



The California Housing Crisis: Time For Government to Look in the Mirror

Early in 2018, California lawmakers tried but failed to repeal the State’s Costa Hawkins Rental Housing Act—the law that restricts the ability of local governments to establish extreme forms of rent control. Had the repeal effort been successful, local governments would have the authority to restrict rents on single-family homes, condominiums, and all newly-constructed housing units. A repeal of Costa-Hawkins would also have brought back vacancy control—the prohibition on rent increases when a housing unit becomes vacant.

While a repeal would have provided protections for tenants against rent increases in the short term, the long-term effects would have devastated the state’s housing supply, as extreme forms of rent control make owning and developing units unprofitable and unmanageable. Moreover, rent control often leads to severe gentrification in which higher income earners eventually push low-income individuals and families out of their rent controlled units.

The long-term negative impact of extreme forms of rent control on tenants, property owners, and managers was precisely the reason the Costa-Hawkins Act was originally signed into law in 1995. It was a bipartisan effort to allow for moderate rent control provisions while curbing out-of-control regulation on the rental housing industry. The resulting bill did just that: it reigned in some of the most extreme forms of rent control by outlawing vacancy control and price ceilings on single family homes and new construction, while preserving local government’s ability to place rent control restrictions on properties built before 1995.

The decision to repeal the Costa Hawkins Act comes at time when the state is in dire need of affordable rental housing. According to the State’s nonpartisan Legislative Analyst’s Office (LAO), California’s ongoing housing shortage and affordability problems are getting worse. The problems stem from years of population growth and a long history of costly government regulatory roadblocks to housing development; local government favoritism toward commercial development and job growth over housing development (“fiscalization of land use development”); high permit and impact fees; and rising land and housing development costs. As is clear from the LAO report, many of the State’s housing problems are directly attributable to government action and inaction.

The irony here is that government leaders are attempting to address the government-created housing shortage problems by adopting legislation that will serve to further restrict the State’s housing supply. The government’s repeal effort, as counterproductive as it may be, however, is consistent with a long history of government decisions that have contributed to, rather than solve, the ongoing housing crisis. This paper focuses on those very government decisions which have contributed to the housing shortage and have kept California in a perpetual state of housing crisis for the last 50 years.

I. The wisdom of the Legislative Analyst’s Office’s 2015 Housing Report

California is building too few homes in coastal areas, the now infamous 2015 LAO housing report says.¹ Land costs are too high, but can be offset by more density, the report continues.² Building costs, development costs, and permitting fees are also through the roof according to the report (and not in those words).³ To the question of why coastal areas are not building enough, the housing report provides four answers: a) NIMBY (“not in my backyard”), b) stringent environmental reviews, c) local finance structures which incentivize nonresidential development over homes (also called fiscalization of land use), and d) limited vacant land.⁴ Notably, while the LAO report notes that rent control eases housing costs for some,⁵ it also does not recommend rent control or other housing regulations as viable options to address the state’s crisis. It does state, however, that incentivizing development of private housing is the number one priority to begin easing housing shortage and affordability problems.⁶

II. Government and its NIMBY policies

“Not-In-My-Back-Yard,” the policy or principle of being anti-development in one’s own neighborhood or city, has long been recognized as one of the catalysts for California’s housing shortage. As summarized by the LAO:

For decades, California’s local communities—particularly coastal communities—have built too little housing to accommodate all those who wish to live here. California’s cities and counties make most decisions about when, where, and to what extent

¹ Mac Taylor. *California’s High Housing Costs: Causes and Consequences*. CA Legislative Analyst’s Office. An LAO Report. March 2015. Web Jan. 2018.

² Id. at 12-13.

³ Id. at 13-14.

⁴ Id. at 15.

⁵ Id. at 7-9.

⁶ Id. at 34-35.

housing will be built. Many local communities have used this authority in ways that have constrained housing development. These community decisions understandably reflect residents' concerns about the changes that new housing may bring. New housing—and the associated new residents—can exacerbate traffic congestion and parking shortages, stretch local facilities, slow home price appreciation, and alter the community's character.⁷

Interestingly, but not surprisingly, NIMBY-ism has racist roots. In San Francisco, for example, as affordable housing needs increased, it began building segregated housing projects by race.

San Francisco did not want its Chinese American residents to live anywhere except in Chinatown. To ensure their confinement in their picturesque ghetto, the Housing Authority imposed a whites only rule for the first three projects it built, all of which still stand: Holly Courts, Potrero Terrace and Sunnydale.

...

The official policy [of the San Francisco Housing Authority] was to accept only tenants who conformed to a “neighborhood pattern” — the racial and ethnic demographics of a given neighborhood. Since the city was largely white, minorities were allowed to live in public housing only in a few rundown areas.⁸

Housing was not welcome in San Francisco. Many neighbors and city leaders opposed the development of public housing projects, fearing the projects would be populated by an undesirable class of people, depress property values, give a false portrayal of the city or an area as a slum, and endanger children.⁹

As San Francisco's population continued to rise, NIMBY-ism morphed, at least on the surface, from discriminatory sentiment to one justified by preserving the city's physical character and environmentalism. Privately, many were concerned with preserving property values.

⁷ Mac Taylor. *The 2016-17 Budget: Considering Changes to Streamline Local Housing Approvals*. Ca. Legislative Analyst's Office. May 2016. See Summary at 1. Web January 2018.

⁸ Gary Kamiya. “How SF's Housing Authority kept its early projects all white.” *San Francisco Chronicle*. July 22, 2016. Web January 2018.

⁹ *Id.*

Over the years, these anti-development sentiments were translated into restrictive zoning, the most cumbersome planning and building approval process in the country, and all kinds of laws and rules that make it uniquely difficult, time-consuming, and expensive to add housing in San Francisco.

This anti-development sentiment has kept San Francisco from meeting its housing needs. When San Francisco should have been building 5,000 new units a year to keep up with demand, it has only averaged 1,500 units a year for the past two decades.¹⁰ All across the city, instead of building up and more densely, it has created roadblocks and restrictions. One of the biggest roadblocks is the city's height limits, which limits buildings to no more than 40 feet.¹¹ On average, San Francisco is three stories high.¹² Compare that to Paris, which averages seven stories, and many Asian cities, which are much taller.¹³ By density, San Francisco does not even figure on the 50 densest cities in the world.¹⁴

NIMBY-ism perpetrated by local governments is one of the root causes of the State's housing shortage. Governments' prioritization of city character over meeting housing demands has led to the adoption of many anti-development laws which in turn has slowed development. Only recently has the state legislature acknowledged the problem. To combat government sponsored NIMBY-ism, it passed several bills in 2017 to address the issue. One of the bills forces cities to approve projects that comply with existing zoning if not enough housing has been built to keep pace with housing targets, while another bill penalizes governments for rejecting housing projects that comply with zoning requirements.

III. Attracting *big* business without accounting for *big* housing demand is a *big* problem.

For years, local governments have been luring big businesses to their cities and counties through tax breaks and incentives, without equally investing in housing to meet demand. In San Francisco, for example, city leaders have successfully lured big tech companies like Twitter, Dropbox, Salesforce, Zendesk, Airbnb, Lyft, Uber, Pinterest, Yelp, and even Google to set up shop right in the heart of the City through

¹⁰ Gabriel Metcalf, Sarah Karlinsky and Jennifer Warburg. "How to Make San Francisco Affordable Again." *SPUR*. The Urbanist. Issue 530. February 2014. Web January 2018.

¹¹ Madeline Stone. "This Is What San Francisco Could Look Like If It Had Enough Housing For Its Growing Population." *Business Insider*. May 22, 2014. Web January 2018.

¹² Christian Nicholson. "Nostalgia and NIMBYism: Rebecca Solnit's San Francisco — The Bold Italic — San Francisco." *The Bold Italic*. February 18, 2014. Web January 2018.

¹³ *Id.*

¹⁴ *Id.*

tax breaks and other development incentives.¹⁵ Before that, in the early 2000's, it was biotech companies. But while politicians have been successful in luring well-paying jobs in droves, they have failed, and miserably at that, to account for population growth and in creating or facilitating the development of housing to accommodate the city's housing needs. By the numbers, the Bay Area has added half a million more jobs than housing units since 2011.¹⁶

Statewide tax break incentives pose similar problems. The State recently approved \$91 million in tax breaks as part of the California Competes initiative, which provides incentives for 114 companies to bring jobs to various parts of California.¹⁷ Sounds great until the statewide job growth exacerbates California's housing problems.

Then there's government's incessant fawning over Amazon. Almost every major city in America is competing for Amazon's new headquarters (including of all places, the San Francisco Bay Area). The bids that are being discussed are jaw-dropping. Chula Vista, California, for example, has offered \$100 million worth of property and 30 years of property tax breaks, with no plan to develop more housing to accommodate the influx of 50,000 new jobs.¹⁸

Fresno, California, however, might be on to something with its controversial yet novel Amazon proposal. It proposed no tax breaks, but promised to funnel 85% of all taxes and fees generated by Amazon into a special fund for housing and other infrastructure.¹⁹ The catch was that Amazon got a say in how the taxes were to be spent. Regardless, Fresno's "build to play"²⁰ proposal was a reasonable one because it required the development of housing to be more or less commensurate with job and population growth. Although Fresno's proposal was ultimately rejected, the approach was noteworthy because it approached job recruitment and growth with housing in mind.

¹⁵ Marissa Lang. "Companies avoid \$34M in city taxes thanks to 'Twitter tax break.'" *SFGate*. Oct. 19, 2015. Web January 2018.

¹⁶ Liam Dillon. "California lawmakers have tried for 50 years to fix the state's housing crisis. Here's why they've failed." *Los Angeles Times*. June 17, 2017. Web January 2018; *see also* Dillon. "What you want to know about California's failed housing affordability law." *LA Times*. July 5, 2017. Web January 2018 ("Bay Area is adding hundreds of thousands more jobs than homes, which is driving up the demand for housing beyond what the targets had anticipated").

¹⁷ Riley McDermid. "Here's what California paid to lure General Motors jobs to downtown San Francisco." *San Francisco Business Times*. April 14, 2017. Web January 2018; *see also* Scott Olson. "Salesforce poised to receive city tax break on tower expansion." *Indianapolis Business Journal*. August 2, 2016. Web January 2018.

¹⁸ Anna Hensel. "How 12 cities are trying to woo Amazon's \$5 billion." *Venture Beat*. Heartland Tech Analysis. November 24, 2017. Web January 2018.

¹⁹ *Id.*

²⁰ "Build to play" is hereby coined.

IV. “Local control” is why Sacramento will be the location of the next big housing crisis.

Local governments argue that repealing Costa-Hawkins will give them back “local control” to address their own housing needs. It is these same governments that blame rental housing owners for housing affordability problems, which they argue justifies why they should have the power to control rents on all rental property. In fact, “local control” means local governments can choose to neglect their housing responsibilities while taking actions that create housing affordability problems, and then blame property owners when affordability problems and housing shortages actually occur.

Take what’s happening in Sacramento as an example. Sacramento is the fastest growing city in California.²¹ It also has one of the hottest housing markets not just in California, but also in the country.²² On top of that, rents are rising faster in Sacramento than any other part of California;²³ some say it’s the fastest in the nation.²⁴ Housing supply is low, while demand is high, and the population keeps growing.

But how did Sacramento go from “cow town” to “wow” town?²⁵ More importantly, what are city leaders doing about meeting Sacramento’s housing demands?

It is no secret that a mass exodus from the Bay Area to Sacramento is in full throttle.²⁶ But Sacramento leaders have also been working overtime to offer tax breaks and incentives to attract new businesses to the region. Just recently, Sacramento agreed to give Centene, a health insurance company, \$13.5 million dollars to establish headquarters in Sacramento. Ironically, the money they are offering to Centene to produce jobs in the area comes directly from old redevelopment funds—funds that used to be reserved for affordable housing production! Five thousand jobs are expected to be generated from the deal.

²¹ Randol White. “Sacramento Is Fastest-Growing Big City In California.” *Capitol Public Radio*. May 1, 2017. Web January 2018.

²² Linda Gonzalez. “Sacramento makes Zillow’s list of hottest housing markets for 2017.” *The Sacramento Bee*. Real Estate News. January 16, 2017. Web January 2018.

²³ Angela Hart. “Rents are rising faster in Sacramento than any other part of California.” *The Sac Bee*. Capitol Alert. July 26, 2017. Web January 2018.

²⁴ Josh Lyle. “Sacramento rents fastest rising in nation.” *abc10*. June 29, 2017. Web January 2018.

²⁵ Patrick Sisson. “Sacramento, emerging from Bay Area’s shadow, becoming booming urban alternative.” *Curbed*. Property Lines, Real Estate. July 11, 2017. Web January 2018.

²⁶ Erica D. Smith. “The Legislature did its part to fix Sacramento’s housing crisis. Now it’s your turn, Bay Area refugees.” *The Sac Bee*. September 19, 2017. Web January 2018; Katy Murphy. “Amid Bay Area exodus to Sacramento, low-income families at risk of being pushed out, study finds.” *The Mercury News*. November 22, 2017. Web January 2018.

Sacramento was also one of several hundred cities to offer incentives to Amazon to build a new headquarters and bring in 50,000 new jobs. In fact, local governments in the Sacramento area offered Amazon more than \$500 million in job grants, land donations, and infrastructure financing to lure the online behemoth to the region. None of the proposals were tied to the development of new housing.

The city has made numerous other recent decisions to grow the area without considering its housing needs. The city just built a new NBA arena for the Sacramento Kings. “[I]n the 26 months the complex was under development, \$530 million in real estate transactions took place in a 10-block radius around the arena, more than 80 new businesses moved downtown, and neighborhood employment jumped 40 percent.”²⁷ A rail yards project is in development,²⁸ as well as discussions about a riverfront district project on both sides of the Sacramento River.²⁹ Sacramento is also hoping to be the home of a new Major League Soccer team. Subsidies for hotels, a science museum, an aquarium, and a new convention center are also either in the works or being discussed.³⁰

Mayor Darryl Steinberg has vowed to make Sacramento a center for jobs, and is unabashed in his bid to attract high-tech startups.³¹ City leaders have even changed Sacramento policy to allow staff members to offer financial incentives to large companies interested in relocating to the Sacramento.³²

This kind of city growth should be commensurate with big investments in housing development, but Sacramento is barely lifting a finger to require new housing development.³³ It’s making the same mistakes the Bay Area made.

Blaming property owners for high rents, therefore, is misguided and misplaced, when city leaders are making decisions everyday that exacerbate the housing shortage problem, while neglecting to contribute toward the development of new or affordable housing.

²⁷ *Supra* note 27.

²⁸ *Id.*

²⁹ Richard Chang. “Sacramento is either ‘unknown or misunderstood.’ Will that change in 2017?” *The Sac Bee*. Business & Real Estate. December 29, 2016. Web January 2018.

³⁰ Ryan Lillis. “Big public subsidy coming for Sacramento riverfront museum.” *The Sac Bee*. City Beat. September 13, 2017. Web January 2018; Anita Chabria. “Sacramento leaders OK convention center rehab – and want another tourist destination.” *The Sac Bee*. Local. May 30, 2017. Web January 2018; Foon Rhee. “Why Mayor Steinberg now owns Convention Center decision, for good or bad.” *The Sac Bee*. Opinion. January 30, 2017. Web January 2018.

³¹ *Supra* note 31.

³² Ryan Lillis. “Hey Amazon, Sacramento is ready to offer you financial incentives.” *The Sac Bee*. City Beat. October 24, 2017. Web January 2018.

³³ Hudson Sangree. “Will Sacramento avoid another housing boom and bust?” *The Sac Bee*. Real Estate News. July 17, 2017. Web January 2018.

V. Rent control removes units from the market and drives up costs.

According to a recent Stanford University study on the effects of rent control, there are 30% fewer rent controlled units in San Francisco than there were when rent control went into effect in 1995.³⁴ "Rent control exacerbates the housing shortage by pushing landlords to remove supply of rental housing," Rebecca Diamond, author of the Stanford study, stated recently.³⁵ The study goes on to show that for every six percent decrease in housing supply, rent prices increased by seven percent.³⁶ The study is in line with previous reports, including by the American Community Survey in 2012, showing that San Francisco has a staggering 30,000 vacant units at any given time.³⁷ Some owners keep units off the market while others convert their properties to ownership housing.³⁸

Rent control proponents argue that these studies show that owners should be prevented from converting their properties to ownership housing and should be heavily taxed for keeping units vacant.³⁹ But more regulation and burdensome controls over rental housing will only serve to squeeze more rental units out of the market while chilling development. The Stanford economists suggest government subsidies, tax credits, and building more affordable housing as workable solutions.⁴⁰

VI. Local governments are unaccountable and stifling growth.

Two statewide housing laws, the Housing Element law and the Housing Accountability Act (HAA), establish local government's responsibility to plan, promote, and remove barriers for housing development. The Housing Element law requires cities and counties to develop comprehensive plans every eight years to build new homes in their communities. The HAA was enacted to ensure local governments work to remove barriers to housing development through speedy approvals and rezoning. Neither of the laws are respected or honored by local governments.

³⁴ Katy Murphy. "Rent-control policy 'likely fueled the gentrification of San Francisco,' study finds." *The Mercury News*. Business, Real Estate. November 2, 2017. Web January 2018.

³⁵ Michelle Robertson. "Rent-control policies likely 'fueled' SF gentrification, Stanford economists say." *SFGate*. November 3, 2017. Web January 2018.

³⁶ Adam Brinklow. "Stanford paper says rent control is driving up cost of housing in San Francisco." *Curbed San Francisco*. San Francisco Rent Control. November 3, 2017. Web January 2018.

³⁷ Sarah Karlinsky and Kristy Wang. "Non-Primary Residences and San Francisco's Housing Market." *SPUR*. SPUR White Paper. October 21, 2014. Web January 2018.

³⁸ *Supra* note 38.

³⁹ Joshua Sabatini. "SF to explore taxing property owners who keep buildings, units vacant." *San Francisco Examiner*. July 11, 2017. Web January 2018.

⁴⁰ *Supra* Note 38.

“We’re kind of lying,” said a Foster City councilmember about his city’s 87-page housing plan, which proposed hundreds of new homes.⁴¹ “We have no intention of actually building the units.” The councilmember’s prediction came true according to a recent LA Times article. “Despite soaring demand for housing in the Bay Area, the city hasn’t approved any new development projects in more than five years.”⁴²

Foster City’s decision to ignore the housing element is pervasive among cities and counties throughout California. That’s because the housing element law has no teeth—it does not hold local governments accountable for any home building.⁴³

State lawmakers have known about the law’s weaknesses for decades but haven’t fixed them. They have added dozens of new planning requirements to the process but have not provided any incentive, such as a greater share of tax dollars, for local governments to meet their housing goals.⁴⁴

In addition to ignoring the housing element, local government housing decisions have made it even more difficult to build new housing.⁴⁵

More than two-thirds of California’s coastal communities have adopted measures — such as caps on population or housing growth, or building height limits — aimed at limiting residential development, according to the Legislative Analyst’s Office. A UC Berkeley study of California’s local land-use regulations found that every growth-control policy a city puts in place raises housing costs by as much as 5% there.⁴⁶

Cities are also bypassing their responsibilities under HAA by rezoning areas for commercial development over housing, and by modifying their zoning plans in ways that make housing infeasible.⁴⁷

City and county inaction has become such a big problem that several bills from the 2017 housing package were necessary to stifle the ability of local governments to

⁴¹ Supra note 18 (article dated June 17, 2017).

⁴² Id.

⁴³ Id.

⁴⁴ Id.

⁴⁵ Id.

⁴⁶ Id.

⁴⁷ Kevin Burke. “How Cities Bypass State Law, Causing the Housing Crisis.” *The Bay City Beacon*. August 2, 2017. Web January 2018.

use zoning, environmental and procedural laws to thwart projects they deem out of character with their neighborhood.⁴⁸

All in all, local governments are not holding up their end of the bargain to accommodate housing needs. Instead of adopting policies that facilitate the development of more housing units, they often target the rental housing industry for regulation, which in turn produces fewer housing units, and forces rental housing owners to remove units from the market.

VII. The high cost of development

Development costs, land values, and permitting fees are soaring, making it more difficult for development of rental housing to pencil out. One architect in 2014 conducted a study on the real cost to build a housing unit in San Francisco. According Mark Hogan, the costs are staggering.⁴⁹ The following is his breakdown of the costs to build a San Francisco unit.⁵⁰ Calculations are based on a 100-unit building assuming 800 square feet per unit, which is approximately 640 square feet of usable space based on typical building efficiency:

Land cost per unit of housing: **\$120,000**
Construction cost per unit: **\$240,000** (\$300 per sq. ft.)
Subsidy to build affordable housing below market: **\$27,000** (based on \$200k per unit subsidy times 12, divided by remaining 88 units)
Permits, city fees and professional services: **\$48,000** (20% of \$240,000)
Selling expenses: **\$34,000** (marketing, legal fees and real estate commissions at 8%)
Total: **\$469,800** (total cost of 800 sq. ft. unit)

It is no wonder rents are so high and housing is unaffordable. It is expensive to build. Rental property owners must charge higher rents to keep up with the cost of development.

The government again plays a significant role in the high cost of development. For one, its permitting and impact fees continue to rise. But more importantly, instead of providing incentives to offset the costs of development, the government continues to focus on burdening the rental housing industry with costly regulations.

⁴⁸ See Sen. Bill 35 (Cal. Stat. 2017), Sen. Bill 167 (Cal. Stat. 2017); Adam Nagourney and Conor Dougherty. "The Cost of a Hot Economy in California: A Severe Housing." *The New York Times*. July 27, 2017. Web January 2018.

⁴⁹ Mark Hogan. "The Real Costs of Building Housing." *The Urbanist*. February 11, 2014. Web January 2018.

⁵⁰ It does not include construction financing expenses, contingencies or developer's profit, among other things.

If the State and local governments want to begin addressing the out-of-control development costs, it must give serious consideration to incentivizing development of new and affordable housing, including density bonuses, upzoning, fee and permitting waivers, and CEQA waivers.

Several recent studies have found that for every 10% increase in density reduces a project cost by up to 5.7% on average, and that for every 20% increase, the likelihood a site will be developed increases by 25%.⁵¹

Moreover, parking requirements can increase the cost of a housing development by 25% - 40%. One study found that reducing parking requirements by 20% increased the likelihood of housing being built by 87%.

Finally, waiving or reducing development impact fees as an incentive to build can help spur growth. In the Bay Area, impact fees can range from \$24,000 - \$40,000 per unit. Even a small reduction in the impact fees, or complete waivers depending on the number of affordable units provided within a development could yield big returns in terms of housing development.

Conclusion

Instead of blaming and regulating the housing industry for the housing crisis, it is time for government to take a good hard look in the mirror and assess how its own actions and inactions over the last 50 years have significantly contributed to the crisis. Until the government can acknowledge that it is part of the problem, the State will continue to make the same mistakes over and over. It will continue to offer up the same problematic legislative measures, like a Costa-Hawkins repeal, that exacerbate rather than solve the State's housing problems.

As California's population continues to rise, its housing problems will continue to get worse, unless real reflection occurs and real solutions are offered. It is time for the government to take responsibility for its actions and begin regulating and reigning itself in.

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⁵¹ Matthew Palm. "Getting the Most Out of California's New Affordable Housing Funds." *The Bay City Beacon*. December 5, 2017. Web January 2018.