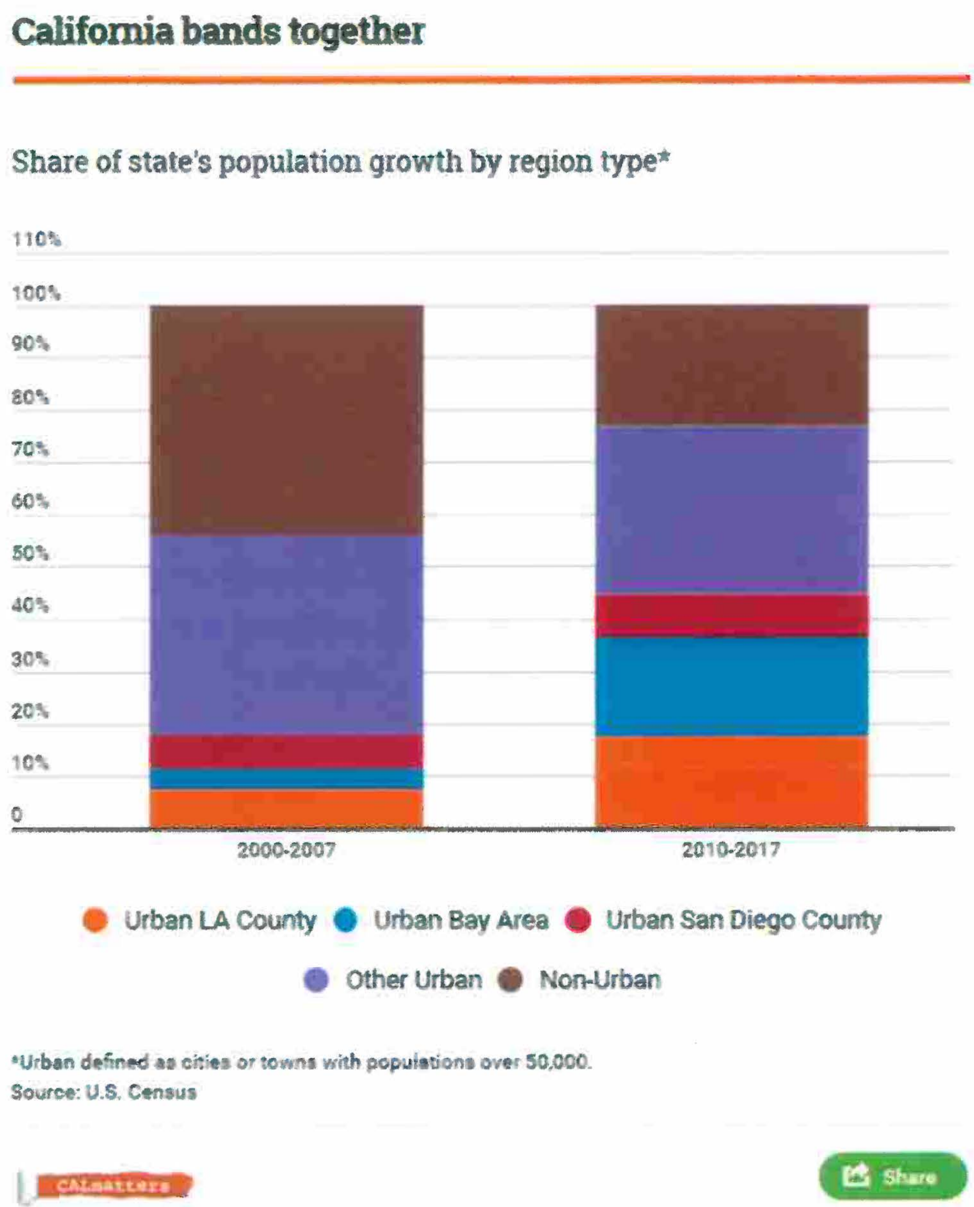


Source: McKinsey Global Institute

2. DEMAND IN URBAN AREAS HAS REACHED A BREAKING POINT — AND PART OF THAT IS GLOBAL

Over the last decade, Californians have increasingly tried to cram themselves into major urban centers that are already jammed with residents.

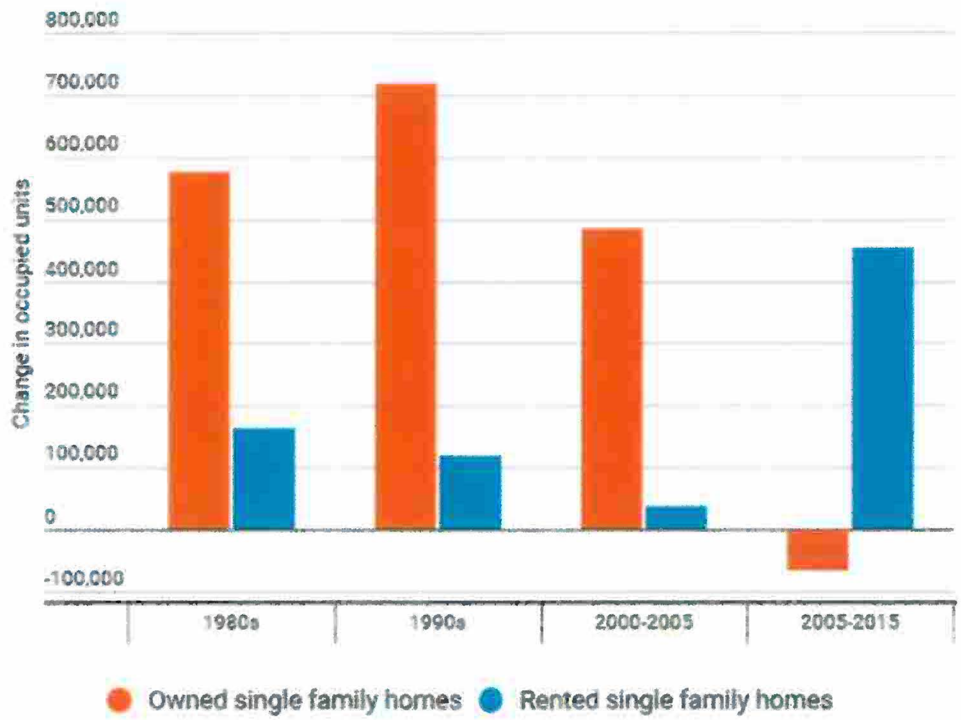
The Bay Area is the poster child here. Between 2000 and 2007, Bay Area cities accounted for only four percent of the state's total population growth. Between 2010 and 2017, nearly 20 percent of all new Californians were either being born in or moving to the Bay.



While the tech industry certainly bears much of the responsibility for that trend, the increased demand to live in California's urban cores extends beyond Silicon Valley. The urban parts of L.A. and San Diego have all seen a major increase in people wanting to live and work there, which means increased competition for rental housing.

And we're not just talking about apartment rentals. Here's a pretty amazing graph.

The rise of single-family rentals in California



Source: Public Policy Institute of California

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Share

The number of single family homes occupied by renters grew by more than 400,000 over the last ten years, while the number of owner-occupied units dropped during the Great Recession and has yet to recover.

So who owns these houses? The vast majority are "mom and pop" investors and wealthy individuals buying one or two additional properties. Foreign buyers, primarily from China, have also become increasingly enamored with California real estate. Last year, nearly one in four California single family homes were sold in all-cash transactions, an indication of investor appetite for California real estate.

Overall, investors are a relatively small part of the housing market, especially when viewed from a statewide lens. But in certain local markets, investors compete directly with California families for homes.

3. PROP 13 DILUTES A CITY'S INCENTIVE TO BUILD NEW HOUSING

Why hasn't California built enough housing to keep up with its population?

Most housing researchers agree that part of the reason is Proposition 13, the landmark 1978 ballot initiative that capped how much local governments could collect from property taxes. While intended to protect California homeowners from unmanageable property tax bills, Prop 13 has produced a host of unintended consequences.

Imagine you're a city, sitting on a huge plot of vacant land. You could zone that land for housing or for commercial use, like a hotel or a Target. Your city obviously needs more housing--prices are sky high.

Easy decision, right?

Nope.

Prop 13 has made development decisions much more complicated. Because property taxes are capped, local governments have become increasingly reliant on other revenue sources. That vacant land is much more valuable to the city's coffers if a big box retailer gets built on it, as opposed to a multifamily apartment building. Housing nerds call this the "fiscalization of land use."

There's debate about just how much Prop 13 is to blame for the state's housing shortage. But talk to local elected officials and you'll see the issue isn't just a hypothetical dilemma.

4. GETTING NEW HOUSING APPROVED IS DIFFICULT AND EXPENSIVE

It can be hard to be sympathetic to developers. From time immemorial, it feels like they've complained about rules and regulations they say make it harder to build their projects. The builder who designed Stonehenge probably thought there was too much bureaucracy involved.

While it may be tough to trust developers, that doesn't necessarily mean that they're wrong. The process by which a piece of land is approved for new construction can be incredibly cumbersome, time-consuming and risky. While good data on exactly how much this adds to housing costs is hard to come by, typical approval time for projects in San Francisco is over a year, while in L.A. it's eight months. That doesn't include when land needs to be "rezoned" for residential development, which can take even longer.

Why the lag? Here's the laundry list.

- **Multiple Layers of Government Review**: A housing project often must go through multiple government agencies, including the planning department, health department, fire department, building department and perhaps most importantly, a city council.
- **Lots of Avenues for "Not In My Backyard" Voices**: The review process for new developments gives ample opportunity for local residents to express their opposition. Locals may fear that new housing projects will change the character of their neighborhoods, increase traffic and hurt their property values. If a city councilmember votes for new housing, he or she may have to face dissatisfied voters.
- **An Often Misused Environmental Law**: The California Environmental Quality Act, or CEQA, requires that local agencies consider the environmental impact of a new housing development before approving it. That sounds like a worthy goal, but the law has often been abused to prevent new developments — even environmentally friendly ones with high-density housing and bike lanes. According to the nonpartisan Legislative Analyst's Office, CEQA appeals delay a project by an average of two and a half years.
- **Local Growth Controls**: Two-thirds of California coastal cities and counties have adopted policies that explicitly limit the number of new homes that can be built within their borders or policies that limit the density of new developments. Subtler growth controls include not zoning enough land for new development or requiring supermajorities to approve new housing.

5. LAND, LABOR AND RAW MATERIAL COSTS ARE HIGH — AND RISING

Unfortunately, California's coastline topography makes it more expensive to build here than most other places. Also, there's the ocean. You can't expand into the ocean.

Limited land plus tons of demand means high land prices. In many markets in California, the bulk of a single family home or apartment building's value is in the land it is built on.

But while the land itself is what typically eats up most of a developer's budget in California's hottest markets, it's not the only cost-driver. Construction labor and the cost of the raw materials have been rising over the last five years, and are higher in California than other parts of the country. According to the Legislative Analyst's Office, construction labor is about 20 percent more expensive in major California cities than in the rest of the country.

On the labor side, a shortage of skilled construction workers bears much of the blame. When the housing market crashed in the late 2000's, construction workers left the industry in droves. And those same workers haven't come back.

Construction today just doesn't seem to have the same appeal to younger workers. Firms are struggling to recruit younger workers to supplement and eventually replace a graying workforce.

Building codes and environmentally-friendly design requirements in many California cities require different types of raw building materials to be used, some of which can be pricier than elsewhere in the country. And nationwide, the cost of vital resources like lumber and concrete are on the upswing.

There are plenty of reasons beyond the five we've mentioned here that help explain why California housings costs have gotten so out of control. The task of making California affordable again--or at least relatively affordable again--defies a simple silver-bullet solution.

CALmatters' Ben Christopher contributed to this report.

The California Dream series is a statewide media collaboration of CALmatters, KPBS, KPCC, KQED and Capital Public Radio with support from the Corporation for Public Broadcasting and the James Irvine Foundation.