



## **The Great Housing Collapse in California**

By Dowell Myers and Julie Park  
*University of Southern California*

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California is enduring a severe housing crisis. For more than a decade, housing construction has tracked well below the needs of population growth, with especially steep deficits in multifamily housing. As a result of the shortages, vacancies have plummeted to near record lows, while prices have shot upwards. This Great Housing Collapse has continued even though in recent years other economic indicators (i.e., employment rates and income growth) are all very positive. How did this come about? What are the causes? And what should be done?

### **An Undersupply of Housing**

During the 1990s, a total of 1.11 million housing units were added in the state, compared with 2.07 million units the previous decade. Although the state's population also grew more slowly in the 1990s, increasing by 4.11 million residents versus 6.09 million the previous decade, the downturn in housing construction was much steeper than the population slowdown. During the 1980s, one housing unit was built for every 2.95 additional residents, while in the 1990s one housing unit was built for every 3.72 additional residents.

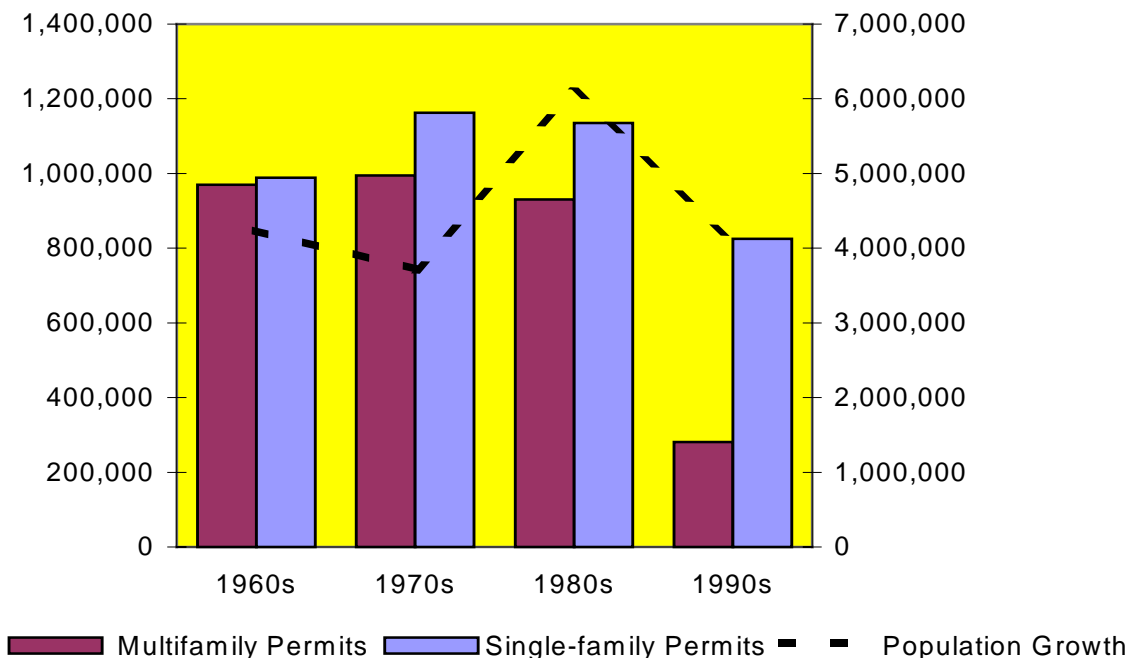
We estimate that construction was nearly one-third lower (33.0 percent) than would have been expected had average household size remained at the 1990 level, and had there been normal allowances for vacancies and replacements due to losses in stock (details in appendix table 1).

Compounding the gravity of this shortfall, multifamily construction in particular has plunged. Whereas multifamily housing accounted for between 45 and 49 percent of total housing construction during the 1960s, 1970s, and 1980s, last decade it fell to 25 percent of the already depressed total. The importance of multifamily housing to the rental sector is such that the multifamily downturn contributed to an even steeper shortfall of new construction in the rental sector during the 1990s—41.3 percent—versus a 28.8 percent shortfall in new owner-occupied housing (see appendix table 1).

### **Anatomy of the Collapse**

The Great Housing Collapse is summarized in figure 1, which shows the number of multifamily and single-family units authorized by building permit each decade. The dashed line shows the volume of corresponding population growth each decade, ranging from 3.70 million in the 1970s to 6.09 million in the 1980s, and back to 4.11 million in the 1990s. Housing production was fairly steady over these decades, with the exception of the 1990s, when single-family construction declined moderately and multifamily housing dropped precipitously.

*Figure 1. The Great Housing Collapse in California*



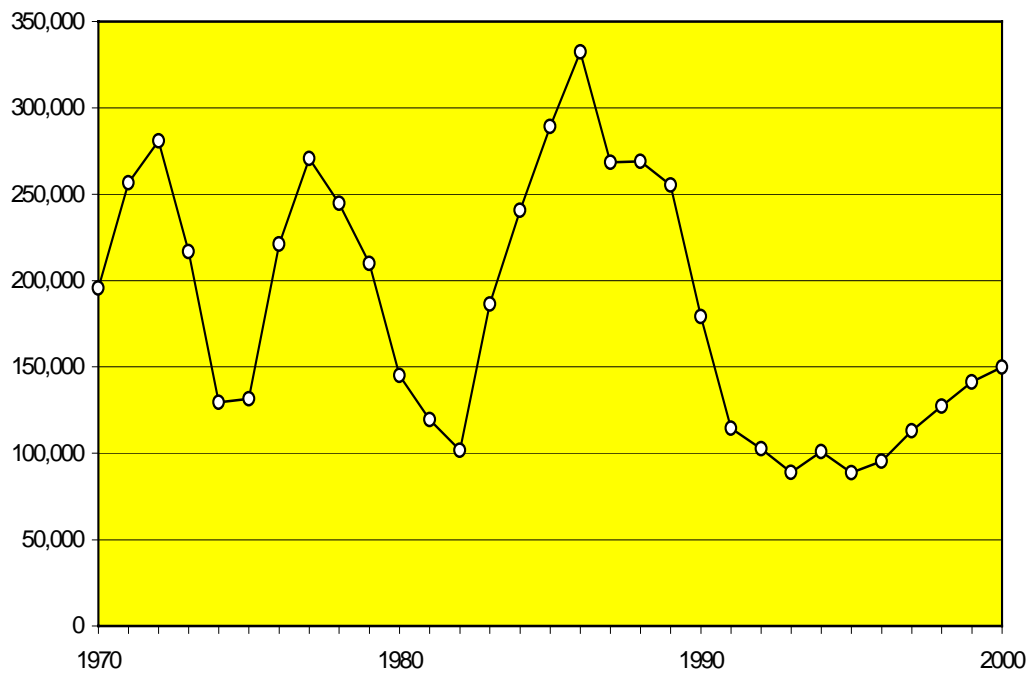
**Number of Housing Construction Permits Each Decade (left scale)  
and Population Growth Each Decade (right scale)**

*Sources:* Population growth (U.S. Census Bureau 1960–2000); building permits (U.S. Census Bureau 1960–69, Construction Industry Research Board 1970–99).

The decline in multifamily construction is particularly alarming because this sector of the housing stock is of growing importance as the state’s population shifts in composition. Growing numbers of immigrants and Latinos suggest that greater than average numbers of multifamily units are needed in the state. Overall, 79.7 percent of the state’s total population growth during the 1990s was among Latinos, a group that has a substantially greater likelihood of occupying multifamily units (Myers 2001).

A more detailed picture of housing construction trends in California is provided by figure 2, which shows the cyclical volatility of housing construction. From 1970 through 2000, three booms in construction reached annual levels in excess of 250,000 units. In the same time period, three downturns are visible, only the third of which lasted for more than two years. The downturn of the 1990s persisted for six years, from 1991 through 1996, before commencing a weak recovery. Although construction levels at the bottom of the recent downturn hovered around 100,000 units, as in past troughs, the recovery post-1996 has failed to exhibit the vigorous rebound witnessed in previous cycles.

**Figure 2. Housing Construction Permits Plus Estimated Mobile Home Placements in California, 1970 to 2000**



Source: Construction Industry Research Board (1970–2000).

How does this pattern of unusually low construction compare with the rest of the United States? Table 1 shows the number of building permits issued in the past two decades for the nation, the four census regions, the West region without California, and California. For total permits issued, the nation as a whole had lower construction in the 1990s than in the 1980s. This is true for the Northeast and South regions while the Midwest region experienced a 32 percent increase in total permits. On the surface, it seems that the West region also had lower construction in the 1990s, resembling the nation. However, the West region actually had 23.4 percent higher construction than the previous decade if California is excluded. In contrast, California only had half (53.2 percent) as many building permits as in the 1980s, a much lower level of production than experienced in other regions. The downturn in multifamily construction is also more severe in California than elsewhere.

*Table 1. Housing Construction Permits for the United States, Regions, and California, 1980 to 2000*

	U.S.	Northeast	Midwest	South	West	West (w/o California)	California
<b>Total Permits</b>							
1980-89	14,295,188	1,923,095	2,178,754	6,334,029	3,859,310	1,800,197	2,059,113
1990-99	13,200,287	1,359,721	2,877,016	5,646,559	3,316,991	2,221,169	1,095,822
Ratio:1990s to 1980s	0.923	0.707	1.320	0.891	0.859	1.234	0.532
<b>Single-Family Permits</b>							
1980-89	8,629,042	1,327,651	1,319,071	3,798,559	2,183,761	1,053,357	1,130,404
1990-99	10,076,553	1,105,267	2,177,129	4,316,420	2,477,737	1,653,321	824,416
Ratio:1990s to 1980s	1.168	0.832	1.651	1.136	1.135	1.570	0.729
<b>Multifamily Permits</b>							
1980-89	5,666,146	595,444	859,683	2,535,470	1,675,549	746,840	928,709
1990-99	3,123,734	254,454	699,887	1,330,139	839,254	567,848	271,406
Ratio:1990s to 1980s	0.551	0.427	0.814	0.525	0.501	0.760	0.292

*Source:* Analysis by Dowell Myers and Noel Hacegaba, University of Southern California, of data from U.S. Census Bureau (<http://www.census.gov/const/www/C40/table2.html>).

### **Causes of the Collapse**

Overall, the pattern of housing construction in the Great Housing Collapse is unprecedented in California, with the exception of during the Great Depression years. What is most puzzling is that the state has recovered strongly from the economic recession of the early 1990s. Unemployment levels in 1998-2000 approached the lowest levels since World War II, and incomes also rose sharply from 1993 to 2000 in the great majority of the state. Yet housing construction has failed to respond in a manner reflecting this overall prosperity.

No single factor explains the recent weakness in construction. No shortage of developable land exists, according to one credible study (California Department of Housing and Community Development [HCD] 2000), but political will might be lacking. Growth management restrictions are slowing the pace of development on the urban periphery, while citizen resistance to denser infill development is impeding apartment construction. The latter is also harmed by the withdrawal of federal tax subsidies that spurred construction in the 1980s. High land prices also discourage apartment developers, because that undermines the feasibility of new construction at rents affordable to the growing, moderate-income work force. Finally, California's restrictions on property tax increases instituted by Proposition 13 in 1976 leave cities fiscally impoverished and dissuade them from encouraging housing construction for new residents whose service needs are greater than the local tax revenues they generate.

## How Was the Shortfall Covered?

With such low housing construction during the 1990s, how did California accommodate the growth of 4.11 million residents recorded by the 2000 census? Several possible factors could have helped the state cope (see appendix table 1). First, the 1.11 million units built during the 1990s did absorb much of the population growth, aided by the fact that average household size (in both the new and existing housing stock) increased during the past decade from 2.78 to 2.87. This increase might seem small, but it offset the need for an additional 298,000 housing units.

In addition, both homeowner and rental vacancy rates have dramatically decreased, which means that previously vacant units are now being occupied. The homeowner vacancy rate decreased by .63 percentage points (from 2.03 percent in 1990 to 1.40 percent in 2000). The rental vacancy rate plummeted even more dramatically, from 5.94 percent to 3.70 percent, a decrease of 2.24 percentage points. The decline in vacancy rates accommodated an additional 157,000 households (115,000 of them renter households). Considering that California HCD calls 5 to 6 percent a healthy benchmark for rental vacancy rates, the state is depleting the vacant housing stock to dangerously low levels.

Finally, California appears to have had fewer housing demolitions and other losses last decade than typical. These forgone losses could have been the source of tens of thousands of additional occupied housing units. (We can be less certain about this component. It is possible that losses continued as before but they were offset by the addition of illegal, uncounted housing units. This is a murky area of housing statistics.)

The draw down of available vacant housing units, larger households, and forgone demolitions allowed California to accommodate significant population growth despite its low housing construction. The state has managed to get by in the past decade, but it cannot continue to support the same kinds of adjustments in the decade to come. In particular, California has already depleted its limited supply of vacant housing to dangerously low levels, creating shortages that drive up prices and rents, and restricting opportunities for residential mobility. At the same time, continued increases in household size may further aggravate the existing problem of overcrowding. In 1990, the overcrowding rate for renters was 19.5 percent in California, compared with only 8.9 percent for the nation. (Comparable data from Census 2000 have not yet been released.)

A number of other studies have also documented the urgency of California's housing crisis (California HCD 2000). A comprehensive review by the California Senate Office of Research (1999) found "housing growth badly lagging both population and job growth." In a commentary, Anthony Downs (2000, 1) observed that sustained housing shortages will "create the nation's largest slums in California." These shortages are severely affecting all income groups, decreasing affordability, and making labor recruitment more difficult, leading to highly publicized economic forecasts with the message: "Housing Gap Threatening State's Economy, Study Says" (Hirsch 2000).

Addressing California's housing crisis will become increasingly important in the coming decade. Household growth projections indicate that construction will need to pick up markedly in the current decade compared with the last one. The Center for Continuing Study of the California Economy (Levy 2001) projects that household growth will be 74 percent higher in 2000-10 than 1990-2000. Our own

study, the California Housing Futures Project (<http://www.usc.edu/schools/sppd/futures/chfindex.htm>), suggests that household growth will increase by 70 percent this decade over last.

Construction would need to increase by more than the 70 percent greater growth in households, because the past decade's household growth was undersupplied by 33 percent and vacancy draw down is no longer an option for the coming decade. Housing construction needs to approximately double in the current decade versus the last. Although one might expect that, as the state eases out of the current recession, a massive boom in housing construction would unfold to meet both new housing needs of the current decade and the deferred needs of the last, in fact a boom will not unfold automatically. Local citizens and elected officials have grown accustomed to a very low level of construction that they already consider burdensome.

### **Some Possible Remedies for the Future**

The magnitude and persistence of the Great Housing Collapse require fundamental solutions to break out of this impasse. Several policy changes would assist in generating necessary solutions.

One policy shift addresses the fiscal incentives for localities to approve housing construction. The prevalent view among local governments is that housing generates less in the way of taxes than it consumes in terms of services. One source of local revenue is the retail sales tax, which the State of California shares with localities where the commercial properties are located. If sales tax receipts were allocated based not simply on point of sale but also on the number of residents and rate of new housing construction, an important fiscal incentive would be created to spur construction. Just such a plan is represented in Assembly Bill 680 sponsored by Darrell Steinberg, which was passed by the state assembly in March 2001 and is waiting approval in the senate. Although AB 680 pertains to only the Sacramento region, it is viewed by some people as an important prototype for the rest of California.

A second policy change would restore the federal tax credits for multifamily housing construction that were removed as part of the Tax Reform Act of 1986. When multifamily rental housing is recognized to be as important a merit good as homeownership, support may grow for subsidizing this form of housing, although those subsidies would never reach the level of the home mortgage interest deductions.

A third policy may be controversial but deserves discussion nonetheless. At present, the State of California requires, but does not enforce, each locality, as part of its general plan, to periodically update a housing element that establishes how it will accommodate its share of new housing for a range of income categories (Article 10.6, California Government Code). The housing crisis in California is one of inadequate supply of all housing, and of multifamily housing in particular, regardless of the income level of the occupants. It is the total undersupply of housing that is the prime factor creating the state's great affordability problems. Accordingly, the State needs to place greater weight on localities' production of total housing construction, including a share of multifamily housing, and that emphasis needs to be backed with stronger teeth than at present. Once housing can be provided in the required volume, price escalation will ease and all housing consumers will be better off.

Surely the Great Housing Collapse will not persist through the coming decade. Whether by means of the policy changes identified above, or by other innovations, the pressing housing needs of the state can no longer be deferred.

### *Authors*

Dowell Myers is Professor and Director of the Master of Planning Program and Julie Park is project manager in the School of Policy, Planning, and Development at the University of Southern California. This article was developed as part of the California Housing Futures Project, which was funded in part by Fannie Mae Foundation.

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Appendix

Table A.1. Covering the Housing Construction Shortfall, 1990 to 2000

	Total Occupied Units	Owner- Occupied Housing Units	Renter- Occupied Housing Units
Growth in Residential Population <sup>a</sup>	4,043,733	2,805,475	1,238,258
Expected Household Growth <sup>b</sup>			
(assumes 2000 household size same as 1990)	1,439,762	987,843	451,919
New Supply Added 1990-99			
Permitted Construction <sup>c</sup> 1990-99	1,105,814	761,477	344,337
Mobile Homes <sup>d</sup> 1990-99	46,284	46,284	-
Total New Units 1990-99	1,152,098	807,761	344,337
Less Vacancy Allowances <sup>e</sup>	- 36,815	- 16,155	- 20,660
Total New Occupied Housing	1,115,283	791,605	323,677
Replacement of			
Estimated Losses to 1990 Stock <sup>f</sup>	223,658	124,397	99,261
Presumed Shortfall in Housing (Total new occupied housing, minus expected household growth, minus replacement of estimated losses)	- 548,137	- 320,635	- 227,503
Percentage Shortfall <sup>g</sup>	- 33.0	- 28.8	- 41.3
Estimated Market Adjustments to Cover Shortfall	Total	Owners	Renters
Vacancy Draw Down <sup>h</sup>	157,120	41,827	115,292
Larger Household Size <sup>i</sup>	297,902	207,454	90,448
Forgone Losses <sup>j</sup>	93,116	71,353	21,763

Source: Census 2000 except as otherwise noted.

Notes:

<sup>a</sup> Population growth from 1990 to 2000 in occupied housing plus the growth of those not living in households (67,894) equals total population growth (4,111,627).

<sup>b</sup> The growth in the residential population was divided by the 1990 average household size to calculate the expected growth in the number of households.

<sup>c</sup> Data from the Construction Industry Research Board. The permit data are for single-family and multifamily construction, so these numbers were allocated to tenure classes based on relative growth in owners and renters from 1990 to 2000.

<sup>d</sup> Mobile home data from California Department of Finance; assumes all new mobile homes are owner occupied.

<sup>e</sup> Vacancy rates as recommended by the California Department of Housing and Community Development.

<sup>f</sup> Demolition rates as assumed by the California Department of Housing and Community Development.

<sup>g</sup> Percentage of expected growth (household growth plus replacements for losses).

<sup>h</sup> The difference in the number of actual vacant units and the expected vacant units using 1990 vacancy rates.

<sup>i</sup> The difference in the number of actual households and the expected households using 1990 household size.

<sup>j</sup> The remainder of the presumed shortfall in housing after taking into account vacancy draw down and larger household size.