Affordable Housing to Get a Bump

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In this quarter’s California report we return to the question of housing affordability. The issue has become one of the prime concerns in Sacramento and in city halls throughout the state. In earlier reports, we made the claim that the high cost of housing is a deterrent for in-migration to California, and as such, limits the growth rate of State GDP once full employment occurs. Since we are in the neighborhood of full employment, it is worthwhile to consider the various plans being offered and ask if they are going to change this dynamic.

In Sacramento, the State legislature is sending a $4B affordable housing bond bill to be sent to the voters as well as several bills that would change the approval process for new construction. It also proposes to add a transfer tax to fund affordable and veterans housing.

Locally there is action as well. For example, Los Angeles modified its rent stabilization law, is moving to legalize currently unpermitted housing and is exploring creative ways to increase affordable housing. San Francisco passed the HomeSF law granting height exemptions to developers in exchange for affordable housing units in the most expensive city in the country. Other cities around the state are considering or have passed measures to add funds and ease building restrictions so as to increase the supply of housing, all in the name of easing the “affordability crisis.”

These State and local measures will presumably boost the number of homes built in the State each year.

The increased density in California cities will indeed increase the stock of housing. More housing makes homes less expensive than they otherwise might be, but will it make them less expensive in absolute terms? We explore this question and its relation to the forecast by first examining the current employment situation, and then by delving into the question of density and affordability; why this will or will not make a big difference in migration to and from The Golden State. The answer then feeds into the updated forecast for September.

Employment Retrospective

Before turning to the question of housing costs, let’s consider the employment situation. This is the basis for the demand for housing. The July jobs numbers brought good news to California and August followed by taking a bit of the wind out of the sails. The State’s unemployment rate ticked up to a still low rate of 5.1% from July’s 4.8%. This was likely a result of a stellar July bringing more job seekers into the market, but not more jobs.

California’s population is on average younger than the rest of the U.S. due to it being an immigrant heavy state.
AFFORDABLE HOUSING TO GET A BUMP

Chart 1

SA CHANGE IN NON-FARM PAYROLL JOBS & UNEMPLOYMENT RATE

Source: EDD.ca.gov

Chart 2

Change In Jobs By Sector (July 2016 to July 2017)

Source: EDD.ca.gov
Therefore, one expects the unemployment rate differential to be at about the levels currently experienced relative to the national rate. Younger workers take longer to find employment as they lack as compelling a resume as older workers, and they tend to change jobs more often as they experiment with alternatives for life-long careers. Thus, the slightly higher unemployment rates are not suggestive of room for more rapid job growth.

However, the surge of new entrants to the labor force in August does suggest there may be some room for increased employment, but not much room. We should expect, all other things equal, a mixture of July and August numbers averaging about 30,000 per month in the future.

On a sectoral level, job gain has been widespread during the past twelve months. The mining and logging and non-durable goods manufacturing sectors continued to post job losses. The big winners have been construction, education, health care & social services, and leisure & hospitality. Continued growth in the first of these is threatened by higher interest rates, and the latter two are at risk from changes to Obamacare and reductions in international tourism. Professional and business service sector employment, long a bright spot in the recovery from the 2008-09 recession has been flat over the last twelve months.

Though the national data does not suggest a significant downturn in economic growth over the next twelve months, these patterns do not give us much in the way of historical evidence for continued robust employment growth. Indeed, to continue the very rapid growth in employment requires immigration. With Trump’s policies decidedly reducing immigration, net domestic migration to California would be required. And that brings us to the high cost of housing.
Urban Density and Housing Affordability

That housing in California is relatively expensive is obvious. At the state level, housing bills designed to add more housing through subsidy and streamlined building permits have been passed to alleviate the problem. To consider the impact on in-migration and therefore economic growth, we first look at density and housing costs across the U.S. and then turn to the question of how much will the increased housing induced by current policy change home prices.

If one examines density in housing across the U.S. for cities with populations greater than 500,000 (Chart 4) it is clear that there is no relation between actual density of housing and the affordability of the city. The reason for this is that, where land is expensive due to either physical or man-made restrictions on building, people economize, use less of it, and therefore live more densely.

But density is part of the issue. Certainly, more supply means lower housing prices; but how much lower? If the answer is 1%, then most would agree that not much has been accomplished. Rolling back the last three years of home appreciation (18.23%) or more would be something different.

To understand what this means, consider the elasticity (or responsiveness) of the demand for housing in California when prices decline. San Diego and San Francisco will be different than say, Youngstown, Ohio or Cheyenne, Wyoming because those and many other cities in the United States are not attractors. They have very affordable housing, but making it even more affordable will not do much to attract new residents.

It is well known that the high price of housing excludes many people who would otherwise move to California. At least part of the reason why California housing from Bakersfield and Fresno to San Francisco and San Diego is uniformly higher than elsewhere in the U.S. is the premium, attributable to the amenities that Californians enjoy. The premium has been going up much faster than home prices in the rest of the country of late and that is the “housing affordability crisis” that the State legislature and city councils around the state have been grappling with these past few years.

So what happens when there is an increase in the stock of housing of the magnitude expected from current policy? The California LAO, the research body attached to the legislature for policy analysis, studied the demand for housing in California and estimated that 80,000 to 100,000 more units per year would need to have been built to keep the differential between California’s housing prices and the rest of the country at 1980 levels. In other words, we are three million shy of achieving the 1980 premium.

Using their estimates of the need for housing for both Californians and migrants attracted by the California lifestyle and more affordable housing, we find that to obtain a modest 10% reduction in price requires a little over 20% more housing. In Los Angeles County there are currently 3.5M housing units. This means rolling back to 2014 price levels requires 1.28 million new units. Some of that will support people doubling up who will now move to newly available units and some to support new residents. The City and State affordable housing initiatives will contribute only a small percent of that.

Achieving anything close to this by the end of 2019, our forecast horizon, is pie-in-the-sky. Indeed, even in a 10-year building program at 130,000 additional homes would be a challenge. Moreover, the new households will require utilities, water, transportation, and city services, and if the experience of the 1960s to the 1980s, the era of large migrations to California provide any guidance, that infrastructure will need to be funded, at least in the near term, with more taxes.

The above analysis suggests that making housing affordable in California is difficult at best. Before turning to the forecast, let’s digress and ask what are the alternatives? Targeted affordability appears to be the most effective solution. For example, if having teachers live in the community where they teach is deemed to be important, then perhaps a government/teacher equity-sharing plan would be efficient. A school district, for example could purchase x% of a home and the teacher the balance. The two would share in the appreciation of the house, and the district would be able to attract quality teachers to the classroom.

Churches have done this for years. It is relatively common for a church to purchase a rectory or parish house as a residence for the priest or pastor in order to keep the clergymen in the community of their parishioners. So it is not a novel idea, but it does take some thought on the part of governmental bodies to decide who the privileged groups are and it takes an admission that achieving affordable housing for all might be a worthwhile goal and at the same time impractical.

Returning to the forecast, the current legislative initiatives will moderate the increase in the price of housing, but will not do much to alleviate the high cost of living in California in the near-term. Therefore, the growth in California employment and income, limited by full employment, is not
likely to be more rapid than the natural increase in population. However, growth in housing starts and construction employment will be higher than previously projected. In other words, expect relatively slow growth in California, just slightly above the U.S. through the next few years with a tilt, a slight tilt, towards more new home construction.

The Forecast

Once again, the current forecast is slightly lower and pushed out in time than our previous one. This reflects the difficulties that the Trump administration is having in getting any of its proposals passed. The tightening of immigration has been mitigated by the protections put into place by the State, but is expected to be negative. The national forecast has imbedded a change in the tax law and that is reflected in the 2018-19 forecast. In addition, the aforementioned increase in home construction has boosted growth in that sector. We expect California’s unemployment rate to have its normal differential to the U.S. rate at 4.5% by the end of the forecast period (2019), the same as in June’s forecast.

Our forecast for 2017, 2018 and 2019 total employment growth is 1.1%, 0.9% and 0.9% respectively. Payrolls will grow at about the same rate over the forecast horizon. Real personal income growth is forecast to be 2.0%, 3.1% and 3.1% in 2017, 2018 and 2019 respectively. Homebuilding will accelerate to about 123,000 units per year through the forecast horizon.

Source: Demographia.com, U.S. Census