THE RALPH & GOLDY LEWIS CENTER FOR REGIONAL POLICY STUDIES
UCLA SCHOOL OF PUBLIC AFFAIRS

The State of Southern California's HOUSING

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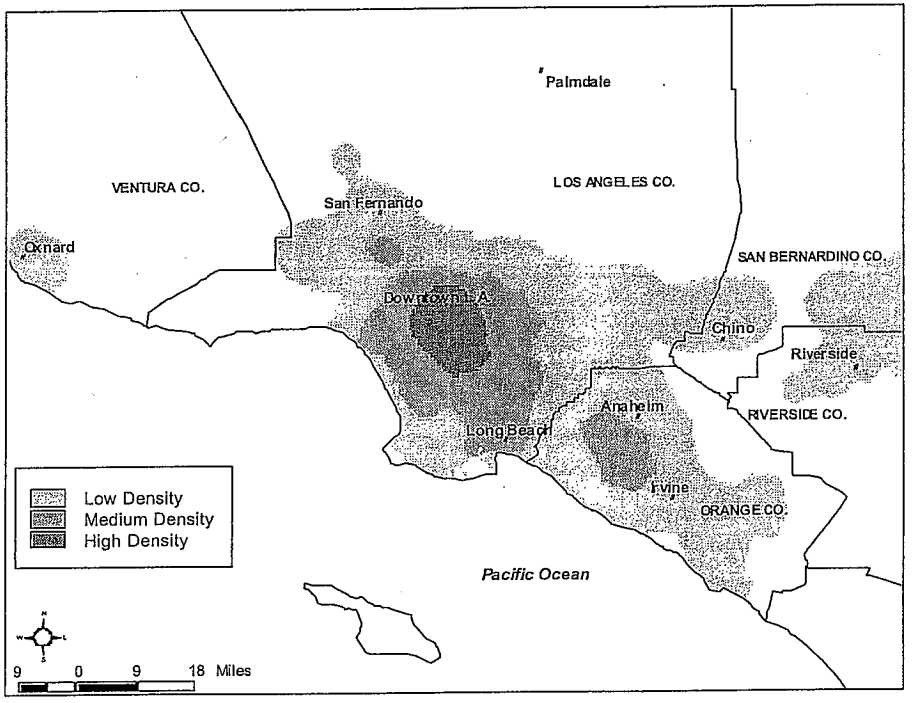
Section 1: Introduction

This report contains the findings from an analysis of Southern California's housing sector, which has been fundamentally shaped by sustained long-term growth over the last half century. The population in the five-county region (Los Angeles, Orange, Riverside, San Bernardino, and Ventura) more than doubled from 7.8 million in 1960 to 16.4 million in 2000, making Southern California the second largest metropolitan region in the nation. This population is spread over 33,955 square miles; however, much of the land is comprised of open spaces that are sparsely populated. The vast majority of the population (13.6 million) is concentrated in the 2,182 square miles of urbanized areas.[i] The geographic distribution of the population by density is shown in Figure 1.1.

The emergence of Southern California as a mega-metropolis has been accompanied by growing pains in terms of high housing costs that discourage homeownership and create a heavy financial burden on both renters and owners. The costs have escalated to such a level that the media has proclaimed that the region is suffering from a housing affordability crisis that threatens the economy and quality of life. How to address the housing problems is now a major policy debate. This report contributes to the public discussion by examining this region's housing trends, patterns, and challenges.

Figure 1.1: Population Density Southern California, 2000



As Section 2 discusses, the current housing crunch in Southern California is a product of long-term influences on the housing market from 1960 to 2000. An analysis of the data from the decennial censuses shows tremendous variation by decades. Homeownership rates, housing prices, rents, housing cost burdens, and overcrowding rates were fairly similar in Southern California and the U.S. in 1960. Things began to change during the 1970s, a period marked by stagnant income but rising housing prices. Although housing production was high in the 1980s, population growth was also at its highest point. During the 1990s population growth dropped off considerably, but so did housing production and housing prices. Despite the decade-to-decade differences, the long-term trend is best characterized as a secular increase in the cost of housing relative to income. The net result is an inability of this region to keep pace with the improving home ownership rate for the nation. As a result of the heavy financial burden of housing cost, many are squeezing themselves into small quarters; consequently, over crowding is substantially more prevalent in Southern California than in the rest of the nation. The segment most adversely affected by the high housing cost is the poor.

In recent years, the problem of affordability has reached what many consider a crisis level. Section 3 examines the short-run fluctuation of Southern California's housing market over the last business cycle. While the housing market suffered a dramatic collapse during the early 1990s, increasing housing demand since the late 1990s has been driven by population growth, increasing personal income, and declining interest rates. Unfortunately, housing supply has not been as responsive to the changes in macro-economic factors, in part because the construction industry has adopted a strategy of building new units only after they have secured buyers. The relative unresponsiveness of supply in the face of increasing demand has pushed real estate prices to record highs and decreased the number of households that can afford to purchase a home. The upward pressure on prices has also spilled into the rental market, and one visible impact is a decrease in residential choice for low-income families.

Section 4 examines whether the recent rapid housing appreciation in Southern California is sustainable in the near future. Over the last seven years, prices in real dollars have increased 80%, with the rate of appreciation accelerating over the last year. The escalation is not unique to this region, although the magnitude here is noticeably higher than for the U.S. as a whole. Three factors have contributed to the recent surge in Southern California: 1) the lowest mortgage rates since the 1960s; 2) increasing demand from a growing population and rising income; and 3) tight short-term supply of new housing. However, the recent appreciation of prices is not sustainable because the interest rate is not likely to remain so low and the supply of new housing is more elastic in the long run. The region will likely experience some downward correction in the price of housing, although not as severe as the decline during the first half of the 1990s. Although these developments may provide some relief to the current housing crunch, any correction will not significantly alleviate the long-run problem of low homeownership rates in this region.

Housing is a critical element in the region's economy, affecting the ability of businesses to recruit and retain workers. The higher housing cost makes Southern California less attractive. Section 5

compares those who moved into the region with those who moved out of the region. Interestingly, there is little difference in earnings, indicating that Southern California does not offer any significant advantage in terms of higher pay for most people. However, those who move out of the region are more likely to become homeowners, largely because housing is less expensive elsewhere. Despite the disadvantage in housing affordability, people do continue to move to Southern California because it offers other advantages (such as its climate) and jobs, and because social networks continue to chain migration into the region. However, any future significant increase in housing cost will chip away at these advantages.

Public policy has an impact on the availability of housing, particularly affordable housing. This can be seen in Section 5, which examines local barriers to housing production as cities fail to support housing development. Multifamily housing production, in particular, has dropped considerably throughout the region (as well as statewide and nationwide) since the 1970s, and is particularly scarce in many affluent cities, which limits residential choice for low-income families. Willingness to fund affordable housing development has increased over the past thirty years, but the siting of low-income housing continues to encounter local resistance (NIMBYism). While state and federal policy supports the effort to have all local jurisdictions provide their fair share of low-income housing, current laws and regulations have not been particularly effective. Moreover, state and federal housing funds appear not to be effectively targeted to areas with the most low-income households. The implication is that the region needs to formulate more effective policies and programs to help increase the supply of affordable housing, particularly in the jurisdictions that have few such units.

Policy Options

Given the trends and problems identified in Sections 2 to 5 of this report, it is not surprising that a number of recent studies have proclaimed that Southern California, along with the state and the nation, is facing a major housing affordability problem.[ii] Documenting the magnitude of the problems is, however, easier than identifying points of effective policy intervention. The latter requires an analytical understanding of the major structural factors that determine the cost of housing.

Many of the characteristics of Southern California's housing sector are tied to its large size, and this can be seen in the fact that this region shares some similarities with the two other mega-regions in the U.S. Statistics for the U.S. are included for comparison. The regions in Table 1.1 are consolidated metropolitan statistical areas (CMSAs), the official geographies designated by the Bureau of the Census for large regions. The statistics come from the 2000 decennial census, which counted 21.2 million persons in the New York CMSA, 16.4 million in the Southern California CMSA, and 9.2 million persons in the Chicago CMSA. Together, these three regions house about one-fifth of the nation's total population. As a relatively younger region, Southern California had a higher growth rate than the other two more mature regions during the 1990s.

The mega-regions are large because they have an economic base that can attract people. They have human, social, public, and natural resources that give them a comparative advantage. Economies of scale (greater efficiency associated with concentrating production in one location) and

agglomeration effects (greater economic efficiency from geographic proximity of inter-related firms) strengthen that comparative advantage. Moreover, the basic industries that are part and parcel of a region's comparative advantage generate jobs in other industries (the multiplier effect). Because of these factors, the median household income in the largest metropolitan areas tend to be higher than for the nation as a whole.

Despite higher incomes, home ownership rates in the two largest metropolitan areas are noticeably lower than the national rate, due primarily to the higher cost of housing. As the largest CMSA, New York has the highest average home value, but Southern California is not far behind. In both regions, the median value of a house is about four times as great as the median household income, while the comparable figure for the nation is less than three times. Consequently, the home ownership rate is 11 to 12 percentage points lower than the national rate. Rental housing is also considerably more costly in New York and Southern California than in the nation. The one housing indicator where Southern California deviates from New York is in the percent of households residing in over crowded conditions, defined as housing units with more than 1.5 persons per room. The rate in this region is three times higher than that in New York. The two regions have nearly identical housing costs, but Southern California has a lower average income.

Table 1.1. CMSA and National Statistics

	Southern California CMSA	New York CMSA	Chicago CMSA	United States
Key Population Characteristics				
Growth Rate, 1990-2000	13%	8%	11%	13%
Median Household Income	$45.9k	$50.8k	$51.0k	$42.0k
Housing Outcomes				
Home Ownership Rate	55%	53%	65%	66%
Over Crowding	12%	4%	3%	3%
Median Home Value	$203.3k	$203.1k	$159.1k	$119.6k
Median Gross Monthly Rent	$733	$740	$659	$602
Urban Form				
Housing Density in Urbanized Area	2,101	2,042	1,490	1,073
Percent Single-Family Homes	53%	40%	51%	60%
Percent in 10+ Unit Buildings	20%	29%	18%	13%

Source: U.S. 2000 Census

Housing costs are high in Southern California and the other two mega-regions because of high land prices. The relationship between the two can be seen in Figure 1.2, which plots estimated average land cost per square feet and median housing value for 26 metropolitan areas.[iii] Urban land has value when it provides geographic access to desirable destinations such as employment centers.[iv] Firms and individuals are willing to pay for closer proximity to these sites because the location lowers the cost of travel and transport. The demand for spatial access is capitalized as land value.

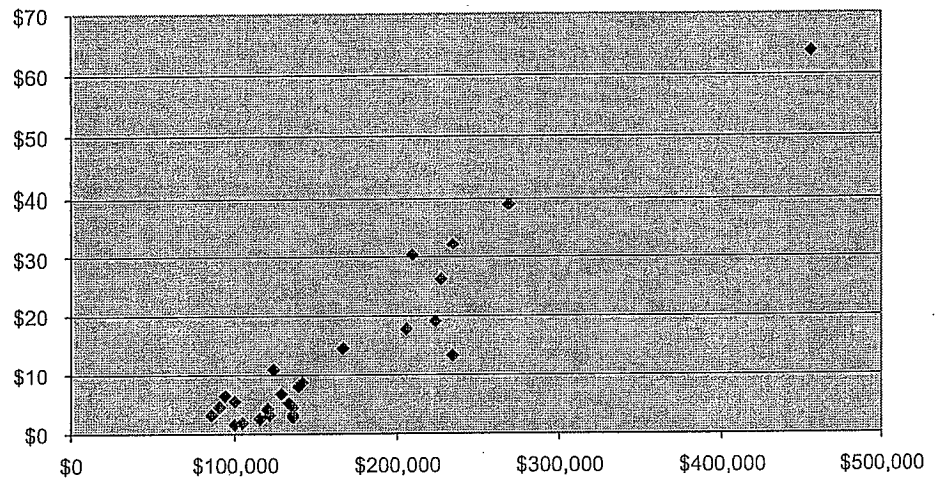
Two fundamental factors influence the price level of urban land. The first is population size. A large population means more competition for land and higher land prices. A metropolitan area accommodates a larger population and higher land value by expanding outward and building upward. This

can be seen in the statistics for the three regions. Housing density in the urbanized core of the three regions is about one and a half to over two times as great as for the nation as a whole.[v] Vertical density is manifested in terms of relatively fewer single-family homes and higher concentration in buildings with 10 or more units. The second factor is the intra-metropolitan cost of travel, particularly the opportunity cost associated with travel time. Consequently, for a metropolitan area, the level of traffic congestion influences the average land cost. [vi]

Along with the two basic structural determinants, there are also the myriad of other factors that adversely affect the housing market. The list compiled from existing studies includes, but is not limited to, regulatory constraints (restrictive zoning and no-growth and slow-growth limitations), lack of developable land, poor transportation planning, lack of regional coordination, changes in the construction and building industries, new liabilities facing developers, and increasing development fees. These causal factors contribute to the decline in affordability and amplify the recent cyclical increase in housing prices.

There is also an equally long list of recommendations to address the housing problems. Although it is beyond the scope of this report to evaluate the recommendations, the findings from the above analysis of land cost and the analyses in Sections 2 to 5 provide some insights and precautionary notes about what are reasonable expectations. The high land value associated with the region's large size imposes a structural floor on how much the cost of housing can be lowered on the long run. Many of the underlying causes of the extreme short-run swings in housing prices are macro-economic factors that are not amendable to local and regional interventions. Even when there are opportunities for local and regional action, there is no single panacea given the complexity of the housing market and its interactions with other sectors. A piecemeal approach may produce unintended outcomes that could cause other problems such as increasing urban sprawl, exacerbating congestion, and further damaging the environment. These limitations, however, should not be accepted as reasons for inaction.

Figure 1.2: Land Value and Housing Value

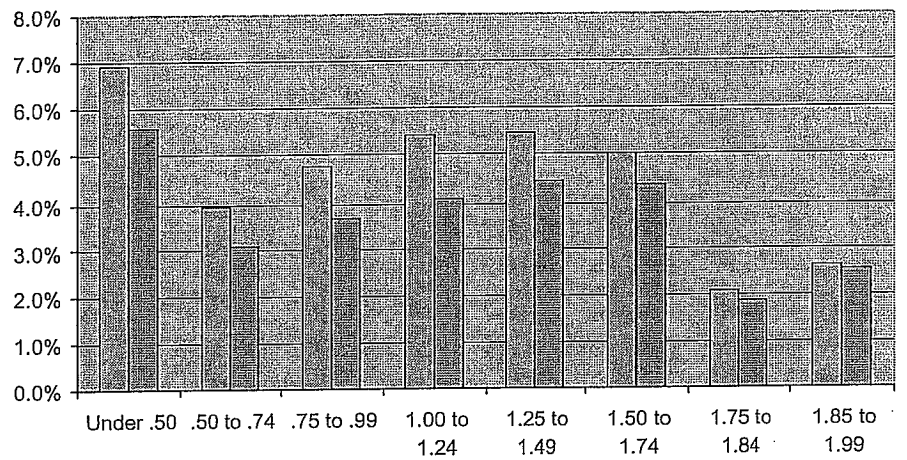


Source: See Endnotes

Addressing the complexity of Southern California's housing problems requires a more comprehensive and coordinated strategy. Ideally, the region should simultaneously lower the cost of travel through congestion relief, increase the supply of developable land in the urbanized area, and allow for higher density development. Congestion relief requires a combination of improving the road network and increasing carpooling and ridership on public transit. Facilitating in-fill development would provide a source of land for additional housing in Southern California.. At the same time, it is important to ease the restrictions on building multi-family units and allow for more housing development close to major employment sites. These changes will not produce immediate results, but then again, the problem also did not materialize overnight.

While attenuating the overall cost of housing would benefit everyone, the region faces another housing problem because of its income inequality. Low-income families have been particularly hurt by the high cost of housing. Southern California has a disproportionately large number of people living in low-income households. According to the 2000 Census, the poverty rate was 15.6% for Southern California, compared to only 12.4% for the nation.[vii] In fact, the percent of Southern Californians falling into each of the poverty levels reported by the Bureau of the Census is higher than for all Americans. (See Figure 1.3) Worse, the purchasing power of the income available to the poor in Southern California is lower because of the high cost of housing.

Figure 1.3: Percent of Population by Poverty Levels



Source: See Endnotes

The region's low-income population is not only relatively larger, its composition also differs from that of the nation. Latinos and Asians make up a majority of Southern California's poor, due in part to the relatively large number of immigrants.[viii] Foreign-born individuals comprise 31% of the population in Southern California, compared with only 11% for the nation. The availability of jobs and migration networks has made Southern California the gateway for contemporary immigration. A disproportionate number of these immigrants have very limited educations and marketable skills, and their low earnings put many of them and their families below the poverty threshold. Improving housing conditions and home ownership

rates for this population can be done in three ways. The first is to provide housing subsidies, but this is problematic because of a recent decline in state and federal funding. Moreover, even with some increase in subsidies, only a small fraction will be helped. The second approach is to eliminate institutional barriers, such as housing discrimination, lack of access to financial institutions, and local restrictions on the supply of affordable housing. The third approach is to increase the earning power of the poor. This will require providing the training and skills needed to promote the economic assimilation of immigrants. Equally important is providing quality education to the children of immigrants so they will be better equipped when they enter the labor market. Again, we should not expect immediate dramatic improvements, but pursuing these approaches should be seen as a wise investment for the future.

Clearly, the housing challenges facing Southern California are enormous, and they will become even more severe in the coming years. The region's economic and social viability will depend on the ability to address existing unmet housing needs and to produce over one and a third million new housing units for an estimated 4 million additional people by the year 2020, when the total population will be an estimated 21.8 million. Accommodating growth and addressing today's problems are daunting tasks. Many of the policy recommendations are politically difficult and economically costly to implement. The price of not acting, however, will likely leave this region worse off. A critically important step in moving forward is to have an informed public discourse on the issues. Hopefully, this report provides some useful insights to guide the formation of policies and development of programs that will improve housing for all.

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[i] According to the Bureau of the Census, an urbanized area (UA) or an urban cluster (UC) are densely settled territory, including "core census block groups or blocks that have a population density of at least 1,000 people per square mile," and "surrounding census blocks that have an overall density of at least 500 people per square mile."

[ii] California Budget Project. 2002. *Locked Out 2002: California's Affordable Housing Crisis Continues*; John Landis. 2000. *Raising the Roof: California Housing Development Projections and Constraints 1997-2020, Statewise Housing Plan.* Report prepared for California State Department of Housing and Community Development and University of California, Berkeley, Institute of Urban and Regional Development; Guerra, Fernando J., Mara A. Marks, and Harold Brackman. 2001. *Rebuilding the Dream: A New Housing Agenda for Los Angeles.* The Center for the Study of Los Angeles, Loyola Marymount University; Housing Crisis Task Force. 2000. *In Short Supply*, Los Angeles, Ca.; Joint Center for Housing Studies of Harvard University. 2003. *The State of the Nation's Housing*.; Landis, John D., Land Deng, and Michael Reilly. 2002. "Growth Management Revisited: A Reassessment of its Efficacy, Price Effects, and Impacts on Metropolitan Growth Patterns." Working Paper 2002-02. Berkeley: University of California, Institute of Urban and Regional Development; Myers, Dowell, and Julie Park. 2002. "The Great Housing Collapse in California." Fannie Mae Foundation; *Report of the Housing Trust Fund Committee*. November 2002. Los Angeles, Ca.; Southern California Association of Governments. 2001. *Housing in Southern California: A Decade in Review.*

[iii] The data on land prices comes from Edward L. Glaeser and Joseph Gyourko, "The Impact of Building Restrictions on Housing Affordability," *FRBNY Economic Policy Review*, June 2003, pp. 21-39; and the data on median housing value comes from Summary File 3 of the 2000 Census. The simple correlation coefficient for the two variables is .95, which is statistically significant at the $p<.0001$ level. Eliminating the outlier (New York) produces a correlation of .89, which is also statistically significant at the $p<.0001$ level.

[iv] For a general discussion on land prices (also known as Ricardian rent), see Richard Muth (1969), *Cities and Housing*, Chicago:

University of Chicago Press.

[v] The housing density for Southern California covers three urbanized areas: 1) Los Angeles-Long Beach-Santa Ana; 2) Riverside-San Bernardino; and 3) Oxnard. The housing density for the other two CMSAs covers only the largest single urbanized area in each. The largest single urbanized area in Southern California is the Los Angeles-Long Beach-Santa Ana area, and its density is 2,395.30.

[vi] An ordinary least-squares linear regression model is used to test and separate the influence of population size and intra-metropolitan travel cost on land prices. Data on estimated land prices come from Edward L. Glaeser and Joseph Gyourko, "The Impact of Building Restrictions on Housing Affordability," *FRBNY Economic Policy Review*, June 2003, pp. 21-39. Data on population size comes from the 2000 Census for urbanized areas, which cover one or more contiguously populated metropolitan areas. Travel costs are approximated by the congestion measure developed by the Texas Transportation Institute. The dependent variable is the log of land cost per square foot. The number of observations is limited to the 27 areas with estimated land prices. The results indicate that each factor has an independent impact. The estimated coefficient for population size is statistically significant at the $P<.02$ level, and the estimated coefficient for congestion is statistically significant at the $P<.0001$ level. The adjusted R-square value for the model is .69. Two alternative models are used to test the robustness of the results. The first uses the land cost without transformation as the dependent variable, and the second excludes New York. In both models, the estimated coefficients are statistically significant.

[vii] Those in poverty are defined as people living in families or individuals with an annual income below the federal poverty line (FPL). The FPL was developed in the 1960s and is roughly equal to three times the minimum cost of purchasing food that meet the nutritional requirements established by the Department of Agriculture. The FPL is adjusted annually by the inflation rate, but there is no adjustment for geographic differences in the cost of living. In 1999, the poverty line for a family of four was approximately $17,029. The exact figure varies slightly based on the family composition. For further information see www.census.gov/hhes/poverty/threshld/thresh99.html

[viii] Shannon McConville and Paul Ong, "The Trajectory of Poor Neighborhoods in Southern California, 1970-2000," the Brookings Institution's Center on Urban and Metropolitan Policy, and the UCLA Ralph and Goldy Lewis Center for Regional Policy Studies, November 2003, 18 pages.

Section 2: Long Term Housing Trends in Southern California

This section examines the long-term trends in homeownership rates, housing costs, housing cost burdens, housing production, and crowding rates in Southern California between 1960 and 2000. California and U.S. housing data are also examined for comparison. The three major findings are

- A remarkable increase in home values over the last three decades, combined with much slower rates of income growth, has led to lower rates of homeownership than in the rest of the nation, as well as a tremendous increase in housing cost burdens.
- While renters do not appear to have experienced quite the same degree of high cost burdens, the impact of an expensive housing market on renters has been reflected in very high levels of overcrowding.
- The most likely explanation for continued increases in housing costs and overcrowding levels over the last three decades is tremendous population growth combined with limited levels of housing production.

Homeownership and Rental Rates

Homeownership rates in Southern California have not kept pace with U.S. homeownership rates, particularly in the decades since 1960. In 1960 Southern California homeownership rates stood at 57 percent, while nationwide homeownership rates had climbed to 62 percent. By 2000 Southern California homeownership rates remained at 55 percent, while U.S. rates had climbed further, to 66 percent. Statewide, homeownership rates also continued to hover around 56 percent over the same period.

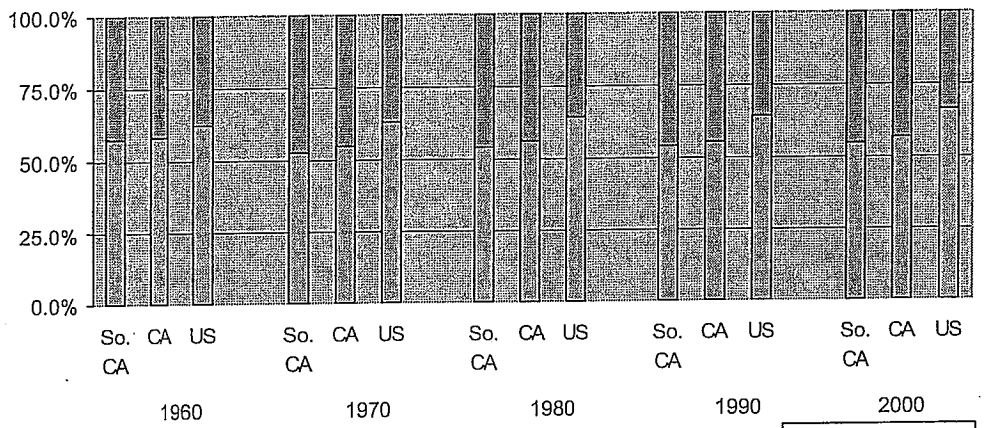
Rental units are generally the most affordable housing available to low-income households. In both Southern California and California as a whole, the proportion of housing units that are rented has remained fairly steady over the last four decades. In 2000, 45 percent of housing units in Southern California were rented. Overall, the percent of rented units in the housing market has increased only 3 percent since 1960. For the U.S. the percent of housing units that are rented has declined over the decades, from 38 percent to 33 percent. The remainder of this chapter is divided into two sections. The first focuses on homeownership, the second on multifamily and rental units.

Home Values

Median home values in Southern California rose 120 percent between 1960 and 2000. The median price of a home in Southern California was $97,500 in 1960, which was 30 percent higher than the national median. By 2000 prices had climbed to $217,000, jumping 70 percent higher than U.S. home values.[i]

After 1970 Southern California home values increased at a much faster pace than U.S. home values, with the most rapid growth occurring between 1980 and 1990.

Figure 2.1: Renter and Home Ownership Rates 1960 - 2000



Source: U.S. Census

While U.S. home values rose 40 percent between 1970 and 1980, home values in Southern California rose almost 75 percent. U.S. home values then declined slightly between 1980 and 1990, while Southern California home values continued to climb another 53 percent.

California home values also increased at a rapid pace between 1970 and 1990. Home values in Southern California have been fairly consistent with home values statewide over the past four decades, except in 1990 when Southern California home values rose to $298,000, outpacing California's median home value of $274,000. Home values then declined in the 1990s in both areas. Median home values for the U.S. followed a different pattern, declining slightly in the 1980s and rising again in the 1990s.

Housing Cost Burdens for Homeowners

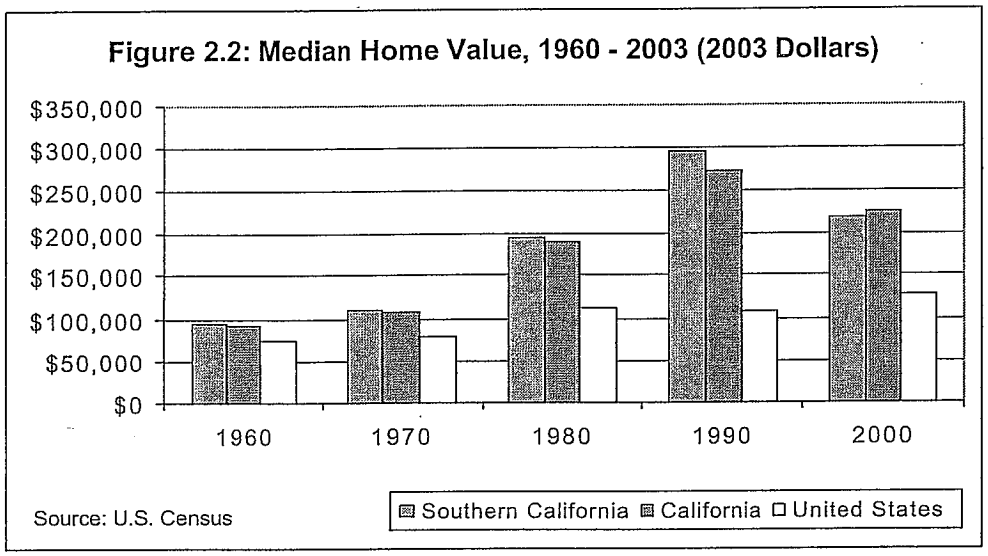
During the 1960s income was rising much faster than home values in Southern California as well as in the rest of the nation. By the 1970s income growth had slowed considerably while home values soared. Between 1970 and 1980 income growth in Southern California was only 1 percent while home values rose 73 percent. During the 1980s income growth was slightly higher, at 10 percent, but home values again rose more quickly – another 53 percent. A brief recession in the 1990s slowed both income and home value growth, but the slowdown did little to lower cost burdens.

We looked at home values as a percent of median family income to determine the change in housing cost burdens since 1960.

Table 2.1: Incomes and Home Values, Percent Change Over Time

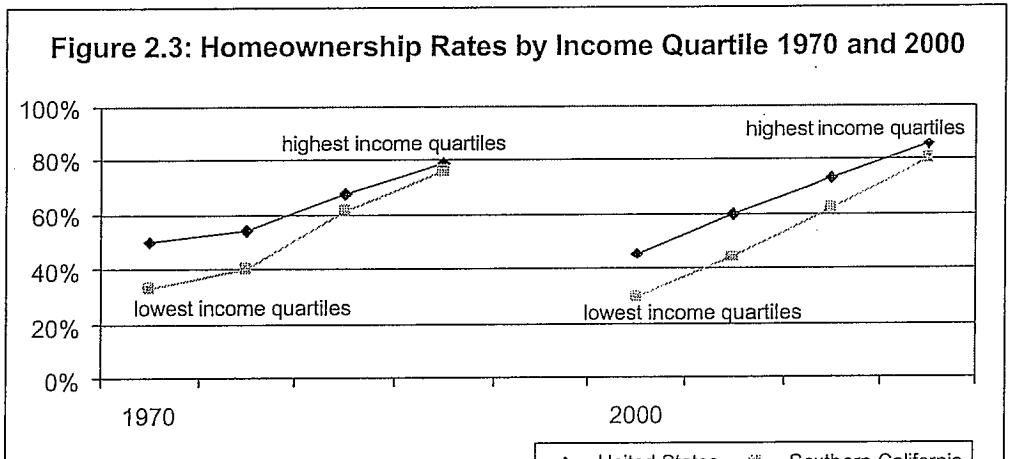
Income - Percent Change	1960-1970	1970-1980	1980-1990	1990-2000
Southern California	27%	1%	10%	-8%
California	27%	1%	10%	-3%
United States	34%	5%	4%	6%
Home Values - Percent Change	**1960-1970**	**1970-1980**	**1980-1990**	**1990-2000**
Southern CA	16%	73%	51%	-26%
California	17%	72%	45%	-17%
United States	9%	42%	-4%	16%

Note: Percent increases are in real terms.
Source: U.S. Census



(The median is the midpoint – half of the families in the region earn more than the median and half earn less.) Dividing home values by median family income provides a ratio that indicates how much cost burdens have increased over the last four decades. In 1960 home values were 230 percent of median family income in Southern California. By 2000 they were almost 400 percent of median income, while nationally home values were only 230 percent of income. The highest cost burdens in Southern California occurred in 1990 when home values rose to almost 500 percent of median income. (Statewide, cost burdens have followed the same trajectory as in Southern California).

Low-income families are most adversely impacted by the high cost of homeownership. This can be seen in an analysis of homeownership by income quartile in Southern California and the U.S as a whole. (Income quartiles break down the income range into four equal parts indicating the top 25 percent of income earners, the 25 percent of high-middle income earners, the 25 percent of low-middle income earners, and the bottom 25 percent of income earners). As expected, those in the lower quartiles are less likely to be homeowners. What is most insightful is that ownership rates in each quartile are lower in Southern California than in the U.S. For the two lowest income quartiles home-ownership rates in the U.S. are 16 percentage points higher than in Southern California. Notably these differences were about the same in 1970, though the homeownership rates



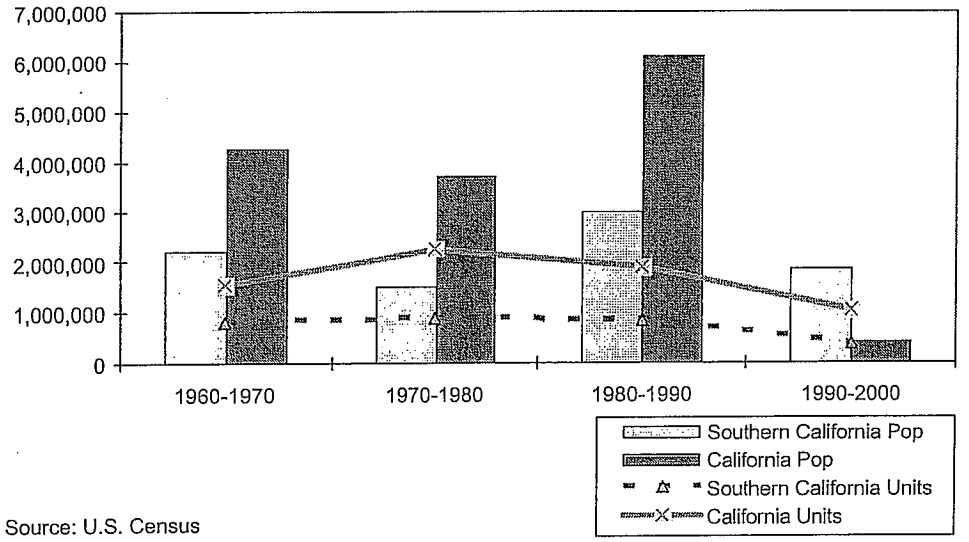
for these income groups dropped about four percentage points over the past thirty years in both the U.S. and in Southern California. In the two top income quartiles home-ownership rates have climbed in both areas, but U.S. gains have outpaced the Southern California region. At the top income level, where discrepancies between the two areas are smallest, the difference in home-ownership rates between the U.S. and Southern California grew from 3 percent in 1970 to 6 percent in 2000.

Housing Production

Housing production was calculated in two ways: as the total increase in housing units each decade, and also as the number of housing units added per unit of population increase. Production of new housing units in Southern California has dropped off considerably between the 1960s and 2000, in terms of both net units added and net units added per unit of population increase. The big drop in terms of number of housing units (net) was experienced during the 1990s. Between 1950 and 1960, there was a net increase of over 1 million housing units in Southern California. Between 1990 and 2000 the region netted only 385,000 housing units. However, during the 1960s, 1970s, and 1980s between 800,000 and 900,000 units were added each decade, so the real drop in production occurred in the 1990s. When measured in relation to population growth, however, production levels were similar in the 1980s and 1990s.

Southern California has experienced tremendous population growth since 1960. Between 1960 and 2000 the population in the region jumped from 7,750,000 to 16,375,000, an increase of 110 percent. California experienced similarly large population increases over the same time period, while in the U.S. population growth between 1960 and 2000 was only 60 percent. The two largest waves of population growth in Southern California occurred in the 1960s and 1980s. In the 1960s the population increased 29 percent over the previous decade. In the 1980s population growth was 26 percent higher than in the 1970s. By the 1990s population growth had slowed to about half of 1980 levels, increasing by only 13 percent. Thus, although half as many housing units were built in the 1990s than the 1980s,

Figure 2.4: Population and Housing Unit Increases By Decade, 1960 - 2000



Source: U.S. Census

lower population growth resulted in similar per capita production in 1990 and 2000. In 2000 Southern California was adding just .21 housing units per unit of population increase, and California was adding .25 units, down from a high of .60 units in both areas in 1980. Nationwide, housing unit production hit a high of .85 units in 1980, but that number had also dropped by half in 2000.

Production of single-family units in Southern California peaked in 1980. The region was producing .25 units of single family housing per capita in 1980. That number declined to .16 in 1990 but went up slightly to .18 units in 2000. U.S. housing numbers showed a similar pattern of decline, down from .45 units per capita in 1980 to .32 in 2000, but unlike in Southern California, population growth nationwide was higher in the 1990s than 1980s. Production of single-family housing (in relation to population growth) was at its lowest point in Southern California, California, and the U.S. by 2000.

Homeowner Crowding

Overcrowding has become a major problem in Southern California over the past four decades. Overcrowding is mostly a problem for renters. However, among homeowners, crowding levels have increased significantly since 1960. We looked at crowding using the standard of 1.0 person per room as well as a higher standard of 1.5+ persons per room.The rate of overcrowding among homeowners in Southern California jumped from 7 percent in 1960 to 11 percent in 2000, which is three and a half times higher than the national rate of crowding among homeowners. Crowding at the higher level of 1.5 persons per room jumped from 1.3 percent in 1960 to almost 6 percent in 2000. Nationwide this level of crowding actually dropped from 2 percent to 1.2 percent over the same time period.

Some of the overcrowding in Southern California is explained by immi-gration and ethnicity. Hispanics, who do tend to have larger families, are most affected by overcrowding. In Southern California 21 percent of Hispanic homeowners live in very crowded conditions (1.5+ persons per room) versus only 11 percent of Hispanics in the U.S. Crowding rates for homeowners of other ethnic groups in Southern California is only slightly higher than for the U.S. as a whole.

Rental Prices

Rental prices in Southern California have not increased to quite the same degree as home values, most likely because of various rent control and rent stabilization policies some cities have in effect. However, rents have increased considerably since the 1960s and in Southern California the annual median gross rent rose from $6,050 in 1960

Table 2.2: Homeowner Overcrowding By Ethnicity

1.0+ persons per room	ASIAN	BLACK	WHITE	HISPANIC
United States	14%	5%	2%	21%
California	16%	6%	4%	31%
Southern CA	17%	7%	6%	35%
1.5+ persons per room				
United States	6%	2%	1%	11%
California	7%	2%	2%	18%
Southern CA	7%	3%	3%	21%

Source: U.S. Census

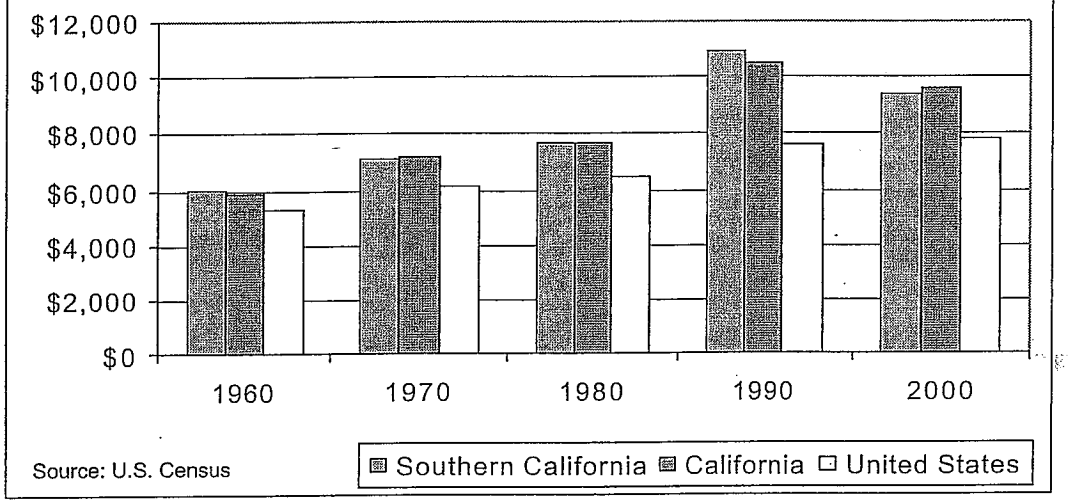
to $9,400 in 2000 (2003 dollars).

Rental prices in Southern California climbed steadily between 1960 and 1980, then jumped steeply between 1980 and 1990. The median gross rent in Southern California increased 45 percent in the 1980s, with monthly rents climbing from over $600 in 1980 to over $900 in 1990. Rents statewide and in Southern California peaked in 1990, and then declined. Rents in both areas have been consistently higher than rents for the U.S. as a whole, with the greatest disparity occurring in 1990. Rents in the Southern California region in 2000 averaged just under $800.

Rental Cost Burdens

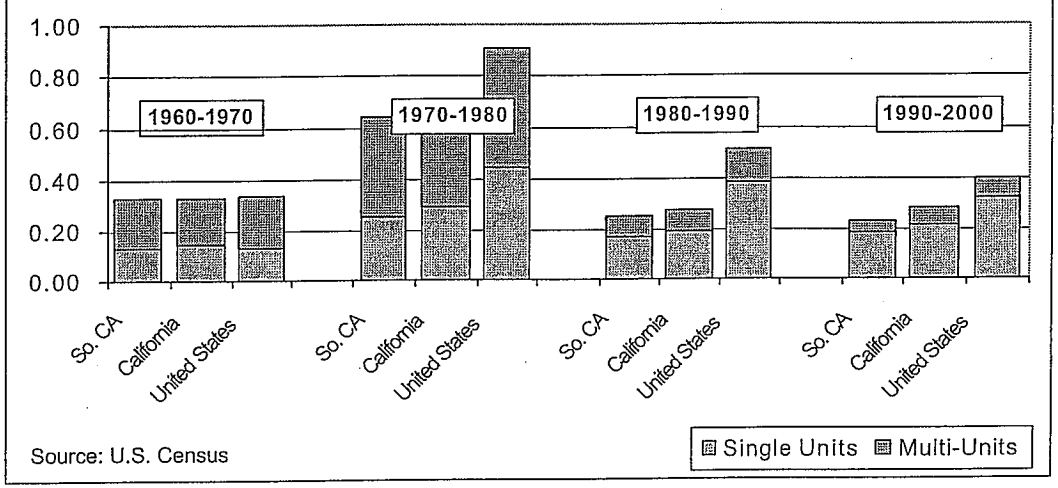
We estimated rental cost burdens by dividing annual gross rents by the 25th percentile of income in each region. We used this figure as renters tend to have lower incomes than homeowners do. While rental burdens were actually higher in the U.S. than in Southern California in 1960, (29 percent and 27 percent, respectively), by 2000 rental cost burdens in Southern California had risen to 37 percent, versus 32 percent for the U.S. as a whole. Rent burdens jumped significantly between 1980 and 1990, rising

Figure 2.5: Median Gross Rent Annually, 1960 - 2003 (2003 dollars)



Source: U.S. Census

Figure 2.6: Single and Multi-Units Per Capita Added Over Each Decade, 1960-1970 through 1990-2000



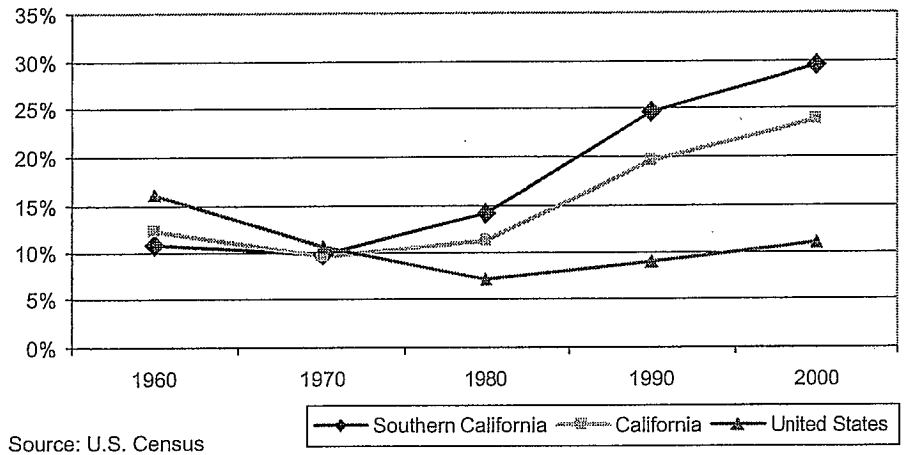
Source: U.S. Census

from 31 percent to 38 percent in Southern California and the state as a whole, and rising from 30 percent to 34 percent nationwide. Thus, rental cost burdens were actually higher in 1990 than 2000.

Rental Housing Production

In Southern California the percent of new rental units increased greatly between 1960 and 1970, but has declined significantly since then. The percentage of newly built rental units in Southern California jumped from 40 percent to 50 percent between 1960 and 1970, but by 2000 it had dropped to 36 percent. (In California the percentage of new rental units also peaked around 1970, then slowly declined thereafter). The percentage of rental units built in the U.S. has also dropped over time, from a high of 37 percent in the 1970s and 80s, to a low of 25 percent in 2000. The data on multifamily housing units indicate that production of these units declined dramatically in Southern California between 1980 and 2000. Census data also indicates that the production of multifamily housing units has declined in California and the U.S. as well, but in relation to population growth it appears that the largest drop took place between 1980 and 1990. In Southern California the number of multi-unit structures added per unit of population increase dropped from .33 in 1980 to .12 in 1990. In California the drop was even greater. Multifamily housing production in the U.S. dropped after 1980 as well, but less drastically than in California in relation to population growth. The result of such large population increases and production shortages in the region has been increasing levels of overcrowding.

Figure 2.7: Percent of Renter Occupied Households with More Than 1 Person Per Room, 1960 - 2000



Source: U.S. Census
Note: 1960 Southern California data do not include Ventura County.

Renter Crowding

Overcrowding has become a significant problem for renters over the last four decades. Overcrowding levels have almost tripled since 1960, jumping from 10 percent to 30 percent. The percent of more severely overcrowded rental units (1.5+ persons per room) increased more dramatically, up from 3 percent in 1960 to 20 percent in 2000. Statewide overcrowding also increased, to a high of 24 percent in 2000. By contrast, the percentage of crowded rental units in the U.S. dropped between 1960 and 1980, then rose again slightly, ending at 11 percent in 2000. More severe overcrowding rates have remained roughly the same since 1960.

Among renters, Hispanics are most overcrowded; 56 percent of Hispanic renters live in crowded conditions in Southern California, versus 36 percent in the U.S. as a whole. Using the standard of 1.5 persons per room crowding is still high: 41 percent of Hispanics live in overcrowded conditions in the region, versus 22 percent nationwide. The large Hispanic population in Southern California, which includes many new immigrants as well as larger families than other ethnic groups, drives some of the high crowding numbers among renters, but crowding rates in the region are also higher for all other ethnic groups. For example, thirteen percent of white renters in Southern California live in crowded conditions versus three percent in the U.S. as a whole. So while some of the crowding is due to the nature of the population in Southern California, the lack of affordable housing has clearly had an impact on the rental market.

CONCLUSION

Southern California began experiencing an affordability crisis in the 1970s as home values began to outpace incomes in the state, and this crisis continues today. Income continues to lag behind housing costs, leading to high cost burdens both in Southern California and throughout the state.

Many policymakers have questioned whether the housing crisis in California is a housing problem or an income problem. It is clear that over the last two decades production of housing units has not kept pace with population growth, which has contributed to the housing crisis. The data indicate that multifamily housing production dropped off steeply after 1980 and all housing production dropped off after 1990. There have been many possible explanations for the drop in housing production, including the effects of federal tax reforms, high land prices, and property tax restrictions, but at this point there is no definitive explanation. It is clear that with limited land supplies in the region production will not be able to meet demand if strong population growth continues. In the meantime, the dwindling supply of, and the continued demand for, housing, will continue to drive up prices and lead to continued overcrowding, both of which will take a heavy toll on the region's low and moderate income households.

Table 2.3: Renter Overcrowding by Ethnicity, 2000

1.0+ persons per room	ASIAN	BLACK	WHITE	HISPANIC
United States	28%	12%	6%	36%
California	35%	17%	15%	51%
Southern CA	36%	18%	19%	56%
1.5+ persons per room				
United States	17%	5%	3%	22%
California	23%	8%	9%	36%
Southern CA	23%	9%	13%	41%

Source: U.S. Census

[i] For home values cited here we used "specified owner occupied units" for comparability over time. In 2000 the median home value for all owner occupied units in Southern California was $206,636. All values are in 2003 dollars.

Section 3: Short Term Housing Trends and Affordability

The previous section identified the long-term trends of Southern California's housing markets, but there are considerable year-to-year variations driven by short-term economic and demographic factors. This section examines the short-term trends over the last business cycle, roughly from 1989 to 2003. Although this chapter covers some of the same topics as Chapter 4, the emphasis here is on affordability. The data show that:

- The housing market in Southern California has been affected by fluctuations in the business cycle, population growth, and a significant decline in interest rates. These factors, along with changes in income, have driven housing demand.
- Housing construction has also been cyclical. A period of relative expansion has followed an initial period of contraction of the housing market in Southern California, coinciding with the early 1990s' economic recession. Despite such expansion, however, single-family and multifamily housing supply has not been highly elastic and has not kept pace with population growth.
- As a result, increasing housing costs and a decline in affordability have characterized the housing market for homeowners and renters. In general, such trends have manifested themselves differently in the various parts of the region, revealing tighter markets in Los Angeles and Orange County.

The Affordability Crisis in California

Several studies indicate that a housing crisis has affected the nation during the past decade.[i] This crisis has manifested itself through increasing affordability problems and an under-supply of housing units. Population growth has soared as a result of both natural increase and immigration, and this growth has exceeded housing production. In particular, the supply of multifamily housing has been shrinking and affordability has worsened for low-income households, especially among renters and immigrants, many of whom spend over half or more of their incomes on housing and cannot afford homeownership.

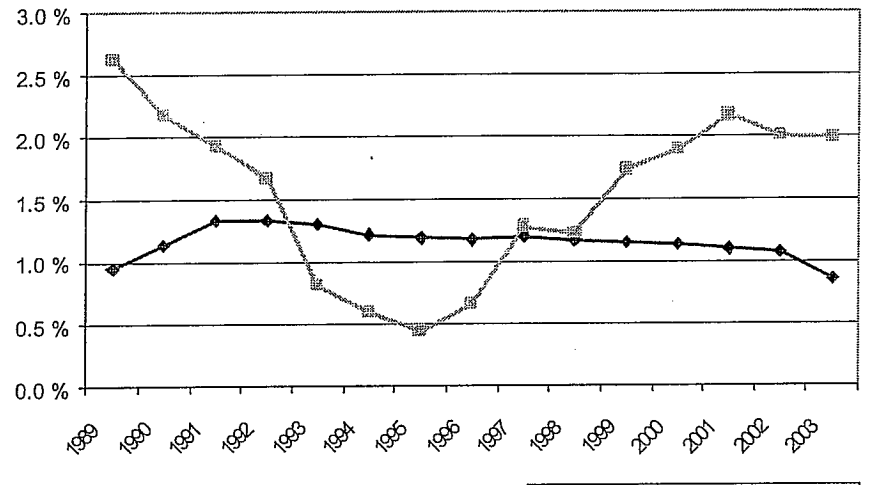
The shortage of affordable housing, however, has not been equal throughout the nation. Under-supply has been most critical along the Eastern and Western coasts, particularly in California. Here, as a result of the shortage of affordable housing units, overcrowding and severe overcrowding have reached the highest proportions compared to any other state in the nation. The severity of the housing production shortage varies in different parts of the state of California.[ii] Overcrowding problems are especially pronounced in large multiethnic urban counties like those in Southern California. Accounting for 20 percent of the national overcrowded housing units, Southern California is the most overcrowded region.[iii]

Large metropolitan areas have

experienced particularly tight housing markets, where housing affordability has declined across all income groups and homeownership rates have remained stagnant, in contrast with increasing national rates.[iv] Affordability is particularly critical in coastal areas. New home sales have decreased in Southern California compared to the late 1980s. Los Angeles features the highest percentage of households paying more than 30 percent of their income for housing in the state (45 percent) and a homeownership rate that is lower than both California's and the national average for metropolitan areas. Further, Southern California features increasing price gaps between coastal and inland areas.

Southern California counties are the fastest growing counties in the state, with Los Angeles County featuring the highest share of population growth.[v] Southern California's market for new housing units has been consistently dominated by the suburbanization of construction, with heavy consumption of land, and by larger and more expensive single-family homes at the expense of multi-family units or smaller single-family units.[vi] Given the scarcity and the high price of land in the region coupled with continuing population growth, construction of new affordable units will pose significant problems in the near future.[vii]

Figure 3.1. Annual Percent Population Change Southern California 1989-2003



Sources: Bureau of Economic Analysis; State of California, Department of Finance

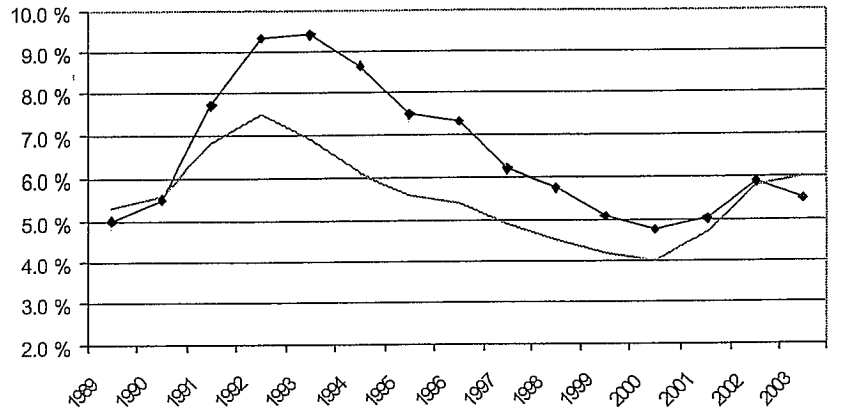
Population and Economic Trends

Southern California has experienced significant socioeconomic changes over the past two decades. The regional population has grown from 14 million in 1989 to 17 million in 2003. Compared with national trends, population growth rates in Southern California have fluctuated over time. During the early 1990s population growth in Southern California slowed down with respect to national rates, but after 1995 growth rates started to climb again. Since 1998, the population has grown at a much faster rate in Southern California than in the nation as a whole (Figure 3.1).

In general, population trends in Southern California have reflected cyclical economic variation over the past two decades, climbing during periods of economic expansion. Using unemployment rates as an

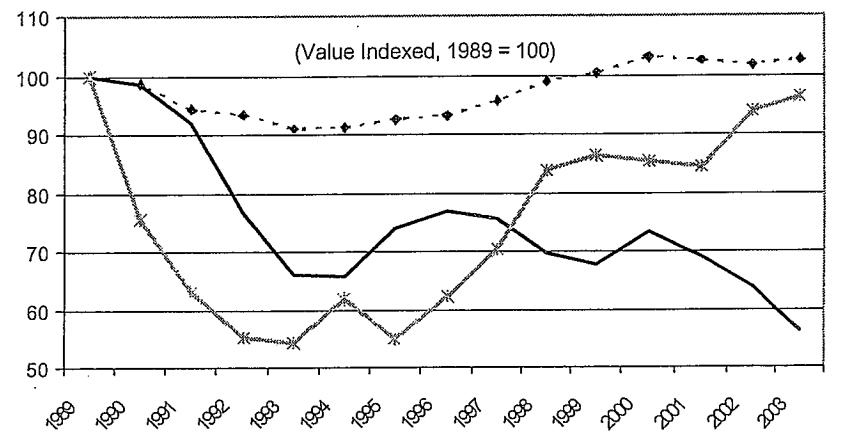
indicator of the business cycle, Figure 3.2 illustrates the depth and duration of the business cycle in the region compared with national trends. Southern California was impacted by a general economic slowdown in the early 1990s which, coupled with the simultaneous restructuring of the regional economy and labor force, and substantial cuts in defense production, manifested itself in high unemployment rates and a prolonged recession. The regional economic cycle peaked in 1988 – one year before it did for the nation as a whole – with an unemployment rate of 4.8 percent. The subsequent recession in Southern California was both deeper and lengthier than for the nation because of structural changes associated with the post-Cold War defense cuts and the devastating impact on the region's aerospace industrial complex. While the growth cycle in the country bottomed out in 1992, in the region it did not bottom out until 1993, when the annual unemployment rate reached a high of 9.4 percent. This was followed by a slow recovery. Throughout the late 1990s, unemployment in Southern California remained higher than in the rest of the nation and the gap between the national and regional unemployment rates did not narrow until after

Figure 3.2. Unemployment Rates Southern California vs. United States 1989-2003



Sources: Bureau of Labor Statistics; RAND

Figure 3.3. Economic Trends, Southern California, 1989-2003



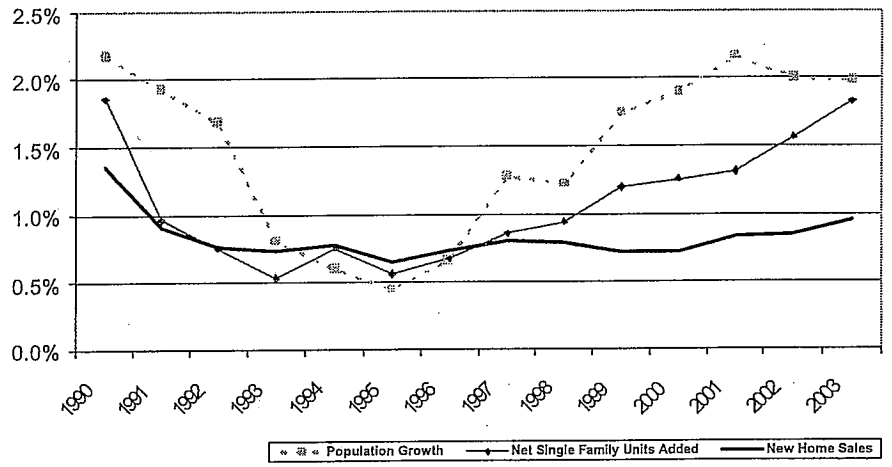
Sources: Bureau of Economic Analysis; Federal Housing Finance Board; Real Estate Research Council of Southern California.

2000. Unemployment rates in Los Angeles County, however, were still substantially higher than in the nation in 2003 – 6.6 percent compared with 5.8 percent.

Cyclical fluctuations are also clear in the trends of personal income in real terms. Per capita income has generally fallen with business cycle recessions and higher unemployment rates and climbed with an expansion. While in the nation as a whole per capita income has climbed consistently between 1989 and 2003, in Southern California per capita income dropped during the early 1990s, climbed during the late 1990s, and leveled off during the most recent recession.

At the same time, average mortgage interest rates have experienced only a moderate degree of fluctuation during the early 1990s, followed by a downward trend in the second part of the decade and between 2001 and 2002 (Figure 3.3). In 2003, mortgage interest rates reached a historic low of 5.58 percent. Periods characterized by lower interest rates have usually featured higher home sale activity and decreasing foreclosures. Home sales climbed steadily until the end of the 1990s, levelled off during the recent recession, and climbed again

Figure 3.4. Annual Changes in Housing and Population Southern California, 1989-2003



Sources: State of California, Department of Finance; Real Estate Research Council of Southern California.

starting in 2001. The increase in home sales has been particularly pronounced in Orange and Riverside Counties, where the average annual increase in home sales between 1995 and 1999 was 11 percent and 18 percent respectively, compared to 8 percent and 4 percent annually in Los Angeles and San Bernardino Counties. Similar to home sales, foreclosures have experienced a cyclical trend. The number of foreclosures climbed during the early 1990s, peaked in 1997, and declined at a fast pace throughout the remaining years.

Housing Construction

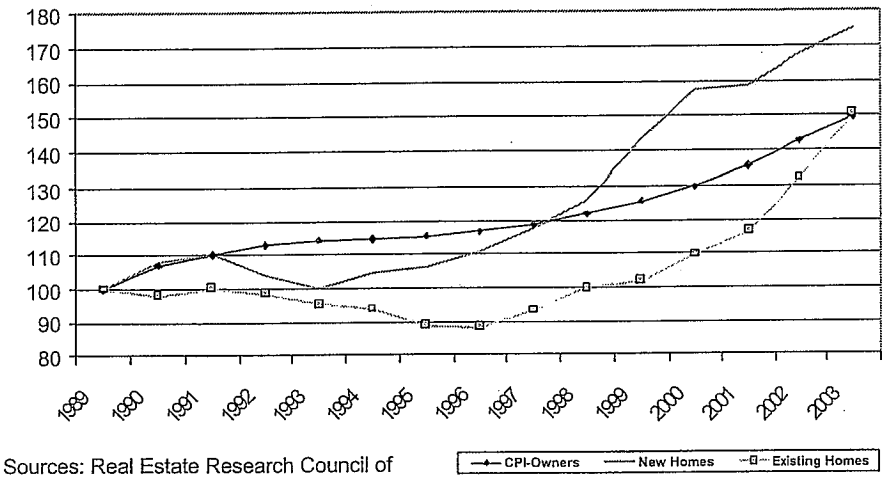
Similar to demand, the supply of housing has followed the yearly ups and downs of the regional economy. [viii] A period of relative expansion has followed an initial period of contraction of the housing market. A common measure of housing construction consists of the number of building permits that are issued annually. [ix]

After a substantial decrease in the

number of single-family housing building permits issued during the early 1990s' recession, the issuance of permits in the region has climbed consistently after 1995. Building permit activity declined from 73,000 units in 1989 to 22,000 units in 1993. Permit levels began increasing after 1995, reaching 54,000 units in 2003, which is still well below the permit levels of the late 1980s. Most importantly, despite such recovery, housing growth has not kept pace with housing demand. Figure 3.4 illustrates the trends in population growth, new home sales, and new construction, after adjusting for the estimated annual loss of housing units.

The chart shows that housing construction has not filled the gap between population growth and housing supply during the recent economic recovery. The gap is even more evident when looking at the volume of new home sales, which is an indicator of the actual housing supply, given the lapse of time that normally takes place between the issuance of building permits and the availability of new housing units for sale. In addition, according to the *Los Angeles Times*, subdivision developers have taken a cautious approach after the collapse of the building industry in the late 1980s and early 1990s, when the economic recession resulted in several uncompleted houses and vacant lots. Despite the high demand, in recent years builders have tended to put up new houses only after securing buyers.[x]

Figure 3.5. Housing Price Index Southern California 1989-2003



Sources: Real Estate Research Council of Southern California; Bureau of Labor Statistics

Home Prices and Affordability

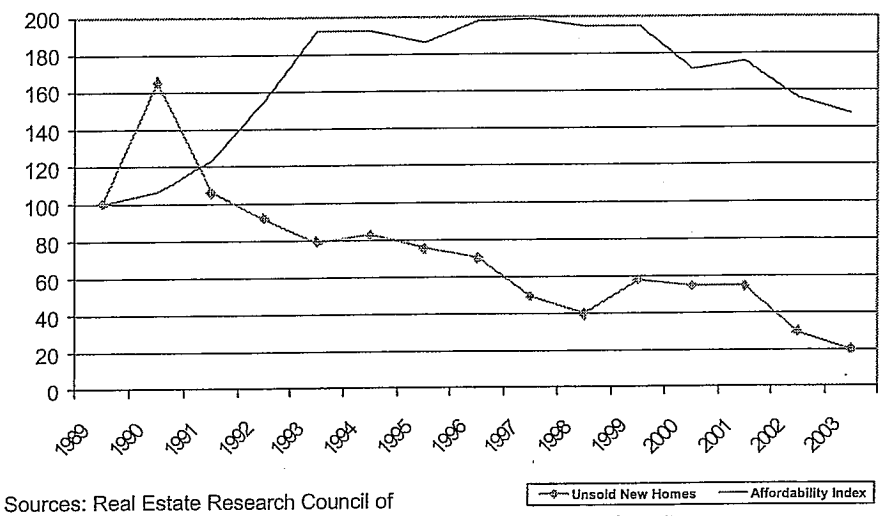
With housing demand exceeding housing production, home prices have climbed and affordability has decreased. Figure 3.5 illustrates the trends of owner expenses and sale prices of new and existing homes. During the early 1990s' recession, owner expenses climbed rapidly, then leveled off between 1993 and 1995. After 1995, housing costs quickly increased again, outpacing inflation by the end of the decade. Reflecting the trends of owner expenses and consistent with the business cycle, home sale prices, particularly for new homes, experienced a downturn during the early 1990s. Home prices reached the lowest point in 1996 – $236,000 for all homes – and then climbed steadily during the following years. Since 1999 new home prices in Southern California have escalated at a higher rate

than the local consumer price index for homeowners. Sale prices have been the highest in Orange County and Los Angeles County, where after the mid 90's recession, they have climbed at an annual average of 7 percent and 6 percent respectively, compared to an annual average increase of 5 percent and 3 percent in Riverside and San Bernardino counties. In 2003, the average price of a new home reached $450,000 in Orange County and $418,000 in Los Angeles County.

The annual affordability index indicates the percentage of households that can afford to purchase the median-priced home. Figure 3.6 shows that the trend corresponding to the affordability index is consistent with that of home prices and sales trends. The percentage of households that could afford the median-priced home increased during the early 1990s from 21 percent in 1989 to 41 percent in 1994. During the second part of the decade the regional affordability index remained stable, but it began to decline again after 1999. In 2003, only 31 percent of Southern California households could afford purchasing a median-priced home. There are, however, some differences in the affordability index trends within the region. While the housing market for home buyers in Riverside and San Bernardino has remained the most affordable over time, Los Angeles County and Orange County have been consistently less affordable than the regional average, especially after the mid 1990's recession. In particular, Orange County has featured the lowest affordability levels since 1996, and the gap between the affordability index in this county and the rest of the region has widened over time. In 2003, only 22 percent of Orange County's households could afford the median-priced home. As a result of high housing prices, prospective buyers have tended to purchase homes in the fringes of the metropolitan area, as Figure 3.7 illustrates. One exception is represented by the Downtown area, where the renovation of old buildings and their conversion into luxury apartments has attracted several home buyers in recent years.

Figure 3.6 also illustrates unsold new homes. The abrupt fall in the number of unsold homes confirms that the housing

Figure 3.6. Housing Affordability and Unsold New Homes Southern California, 1989-2003



Sources: Real Estate Research Council of Southern California; U.S. Census Bureau; California Association of Realtors

market has been particularly tight in recent years.

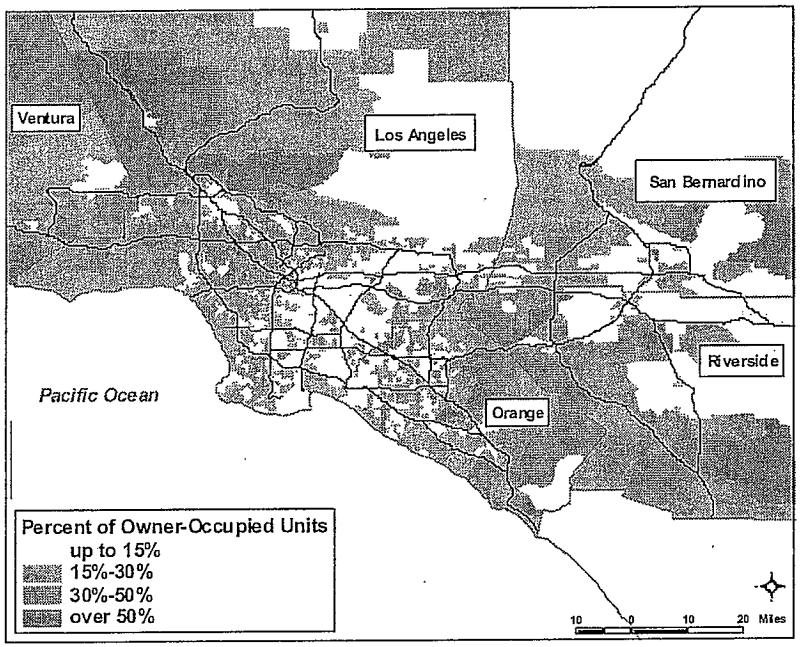
Multifamily Housing and the Rental Market

Similar to single-family housing production, the construction of multifamily units in Southern California has reflected cyclical economic variation over the past two decades. A contraction in multifamily housing production took place during the recession of the mid 1990s, as Figure 3.8 shows. The construction of multifamily units was particularly depressed in 1993, when it reached a low of 22,000. The proportion of multifamily housing construction activity, however, differed in different sub-regions. Despite a steep decline during the early 1990s recession, the proportion of multi-family housing permits has remained higher in Los Angeles County and Orange County than the regional average. In contrast with the rest of the region, in 2003 such permits accounted for over 50 percent of total construction activity in Los Angeles County.

Like single-family housing, the supply of multifamily housing has not kept pace with population growth, particularly after 2000. The shortage of rental units is even more evident when looking at rental vacancy rates, which have plummeted since the mid-1990s. In 2003, the rental vacancy rate in the region was four percent, five percentage points lower than in 1993. As the abrupt fall in vacancy rates suggests, the rental market has been particularly tight in recent years.

A major consequence of the shortage of rental units has been the increasingly higher cost of housing for renters (Figure 3.9). Rents started at a high level in 1989-1990 ($646 compared to $447 in the United States). After declining during the recession (as vacancies increased due to weak demand), real rents increased with the recovery. The average cost of shelter for renters grew faster than inflation, and by 2003 it climbed in real terms to levels equal to those observed in 1989-1990. The asking rent for vacant units increased even more rapidly, creating a greater burden on those

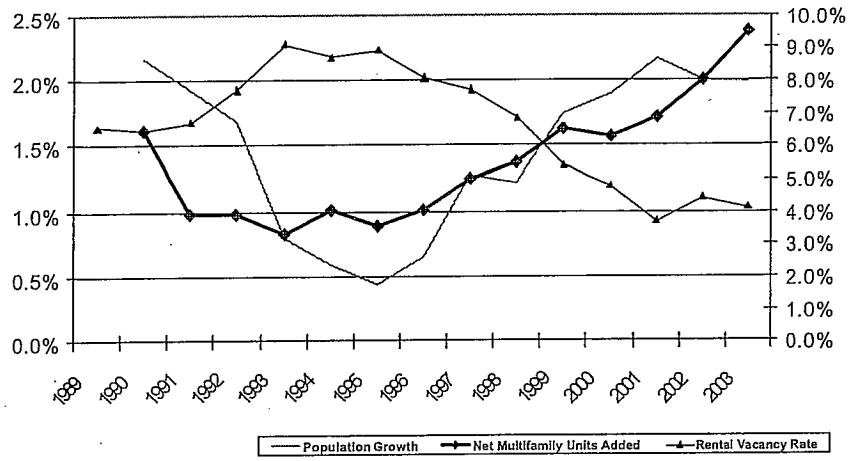
Figure 3.7: Mortgage Loan Applications Southern California (1999-2001)



moving into rental units.

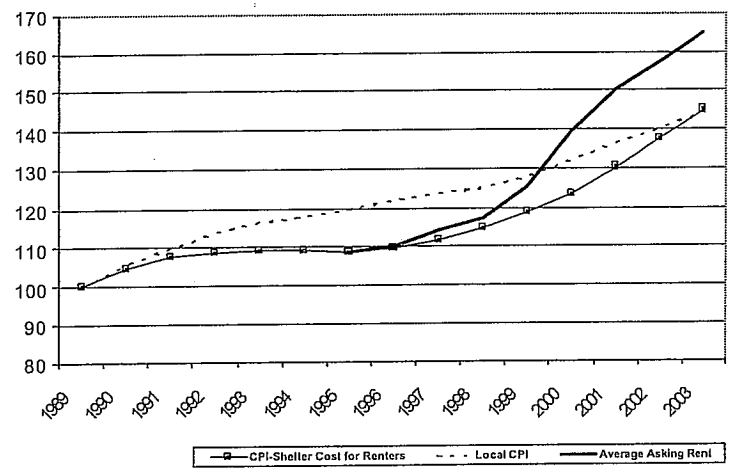
The impact of rising rental costs is felt most acutely among lower-income households. One of the consequences is a decline in residential choice. This can be seen in the locational distribution of participants in HUD's (Department of Housing and Urban Development) Section 8 program. The program subsidizes rent for low-income households, and one of its goals is to disperse low-income families away from ecomomically distressed neighborhoods. Section 8 participants are vulnerable to rapid rent increases because HUD's Fair Market Rents do not always keep up with the actual market prices. When this happens participants often have to move to lower-income neighborhoods to find units they can afford. We looked at the distribution of Section 8 participants in Southern California among low poverty neighborhoods, moderate poverty neighborhoods, poor neighborhoods, and underclass neighborhoods[xi], in 1997 and in 2002. The percentage of Section 8 participants in low and middle poverty neighborhoods dropped over the five year period, while the percentage of participants in low-income neighborhoods (poor and underclass) climbed from 50 percent in 1997

Figure 3.8. Annual Changes in Multifamily Housing and Rental Vacancy, Southern California, 1989-2003



Sources: State of California, Department of Finance; Real Estate Research Council of Southern California; U.S. Census Bureau.

Figure 3.9. Renter Costs; Southern California, 1989-2003



Sources: Bureau of Labor Statistics; Illescas 2004

to 58 percent in 2002. The number of Section 8 renters in the poorest (underclass) neighborhoods has climbed almost 40 percent over the past five years, up from 8 percent in 1997 to 11 percent in 2002[xii]. Considering that 58 percent of the total poor population of Southern California also live in poor or underclass neighborhoods the distribution of Section 8 participants is not completely out of line, but it does indicate that the Section 8 program is having a difficult time providing greater residential choice. The impact of rising rental costs on low-income families without Section 8 support is even greater, as they have to bear the entire cost of housing on their own.

In summary, the analysis in this section has shown that the trends in the housing market in Southern California during the past decade have paralleled the fluctuations in the business cycle. Housing construction during periods of economic expansion, however, has not kept pace with population growth. As the declining proportions of unsold homes and rental vacancy rates suggest, existing homes have tended to accommodate the surplus of housing demand and housing has become increasingly more expensive, especially in tight markets such as those in Los Angeles and Orange counties.

Table 3.1: Distribution of Households

Neighborhood Poverty Rate	Total Population 2000	Poor Population 2000	Section 8 1997	Section 8 2002	Percent Increase 1997 - 2002
Low Poverty	40.0	14.2	13.0	11.1	-13.9 %
Moderate Poverty	30.4	28.6	36.0	31.0	-13.0 %
Poor	25.8	45.7	42.9	46.8	10.5 %
Underclass	3.9	11.5	8.1	11.1	39.3 %

Source: U.S. Census; Department of Housing and Urban Development

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[i] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing*, 2003; Simmons, Patrick A., "Patterns and Trends in Overcrowded Housing: Early Results from Census 2000" *Fannie Mae Foundation Census Note 09* (August 2002); Lang, Robert E., "Is the United States Undersupplying Housing?" *Housing Facts & Findings* 4(2), 2002.

[ii] Department of Housing and Community Development, *Raising the Roof: California Housing Development Projections and Constraints 1997-2020, Statewise Housing Plan,* Report prepared by John Landis, Berkeley Program on Housing and Urban Policy, 2000.

[iii] Simmons, 2002, op.cit.; Department of Housing and Community Development, 2000, op.cit.; DeGiere, Gregory, *The Right Home in the Right Place at the Right Price,* California Senate Office of Research, 1999; PPIC 2004.

[iv] DeGiere 1999, op.cit.; Guerra, Fernando J., Mara A. Marks, and Harold Brackman, *Rebuilding the Dream: A New Housing Agenda for Los Angeles,* The Center for the Study of Los Angeles, Loyola Marymount University, 2001; Housing Crisis Task Force, *In Short Supply*, 2000; Tepper, Paul, and Jessica Barrett Simpson, *The Puzzle of the Los Angeles Economy: A Look at the Last Thirty Years,* Los Angeles: Institute for the Study of Homelessness and Poverty at the Weingart Center, 2003.

[v] SCAG 2003.
[vi] SCAG 2003.
[vii] Guerra et al., 2001, op.cit.; Housing Crisis Task Force, 2000, op.cit.

[viii] See also PPIC 2004.

[ix] This measure, however, is not perfect in that it may not reflect actual construction.

[x] Peltz, James F., "Made to Order," *Los Angeles Times*, June 3, 2004.

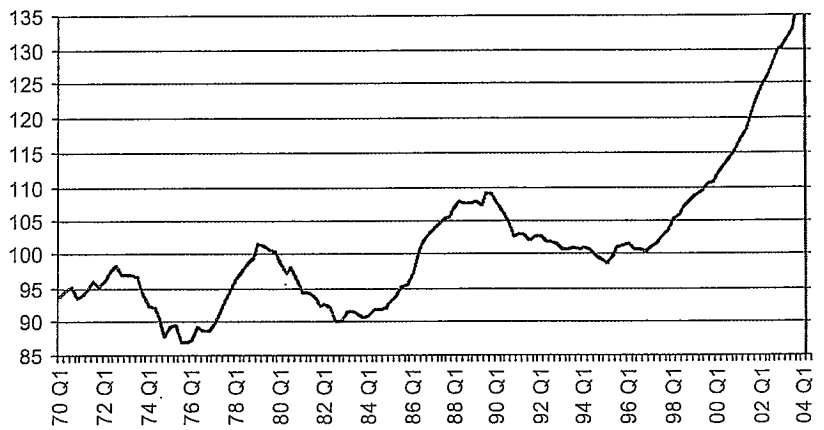
[xi] Low poverty = less than 10 percent
Moderate poverty = 10 - 20 percent
Poor = 21 - 39 percent
Underclass = 40 percent or greater

[xii] These results are similar to those found in Los Angeles County in a paper by Rafael Yaquian Illescas (2004).

Section 4: Housing Assets: Recent Trends and Future Prospects

This section[i] focuses on whether the recent rapid housing appreciation in Southern California is justified by the underlying drivers, and as such, is it sustainable in the long run. To understand this question, it must first be understood how housing is an asset, similar in some ways to other investment instruments such as stocks and bonds. The first part of this section compares the current period of price appreciation to past periods in the national market, regional housing markets, and Southern California. While the current pace of appreciation has been similar to past housing cycles, there are important differences between the two periods. The second part of this section explains why it is unlikely that housing prices will continue to increase over the next few years, and why there may even be some distinct risk of a major decline in prices despite little historical precedent for such an occurrence.

Figure 4.1: Trends in the National Housing Market



Sources: BLS (Employment, Prices) OFHEO (Housing prices). Quality controlled data, CPI Adjusted

Price Appreciation

Southern California is currently in the midst of housing appreciation quite unprecedented in recent history. In real terms prices have risen by 80 percent over the past seven years. By comparison the last major run up in prices in the late eighties saw prices increase by a comparably mild 45 percent, again in real terms. While California has seen some of the greatest appreciation, it is certainly not unique to the region. Most of the U.S. has experienced some degree of unusual appreciation in recent years. (See Figure 4.1.) This bout of appreciation is unusual for many reasons beyond the overall magnitude. The price boom accelerated during the economic dow-nturn, something never seen in recent his-tory. Looking at price appreciation and reg-ional housing markets indicates that many of the communities with high appreciation today experienced a similar situation in the 1980s, but the appreciation was never as consistent across the U.S. as it

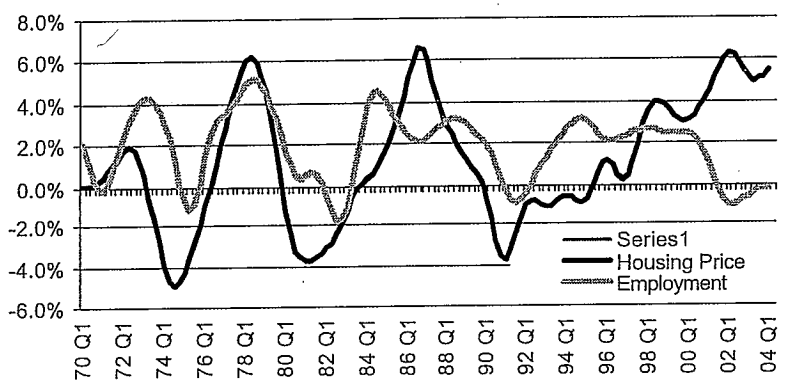
has been today.

The National Market

Real (CPI adjusted) housing prices have had a very strong cyclical component to them in the past, with long periods of real appreciation during economic expansions followed by periods of real depreciation around economic downturns, as can be clearly seen in Figure 4.2 and 4.3. The last two major bouts of rapid appreciation were in the mid-1970s and mid-1980s. The earlier episode saw the national average price increase by 17 percent over a three-year period. The latter period saw real prices increase by 20 percent over a six-year period.

Housing prices have a lag / lead quality to them, which is rather unusual. Typically increasing housing prices lag increasing employment growth. Yet they also tend to lead slowing employment growth. In both previous housing cycles the bout of appreciation slowed and eventually began to reverse itself prior to the actual economic downturn. As a result housing prices have an extreme boom-bust cycle to them, since the housing cycle occurs within an expansion rather than across the entire business cycle.

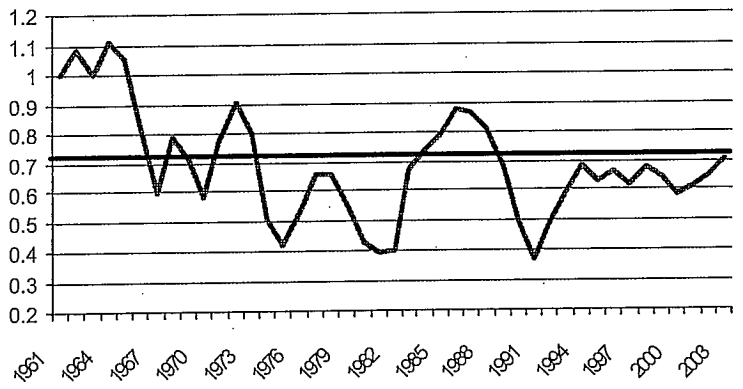
Figure 4.2: Employment and Real Housing Prices Year on Year Changes



Sources: BLS (Employment, Prices) OFHEO (Housing prices). Quality controlled data, CPI Adjusted

Figure 4.3: Residential Building to Population Changes: U.S.

New Housing Units / New Adult Population

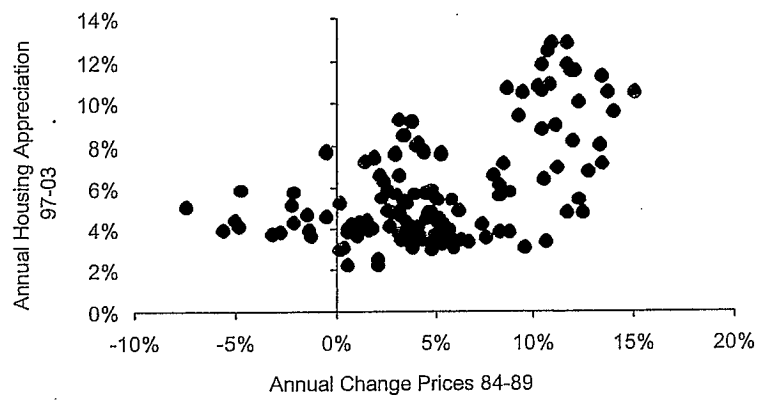


Sources: U.S. Census

It should be noted that in both previous housing cycles *nominal* prices continued to rise after the peak, but at a pace slower than overall price inflation. As a result *real* housing prices fell, although not to the housing prices fell, although not to the previous low. It should be noted that nominal prices at the national level have never fallen for as far back as the data is available, although they have fallen within certain areas.

The recent wave of appreciation is very unusual compared to past episodes, as the housing market has not been responding in its typical cyclical manner. This period was very similar to past cycles up until 2000—real prices increased by 20 percent over the six year period starting in 1995, lagging the surge in employment growth after the 1990 downturn, as is usual. The market actually began to cool slightly in mid-2000, again as might be expected in the period leading up to a downturn. However the difference this time came during the economic downturn that began in 2001. This recession was different in that it was led by business spending, rather than consumer spending, and consumers never slowed their spending as they had in past recessions. This was at least in part due to aggressive monetary and fiscal policies aimed at spurring consumption. As a result, instead of home price appreciation slowing it actually accelerated in 2001, adding another 20 percent to real values over the next three years. Real housing prices have moved farther beyond their long run trend than ever before.

Figure 4.4: Nominal Housing Appreciation for MSA's 1984 to 1989 Compared to 1997 to 2003



Source: OFHEO, quality controlled data

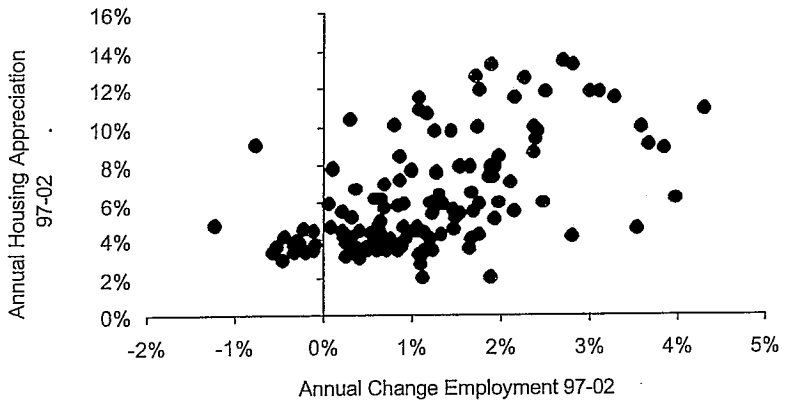
To some extent this different pattern can be explained by other forces that exist now but not during past episodes. Nominal mortgage rates, for example, have hit lows not seen since the 1960s. Perhaps more significantly is that this time the U.S. has not experienced the residential housing boom-bust cycle as experienced in the past. Instead homebuilding over the past decade has grown at about the "proper" pace relative to the growth in the adult population: about .65 units for each new adult (considered to be people aged 20 and older) entering the population, the average ratio seen since accurate national building statistics started to be kept in the late 1950s. However these facts cannot explain all the appreciation. While there has not been over building, neither can it be said that the US has a housing shortage. And while nominal mortgage rates have fallen considerably in

recent years, real mortgage rates have not fallen by as much—much of the decline in nominal rates is due to the slowing of inflation that has occurred over the past decade. Real rates have been hovering around 4 percent, down from the 5.5 percent average seen since the 1990 economic recession.

Regional Markets

As with many national statistics, these aggregated numbers tend to hide a considerable amount of inter-regional variation. The greatest levels of appreciation have occurred in urban areas located on the coasts; primarily in California, Massachusetts, New York, New Jersey and Florida. This pattern is not unusual. Figure 4.4 shows the pattern of price appreciation in the late 1980s compared to today. Two things immediately stand out in this picture. First, there is a high degree of correlation between the two periods—much of the appreciation seen recently has occurred in communities that also saw a rapid run up in prices in the late 1980s. Secondly, the range of appreciation was actually wider in the late eighties period compared to day, with a range from negative 8 percent per year (in nominal terms) to upwards of 16 percent per year in

Figure 4.5: Housing Prices and Employment: 1997 - 2002



Source: Office of Federal Housing Enterprise Oversight BLS

Figure 4.6: Housing Prices and Employment: 1989 - 1994

Source: Office of Federal Housing Enterprise Oversight BLS

other areas. Between 1997 and 2003 the range is considerably smaller—from between two percent to 13 percent annually.[ii] All boats have been rising with the current tide.

As for the period of price declines that began prior to the 1990 downturn, average price appreciation across the various cities slowed from five percent per year in nominal terms to two and a half percent per year—slower, but still positive. There was a substantial degree of variation in the change in housing prices, with a range from negative four and a half percent per year in nominal terms to upwards of 10 percent per year. Much of this variation can be explained by changes in local employment. (See Figure 4.6.) Those cities that experienced the most difficult regional downturn were those who also saw the largest decline in nominal housing prices. The two exceptions to this (the two dots that show up in the lower left hand quadrant) are Ventura and the Inland Empire—two areas that experienced significant appreciation in the late eighties (an annual pace of nine and a half percent and 13 percent) and were located near economies that had significant economic difficulties—Los Angeles and Orange Counties. The implication is that a weak larger economy combined with a large appreciation can cause nominal prices to fall—even if local employment is growing. This is a lesson that may prove relevant for the current situation. Some pundits claim that a growing economy is enough of an insurance policy against falling home prices: not necessarily.

Table 4.1: New Population / New Building Units

	Population Change	Building Permits	Ratio
	1999-2003		
Orange County	241,200	54,691	4.4
Los Angeles	772,900	90,383	8.6
Inland Empire	506,100	147,430	3.4
Ventura County	66,400	18,000	3.7
	1985-1989		
Orange County	254,800	110,060	2.3
Los Angeles	711,500	279,738	2.5
Inland Empire	681,400	237,132	2.9
Ventura County	76,100	28,080	2.7

Source: Department of Finance and U.S. Census Bureau

There are also other examples of this combination of falling housing prices in regions that have growing employment. During the 1984 to 1989 housing expansion there was a high level of correlation between job growth and housing price appreciation. Two exceptions stand out, Austin and San Antonio.[iii] This situation occurred in the wake of the oil price bust. Both areas experienced double-digit levels of appreciation in the early eighties as a result of the oil rush, some of the fastest appreciation in the nation during this period of time. Despite the crash, the normal economy was still producing new jobs.

Southern California

The situation here in Southern California is basically mimicking what has been happening nationally, although the magnitude of appreciation is considerably

higher. After a period of real price stability in the early 1980s, the late 1980s bubble was driven by a spurt of growth that saw property prices appreciate at about seven and a half percent per year. Like the U.S., Southern California experienced a strange counter-cyclical pattern during this downturn. Starting in the second half of 2001 price appreciation has surged to about 12 percent per year on average, close to the rates seen in the late 1980s. Over the past year this pace has accelerated yet again, up to approximately 20 percent per year.

Of course, while the pace of appreciation is similar, there are other factors that are different between the two periods. As noted, a building boom has not accompanied this current bout of real estate appreciation. In the late 1980s Los Angeles and Orange Counties were building new residences at a pace that exceeded one unit for every two people entering the county. (See table 4.1.) Given that the average household is roughly three people, this pace is clearly too rapid. This time the numbers are completely different. Orange County has added four 4.4 people to the County for each new unit being built, while Los Angeles is building one unit for each 8.6 people added to the county. Excess supply is clearly not an issue this time.

Of course, many people in the housing industry have used this tight housing situation to justify the current price appreciation. While this certainly plays some role, this fact cannot justify all the appreciation we have seen. Indeed while these pundits argue that tight supply is an important component to price increases, they neglect to explain how this linkage works, nor do they ever define what would be the logical upper limit that must exist even under tight supply conditions. "So how high can prices go?" is the question for those who use supply to justify prices. The reality is that houses are an asset, and like all assets have a fundament value. Even with tight supply the housing market in the US and in Southern California has already passed this fundamental value and is clearly in a bubble. The next section details the argument for this point.

The Future of Home Prices in Southern California

Over the next few years home prices in Southern California will certainly not experience the level of appreciation seen over the past few years, and may even experience some level of nominal price declines. The reasons for this can be summed up as follows. 1.) A portion of the recent housing appreciation is due to the decline in mortgage rates. When mortgage rates rise again, these gains in value will be reversed. 2.) The true increase in demand for housing in Southern California's housing market is not as large as it would appear to be as a function of population alone. 3.) Housing supply and demand is more elastic in the long run than in the short run. Tight supply today does not necessarily imply tight housing markets tomorrow.

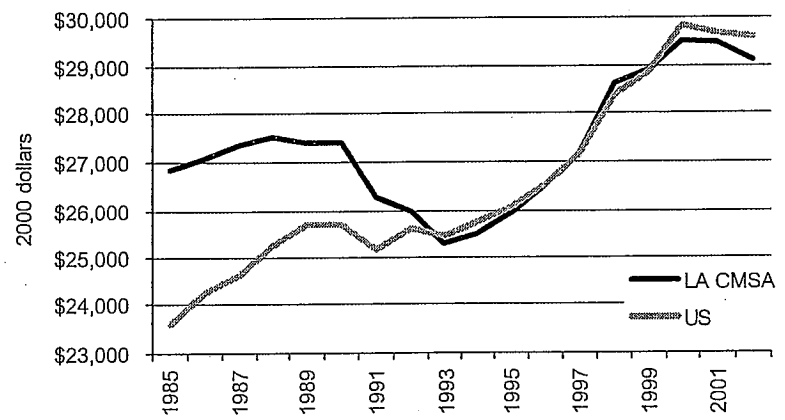
Mortgage Rates

The return that a housing asset brings is the value of the housing services it provides—whether housing is rented or owner-occupied. The fundamental value is based on the sum total of the net rental value of the property today and in the future. Future rents are not as valuable today as they are in the future, and must be discounted in order to turn them into present value form. A large portion of this discount rate is the opportunity cost of capital tied up in residential real estate—the mortgage rate. Cheaper capital causes the fundamental value of assets to rise holding all else equal,

since it implies that future returns are now more valuable in today's terms. Similarly, rising mortgage rates will cause prices to fall by an equivalent amount. Holding all else constant, interest rates have a distinct impact on property values. A two and a half percentage point swing in real mortgage rates causes prices to change by 20 percent to 25 percent. The cost of capital for buying a property has been falling dramatically over the past four years as a result of aggressive Fed rate action. In real terms rates fell from their long run average rate of five and a half percent to approximately three and a half percent. Cheaper capital makes buying properties cheaper, thus increasing demand for properties. This clearly explains a portion of the appreciation seen over the last few years.

What is clear in either case is that mortgage rates have fallen to the lowest level they can achieve, and so we cannot expect more appreciation driven by mortgage rates. Indeed, the rapid appreciation of housing after mortgage rates started falling is one indication that we have moved into an asset bubble situation, since flattening mortgage rates should imply that appreciation should slow. Instead, appreciation has been accelerating.

Figure 4.7: Real Per Capita Personal Income



Source: Bureau of Economic Analysis

The important question is what will happen to mortgage rates in the future. One argument is that rates have subsided to a new low that reflects a lack of inflation risk. Real rates at their current levels are not unheard of—in fact prior to the 1970s real mortgage rates were at the current level. Another argument is that rates simply reflect a bubble in interest rates driven by very aggressive rate action—in short, the imbalance in place may be a negative bubble in rates. If rates do start to rise, then the fundamental value will fall—making the current bubble that much worse.

Demand

The second issue is demand. While there definitely has been accelerating population growth here in Southern California over the past decade, these numbers do not tell the whole story. The number of households in Southern California is growing much more slowly than the overall population. In Los Angeles, for example, the population grew by 11 percent between 1990 and 2002, yet the number of households only grew by five percent. Much of the population growth

that has occurred over the past decade has been made up of immigrant families who tend to be younger and have more kids on average, which is one driver behind larger households—families are just bigger in Los Angeles County.

It is not just the family size that is of issue—it is also the demographic characteristics of many of the new entrants into the area. Between 1990 and 2002 the number of people in Orange County with a bachelor's degree and above increased from 28 percent to 33 percent of the population ages 25 and up. At the same time the number of people without a high school degree increased from 18.5 percent to 20.5 percent. In Los Angeles the proportion of people without a high school degree dropped from 30 percent in 1990 to 26 percent today, but it is still quite high. Real per capita income in the Los Angeles / Riverside region has actually grown much more slowly than for the U.S. overall over the past two decades. In 1985 real income was 15 percent higher here than in the nation as a whole. In 2002 income was slightly lower.

The region's trend in income is driven by population growth and international immigration. Many of these immigrants did not have the opportunity to obtain the education or technical training to earn a high wage in the U.S. economy. Domestically speaking there has been a net outflow of people from Southern California. As a result there is a dual economy forming, particularly along the coast, with a portion of the middle class simply moving from the region to find affordable housing inland or in other states. Low and high income individuals remain. So while the population growth in Southern California has been high, a large portion of this population growth is made up of families that could not afford to purchase housing even if prices had not appreciated to the extent that they have.

Long Run Supply and Demand

The final issue is long run supply and demand. The long run elasticity of supply and demand is considerably larger than the short run elasticity—implying again that short run supply tightness cannot drive prices too far. Consider the supply side. While building has been constrained in California, this is in part due to regulatory hurdles and high fixed costs that slow the residential investment process. Nevertheless, where there is a profit, there is a way. High prices spark housing growth both by increasing public pressure on zoning boards and by making it easier for developers to 'sweeten the pot' to get approval for projects. It also creates greater demand for infill, which will ultimately be the solution to housing in the now-crowded Southern California economic region.

While new housing has not kept up with population growth, it has been growing in line with this thinking. In 1996 the greater Los Angeles region built 30,000 new residential units. By 2000 this had grown to 52,000 units, and last year the region added 77,000 units. Building is accelerating, and will continue to do so as long as prices remain relatively stable.

On the demand side long run elasticity is also an important consideration. Southern California is not an island—people have an option to live here or in the myriad of less expansive places in the US. For many people, particularly those who are retired, there will come a point in time when cashing out will become a more attractive option. Higher prices will encourage exiting the local market, thus making homes available that way. Further it tends to discourage in-migration, there is slowing population growth nd again slowing rental growth rates.

Summing Up

The previous section highlighted the various reasons for the argument that prices have moved beyond the point of sustainability. Yet while we are due for a correction of some sort, it is unlikely (as of now) that we will experience anything similar to what was seen in the early nineties in the region. Instead prices are likely to only decline slightly or remain nominally stable until the "fundamentals" catch up. Until recently the Southern California economy has been performing better than the U.S. overall and there is no reason to think that this will change in the near future. Demographic changes in the population imply an increase in the number of twenty-something and empty-nesters. These changes alone will cause a secular decrease in household sizes and create some increase in the demand for housing that will help maintain stability. In addition, high equity rates in Southern California imply that falling prices will not lead to any substantial bout of foreclosures. This will also help maintain the market.

So what does this all imply? Basically, unless we have a major decline in employment it is unlikely that the U.S. will experience much in the way of a major downturn in nominal real estate prices. Instead, when this episode ends we shall see yet again a sustained period of low housing turnover and housing appreciation that grows, but at a pace that is slower than the pace of inflation, allowing the fundamentals to catch up; in short real estate bubbles do not die, they simply fade away.

There are a couple of cautions to this message, however. The first caution has to do with low inflation. During the past periods of price appreciation the U.S. was experiencing higher rates of inflation than it is now. This implies that it was easier for the fundamentals to catch up with market prices without declines in nominal prices. In a low-inflation economy this process is slower, and may pull downwards on nominal prices.

Another caution is that another recession may be forming in the U.S. economy as consumers and the government continue to spend beyond their means. A consumer led downturn will likely have a larger impact on the housing market than the last business led downturn did, particularly with the extraordinary increase in housing prices seen over the last few years. There is very good evidence that there is a strong rebound effect—those areas that have seen the greatest appreciation over the previous cycle experi-enced the largest downturn in prices after. Hence Southern California may be one area that is at high risk—even if we do not experience a large regional downturn.

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[i] This chapter is adapted from a report in The UCLA Anderson Forecast, June 2004. For further info on data sources go to www.uclaforecast.com

[ii] Note that real growth in the nineties is larger even if nominal growth is lower because the pace of inflation has been falling over the past fifteen years.

[iii] Dallas and Fort Worth also experienced this, but are not included in the data set used to construct these graphs.

Section 5: Migration and Housing Opportunities

One implication of the growing affordability problem in Southern California is "regional flight," the exodus of families priced out of the housing market. At the same time, other families have moved to Southern California despite its high living costs. For many, the region still remains a land of economic opportunity. While the media has provided intriguing stories about the exodus of the middle class from southern California, this section provides a more systematic assessment of the housing implications of moving away from, and into, Southern California. Specifically, this section explores the relationship between migration to and from Southern California, and selected housing outcomes, such as homeownership and housing affordability. Focusing on family households and using data from the 1980, 1990, and 2000 Census, the analysis indicates that:

- Homeownership opportunities are greater for families who decide to leave Southern California than for families who move to the region
- Housing costs, both for homeowners and renters, are more advantageous for families moving out of Southern California, who also tend to move to larger housing units
- Families relocating to Southern California from other parts of the country tend to purchase or rent homes in the fringes of the metropolitan area, where housing units are supposedly more affordable.

Much debate has focused on the housing shortage and affordability crisis in Southern California. The media have emphasized the slow pace of construction in Southern California during the past decade and the increasing housing costs both for homeowners and renters, often suggesting that people have to leave the area because of housing affordability. According to the *Los Angeles Times*, home values in Los Angeles County are at a record high, having increased by nearly 30 percent in the last 15 years. In addition, it is becoming increasingly more difficult for many companies to attract workers to Southern California because of its high home prices.[i] Nevertheless, the Census has estimated that Los Angeles County as well as the surrounding counties making up the Consolidated Statistical Metropolitan Area (CMSA) have continued growing since the year 2000. Los Angeles County alone has experienced a 3.7 percent population increase from 2000 to 2003. While much of the increase may be attributed to natural growth, part of the population increase is due to net migration, despite the slow pace of regional job growth during recent years.[ii] This chapter examines the difficulty of becoming a homeowner for those moving to the region versus those moving out; whether the housing burden is higher when moving to the region or out of the region; and finally, what is driving people to move to the region given its high housing

costs.

Over the past three decades, the moving rate of families has decreased from 51 percent in 1980 to 46 percent in 2000. In contrast, the percentage of families occupying the same home as five years prior to the census has increased from 49 percent in 1980 to 54 percent in 2000, suggesting a decreasing degree of geographic mobility among families in Southern California over time.

In 2000, 3.8 million families resided in Southern California (Table 5.1). Of these, 2 million resided in the same home as in 1995, whereas 1.7 million resided in a different home than they did in 1995. A look at moving behavior in Southern California reveals that while the majority of moves have increasingly occurred within the same county, the proportion and absolute number of moves from other parts of the country and from abroad has declined over time. According to the 2000 Census, of those who moved during the prior five years, 73 percent moved within the same county, and another 10 percent moved from a different county in the same region. Only 6 percent of those who resided in a different home in 1995 moved to Southern California from a foreign country.

Table 5.1. Geographic Mobility of Families, Southern California 1975-2000

	1975-1980	1985-1990	1995-2000
Stayed in the same home	49 %	48 %	54 %
Moved from other home	51 %	52 %	46 %
Total Families	100 %	100 %	100 %
(N - Thousands)	(2,716)	(3,418)	(3,783)
Within Southern California	76 %	79 %	83 %
From other part of California	4 %	4 %	4 %
From other part of the country	11 %	9 %	8 %
From abroad	9 %	8 %	6 %
Total moved from other home	100 %	100 %	100 %
(N - Thousands)	(1,387)	(1,766)	(1,728)

Source: U.S. Census 1980, 1990, 2000, Public Use Micro-Samples, 5%

More families left the area between 1995 and 2000 than those who moved to the region (348,000 and 292,000, respectively), reversing the trend observed in the 1980s and resuming the trend observed in the late 1970s. Clearly, the importance of geographic mobility within the region has climbed over time, pointing to an increasing dynamism in the internal regional patterns of residential mobility and household formation. Such internal dynamism is perhaps associated with the efforts by many households to lower their housing costs by moving to more affordable areas within the region.

How do affordability and tenure choices play out in terms of out-migration and in-migration? Figure 5.1 summarizes the observed differences between families who moved out of Southern California and those who moved to the region between 1995 and 2000 in terms of homeownership, income, and housing costs. The chart also shows the same differences after controlling for personal characteristics. A parity index equal to 1.0 indicates that there is no difference between the two groups, and values that are above 1.0 indicate a proportionally higher figure for families moving out of Southern California relative to those moving to this region.

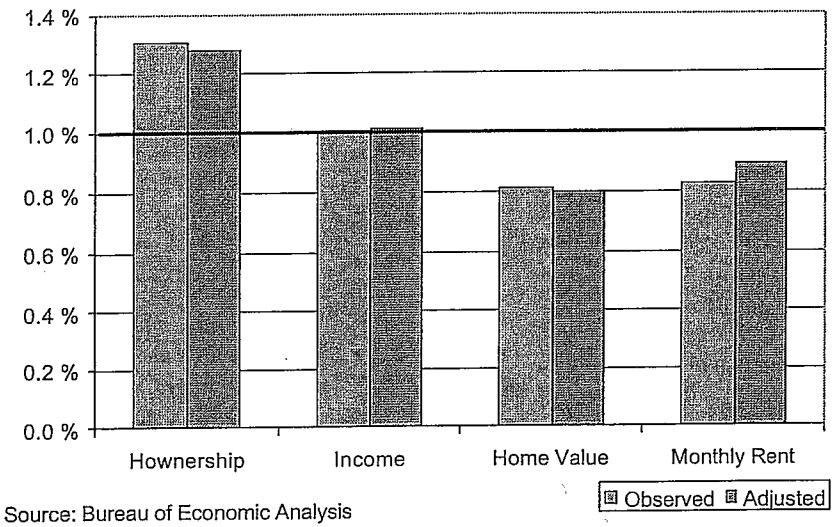
The analysis shows that home-ownership opportunities are greater for

families who decide to leave Southern California than for families who move to the region. In 2000, 36 percent of the families who moved to Southern California owned their home, but those moving away were 1.25 times more likely to be homeowners. A similar trend was observed in previous decades, although the inverse relationship between migration and tenure seemed to be stronger in the late 1980s than in the late 1990s. In addition, while renters accounted for the overwhelming majority of those who moved to the area during each period (over 60 percent), the proportion of renters was much lower among those who left the area, although it has increased from 40 percent in 1980 to 53 percent in 2000. In the late 1980s, those who moved to the region tended to be renters (65 percent), while those who moved out of Southern California were more likely to own a home (60 percent). The percentage difference in ownership rates between those who moved to, and those who moved out of the region was 25 percent in the late 1970s. The difference dropped to 11 percent in the late 1990s.

Differences in homeownership rates between families who moved out of Southern California and those who moved to the region do not seem to be associated with any significant disparities in household income levels. In the late 1990s, the median household income of both groups was approximately $46,000. Differences in homeownership rates hold even after controlling for personal and household characteristics.

The relative advantage of moving out of the region is also manifested in home prices. Over time, average home values have consistently been higher for families moving to the region. In 2000, while observed home prices for families moving to Southern California averaged $281,000, prices were 20 percent lower for families moving out of the region. Most importantly, the widening gap in home values between families moving out of Southern California and those moving to the region has corresponded with a narrowing disparity in income levels between the two groups over time. This trend suggests that the region has increasingly lost advantage in terms of housing costs compared to

Figure 5.1: Ratio of Out Movers to In Movers, 1995-2000 (Out Movers = 100%)



Source: Bureau of Economic Analysis

other areas and families moving to Southern California have experienced increasing housing cost burdens compared to those leaving the area. Indeed, an analysis of the percentage of families whose housing costs exceed 30 percent of household income suggests that housing for families moving to the region has become significantly less affordable than housing for families moving out of the area.[iii] This might be particularly true for low-income families who end up living in overcrowded conditions and in older housing units.

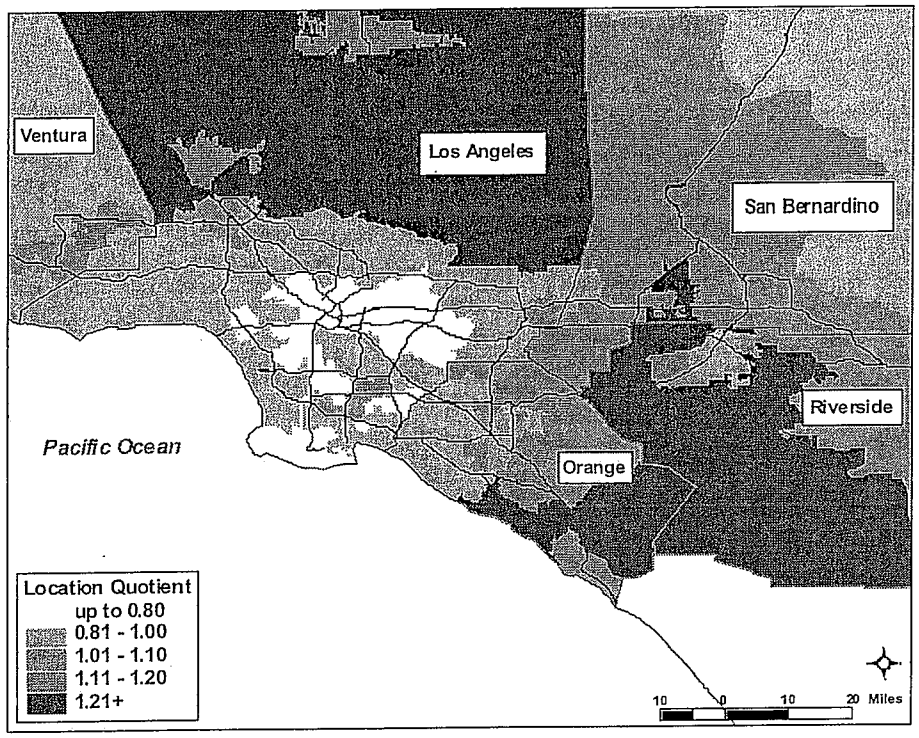
Differences in home prices between the two groups also hold after controlling for type and size of housing. In particular, the analysis reveals that families who move out of Southern California are not only better off than those who move to the area in terms of housing costs but also in terms of type and size of homes across a number of measures. While families relocating to Southern California have generally found a home predominantly in multi-family housing units, those who left the area have tended to move to single-family housing units. However this proportion has decreased over time from 56 percent in 1980 to 50 percent in 2000. In addition, families moving out of the region have tended to move into newer homes relative to families moving to Southern California, although the proportion of those moving into units built within the ten years prior to the census has also decreased over time. Among movers to California the percent purchasing new homes dropped from 30 percent in the late 1970s to 18 percent in the late 1990s, suggesting that the slowdown in new construction during the past decade might have affected the housing opportunities of families moving to the area. Interestingly, though, while overcrowding rates have remained relatively stable over time for those moving to Southern California – ranging between 16 and 20 percent – overcrowding rates have increased considerably for those moving out of the region, climbing from 5 percent in the late 1970s to 15 percent in the late 1990s. This might be associated both with the cost and availability of housing at the new destination of migrants as well as with household composition and characteristics. Indeed, many families moving out of Los Angeles consist of immigrants and other low-income individuals and might include extended family members sharing the same housing units.[iv]

An analysis of the relationship between migration and the size of homes along a number of measures such as acreage, number of rooms, and number of bedrooms reveals that in the late 1990s, 17 percent of families who left Southern California moved to single-family housing units that were 1 acre of size or larger. In contrast, only 6 percent of those who relocated to the region moved to housing units of this size.

How do renters fare when moving into or out of Southern California? Similar to housing values, rent amounts are significantly lower when moving out of the region than when relocating to Southern California. In 2000, families who had moved away from the region paid an average of $711 compared to $860 paid by those who had moved to Southern California during the five years prior to the census. These differences hold even after controlling for personal characteristics, the number of children and workers in the family, household income, home size and type, and size of the metropolitan area from/to which families move. This finding suggests that families who move out of the region and end up renting a home are in general better off than comparable families moving to Southern California.

While we know that most families leaving Southern California relocate to other areas of the West, to the South Atlantic region, or to the Northeast Central region, it is interesting to explore where families who move to the region tend to reside and identify their housing costs in different parts of the metropolitan area, be they homeowners or renters. The spatial distribution of movers to the region suggests that they are more likely to purchase homes in the fringes of the metropolitan area, where most new homes are located (Figure 5.2). The location of homes in the fringes, however, does not necessarily translate into lower home values. This is particularly clear in the northern part of Los Angeles County and the southern part of Orange County, where the location quotients associated with home values for families who moved from other regions seem to be higher than in the rest of the area. Such geographic disparities in home values are in general reflected in higher housing cost burdens for families who move to Southern California. Similar to homeowners, the settlement patterns of families who move to the region and rent a home suggest that these families tend to move to the fringes of the metropolitan area, where the rental market is supposedly more affordable than in the central part of the region (Figure 5.3).

Figure 5.2: Homeowner Family Movers to Southern California (1995-2000)



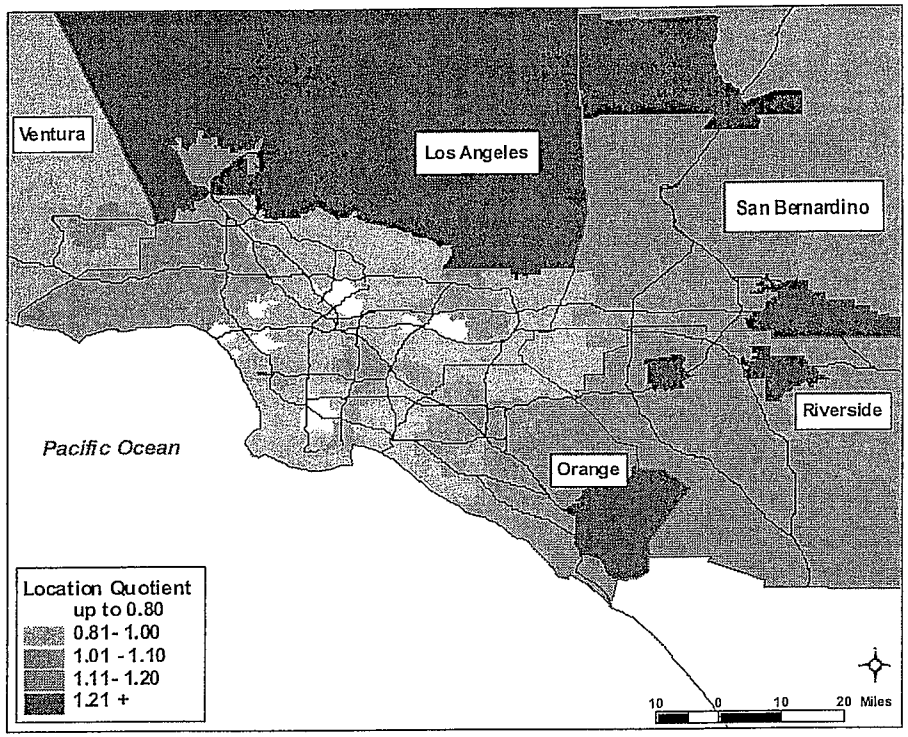
At the same time, shorter travel times do not always compensate for higher housing costs, as the location quotients of travel time throughout the region suggest.[v] In particular, families residing in the central and western parts of Los Angeles County seem not only to be burdened by high homeowner costs but also by long commutes.

The analysis of this section supports the argument that housing opportunities, both in terms of homeownership, affordability, and type of housing, are in general better for those who move out of the Southern California region. However, the analysis also shows that families keep on moving to the metro-

politan area, despite its high housing costs. Why would families want to move to an area characterized by such an expensive housing market? Data from the Current Population Survey from 1999 to 2003 reveal that over 70 percent of families who moved to Southern California during the past five years have done so for job-related reasons, whereas only 7 percent have moved for housing-related reasons. In contrast, 20 percent of families who moved out of the state during the same period have done so for housing-related reasons. Over 50 percent of families who reported moving out of California for housing-related reasons have done so because they wanted a better home (30 percent) or wanted more affordable housing (25 percent).

Other unmeasured characteristics and amenities of the region may play an important role in attracting such families, especially in the current climate of small job growth. Such families, be they homeowners or renters, may be able to offset the high costs of housing by moving to peripheral areas. Nonetheless, there is no doubt that their presence puts further pressure on the local housing market, which features a well-documented shortage of new housing units for newcomers and increasing housing cost burdens both for renters and homeowners residing in the region. Such pressure is reflected in the choice of homes in localities that might be at great distance from places of work as well as in the increasing dynamism of internal regional patterns of residential mobility observed in recent years.

Figure 5.3: Renter Family Movers to Southern California (1995-2000)



[i] Vincent, Roger and Don Lee, "Home Prices in L.A. Soar at Record Rate," *L.A. Times*, April 13, 2004.

[ii] Migration is generally defined as the movement to and from different regions, which is often motivated by job-related reasons. It is different from geographic mobility, which usually consists in the relocation within the boundaries of a specific region.

[iii] Data not shown but available from the author.

[iv] Twenty-seven percent of families moving out of the region between 1995 and 2000 were immigrant and 15 percent were below the federal poverty line.

[v] Data not shown but available from the author.

Section 6: Southern California Cities and Fair Share Housing

As discussed in earlier sections, housing affordability problems in Southern California have become worse over the last few decades. The burden is particularly hard on low-income households. There is a spatial dimension to this problem because the supply of low-income housing units is not evenly distributed throughout the region. Limitations on residential choice can have profound implications because where one lives determines quality of life, educational and employment opportunities, and access to cultural and other resources. The restrictions on choice are due in part to how the housing market responds to demand by creating relatively homogenous neighborhoods that cater to households defined by income and lifestyle. However, government action or inaction can attenuate or accentuate the constraints on low-income households. This section examines attitudes toward affordable housing in Southern California and how these attitudes may be influencing the distribution of affordable housing among cities. When cities hinder affordable housing development, options for siting these projects are limited. Although state law requires cities to accommodate low and moderate-income residents in their general plan in order to fairly distribute affordable housing ("fair share" housing), the state does little to insure that affordable housing actually gets built. Our analysis here indicates that:

- In general there is more support for affordable housing development in Southern California over the past 25 years, but there is still reluctance to site affordable housing in one's own backyard.
- Affordable housing is not evenly distributed throughout the cities in Southern California.
- Funds for low and moderate-income housing development may not be directed to areas with the most low-income households.

Fair Share Housing

Although increasing the number of affordable housing units is the obvious solution to dealing with a shortage of these units, the related question involves where affordable housing should be built. Some argue that affordable housing should be developed wherever it can be built most quickly and economically. Others argue that certain communities should not be forced to accommodate large populations of low-income households while other communities cater only to the wealthy. The idea of "fair share" housing implies that all cities should accommodate a certain portion of the region's low-income households. Spreading low-income housing throughout a region relieves some communities of carrying the full social and economic burden of housing a region's low-income population. Cities that only offer high-end housing limit opportunities for homebuyers and prevent moves that would bring some families greater opportunity – opportunities for better public education,

good jobs, and a safer living environment. Providing a range of housing throughout the region also has the added benefit of allowing more workers to live near their jobs. Less commuting means less traffic and less air pollution for all residents. Unfortunately, the idea of fair share housing is more popular among policymakers than city residents. Few cities welcome the development of affordable housing.

The main reason some cities restrict or exclude low and moderate-income housing development is to maintain high property values in their community. Homeowners benefit from high home values because their home is often their largest investment and most valuable asset, but also because high property values work to maintain racial and economic exclusivity in the community. Suburban governments in particular tend to be politically dominated by homeowners concerned with maintaining high property values. Residents will often oppose any low-income housing development in their community. NIMBY (Not-In-My-Backyard) tactics usually include the portrayal of old style public housing developments that were notorious for their crime and lack of aesthetics, despite the fact that most affordable housing projects today are virtually unrecognizable. Opponents to a recent proposal for an affordable housing development in Mission Viejo, a community in Orange County, used such a tactic. They circulated a flier reading 'Stop the Nightmare Before It Starts,' accompanied by a drawing that looked like the notorious Cabrini-Green Project in Chicago" (LA Times, McKibben[i], 4.19.04). City politicians also benefit more from high-end housing development than low and moderate-income units. Although property tax revenues in California are limited by Proposition 13, high cost housing brings in more tax revenues than low-cost housing. Some also argue that high-cost housing is associated with lower service costs as well. When cities deny permission to develop low-cost housing it becomes even more difficult to address affordable housing shortages.

Despite the reluctance of cities to accommodate low-income households, California has made fair share housing a statewide policy goal for the past thirty years. During the 1970s the state's Department of Housing and Community Development (HCD) was given the task of helping local governments provide housing for people of all income levels throughout California. In 1975 HCD was required by state law to set housing element guidelines for cities, and these guidelines emphasized a regional fair share concept. In the 1980s and 1990s the present system of allocating fair share housing within California regions began to take shape. Under this system HCD allocates housing goals to each region, based on projections of future household growth. Then a regional planning authority (a COG, or council of governments) allocates those units among the localities in the region who are required to plan for those additional housing units in the city's housing element.

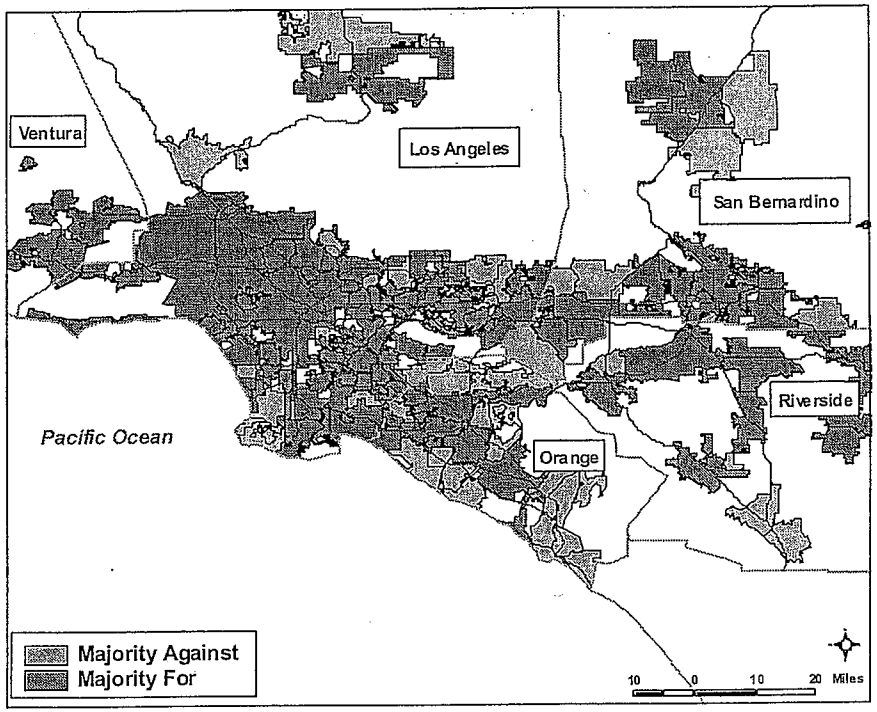
Unfortunately, state housing laws have done little to realize the goal of fair share housing. Thus far the state has not forced cities to approve affordable housing developments. One reason the state may be reluctant to push for stricter housing laws is because voters have indicated that they support local approval of low-income housing developments. Over the course of the last thirty years California voters have had a few opportunities to cast their votes on housing issues. The outcome of these ballot propositions in Southern California is indicative of how some attitudes toward

affordable housing have changed over the past three decades while others have not.

Housing Ballot Issues

The California Constitution contains a provision that allows communities to vote on certain proposals for affordable housing development. Article 34 of the California Constitution requires voter approval of any housing development in which 50 percent or more of the units are subsidized by public funds. There have been two ballot Propositions that would have amended Article 34. The first, Proposition 15, on the ballot in 1974, sought to repeal the Article completely. It failed, receiving support from only 38 percent of voters both statewide and in Southern California. The second, Proposition 168, on the ballot twenty years later in 1993, would have amended Article 34, and required voter approval only upon qualification of ballot petition. Twenty years after Proposition 15 this measure also failed by a similar margin. Voting outcomes on housing bond propositions on the other hand, indicate that there is more acceptance of the need for affordable housing today than there was three decades ago. Proposition 46, also known as the Housing and Emergency

Figure 6.1: Proposition 46 Vote Southern California, 2002



Shelter Trust Fund Act, was approved statewide in 2002. In Southern California 58 percent of voters approved the bond. (Figure 6.1 indicates how Southern California cities voted). The passage was significant considering that in 1976 when Propostion 1[ii], another housing bond, was on the ballot, the measure failed statewide, and only 40 percent of voters in Southern California supported the measure.

The success of Proposition 46 in 2002, after the dismal failure of Proposition 1 in 1976, indicates a large-scale change in voter attitudes toward affordable housing. In 2002 Southern California residents recognized the need for such housing in a region where many middle class workers can no longer find homes they can afford. However the failure of Proposition 168 in 1993 (which also appeared on the ballot after

a period of record high housing prices in the late 1980s and early 1990s) indicates that most residents are still wary of having this housing built in their neighborhoods. When we looked at voting outcomes not just by overall percentages, but also by cities – how many cities had more than 50 percent of voters supporting the propositions – support was also very weak, except in the case of Proposition 46, where city support was quite high.

This suggests that many cities are still wary of affordable housing development in their borders and may not be assuming their fair share of housing for low-income households. The following analysis examines the distribution of low-income households in different types of cities in the Southern California region.

The Distribution of Affordable Housing in Southern California

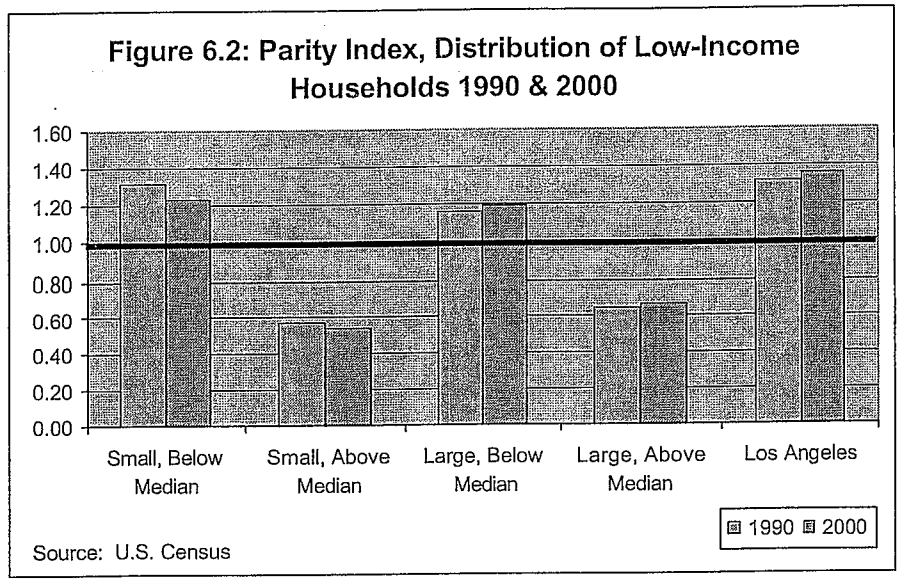
Using low-income households as a proxy for affordable housing, we looked at where the bottom 20 percent of income earning households reside in Southern California[iii]. We divided the region into groups based on population (above or below 50,000) and income (above or below the CMSA median of $46,000). We chose the 50,000 cut-off because cities with populations over 50,000 in a metropolitan area are known as "Entitlement cities" and are eligible to receive an automatic federal allocation of CDBG (Community Development Block Grant) funds[iv]. By law, the primary beneficiaries of CDBG funds are persons of low and moderate income. We divided by income because generally wealthier cities are more likely to exclude low-income households. We kept the city of Los Angeles as its own category. We calculated a parity measure by dividing the percentage of CMSA low-income households in each city group by the percentage of total CMSA households in each group. A ratio of 1.0 equals parity. The results for 1990 and 2000 are displayed in Figure 6.2. Predictably, cities with lower median incomes have parity measures greater than 1.0, indicating a greater proportion of CMSA low-income households than total households. The city of Los Angeles houses one third of the regions' low-income households, but only 24 percent of all households, a much higher ratio of the region's poor households to total households than for the group of other large cities in the region. The city's parity measure in 2000 was 1.3. The higher income city groups both have parity measures that are significantly less than 1.0. Figure 6.2

Table 6.1: Households and Low-Income Households by City Type

N	Type of City	Households 2000	Households 1990	Percent of CMSA Low Income Households 2000	Percent of CMSA Increase in Low Income Households 1990 - 2000
	CMSA	5,351,556	4,909,218	100%	100%
49	Small, Below Median	399,241	349,491	9%	9%
53	Small, Above Median	462,753	396,815	5%	5%
31	Large, Below Median	1,083,484	1,015,285	24%	25%
45	Large, Above Median	1,531,165	1,340,651	19%	25%
1	Los Angeles	1,276,609	1,219,770	32%	31%

Source: U.S. Census

depicts the distribution of low income households throughout the region by cities and the corresponding parity index.



Changes since 1990

Total households in Southern California increased by 9 percent between 1990 and 2000. The higher-income large cities absorbed by far the largest percentage of these new households in the region, 43 percent. The other groups of cities only took in between 11 to 15 percent of new households.

Low-income households composed 45 percent of all new CMSA households between 1990 and 2000. The city of Los Angeles absorbed one third of the increase in low-income households, even though it only absorbed 13 percent of all new households. Los Angeles gained more low-income households than total households, indicating that some existing households dropped below the poverty threshold. The other large cities in the region each took in another 25 percent of the increase in low-income households. The small high-income cities absorbed the fewest low-income households, only 5 percent of the CMSA total. Overall though, there was little change in the total composition of these city groups over time. The percentage of households and low-income households in each of these city groupings stayed virtually the same between 1990 and 2000, indicating little progress toward fair share housing.

Regional Share of Housing Funds and Low Income Housing Units

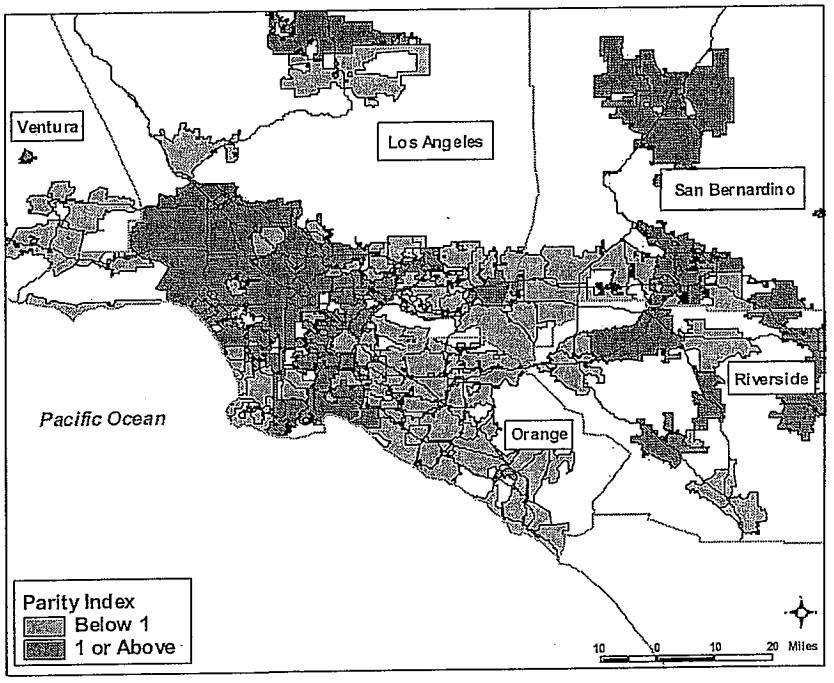
Next we examined the distribution of some of the money available for affordable housing development in relation to the distribution of low-income populations. Tracking all public sources of housing funds to Southern California is extremely difficult given the diversity of funding sources and various methods of record keeping. However two sources of affordable housing support were more easily accessed. One was Redevelopment Agency Low and Moderate Income Housing Funds and the other was the number of Low Income Housing Tax Credit (LIHTC) units built in the region.

All redevelopment agencies in the state of California are required to set aside 20 percent of gross revenues to a Low and Moderate Income Housing Fund. State law

requires that these funds be used to increase the supply of affordable housing in the city where the redevelopment agency is located. Between fiscal year 1991-1992 and fiscal year 2000-2001, cities with redevelopment agencies in Southern California set aside a total of almost $3 billion for affordable housing.[v] A large percentage (29 percent) of these funds were accumulated by the large cities with median incomes above the CMSA median income – cities that as a group have a slight under-concentration of low-income households, only 19 percent of the CMSA total. The amount of set-aside money in Los Angeles was only 14 percent of the CMSA total, despite having the largest percentage of low-income households in the CMSA.

Between 1990 and 2000 a total of almost 22,000 affordable units were built in Southern California with the LIHTC[vi]. The majority (33 percent) of these units were built in Los Angeles, which is on par with Los Angeles' portion of the CMSA's low-income households. Almost 25 percent of the units were built in the large, high-income cities, which, as noted, contain 19 percent of the region's low-income households. The small low-income cities had 17 percent of the region's LIHTC units, more than their 9 percent share of low-income households. In the remaining groups of cities the percent of LIHTC units was closer to par with their percentage of low-income households.

Figure 6.3: Parity Index
Low Income Households, Southern California, 2000



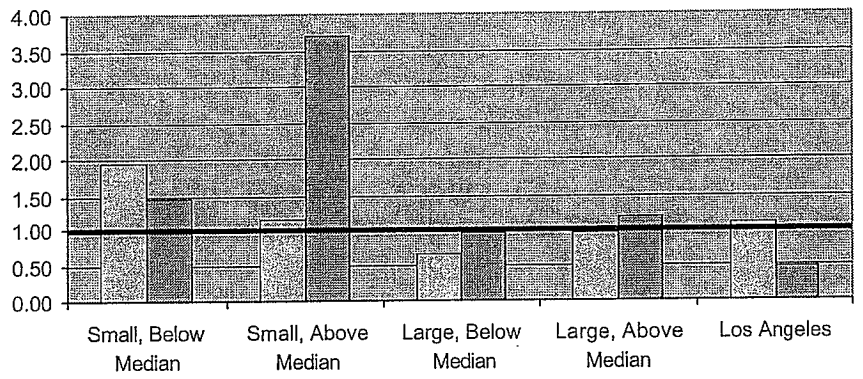
Does affordable housing money follow low-income households?

Neither of these funding sources are distributed on the basis of a city's low-income population. While redevelopment funds are accumulated in cities according to redevelopment activity, LIHTC funds go to cities where the developers that use them are able to build low-income units. Since LIHTC projects only have to have 20 percent of their units affordable to low-income occupants these types of affordable units may be more acceptable in areas that normally reject low-income housing. That may explain why we do see a good portion

of these units built in areas with a lower proportion of low-income households, and a somewhat more equitable distribution of the funds to areas that need them.

Redevelopment funds, on the other hand, are not distributed according to area need. These funds are accumulated according to redevelopment activity, which may not be the best distribution scheme to assist the region's low-income households. However, the other side of the argument is that the areas without as many low-income households are the areas not doing their fair share to accommodate affordable housing. Directing money to these cities may further fair share housing throughout the region. The question is whether the money directed to these cities is benefiting residents currently residing there, or whether it is helping to accommodate any new low-income households. The analysis here, at the aggregate level, cannot answer this question. We really do not know who is benefiting from the current distribution of these funds.

Figure 6.4: Parity Index for LIHTC Units and Redevelopment Housing Funds



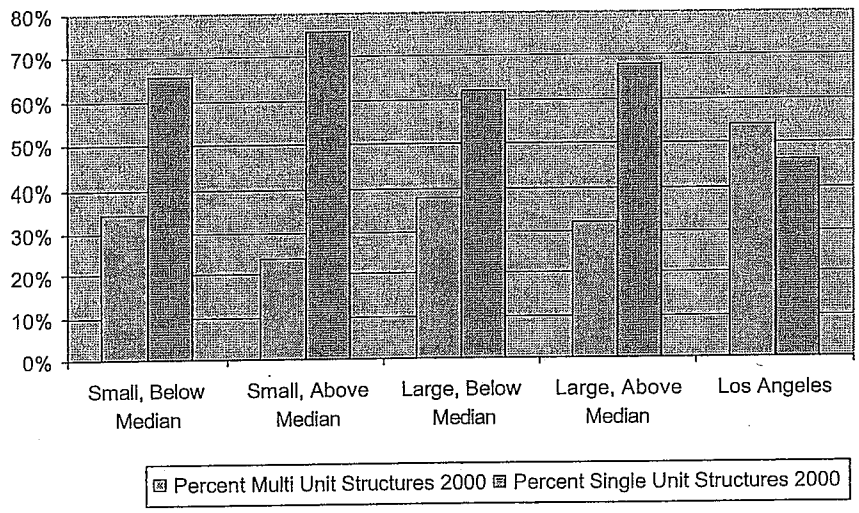
Source: U.S. Census

CONCLUSION

This analysis provides one indication of current attitudes toward affordable housing development in Southern California, as well as some evidence that these attitudes are reflected in the distribution of affordable housing throughout the region. The outcome of the ballot propositions indicates that there is more widespread acceptance of the need for affordable housing in Southern California. However, it also indicates that there is still a reluctance to site these housing developments locally. The distribution of low-income households throughout the region, that we used as a proxy for affordable housing distribution, indicates that the city of Los Angeles houses the largest proportion of the region's low-income households in comp-arison to its proportion of total households. The small, high-income cities in the region house the lowest percentage of low-income households, particularly in relation to total households. These cities made no progress toward fair share housing over the last decade either, actually moving slightly away from parity in terms of percentage of low-income households. It appears that smaller, higher income cities are least likely to accommodate low-income households, despite accumulating a significant portion of redevelopment housing funds. Though some cities may argue that low-income households

simply do not want to locate in their community because they lack transportation, housing, and services for them, it is possible that those amenities are purposely not provided to avoid attracting low-income households. A separate analysis of the increase in housing units in Southern California between 1990 and 2000 confirmed that a lack of housing production is not keeping out low-income households. The small, above median income cities built 13 percent of the new housing units in the region, slightly more than the city of Los Angeles, which absorbed a much higher percentage of new low-income households. A closer look at the type of units in each city group reveals a much lower percentage of multi-unit structures (which tend to be more affordable) in these cities than in other city groups (see Figure 6.5). The percentage of multi-unit structures in the small, above median income cities was only 27 percent in 1990, dropping to 24 percent in 2000. Only 2,300 multi-unit structures were built over the ten year period, while over 50,000 single unit structures were added. So clearly housing is being built in these cities, but it is not housing low-income households can afford.

Figure 6.5: Multi and Single Unit Structures 2000



Source: U.S. Census

Getting cities to increase their housing supply is important not just to meet fair share goals, but also to meet the increased demand for housing in Southern California. As discussed in other sections of this report, housing production in the state has not kept up with population growth. As vacant land on the fringes disappears there will be more pressure on cities to find creative ways to develop additional housing. It is likely that the state will have to reform land use control. Local control has meant that NIMBY attitudes limit housing development. Efforts toward using regional governing bodies such as the Southern California Association of Governments (SCAG) have done little to force localities to think about regional goals instead of purely local goals. The state will have to find much stronger mechanisms – both incentives and sanctions – to secure an adequate supply of, and fair distribution of, housing in Southern California and the state as a whole.

[i] "Orange County; Developer's Plan B for mission viejo; opposition to a proposal for affordable housing has forced a new ideas: putting high-end homes on the same lot" (Los Angeles Times, April 19, 2004)

[ii] Prop 1 provided for a bond issue of $500 million to provide funds for financing housing through the California Housing Finance Agency.

[iii] Technically, we denoted the bottom 20.7 percent of households as low-income, as this coincided with the Census income category cut of of $19,999 in 2000. The adjusted income figure for 1990 was very close to another Census income category cut off of $14,999, which was also used. 18.5 percent of households fell into this category in 1990.

[iv] While smaller cities can compete for the funds through the States and Small Cities Program, and by forming consortiums with other cities and counties, 70 percent of all CDBG funds go to the larger entitlement cities, providing extra funding to assist low-income residents

[v] Source: State of California. Fiscal Years 1992-2001. "Redevelopment Housing Activities in California." Sacramento, CA: Department of Housing and Community Development "Total added to L&M Fund"

[vi] The LIHTC provides developers a federal tax credit of up to 9% of the costs of acquisition, construction, or rehabilitation of low-income housing. The credit can be claimed each year for ten years. A project must have 20% of its units rented to households with incomes of 50% or less of area median income, or, at least 40% of units must be rented to households with incomes of 60% or less of area median income.

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