



Investing in Home Production to Stimulate California's Economy

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Introduction

Failures in the housing and home-lending markets have triggered the current crisis in the financial sector that is being felt throughout the economy. The crisis requires decisive state action to stabilize the housing market and invest in proven solutions that will help jumpstart the state's economy.

In the midst of the current crisis, there is an ongoing success story — bond Propositions 46 and 1C have successfully financed the production of a wide variety of homes at prices that are finally affordable to most Californians.

Proposition 46 alone created a new supply of homes affordable to more than 111,000 Californians, provided thousands of jobs, and continues to be a positive economic multiplier in communities throughout the state.¹

The governor and legislature accelerated the state's Proposition 1C investments as a vital part of the economic recovery strategy. But those bond funds will begin to run out in 2009, resulting in job losses and further cuts to state and local revenues. In order to keep this production pipeline flowing and working to support the economy, California needs a steady, dependable source of investment for increasing supply and variety in the housing market. This investment in homes will also help defrost credit markets and help the full housing market recover.

The Housing Crisis

California's housing market was broken long before foreclosures began to increase. Each year, the housing demand in California grows by an average of 220,000 homes. Even in the most productive years, supply has not met demand.² The gap between the number of homes built and the number needed by people at lower and middle-income levels has grown annually since the 1980s.

Additionally, for the past two decades, there has been little variety or choice in the housing market — the market has focused primarily on producing one product: large, single-family, for-sale homes. At the market's peak, only 11% of Californians could afford these products,³ and many only with risky mortgages. Even the rental market lacked variety and choice, also focusing on the highest wage-earners.

1. California Department of Housing and Community Development, "Cumulative Proposition 46 Bond Awards." (through June 30, 2008) www.hcd.ca.gov/fa/Prop_46.pdf.

2. California Department of Housing and Community Development, *California's Deepening Housing Crisis*. (November 17, 2005). California Budget Project, *Locked Out: 2008* (February 2008), cites a range of housing numbers in a given year, 190,000 to 240,000, using HCD's projections for 1997-2010, p. 27.

3. California Association of Realtors, Traditional Housing Affordability Index, Second Quarter 2007.

The gap between the median priced for-sale home and what most Californians could afford began to significantly widen in the 1980s. To make matters worse, at about the same time, apartment construction failed to keep pace with demand, making it much more difficult for working families to find an affordable place to rent. Among the many factors that created this supply and demand imbalance was an inadequate amount of land zoned for homes — especially multifamily — and the rising costs of land, labor, and supplies.

In the current housing-market crisis — even with foreclosures and declining housing prices — California is still experiencing a housing shortage.

The bursting of the housing bubble is a tragedy for millions of families who have lost significant equity or been forced to move, and has reverberated throughout the state's economy. The foreclosure crisis is not yet over. California is impacted more than any other state, with a foreclosure filing rate more than twice the national average.⁴

Contrary to popular belief, foreclosures do not increase the housing supply. Obviously, when an owner-occupied home forecloses, the owner no longer has a place to live, and owners aren't the only ones being affected. As many as 25% of the people evicted in California — due to foreclosures — are renters.⁵ Once evicted, former owner-occupants and tenant occupants still need a place to live. Homes reentering the marketplace due to foreclosures do not increase the overall supply. And while they may be available, they are still not affordable to nearly half of California households.⁶

Meanwhile, California's renters represent one-third of the nation's rental households, with four out of ten California households renting their homes in 2006.⁷ With rental vacancy rates at around two percent in most California communities,⁸ the greatest need is for the production of affordable rental homes/apartments.

How Did We Get Here?

Offers of easy, inexpensive credit with low underwriting standards inflated the demand for for-sale homes, which in turn inflated home prices. The booming housing market made mortgage-backed securities increasingly attractive, creating more demand among investors for these securities, who responded with even-less-secure subprime loans for homebuyers.⁹ At the same time, this credit was increasingly securitized: that is, banks would pool together many different loans and sell securities based on the rights to the payments from the loans to outside investors.

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4. Dan Levy, "Foreclosure Storm Will Hit U.S. in '09 Amid Job Loss (Update 1)." Bloomberg.com. (December 11, 2008).

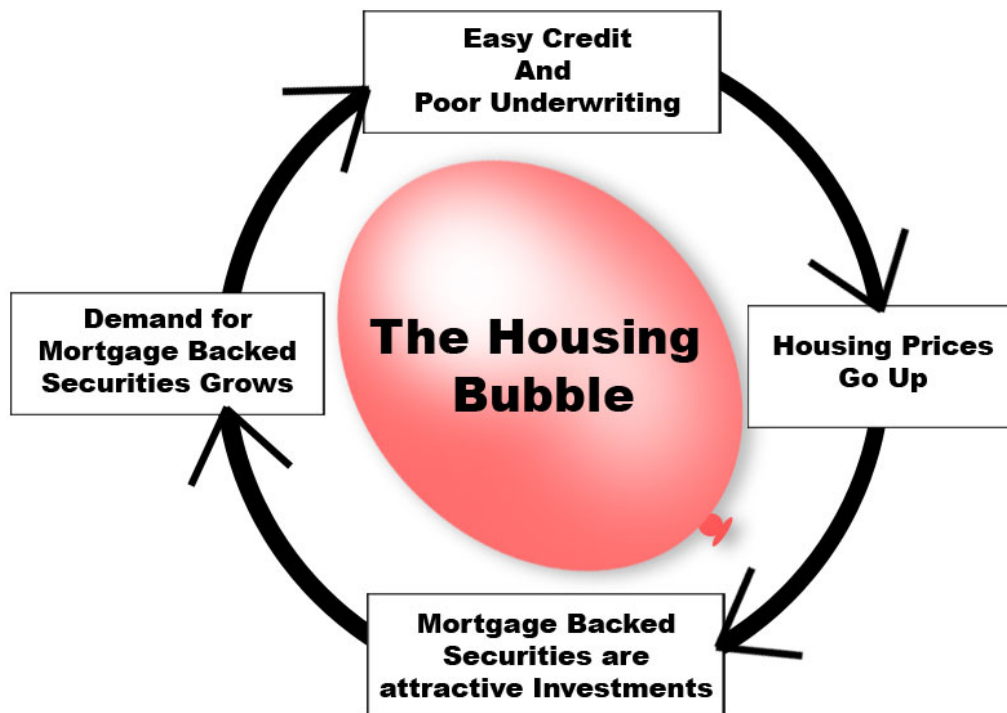
5. Interview with Kevin Stein, California Reinvestment Coalition (January 2009).

6. California Association of Realtor's First-Time Buyer Housing Affordability Index (FTB-HAI) rose to 53 percent during the third quarter. <http://www.car.org/newsstand/newsreleases/som2008release/>.

7. 2005-2007 American Community Survey 3-Year Estimates. Of the 12,140,188 households in California, 5,055,754 are renters.

8. Natalie Siniavskaja, *Local Vacancy Rates in Government Databases*, National Association of Home Builders (October 2007).

9. "From Wall Street to Main Street: Understanding How the Credit Crisis Affects You." Prepared by the Joint Economic Committee Majority Staff. (October 3, 2008).



Graphic excerpted from U.S. Congress Joint Economic Committee Majority Staff report, "From Wall Street to Main Street: Understanding How the Credit Crisis Affects You." (October 3, 2008)

It is now obvious that the safety of many of these securities was overrated and the underlying assumptions faulty. This has resulted in some financial institutions having to take huge write downs in recent months, while those without sufficient capital — including Countrywide, Wachovia, and Washington Mutual — have failed. Approximately 3.5 percent of all housing units in the state, or 400,000 homes, are currently in the foreclosure process or already bank-owned.¹⁰

Impacts on the State

The housing market failure is reflected in the state's budget in the form of declining property tax and sales tax revenue. An estimated \$4 billion of last year's budget deficit is attributable to it.¹¹ Fred Silva, fiscal policy advisor to California Forward, predicts that 2008-09 will be the first year-over-year decline in state property tax since the Great Depression.¹²

Because of the economic downturn, the real cost of staying in a home — whether rented or owned — is reducing families' discretionary income, which further strains the economy. Fifty-eight percent of California households spend more than 30 percent of their income on housing.¹³

10. Beacon Economics, *An Economic Backdrop for Fiscal Reform in California* (November 2008), p. 10.

11. Speaker Karen Bass, Pedro Nava, and Ted Lieu, Assembly California Legislature, Letter to Governor Arnold Schwarzenegger. (October 24, 2008).

12. In press conference for release of Beacon Economics report for California Forward, *An Economic Backdrop for Fiscal Reform in California*, (November, 2008). "We expect California's total property tax revenues to fall 10 percent before finding a bottom." p. 13.

13. The Working Poor Families Project, *Working Hard, Still Falling Short* (2008). www.workingpoorfamilies.org.

For many years government has played a successful and vital role in the housing market.

Government programs have simplified home purchases for many first-time homebuyers and established protections in the contracting process.

By building a greater supply of affordable choices in homes, more money would be available for other goods and services. The situation is even more dire for almost one-third of families in low-income households, which are home to 35% of California's children. Parents are typically working more than 40 hours a week and paying more than one-half of their income to keep a roof over their heads.

The current economic downturn is already driving more families into poverty.¹⁴ Many of these families are becoming homeless. The already strained community and social-service safety net cannot absorb the growing pressure. More than 200,000 school-age children were homeless at some point during the 2007-08 school year, a 26 percent increase over the prior year.¹⁵ Increasing the supply of affordable homes will help some of the families displaced by foreclosures, including renters who — through no fault of their own — are evicted from foreclosed properties due to landlord mortgage defaults.¹⁶

Repairing the Broken Housing Market

For many years government has played a successful and vital role in the housing market. Government programs have simplified home purchases for many first-time homebuyers and established protections in the contracting process. The federal mortgage interest tax deduction has been a great incentive to home ownership. Federal, state, and local governments have partnered with private home builders to increase the supply of rental homes affordable to the most vulnerable — people with low incomes or special needs.

State investment through Propositions 46 and 1C have proven highly effective. The investment made in communities has paid dividends in increased tax revenue, job creation, and other benefits to Californians.

There is idle capacity in the home-building sector that can be put to work immediately — every Notice of Funding Availability for state housing programs is oversubscribed.

Public-private partnership–supported state investments, such as the Multifamily Housing Program, have catalyzed successful economic development in communities throughout the state. California has the nation's most sophisticated network of public-private partnerships for producing affordable homes. Home builders in the network provide vital jobs and fuel local economies, while also leveraging a wide variety of financing sources such as bank loans, private investments, tax credits, tax-exempt bonds, community development block grants, state funds, redevelopment funds, local trust fund dollars, grants, and contributions.

14. Sharon Parrott, "Recession Could Cause Large Increases in Poverty and Push Millions into Deep Poverty: Stimulus Package Should Include Policies to Ameliorate Harsh Effects of Downturn." Center on Budget and Policy Priorities (November, 2008). p. 1-2.

15. "Population of homeless children in inland area and beyond grows," *Riverside Press-Enterprise* (December 18, 2008).

16. Parrott, p. 2.

Government incentives such as the mortgage interest tax deduction and first-time homebuyer programs have worked well to encourage home ownership. Homeownership programs provided by California Housing Finance Agency (funded by housing bonds) are not only extremely successful, but have an extremely low foreclosure rate.

Housing Market Stabilization Plan

In 2001, the state's chief economist Howard Roth said that the lack of affordable homes was the second biggest threat to the state's economic prosperity. Housing production — more than home prices or tax levels — is among the most important factors in promoting long-term job growth.¹⁷ Expecting the broken market to right itself without any additional state or federal investment will be costly not only to communities, but also to the state balance sheet.

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State leaders must make a timely commitment to a dependable source of funding for housing programs that will stimulate the economy, increase the supply of affordable homes, and help stabilize the housing market.

Most Californians who are not already homeowners are not in a position to buy, and now they are facing an extremely tight rental market. A dedicated, permanent source of funding for housing programs will help address the tight rental market by increasing the supply of affordable homes and ensuring that people with special needs, farmworkers, homeless individuals and families, limited-income seniors, and low-wage earners all have a place to live. A greater variety and supply of homes affordable to all Californians is needed to relieve overcrowding and reduce pressure on the market-rate rental market.

Making a significant investment to increase the supply of homes affordable to Californians will put people and idle capacity to work and should be a key component of California's strategy for economic recovery and lasting market stability. For the last three years, the Silicon Valley CEO Business Climate Survey cited creating affordable homes as "the most significant action the state government can take to improve the business climate."¹⁸

State Investment in Home Production Will Stimulate the Economy by:

- **Investing in "Shovel-Ready" Projects:** A permanent, dedicated source of revenue for state housing programs will stimulate the economy by investing in home building opportunities that are ready to go.
- **Encouraging Banks to Reenter the Housing Market:** Every \$1 billion in predictable and dedicated annual financing will leverage about \$7.1 billion in private investment by providing banks and other lenders the confidence they need to reenter a more-stable housing market.
- **Creating Jobs:** Every \$1 billion in new state investment will put more than 46,000 people to work in the construction trades and related jobs.

17. "Study finds housing key to job growth," by Robert Gavin, *Boston Globe*, (December 30, 2008). (Refers to study by Edward Moscovitch with Cape Ann Economics.

18. Silicon Valley Leadership Group. CEO Business Climate Survey, 2005-2007 (2007).

- **Helping Balance the State Budget:** New revenue will relieve demand on the state's General Fund and help balance the state budget by replacing periodic bonds that are repaid out of the General Fund.
- **Removing Pressure on the Rental Market:** State investment to increase the supply of affordable rental properties will relieve over-crowding and remove some pressure off the market-rate rental market, where renters not in a position to buy are facing extremely low vacancy rates.
- **Increasing Local Government Revenue:** For every \$1 billion invested, new construction will increase local government's property tax receipts by \$295 million in the first year and \$122 million annual thereafter.
- **Encouraging Smarter, Greener Growth:** New homes built near transit centers will reduce highway congestion and air emissions and new construction methods reduce the impact on the environment and provide more-efficient, healthier, and less-expensive homes.

Any successful state response to the economic housing crisis will have to include strategies to resolve the long-standing and fundamental imbalance in the housing market.

Lasting economic recovery and prosperity cannot be achieved unless the supply and variety of housing choices is brought into better alignment with the many different needs of Californians. Establishing a dedicated and predictable source of new revenue for investment to increase the supply of affordable homes will create a powerful economic stimulus and help workers, businesses, and families in every community.

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