No. S229762

IN THE SUPREME COURT
STATE OF CALIFORNIA

McMILLIN ALBANY, LLC, et al.,
Petitioners
vs.
SUPERIOR COURT OF KERN COUNTY
Respondent

CARL & SANDRA VAN TASSEL, et al.,
Real Parties in Interest

After Decision By The Court of Appeal,
Fifth Appellate District, Case No. F069370

Kern County Superior Court Case No. S-1500-CV-279141
Honorable David R. Lampe, Presiding Judge, Dept. 11

SUPPLEMENTAL MATERIALS TO AMICUS CURIAE BRIEF BY APPLICANTS CALIFORNIA BUILDING INDUSTRY ASSOCIATION, BUILDING INDUSTRY LEGAL DEFENSE FOUNDATION AND CALIFORNIA INFILL FEDERATION IN SUPPORT OF PETITIONERS

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SUPPLEMENTAL MATERIALS TO AMICUS CURIAE BRIEF IN SUPPORT OF PETITIONERS

The Amicus Curiae Brief submitted by California Building Industry Association ("CBIA"), Building Industry Legal Defense Foundation ("BILD"), and California Infill Federation ("CIF") (collectively, "Amici Curiae") presents unique but publicly available historical, industry-related educational materials and other studies in support of their position that Petitioners and the Fifth District Court of Appeal correctly stated that the intent of the Legislature was for SB800 to abrogate common law tort causes of action and act as the exclusive remedy for homeowners who seek to bring any defect-related action against the builder involving their home. Each of these documents are properly referenced in the Amicus Curiae Brief and available to access online. However, for ease of reference for the Court, Amici Curiae has complied each of the referenced articles and reports in this Supplemental

Materials to Amicus Curiae Brief. Attached hereto are true and correct copies of the the following documents:

No.	Document
1	Kelly Zito, *Insurance Nightmare: Flood of Lawsuits Alleging Defective Construction Leaves Builders Scrambling to Find Coverage for New Projects* (July 11, 2002) S.F. CHRON <http://www.sfgate.com/business/article/Insurance-nightmare-Flood-of-lawsuits-alleging-2797712.php> (Last Visited July 6, 2016).
2	Ricardo Sandoval, *When the Roof Falls In, Construction Defect Litigation is Becoming a California Cottage Industry* (September 1992) California Lawyer <http://aguirrelawapc.com/global_pictures/Attachment_1.pdf> (Last Visited, July 6, 2016.)
3	McCarthy & Johnson, *Insurers' Rate Hikes Hammer Builders* (May 4, 2003) Sacramento Business Journal <http://www.bizjournals.com/sacramento/stories/2003/05/05/story3.html?page> (Last Visited July 6, 2016.)
4	Russell Hoyle, *Study Unmasks Litigation Myths* (November 13, 2002) Berkeleyan <http://www.berkeley.edu/news/berkeleyan/2002/11/13_.html> (Last Visited July 6, 2016.)
5	Kroll, et al., *Impact of Construction-Defect Litigation on Condominium Development* (2002) CPRC Brief, Vol 14, No. 7 <http://www.novoco.com/low_income_housing/resource_files/research_center/Defect_Litigation_Effects.pdf > (Last Visited July 6, 2016.)
6	Darin T. Allen, Esq., *Construction Defects Litigation*

	and the "Right to Cure Revolution" (March 2006) Construction Briefings <https://www.yumpu.com/en/document/view/36630277/construction-briefings-national-arbitration-forum> (Last Visited July 6, 2016.)
7	Glucksman, et al., *Right to Repair Reform: Revisions and Proposals to State's "Right to Repair Statutes"* (April 1, 2015) Construction Defect Journal <http://constructiondefectjournal.com/archives/inside-issue/2015/04/right-repair-reform-revisions-and-proposals-state%E2%80%99s-%E2%80%9Cright-repair-statutes%E2%80%9D> (Last Visited July 6, 2016.)
8	California Department of Consumer Affairs, *Construction Defect Notice To Owners Of New Residential, Single-Family Dwellings* <http://www.dca.ca.gov/publications/construction_defects.shtml> (Last Visited July 6, 2016.)
9	Paladin Risk Management, *A Subcontractor's Guidebook for SB800 The "Fix It" Right to Repair Law* (2009) <http://paladinriskmanagement.com/6_may_09_g0000a3.pdf> (Last Visited July 6, 2016.)
10	Construction Industry Research Board, *California Housing Units 1954 – 2015* <http://www.cbia.org/uploads/5/1/2/6/51268865/original_historical_data_1954-2015.pdf> (Last Visited July 6, 2016.)
11	The San Diego Union-Tribune Editorial Board, *How California Should Fight Poverty: Add Housing Stock* (March 6, 2016) The San Diego Union-Tribune <http://www.sandiegouniontribune.com/news/2016/mar/06/housing-costs-too-high-california/> (Last Visited July 6, 2016.)
12	Next 10, *Current State of the California Housing*

	Market (March 3, 2016) <http://next10.org/ca-housing > (Last Visited July 6, 2016.)
13	Thornberg, et al., *Current State of the California Housing Market, A Comparative Analysis* (March 2016) Next 10 <http://next10.org/sites/next10.huang.radicaldesigns.org/files/current-state-ca-housing-market.pdf> (Last Visited July 6, 2016.)
14	Thornberg, et al., *Employment By Income, A Comparative Analysis* (March 2016) Next 10 <http://next10.org/sites/next10.huang.radicaldesigns.org/files/california-employment-by-income.pdf> (Last Visited July 6, 2016.)
15	Thornberg, et al., *California Migration* (March 2016) Next 10 <http://next10.org/sites/next10.huang.radicaldesigns.org/files/california-migration.pdf> (Last Visited July 6, 2016.)
16	Taylor, Mac, *California's High Housing Costs Causes and Consequences* (March 17, 2015) Legislative Analyst's Office Report <http://www.lao.ca.gov/reports/2015/finance/housing-costs/housing-costs.pdf> (Last Visited July 6, 2016.)
17	Siniavskaia Ph.D, *State and Metro Area House Prices: the "Priced Out" Effect* (August 1, 2014) National Association of Homebuilders Special Studies, HousingEconomics.com <https://www.nahb.org/~/media/Sites/NAHB/SupportingFiles/6/Met/Metro2014_HEO_20140801070547.ashx?la=en> (Last Visited July 6, 2016.)
18	Baldassari, Erin, *Housing Costs Push Commuters Outward, Expanding Definition of Bay Area, Study Finds* (June 30, 2016) East Bay Times <http://www.eastbaytimes.com/breaking-news/ci_30075098/housing-costs-push-commuters-

	outward-expanding-definition-bay> (Last Visited July 6, 2016.)

Dated: 7/13/16

Respectfully Submitted,

Donahue Fitzgerald LLP

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California Building Industry Association, Building Industry Legal Defense Foundation and California Infill Federation

Document 1

SFGATE
http://www.sfgate.com/business/article/Insurance-nightmare-Flood-of-lawsuits-alleging-2797712.php

Insurance nightmare / Flood of lawsuits alleging defective construction leaves builders scrambling to find coverage for new projects

Kelly Zito, Chronicle Staff Writer Published 4:00 am, Thursday, July 11, 2002

IMAGE 1 OF 2

A worker from Draeger Construction re-tiles a roof after the company conducted a water test on Tuesday, July 2, 2002, at a home in the Marina Vista Development on San Leandro, Ca., where various residents are ... more

If you believe some homeowners in the Marina Vista development in San Leandro, there's almost nothing right with their homes.

They say their foundations are defective, the drywall was installed improperly and windows leak like sieves, opening the door to rampant -- and possibly toxic -- mold. As a result,

about 85 of the subdivision's approximately 250 homeowners have filed a $15 million lawsuit against the builder.

If you believe the state's building industry, such complaints are the result of hysterical media coverage of mold and of hyperactive attorneys looking to cash in on the state's 10-year statute of limitations for filing such claims.

Whatever the cause, a wave of so-called construction defect litigation, paired with the financial fallout of the Sept. 11 tragedy, has put a squeeze on contractors' liability insurance.

According to the Insurance Services Office Inc., which provides research for the insurance industry, insurers in 1998 collected $19.3 million in premiums from contractors' liability policies in California and paid out about $36 million (that figure includes construction defect, as well as other types of losses, including bodily injury).

In 2000, insurers collected $15.2 million and paid out $44.8 million. In other words, for every $1 insurers collected in 1998, they paid out nearly $1. 87; in 2000, insurers paid out about $2.95 for every dollar in premiums.

Faced with steep losses, many underwriters have pulled out of the condominium construction market, given that condo projects are the most susceptible to defect suits. Others have tripled premiums and dramatically curbed the scope of coverage on all kinds of residential projects.

"If it's not already past, it's nearing a crisis stage for condo builders," said Hugh Coyle, a broker at Willis Insurance Services in San Francisco.

CRIMP ON AFFORDABLE HOUSING

Builders say the insurance crunch is endangering new construction of affordable housing in California. They estimate the state already has a housing deficit in the hundreds of thousands. At the recent Pacific Coast Builders Conference in San Francisco, a symposium on the state of the building industry shifted to a discussion of construction defect litigation and the dire consequences for the state's consumers.

"No one wants to touch (condos) any longer," said Phil Serna, spokesman for the Home Builders Association of Northern California. "Smart growth focuses on more high-density residential development. It's what the environmental community wants and what the social equity folks want. But it's the trial attorneys who have put up the roadblocks to it."

The homeowners and their lawyers say such fears are overblown. They contend builders are trying to shirk the financial responsibility for shoddy work. In fact, some homeowners who have filed recent construction defect lawsuits said they first contacted the builders and asked them to fix the problem, only to be ignored.

"The builders are trying focus attention away from the cause to the remedy, " said Tyler Berding, a San Francisco attorney who spoke at a recent construction defect litigation forum held by the Association of Bay Area Governments. "We don't blame the chemotherapy for the cancer. Cancer is cancer.

Litigation shouldn't be blamed for construction defects; it's a remedy, not a cause."

Insurers are abandoning the market, Berding added, because "they've looked at what's being built in the last 20 years and they've decided that they're being asked to underwrite a bad risk. From a business standpoint, they've said,

'No way.' "

The insurance impasse isn't new. The condo building boom of the 1980s started the first wave of construction defect lawsuits in the 1990s. Berding said condos and town homes often present more problems in part because they require more elaborate infrastructure to link the dwellings.

FAT PICKINGS

But builders say lawyers target condos because they offer a larger pool of potential plaintiffs -- and money -- than single-family houses.

Nevertheless, as condo construction in the state has tumbled -- from 18,691 in 1994 to 2,945 in 1999, according to the Meyers Group, a real estate consulting firm -- lawyers are suing more builders of single-family homes, according to building industry experts.

Now the issue has taken on new significance, as the cost of housing in the state has surged to record highs, even in the face of a sagging economy. Theoretically, if builders' insurance premiums shoot through the roof, they're likely to push home prices even higher.

Coyle, the insurance broker, said that minimum insurance on a $1.5 million, three-unit condo development in San Francisco's Mission District would run about $250,000, twice what it would have been several years ago.

"The bottom line is, it's painful because ultimately it affects the developers' bottom line . . . but it also will affect the homeowner," Coyle said.

LEGISLATION IN THE PIPELINE

State senators are in talks with builders and plaintiffs' attorneys on a construction defect litigation reform measure that may include a so-called "right to repair" item, whereby builders would get the chance to repair the flaw before attorneys get involved. But even if such a measure is passed -- and similar proposals have been defeated in the past -- it may not go into effect for a year or more.

This time, however, builders are confident they will prevail. "Housing is such an issue in the state right now, that the Legislature knows the system is broken, and they know we have to fix it," said Jim Ghielmetti, chief executive of Signature Properties, a Pleasanton builder.

Until then, both the largest and smallest builders find themselves in a tight bind.

Gilroy's Atlantic Concrete, which specializes in pouring foundations for residential buildings, received a notice in April that its insurance was being canceled.

The 150-employee firm was able to secure an interim policy, but that coverage is limited only to on-site mishaps.

In other words, Atlantic is not covered for the first 10 years of the life of the house, as was the case under its old plan. If the owner of a home built on one of Atlantic's foundations in the past three months files a lawsuit against the company, the company must pay for legal fees out of its own pocket.

SKY-HIGH PREMIUMS

Atlantic officials hoped to land a new policy as early as this week. But even that is of little consolation. According to company comptroller Teresa Ortiz, the company's premiums will probably jump to $700,000 to $800,000 a year with a $100,000 deductible, compared with $200,000 annually in premiums with a $15,000 deductible.

"I've talked to so many brokers it's not funny," Ortiz said. "They all come back with the same story. They say, 'The insurance isn't there for you.'

"The builders are saying, 'If you can't get it, I'll find someone else who does have insurance,' " said Ortiz, who added that business could drop by half if Atlantic doesn't secure a policy with broader coverage.

Local plaintiffs attorneys say the prospect of jeopardizing local businesses is a sobering thought. But they and their clients insist that builders and their subcontractors must be held to a higher standard.

Izzy Ahmed and eight family members moved into a brand-new, five-bedroom house in Marina Vista almost five years ago. Almost immediately, they said, they noticed a black efflorescence around many of the windows. Izzy's wife, Nabila, said she scrubbed the windows and sills; but the material reappeared. In addition, some family members say they have noticed in increase in asthma attacks since moving into the home. Ahmed said they contacted the developer, San Leandro's Westco Community Builders, about the problem, but to no avail.

"If they had good management, they would have fixed it," Ahmed said. "The project manager kept telling me he would be there to fix it, and he didn't."

Westco referred comment to attorney Andy Weiner. Weiner would not talk on the specifics of the lawsuit but said of his client, "These are quality people,

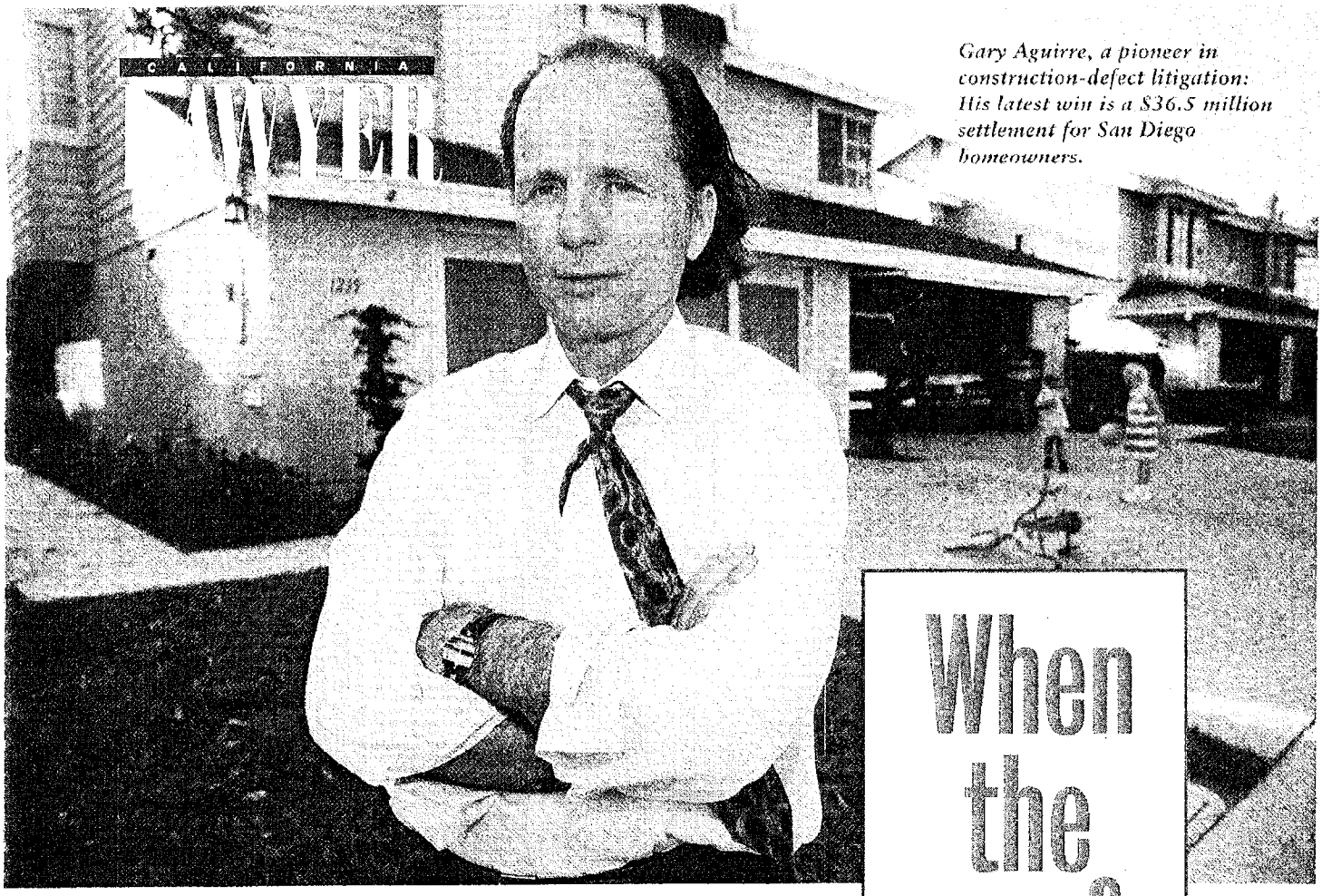
good builders. They're surprised by this."

Ahmed, owner of the Food King grocery store in Oakland, has decided not to take any chances and recently purchased an eight-bedroom home in the Oakland hills. In a telling sign of the Bay Area's almost ludicrous demand for housing,

Ahmed was able to sell the Marina Vista house -- alleged defect disclosures and all -- for $640,000, about $300,000 more than he paid for it.

As a construction crew hired by her lawyer blasted water against her windows in her Marina Vista home to test for leakage, Nabila Ahmed said, "We didn't see any mold with this new house -- and we checked."

Document 2



Gary Aguirre, a pioneer in construction-defect litigation: His latest win is a $36.5 million settlement for San Diego homeowners.

When the roof falls in

CONSTRUCTION DEFECT LITIGATION IS BECOMING A CALIFORNIA COTTAGE INDUSTRY

By Ricardo Sandoval

WHAT YOU SEE FROM 3,000 FEET on the final approach to San Diego's downtown Lindberg Field airport is arid, rocky terrain, canyons, steep hillsides and dry river beds terracing toward the Pacific Ocean. And houses. Almost everywhere on this uncertain and unstable terrain, there are houses.

Most were built in the 1980s, during the breakneck, often careless and haphazard home-building spree that barely kept pace with the region's explosive population growth. Lately, though, the growth industry here has changed from construction to litigation—construction-defect litigation over the myriad problems that plague owners of homes in most of those hastily constructed developments.

For several years California courts have held that home purchasers have remedies against construction defects, in both strict liability and implied warranty. See *Pollard v Saxe & Yolle Dev. Co.* (1974) 12 C3d 374. A 1976 statute (CCP §374) overturned adverse case law to give condominium homeowners associations standing to sue for construction defects.

For lawyers this was pay dirt. Being able to try a case under the theory of strict liability makes construction-defect cases easier to prove (although the home builder must be a "mass producer," an ambiguous requirement). Standing for homeowners associations—which could include hundreds of units—makes the cases far more lucrative.

Not surprisingly, a construction-defect plaintiffs bar has emerged from the subdivisions. Major players include Gary Aguirre of Aguirre & Eckmann in La Jolla; Brian Gerstel of San

Photograph by Cristina Taccone

Diego's Duke, Gerstel, Shearer & Bregante; Mickey McGuire of San Diego's Thorsnes, Bartolotta, McGuire & Padilla; and, more recently, Howard Silldorf of Silldorf, Burdman, Duignan & Eisenberg and Doug Grinnell of Epsten & Grinnell, both in San Diego.

La Jolla-area homeowners from Irvine Co. executive Donald Bren's private construction firm; a $6.75 million jury verdict in favor of owners in the Del Coronado Santee Townhomes project against San Diego financier M. Larry Lawrence; a settlement worth $36.5 million (including assumed liabilities) from 40 defendants for selling a polluted landfill along with homes in Paradise Hills southeast of San Diego.

Hillsborough homeowners discovered they owned a methane-leaking landfill. According to their settlement, San Diego County is now liable.

For more than a decade, these plaintiffs attorneys have recorded a win record so overwhelming that today even the most highly regarded defense lawyers consider it a success when they're able to minimize claims against their clients. Talk of altogether avoiding monetary judgments or settlements is virtually nonexistent. "I measure my success by keeping my client in business and by putting him in a position to pass on a fair share of the claims to subcontractors," says Bruce W. Lorber of Lorber, Volk & Greenfield. Lorber, who has represented some of California's largest developers, estimates that some 90 percent of construction-defect lawsuits are settled out of court. Construction-defect litigation has proven so successful, particularly in San Diego County, that lawyers are scrambling to get into the action and are spreading litigation to other parts of the state.

Who can blame them? Wins seem to come easy for these plaintiffs lawyers. Consider recent awards and settlements: a $23 million settlement for a group of

CONSTRUCTION-DEFECT litigation in its current incarnation began 15 years ago shortly after Florence E. Young, a Navy bride, moved into a new home in the Mesa Village development on the northeastern edge of San Diego. She soon found her dream home more of a nightmare: The gas and water lines leaked, the roof didn't fit, the foundation had shifted, and the swimming pool was sinking. She complained to the building company, but it brushed her complaints aside, saying that more than a year had passed since construction and it was no longer liable for defects that, Young learned, were plaguing hundreds of homes in the development.

Young persisted. Over the next five years she logged hundreds of hours studying pre-construction reports, deciphering blueprints and engineering assessments, sitting through tedious depositions with her attorney, Gary J. Aguirre of Aguirre & Eckmann in La Jolla. Aguirre had gotten rave reviews for helping secure a $3 million settlement from Pacific Southwest Airlines for the relatives of victims of a 1978 mid-air crash over San Diego. Young and Aguirre sought to unravel the liabilities of developers, subcontractors, designers and the tight-fisted insurance companies that covered their work.

Aguirre had to establish that shoddy construction practices had indeed led to the leaking roofs and sagging rooms, then convince a judge and jury that home buyers were entitled to the same rights of redress as consumers who buy any other defective product. It took six years. Experts hired to verify problems with homes in the subdivision kept finding new defects, thus adding to the complaint. In addition, the lawsuit was filed before San Diego's now-established system of completing construction-defect cases within two years.

Developers say the plaintiffs always win: 'Liability seems irrelevant.'

Aguirre says he was unsure at the time how to approach a jury with such a complicated matter. "I had people, including some big-time lawyers in this town, tell me the homeowners would not stick with this case to the end," he says. "People were also saying the jury would not understand what we were trying to prove. I had my doubts about that too. I was intimidated." He chose to bring separate actions in several trials rather than the usual method of dumping all the alleged problems onto a jury at one time. In 1982 Young and Aguirre's perseverance was rewarded with a $7.2 million settlement against Mesa Village. This, according to Aguirre, stood for a time as the largest settlement of its kind.

Aguirre had discovered his calling. The slender, bespectacled, self-described "former radical lawyer" with thinning long hair became a construction-defect pit bull. In the decade since the Mesa

Ricardo Sandoval is a business writer for the San Francisco Examiner.

Photograph by Cristina Taccone

Village victory, he has managed to clench his jaws around several developers and shake out millions in damages for his clients. The aggressive—some say temperamental—courtroom style that shaped Aguirre's post-University of California at Berkeley legal life as a farm workers' advocate and then a public defender has served him well against developers and their attorneys.

After his big wins in the PSA and Mesa Village cases, Aguirre established his reputation with a $6 million jury verdict in 1982 against building materials maker Johns Manville Corp., which had refused to replace the crumbling faux-stucco exteriors of homes throughout Southern California. In that class action, Aguirre gained special notoriety for predicting Manville's financial collapse and convincing the judge to order the company to post a bond to ensure an award for his clients.

Coincidentally, Aguirre met Young again in 1987. Despite her resolution after Mesa Village never again to be duped by developers, she found herself in another tangled construction-defect lawsuit in Hillsborough, southeast of San Diego. The homeowners were suing the builder, Treetops Unlimited, as well as San Diego County and the state air pollution control district, which had threatened them with $10,000-a-month fines for allowing methane gas to leak from a landfill they didn't know they owned.

Earlier this year the parties reached a settlement for shoddy construction and for causing lenders to abandon the subdivision, making it impossible for the owners to sell their property. San Diego County authorities will assume responsibility for the landfill, which still leaks methane and has shown traces of cancer-causing benzene—a large enough threat to force the posting of "Danger" and "No Smoking" signs several yards from unsalable $200,000 homes. Treetops paid $4.3 million for construction defects and $14.2 million for damages relating to the landfill; San Diego County is assuming $18 million in liabilities. The grand total: $36.5 million.

THE WIN COLUMN in the construction-defect game is so tilted toward plaintiffs that developers have come to believe something is wrong with the system. They complain most loudly about a perceived pro-plaintiff bias in the trial courts' reliance on strict fast-track guidelines and alternative dispute resolution. In San Diego County, where the vast majority of California's construction-defect cases originate, fast track means keeping to strict discovery periods, holding regular settlement talks with special masters and moving from filing to settlement or jury verdict within two years.

Under the San Diego system, rarely does a lawsuit go to trial and even more rarely does a defendant emerge unscathed. "I can recall only two cases that went to trial—and there was a defense verdict all around," says defense specialist James E. Chodzko of San Diego's McInnis, Fitzgerald, Rees, Sharkey & McIntyre.

"We are not getting our day in court," adds one development company official. "The judges [and special arbitrators and discovery masters] don't want to see these cases go to court. Liability seems irrelevant. The system is heavy-handed and set to make developers pay roughly half the claim."

San Diego Superior Court Judge G. Dennis Adams, who has heard a majority of the region's construction-defect cases over the last seven years, scoffs at the idea that the system is unfair. "Of course it seems [the system is skewed against them]," Adams says. "That's because they are strictly liable if there is something wrong with a home. The law itself is naturally skewed against them."

Judges push for mediation because they don't want the cases in their courtrooms. "The cases are typically—especially the large, multiparty matters—extremely difficult," says Michael Duckor, a mediator in the San Diego firm of Duckor & Spradling who regularly serves as a special master for construction-defect cases. "It becomes a gang activity, and it puts a great deal of stress and strain on judges. It is even tough to physically pack all the parties into one courtroom. They don't like the big cases with dozens of cross-complaints and defendants, although I've never seen a judge back away from the challenge."

San Diego's crowded civil calendar has little room for the litigators' delaying tactics, endless depositions and re-examination of evidence and experts' reports. "When I first got involved with these cases back in 1984 and '85, trial time was from five to seven years. For us, these cases were as welcome as the plague," says Adams.

"With fast track, a lot of the garbage went away when we said, 'Boo!' " Adams says. "The ones that would not go away were the big ones. I'd call a readiness conference in one of these cases and 65 lawyers would show up. We had to do something."

Even with fast-track disposition, discovery masters and strict schedules, cases can and do bog down. Some maintain that trials just don't make sense for these cases. "The costs for both sides are enormous, and juries often don't understand the scope of claims or the testimony of expert technical witnesses," says Merville R. Thompson, a special master who mediates construction-defect disputes. "So it behooves us to get most of the issues resolved before a trial starts."

In San Diego the easy cases are done with. So lawyers are getting aggressive—or moving on.

Frequent sizable awards do not mean defense lawyers are doing poor work, insists John B. Campbell of Campbell & Associates in San Diego. "The results of some of the cases—the big wins—get a lot of fanfare. But people don't see the many times that lawsuits are settled before trial because we proved the plaintiffs did not have enough evidence or legitimate claims to go all the way. A lot of claims start out big but are whittled down to almost nothing in the end."

Even under the current system, plaintiffs do not always win. But when they don't, it's frequently because they get greedy. "When you get into these cases, your biggest mistake can be trying to overreach," says Adams. "When you overreach, the jury will incinerate you."

Even highly regarded Aguirre & Eckmann is not immune from an occasional misjudgment. In one recent case the firm is said to have rejected an $8 million settlement offer, holding to its courtroom demand for $12 million. The jury awarded the plaintiffs $5 million. "One of the dangers for plaintiffs is throwing in claims for everything but a bad kitchen sink," says a San Diego defense

lawyer. "More and more, juries are aware of that and it can backfire."

SOME DEVELOPERS are quietly hoping proposed changes in state law will curb what they believe are excessive claims against their work. So far no major lobbying effort has been launched by building-industry advocates in Sacramento. Dan Collins, who represents the California Building Industry Association, says tinkering with established consumer laws that protect the right of homeowners to sue—especially involving matters of strict liability—will be futile because no politician wants to appear anti-consumer. Collins does foresee continued efforts to rein in what the industry considers oppressive litigation.

Two bills addressing construction-defect cases are awaiting Governor Pete Wilson's signature. Sponsored by Delaine Eastin (D-Fremont) and backed primarily by building trade associations, AB 3412 would require homeowners associations to obtain certificates of merit from building trade experts such as architects, engineers and dry-wall contractors before filing a lawsuit. AB 3708, sponsored by Carol Bentley (D-El Cajon) and pushed by a coalition of homeowners association lawyers, would restrict the ability of defendants to file cross-complaints against plaintiffs to recover damages caused by managing agents or homeowners associations. A recent appeals court decision (*Daon Corp. v Place Homeowners Ass'n*, (1989) 207 CA3d 1449) allows defendants to sue homeowners for bad management that created problems or exacerbated construction defects that might not have become problems.

In addition, some defense lawyers are thwarting lawsuits by including restrictive covenants in agreements signed by builders and homeowners that require owners to give builders first shot at fixing the problems. Additional language would hold homeowners to keeping their developments well-maintained. "We are advising our clients to include specific maintenance schedules, formulated by design and trade experts," says Jeffrey M. Shohet, a defense lawyer with Gray, Cary, Ames & Frye in San Diego.

On another front, Southern California builders are lobbying the Department of Real Estate to replace litigation with binding arbitration. "I could easily see disputes worth less than $25,000 barred from the court system," says Jonathan Woolf-Willis, a plaintiffs attorney in the Orange County firm of Fiore, Nordburg, Walker & Woolf-Willis who formerly represented construction-industry clients. "I cannot see, however, anyone being able to abridge the right of homeowners to sue over big-dollar disputes."

Lawyers on both sides predict such attempts to curb construction-defect litigation will fail. They say lawmakers won't risk appearing to take sides against consumers, especially since appellate courts have regularly upheld the right of homeowners to sue builders. The lawyers agree the substantive changes in construction-defect cases won't come from Sacramento but from Hartford, Connecticut—that is, from the insurance industry. Shocked by regular million-dollar awards against their customers, insurers are now fighting claims every step of the way.

They are also being stingy with coverage and subjecting developers to a battery of new quality tests. Developers complain that insurance companies—the ones signing the checks to plaintiffs—are jacking up the minimum quality requirements that must be met before a development is insured. In many cases, builders say, insurers are simply getting out of the business of covering home-construction projects, even those built by the biggest developers.

"Generally, no major companies are

At the Plaintiffs Bar

ALONG WITH GARY AGUIRRE, Brian Gerstel, a partner at Duke, Gerstel, Shearer & Bregante, is a leading plaintiffs lawyer. With 21 partners and 75 lawyers statewide, the firm is the state's largest construction-defect specialist. Gerstel claims that over the years he and his firm have scored more than $200 million in settlements and judgments for homeowner clients from San Diego to San Francisco.

Gerstel, 47, started in the construction-defect game in 1977 with a successful lawsuit against developers of a San Diego condo project. Homeowners saw their 75-unit hillside building sink five inches because the large columns holding it up were not sunk into bedrock, as they had been led to believe. Gerstel won a $1.5 million summary judgment for his clients after six months of discovery and trial. In 1986 he won even bigger, with a $36.5 million judgment in a case involving owners of the Christiana Community Development in Tierra Santa north of San Diego.

Another major player is Mickey McGuire, a partner with Thorsnes, Bartolotta, McGuire & Padilla in San Diego. Tall, tanned and seemingly laid-back, McGuire professes a preference for surfing over taking depositions. Often dressed in Hawaiian-style print shirts and casual pants, he listens intently and has every reason to flash his Cheshire cat's smile. Not only will his firm get a share of a $23 million jury verdict for La Jolla homeowners against executive Donald Bren's construction company, but his partners and associates have racked up settlements and awards worth more than $12 million in recent years.

"Mickey is colorful," says a San Diego defense lawyer who has opposed McGuire in several court cases. "He has a careless air about him. But when it comes to playing hardball in negotiations, or when it comes to crunch time in court, no one is better prepared. I've got a lot of respect for him, even though I find myself on the other side of the table quite often."

Like other successful construction-defect lawyers, McGuire and his firm are known for their thorough research. "We [try to] overwhelm and exhaust the defense," McGuire says. At least a dozen associates and clerks do nothing but research, interview homeowners and consult with construction, engineering and design experts.

"You have to do it this way," says Howard Silldorf of San Diego's Silldorf, Burdman, Duignan & Eisenberg. "I think that is what separates our firms from others not so well-established. They either don't have the will or the ability to fund the critical research."

—RICARDO SANDOVAL

The Roof Falls In

still writing residential-development policies," says Phil Capling, manager of Aetna Insurance Co.'s standard commercial lines operation in the San Francisco Bay Area. "We still have litigation in effect that goes back eight years. We are talking about strict liability here. We've lost tons of money. The litigation is expensive upfront, and the premiums we would charge could never cover the potential losses. It is like insuring a big-rig truck driver. The question is not if there will be a claim, but when will the claim come and how big will it be?"

Mary Wisely, chief of National Union Fire and Casualty Insurance Co.'s construction-risk division, agrees. "There are big-time questions about soil subsidence in California, and not just because of earthquakes," says Wisely. "We just don't write [policies for] residential developers anymore. Can you blame us?"

The companies that do underwrite residential developments charge sky-high premium rates.

THE BIGGEST BENEFIT of the flood of construction-defect cases seems to be better-quality homes. "Developers are getting the message," says John F. "Mickey" McGuire of Thorsnes, Bartolotta, McGuire & Padilla, a San Diego plaintiffs litigation firm.

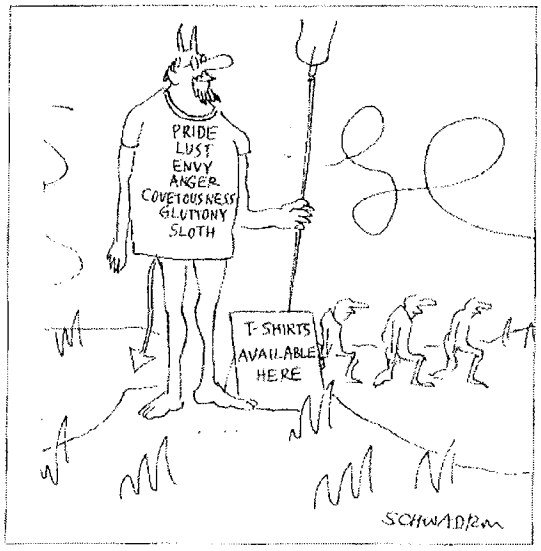
Unleashing the flood, of course, have been lawyers such as McGuire and Aguirre (see "At the Plaintiffs Bar," page 48), and more and more are following them into the field. But in San Diego County, prospects for the highly publicized big awards may be waning. The improved building practices and closer monitoring of subcontractors by both developers and insurers seem to have diminished litigation prospects. "All the easy cases are done with," Aguirre's partner, James K. Eckmann, has said. Eckmann adds that what's left will be increasingly complex cases involving bankrupt construction firms and subcontractors and developers who build without adequate insurance coverage.

So the plaintiffs lawyers are getting more aggressive. Some builders claim they are going beyond ethical bounds in seeking clients by canvassing new developments with surveys asking questions about common defects, or by advertising in everything from homeowners association magazines to free weekly shoppers. Competition for subdivision clients is so tough, the builders claim, it's common for lawyers to line up for the chance to make a pitch to a homeowners association meeting.

Meanwhile, most of the San Diego construction-defect firms are dealing with thinning prospects by sending out feelers—even opening up offices—in Orange County, eastern Los Angeles and San Bernardino counties and the eastern reaches of the San Francisco Bay Area. The major firms, such as Aguirre & Eckmann, Duke Gerstel, Thorsnes Bartolotta and Silldorf Burdman, have satellite offices in other counties or are involved in cases in places such as Los Angeles and San Jose.

"It's happening everywhere," says Jeffrey Shohet, whose firm defends developers throughout the state. "Plaintiffs lawyers can get hold of any project, anywhere, go over it with a fine-tooth comb and find something wrong. The question is the legitimacy of the defects they find—whether it's something that will never cause a problem or something that needs to be fixed right away."

As one plaintiffs lawyer who has already opened offices in Riverside and Orange counties puts it, "Away from San Diego, the market is potentially limitless." ❖



Document 3

Insurers' rate hikes hammer builders

Extra cost per new house: $10K-plus

May 4, 2003, 9:00pm PDT **Updated** May 5, 2003, 1:14pm PDT

INDUSTRIES & TAGS

BANKING & FINANCIAL SERVICES,

Local homebuilders and the framers, plumbers and other subcontractors who do the construction are being blasted by rate increases for construction liability insurance of up to 500 percent this year.

The surge in insurance has helped increased the cost of a 2,500-square-foot house by $12,500 and threatens to throw some contractors out of business. It has also spurred an ardent search for alternatives to conventional policies, including self-insurance and "captive" insurance companies owned by their members.

Rates are soaring because of aggressive lawsuits over mold and construction defects, plus a scarcity of insurers, higher expectations among homebuyers when they pay $300,000 for a house, and a generally poor insurance market. Smaller but still costly hikes in workers' compensation insurance aren't helping.

"We're absolutely being hammered by insurance rates," said house framer Jim Colafrancesco. "It's running people out of business. Some people can't even get insurance."

"This is just an unbelievable nightmare," echoed Steve Benjamin, owner of Production Framing Systems and one of the organizers of a new association that subcontractors have formed to fight back.

From $200K to $1.2M in two years: Rates for construction liability have been increasing for at least a year, but contractors say the trend has worsened in 2003. They're paying more and often getting less coverage.

As few as four liability insurers still cover home construction, subcontractors say, and sometimes a company won't disclose the much higher rates it wants for a renewal until the old policy expires. Homebuilders require subcontractors to have continuous insurance coverage, so the delay pressures the subcontractor to accept the new rate as offered.

If the subcontractor balks, he's up the creek. "I'm in breach of contract on all of my jobs," said one subcontractor whose insurance has expired and says he can't find reasonable rates.

Benjamin will pay $1.2 million for construction liability insurance this year. Last year he paid $900,000, and in 2001 he paid about $200,000.

Some of the sixfold gain is due to his increased workload, he said, but most of the extra $1 million is simply a higher rate.

Meanwhile, he said his coverage has eroded. He is no longer covered for mold-related damage to his frame work, and his deductible went from zero three years ago to $100,000 today.

To make the rate, Benjamin has raised his charge to the general contractors, the homebuilders, by $700 per home last year, $350 this year. He is one of 35 to 40 subcontractors that work on each new home, although most of the others contribute less to the cost of the house.

Lawyers for plaintiffs say the real problem is defective construction, not aggressive attorneys.

"If the builders did their jobs right in the first place, that would certainly cut down on their litigation," said Mark Milstein, managing general partner in the law firm of Verboon, Milstein & Peter LLP in Santa Monica. "We believe in the clients' rights."

An extra $6,000 for framing: Colafrancesco Framing Inc. paid $120,000 for its latest construction liability policy until last year. The renewed policy, which expires June 28, came with a premium of $550,000 -- a 358 percent increase. "My wagon train was one of the first to get arrows in it," Jim Colafrancesco said.

And as with Benjamin, his coverage is shrinking. His $120,000 policy was based on a payroll of $4 million for the year. The current policy is based on a payroll of $3 million. He's told to expect a 25 percent increase in June, "and they're telling me that's if I'm lucky."

Another framing subcontractor, Jon Olivieri of Olympic Construction Co., said his premium last year was $85,000. This year it would be $540,000 if he takes it, despite a flawless 19-year insurance record.

"They have no justification," he said. "Every subcontractor I know has fallen into this. It just puts you right out of business."

The rate increases add $2,500 to his charge for framing an average home, he said, and $6,000 for an upscale home.

One prominent homebuilder, Dunmore Homes, wouldn't accept his increased charges, so Olivieri lost the business.

"I did $12 million in business with them last year," he said, "and that business is gone thanks to the insurance issue."

Olivieri said he has framed more than 10,000 homes in the Sacramento area and only one homeowner has ever sued him.

Plumbing contractor Louis Ferrari of Ferrari Plumbing Inc. is also among the wounded. "It's extortion," he said.

His insurance this year rose to $195,000 -- up 550 percent from $30,000 last year. So far this year, he said, only one of the seven homebuilders he's working for -- Elliott Homes -- has accepted his increase in charges to cover insurance.

An extra $12,500 per house: The subcontractors pass their higher costs on to the homebuilder, who passes it on to the homebuyer.

The impact on general liability premium hikes for subcontractors during the past year or so has probably added $5 per square foot to the cost of a home, said Ed Elkins, director of purchasing for Meritage Homes. For a home of 2,500 square feet, that means an additional $12,500.

Roger Stanton, purchasing director of Beazer Homes of Northern California, calculated a similar sum.

Homebuilders are paying more for insurance too. Beazer paid $550,000 for general liability insurance three years ago, or $625 per house, said Brendan O'Neill, chief financial officer for Beazer and president of the Building Industry Association of Superior California. This year, the amount is up to $3 million, or $2,100 a house. That's a 236 percent increase.

And because deductibles are now as high as $50,000 per house, the company is basically self-insured for anything short of a catastrophe, O'Neill said.

The subcontractors are caught in a special trap. Although many probably could self-insure, the homebuilders they work for require them to get insurance. That's because the homebuilder's own insurers demand that they do so, said the subs.

Homebuilders also don't want to risk contracting with subcontractors who are uninsured, Elkins said.

Subcontractors organize: Some subcontractors are forming an association in Northern California to tackle insurance and other problems, said Jeff Wilson, owner of A-1 Door and Building Solutions.

The group -- Professional Association of Specialty Contractors -- is affiliated with a group of that name in San Diego. The local group met for the first time on April 9.

Wilson, the group's president, said it has about 100 members, has hired an executive director and has collected $100,000 in dues.

The group intends to lobby the Legislature for insurance reforms and changes in construction litigation law. "If we don't solve these things in California," he said, "housing is going to be so expensive that people won't be able to afford it."

The group's territory runs down the state to Merced. The first step will be to set up committees to tackle each issue facing the subcontractors, then to tackle the Legislature, said Brad Diede, the group's executive director.

The group is also offering its own insurance, Artisan's Insurance, through a captive insurance company owned by the group's members.

Insurers are getting scarce: Insurance industry observers say one big problem facing builders is that the number of insurers licensed to offer coverage in California has dropped, and only those licensed insurers have their rate hikes controlled by the state. "Non-admitted" insurers can sell policies for whatever people will pay, if the insured cannot find appropriate coverage among the admitted companies.

Twenty to 30 licensed California insurers offered defect-liability coverage about five years ago, said Mark Sektnan, assistant vice president of the western region for the American Insurance Association in Sacramento.

Sektnan was hard pressed to think of one today.

"There are a small handful of insurers that will provide programs," said Greg Van Ness, managing director of Acordia of California Insurance Services Inc. in Rancho Cordova.

Most contractors in California have to go to the non-admitted market. Non-admitted insurers range from well-known entities such as Lloyd's of London to small, poorly capitalized offshore insurers.

Before one insurer decided to stop writing construction liability, Sektnan said, it was paying out $4 for every $1 of premium it was taking in.

How insurers see it: Insurance has been a tough industry in recent years, with rates for various kinds of coverage generally headed higher. The market was already contracting when reinsurance -- coverage that insurers buy to cover themselves -- became tougher to find after the Sept. 11, 2001 attacks exposed the potential for billions of dollars in losses caused by domestic terrorism.

But the construction industry has its own particular factors. A key factor, insurance industry experts say, is an aggressive plaintiffs bar eager to file construction defect suits.

The market is "very unfavorable" to insurers because of the "explosion of construction defect litigation," Van Ness said. "That's the essence of it. It's the cost of the claims."

The condo insurance market disappeared in the 1990s because of construction defect litigation. Condos lend themselves to class actions. When few new condos were built, plaintiffs attorneys moved to actions against builders of single-family houses, Sektnan said.

The losses from potential claims are particularly tricky for construction liability insurers to predict because suits for defects can be brought as long as 10 years after construction.

Other factors listed by Sektnan:

? The threat of toxic mold. Earlier policies were never priced to factor in the uncertainties of it.

? A buyer's higher expectations. As homebuyers pay $300,000 and up for new homes in the region, they expect a better house. For most people, it's the largest investment they'll make, and it's one on which hundreds of people have worked.

Take a Sun City resident who has bought his beloved last home and looks forward to a care-free retirement. Such a person, with high expectations, might be more likely to contend that a crack in a driveway is a defect rather than a blemish.

? The quality of workers and pace of construction. The regional housing boom has thinned the quality of the work force, and people want their homes built in a hurry.

Builders can construct a perfect home, said Sektnan and Nicole Mahrt, local American Insurance Association spokeswoman, but no one could afford it.

As for workers' compensation, coverage has grown costlier irrespective of industry. After California deregulated workers' comp insurance in 1993, many insurers started to price their coverage below their cost to gain market share from rivals. As long as the stock market boomed, investment income offset the losses. But then costs soared, stocks soured, and rates surged.

Some of the state's largest workers' comp carriers went under or left the state. In recent years, the few remaining workers' comp insurers have been pricing their product more appropriately. But indemnity and medical costs remain high, and a new benefit increase for injured workers has forced rates upward.

Some solutions: One idea for easing the construction problem is setting up a framework in which developers and subcontractors agree to have one law firm represent them collectively in a defect lawsuit, instead of each having its own legal representation. They'd agree on which experts to use, and divide the liability.

For plaintiffs, this would speed settlements, Sektnan said. For the defense, it would reduce or eliminate countersuits between general contractors and subcontractors, and reduce overall defense costs.

Assemblyman Darrell Steinberg, a Sacramento Democrat, has authored Assembly Bill 903, currently a spot bill, that would clean up some insurance problems remaining after last year's state Senate Bill 800. That law gives homebuilders the right to fix defects in homes finished after Jan. 1, 2003, before the builder can be sued for defects.

No language has been written yet, but the idea is that AB 903 would create a collective framework for the construction industry to use voluntarily, Sektnan said.

The idea comes from a 4-year-old pilot program in San Diego that was initiated by large national insurers and developed by a think tank to reduce litigation costs.

Such a system is a start, but it's not the whole solution, Sektnan said. Insurers need to be able to predict their risk better in order to offer coverage.

Beutler forms a 'hybrid captive': Some companies in the construction industry are pursuing alternatives to conventional insurance, both for liability and workers' compensation, with hopes of at least stabilizing their costs.

Members of the Building Industry Association of Superior California are considering forming a group self-insurance plan or a captive for workers' compensation. A group of subcontractors, with help from a Sacramento administrator, have sent their proposal for a self-insured workers' comp group to the state for approval.

Beutler Corp. of Sacramento, the area's largest mechanical contractor with 1,300 employees and gross billings of $114 million, formed its own Bermuda-based captive last September because of skyrocketing insurance costs, said Jeff Starsky, vice president and general counsel.

The captive is for general liability, but it also has a component for workers' comp. Beutler will fold in auto and property next year.

Beutler's is a hybrid captive. Even before Beutler formed it, the traditional liability coverage the company was able to obtain required that Beutler self-insure the first layer of risk.

Beutler's captive is designed to cover that self-insured first layer for liability and workers' comp. It's a tax-deferred mechanism that allows the company to set aside funds for future claims, Starsky said. Beutler uses traditional insurance policies to cover the rest.

Document 4

Berkeleyan

Study unmasks litigation myths

By R. Russell Hoyle, California Policy Research Center

13 November 2002 | A report released recently by the California Policy Research Center examines the impacts of construction-defect litigation, including its effect on condominium development and affordable housing in the state.

Aspects of California's legal environment may have facilitated more defect litigation than has occurred in other states, say the two principal authors, Cynthia Kroll, regional economist at Berkeley's Fisher Center for Real Estate and Urban Economics, and Larry Rosenthal, executive director of the Berkeley Program on Housing and Urban Policy.

The report indicates that litigation — and resulting problems of insuring residential construction when construction carriers leave the California market — is one of several different factors contributing to the decline of new multifamily construction in the late 1980s through much of the 1990s. "California was hit hard by both the legal climate and economic conditions during this period," says Kroll. "As the economy improved, builders found ways to address some of the problems brought on by litigation, and they began building condominiums again."

The study's authors challenge some of the myths of the litigation debate in California. "Many builders will tell you that a key problem in California is that state law permits litigation on construction defects to occur for up to 10 years after the completion of a project," says Rosenthal. "Yet we found that many other states allow such suits as long or longer after construction but have not had similar levels of litigation and insurance problems."

According to Rosenthal and Kroll, resolving the affordable-housing problem in California will require more than reforms just in the area of construction-defect litigation. From a public-policy standpoint, they say, such reforms must be part of a broader strategy that enhances subsidies, loosens overly restrictive land controls, and overcomes unreasonable community opposition to new low- and moderate-income housing stock.

The report is based on a research study conducted by a team affiliated with the Fisher Center and the Goldman School of Public Policy.

Links:

The complete report
A four page summary of the report

Document 5

RESEARCH SERVING CALIFORNIA

CPRC *Brief*

Vol. 14, No. 7 October 2002

The Impact of Construction-Defect Litigation on Condominium Development

Cynthia Kroll, Larry A. Rosenthal, Robert Edelstein, John Quigley, David Howe, and Nan Zhou

This Brief summarizes study findings about the impact of construction-defect litigation on condominium development in California. The purpose of the study was to inform the policy debate—principally between builders and insurers on one side, and attorneys for homeowner plaintiffs on the other—over whether defect litigation is reducing the amount of affordable, for-sale attached housing built in California. If so, litigation reform might improve opportunities to build such lower-cost housing.

To contribute to an understanding of current concerns about defect litigation and construction levels, the study documented trends in building activity; examined litigation and the California legal environment in context; and investigated legislative, builder, and insurance company responses to the problem.

Specifically, our findings indicate the following:

- Construction of multifamily housing and condominiums slowed in the 1990s
- Builders and insurers have grown increasingly concerned over litigation
- Aspects of California's legal environment may facilitate more defect litigation than occurs in other states
- Legislative reform and recent court decisions may dampen litigation activity
- Builders and insurers are finding new ways of doing business

According to builders and insurers, "frivolous" construction-defect lawsuits have stopped the production of attached projects and have led to skyrocketing construction-insurance premiums. Builders' general experience is that insurance and litigation costs are significantly higher in California than other states.

Homeowners associations and trial lawyers, on the other hand, argue that unfettered construction-defect litigation is necessary to protect the rights of homeowners. Some see the shortage of affordable housing as being caused by many complicated factors in the real estate market—not lawsuits. Construction-defect litigation, they argue, is caused by poor-quality construction and builders' refusal to fix their costly mistakes. They argue that insurance is a small percentage of the sales prices of single-family homes or condominiums.

Earlier studies have not resolved the welter of issues raised by these different points of view, and neither does the present research. The authors sought to add an analytical perspective to the conflicting claims regarding existing conditions and litigation policies.

This perspective is based on an examination of changing construction levels of condominiums and multifamily housing; interviews concerning the availability of insurance for residential builders; a survey of legal conditions in comparison with those in other states' housing markets; and a review of innovations by builders and insurers that have expanded building opportunities in California.

Research Approach

Ideally, an analysis of the defect-litigation

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issue would compare California with other states and regions over a 20- to 30-year period, to account for economic business cycles. This ideal method would track (a) new home construction by condominium status and number of units per building; (b) construction-defect litigation by number and type of lawsuits and sizes of settlements and enforced judgments; (c) shares of litigation recoveries dedicated toward homeowner compensation, defect repair, and legal expenses; (d) insurance costs and availability; and (e) background economic and demographic data by geographic area.

Unfortunately, the cost and inaccessibility of much of this data make such a study prohibitively expensive. Basic economic and demographic factors are most easily tracked, yet even these data are affected by changing geographic definitions over time. Detailed data on building permits (but not housing starts) are also available at the state and metropolitan levels, but published series do not identify whether units are built as condominiums.

Housing surveys provide much more restricted data on condominium stock and construction, and report data by aggregated time periods (e.g., five-year time increments) rather than annually and for few geographic areas. (The present research was conducted prior to the release of data from the 2000 census, which may become an alternative source for analyzing changes in condominium construction in the 1990s.)

No available data sources report the amount of construction-defect litigation or insurance availability, the size of settlements, or changes in insurance costs and accessibility. Court-docket systems are designed for judicial management rather than systematic data analysis. Insurance-market information is the basis for actuarial analyses that form the private, proprietary knowledge base for firms in the insurance business.

For these reasons, the best sources of information on litigation activity and insurance costs are interviews with builders, insurers, and attorneys. While limited interviews do not generate reliable statistical measures of important policy factors such as insurance costs or litigation frequency or cost, key-informant interviews can illuminate concerns and strategies of builders, insurers, and related services such as property management and trade associations in addressing defect-litigation risk.

In the present study, such interviews also identified critical years in California, starting in the early to mid-1990s, when litigation concerns and demands for reform among builders appeared to gain momentum and when the availability of liability insurance became much more restricted.

Residential Construction Trends

Analysis of construction data indicates that total residential building dropped sharply in California and nationally during the first half of the 1990s. The construction industry's recovery in California was weaker than that of the nation's builders overall. Importantly, this differential included both single-family and multifamily buildings and was not limited to condominium units.

Throughout the country for much of the 1990s, multifamily permits made up a lower share of total residential permits than in previous decades. California's multifamily share of total permits in the mid-1980s was at a higher level than the multifamily share nationally; by the mid-1990s, California's multifamily permit share had dropped more sharply than nationwide. Economic and geographic factors explained part, but not all, of this differential.

Since the mid-1990s, California's multifamily construction activity has partially recovered. While its level is now similar to that of the United States as a whole, California's recovery appears weaker compared to pre-1990 levels.

A variety of sources indicate a similar drop in the construction of condominiums in the 1990s. The extent to which this has occurred varied widely among places in California and also among other U.S. metropolitan statistical areas (MSAs).

In California, the share of new homes built as condominium units declined in the 1990s in the majority of MSAs for which data are available, and all of these MSAs experienced a sharp drop in the total numbers of new condominiums built. Some other MSAs had similar experiences. Our statistical analysis could not demonstrate what share of the decline in California was due to background economic conditions rather than litigation or other unidentified factors.

Changes in the price and characteristics of condominiums in California also indicate that shifts occurred in the state's condominium market in the 1990–2000 period. Condominium prices have risen

relative to single-family home prices within the state, and the relative price differential between California and other U.S. condominiums was less affected by the recession of the early 1990s than the relative price differential for single-family homes.

California's Legal Environment

Interviews with builders and insurers confirm that, throughout most of the 1990s, construction-defect litigation became more prevalent in California than it did elsewhere, and affected condominium projects more than single-family homes or apartments. The comparative incidence or cost of litigation within California, in the aggregate, remains to be measured. However, a review of Internet information sources on construction defects revealed a more intense market for litigation services in California than elsewhere, even accounting for population size and recent growth.

Builders and insurers regularly argue that California's legal environment is particularly conducive to defect litigation. However, a detailed comparison of the legal environments in California and 20 other places (19 states and the District of Columbia) reveals great similarity on the procedural side. California's statutes of limitations and repose—four years and 10 years, respectively—governing the period of years when post-construction lawsuits may be filed, are at the median for the 21 places. States commonly allow legal action for latent defects to be taken up to 10 years following a building's completion.

In the area of substantive liability standards, California appears more unusual. Of the 21 places studied, it is one of only five that apply the plaintiff-friendly doctrine of strict products liability to claims of defective residential construction.

Three of these five places had other factors that could mitigate the effects of strict liability. For example, New Jersey has an aggressive home warranty program, whereas Pennsylvania has applied the economic-loss doctrine, narrowing the scope of recoverable damages and reducing overall litigation risk to builders. Although Washington, D.C. has neither the economic-loss doctrine nor a warranty program, it has lost rather than gained population in recent years—and may have little new construction raising the potential for litigation. The neighboring states that include the greater District of Columbia MSA have not applied strict liability to construction-defect cases. In contrast, California and Nevada were left during the 1990s without any significant legislation moderating substantive liability standards.

Legislative and Judicial Reform

The state legislature has attempted to encourage means other than litigation to resolve construction-defect disputes. In 1995, for example, a new law modified court procedure in such cases by requiring more meaningful exchanges of information between plaintiffs and defendants as well as dispute resolution to encourage pretrial settlement. Interviews with litigants revealed that this procedure—known as the "Calderon process," for the bill's author—is easily circumvented, and thus less successful than originally intended.

However, recent amendments taking effect in 2002 may improve the Calderon process by lengthening the dispute-resolution period and expanding the participation of subcontractors and insurers. Additionally, the California Supreme Court in December 2000 rejected a lawsuit, applying the economic-loss doctrine in a case where no personal injury or damage to property had occurred.

New Business Methods

The building industry has adapted to daunting legal challenges and insurance limitations, but these adaptations carry their own costs. Key business adjustments by builders and insurers, designed to address heightened litigation risk, include: (a) peer review of project design; (b) third-party construction inspections, often documented via videotape; (c) post-sale building maintenance programs; (d) segmented and wrapped insurance policies; and (e) pooled insurance coverage provided through trade organizations, particularly among subcontractors.

These steps aim to enhance insurance availability and improve building quality and maintenance. While such efforts add to total project cost, the industry's adaptations to litigation realities suggest it believes these changes will reduce legal expenses in the long run.

Changes in building practices and insurance products allowed California builders to respond to market demand, boosted by a rapidly expanding economy and growing population, at the end of the 1990s. In addition, builders and insurers new to California entered some of the state's more lucrative condominium markets, but have focused on luxury condominiums, not affordable units.

Policy Implications and Recommendations

Much of the policy development concerning these issues has been hampered by poor information and few means for tracking the effects of programs. This Brief also leaves some key questions unanswered. The research has demonstrated that multifamily building levels remain low in California after a sluggish recovery, that litigation levels are high, and that builders have had difficulty obtaining insurance for residential projects that involve homeowners associations, especially when attached units are involved. The research has not demonstrated the presence, nor proved the absence, of a direct link between litigation and the shortage of affordable housing, nor has it identified specific policies and programs that could alleviate the situation.

The lack of good measures makes it premature to make specific policy recommendations. However, some general points are evident, and new policy approaches would benefit from better data on defect litigation and housing-market conditions, as well as more information on other states' experience with some of the more promising means for addressing the problem. Thus we recommend:

- Continuing policy efforts to move construction-defect disputes out of the courtroom to the bargaining table.
- Policymakers seeking further reform need to consider all parties with systematic stakes in maintaining construction-defect litigation, such as developers and homeowners associations, insurers, and trial lawyers.
- Better data and analysis would make it much easier to determine the effectiveness of existing and future reforms. Analysis of the 2000 census will help measure how condominium construction and costs differ in California markets from other parts of the United States. Further econometric analysis of annual building-permit data at the metropolitan and state level could also explain how specific legal conditions affect multifamily construction.
- Monitoring of court cases over the next few years would help to determine whether the anticipatory strategies of builders and insurers—such as peer review, construction documentation, and third-party inspection—are effective and should be incorporated into programs to reduce litigation cost. We also recommend evaluation of recent dispute-process reforms in California and evaluation of warranty programs elsewhere.
- Survey construction-risk insurers nationwide to identify the extent of California's troubled market conditions.

Resolving the affordable-housing problem in California will require more than reforms in the area of construction-defect litigation. From a policy standpoint, such reforms must be part of a broader strategy that enhances subsidies, loosens overly restrictive land controls, and overcomes unreasonable community opposition to new low- and moderate-income housing stock.

Robert Edelstein is professor at UC Berkeley's Haas School of Business and co-chair of the Fisher Center for Real Estate and Urban Economics. John Quigley is professor at the Haas School of Business and the Department of Economics. He also holds an appointment at the Goldman School of Public Policy and directs the Berkeley Program on Housing and Urban Policy. Cynthia Kroll is regional economist at the Fisher Center, and Larry A. Rosenthal is executive director of the Berkeley Program on Housing and Urban Policy and a lecturer at the Goldman School of Public Policy. David Howe and Nan Zhou were graduate students in economics and information and systems management, respectively, during the course of the study.

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Document 6

Construction Briefings

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CONSTRUCTION DEFECTS LITIGATION AND THE "RIGHT TO CURE" REVOLUTION

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For many businesses, the prospect of costly and time-consuming litigation is a significant threat, and one from which the construction industry is not insulated. The complexities of a construction project create an infinite source of litigable disputes. Construction flaws and errors by general contractors and subcontractors are often difficult for the homeowner to detect. Nonetheless, such defects create animosity between homeowner and builder, leading many homeowners to pursue litigation without attempting to negotiate for repairs or other remedies. While the costs of excessive litigation harm contractors through attorneys' fees and insurance premiums, these costs are also passed on to consumers in the way of higher construction prices and housing shortages.

In response to this expanding problem, approximately half of the states have enacted "right to cure," or "notice and opportunity to repair" legislation. "right to cure" statutes do not deprive homeowners of any remedy they could normally obtain through a court of law. Instead, the laws aim to prevent unnecessary litigation by first requiring consumers to comply with a statutory procedure. The homeowner must provide the contractor with written notice of the alleged defect, usually 60 or 90 days prior to filing suit. In most states, this notice gives the contractor 30 days to request an inspection of the premises, offer to repair the defect, negotiate a monetary settlement, or reject the claim altogether and proceed to litigation. If the parties previously agreed to resolve their disputes through arbitration or another dispute resolution technique, then the terms of such an agreement will control the dispute resolution process.

"Right to cure" statutes aim to protect construction professionals and improve the housing market for consumers by encouraging

less expensive resolution of construction defect disputes. The statutory waiting period also provides a "cooling off" stage where homeowners will be forced to consider negotiation rather than heading straight for the courtroom.[1] Also, "right to cure" statutes open the door for alternative dispute resolution methods, such as mediation, which are more likely to be effective during this period before the litigation process has begun.

Yet, the "right to cure" movement is not without its critics. In particular, homeowner and condominium associations have expressed concern that these new laws create unnecessary and expensive hurdles for consumers with legitimate claims. While "right to cure" legislation has been billed as the construction industry's version of "tort reform," consumer advocates question why contractors are not similarly restricted from suing homeowners for withheld payments.[2]

This article analyzes the various provisions of a typical "right to cure" statute, and considers the potential effects of the legislative approaches articulated in select states. Attention will be paid to the policy arguments supporting and opposing this legislation, as well as future approaches that might reconcile some of the concerns in the "right to cure" debate. Finally, this article looks to the future of "right to cure" legislation, and examines what new methods may be used to resolve construction defect disputes.

Construction *Briefings*

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Overview of Construction Defects Lawsuits

As the construction industry expands rapidly in the western United States and in many other developing areas of the country, the volume of construction defects litigation has grown exponentially. The definition of a "construction defect" varies from state-to-state, and is largely controlled by state laws and judicial interpretation. Generally speaking, a defect occurs when a construction professional fails to complete some aspect of a building project in the appropriate manner. Some examples of "construction defects" are: conditions causing a building or system to not function properly (design deficiencies); the use of inferior materials or components (material deficiencies); poor quality or workmanship resulting in undesirable conditions (construction deficiencies); and a failure to account for soil conditions, resulting in damage to the building's foundation (subsurface/geotechnical problems).[3]

While construction defects have been around as long as construction itself, three factors explain the recent explosion in defects litigation. First, the sheer volume of new projects has increased the potential for liability, especially as construction firms are challenged by stricter time deadlines. For example, in Clark County, Nevada, which includes Las Vegas and its surrounding areas, there were approximately 170 construction defects lawsuits filed between 2000 and 2001.[4] While competition benefits the construction industry by offering choices for consumers and keeping estimates and costs low, the homeowner's expectations can be difficult to meet in such a fast-paced, cost-conscious environment. Construction projects invariably run into delays, and the pressure to comply with the estimated

price might lead to the use of substandard materials or workmanship in completing projects. Strapped by costs, many developers refuse to hire a full-time quality control supervisor who would be able to detect most construction defects before a project is completed.[5]

Second, the number of lawyers educated in construction law has also increased as construction litigation becomes more prevalent. In many states, a specific common law action for construction defects has only been available for a half-century.[6] Defect disputes are extremely fact-intensive and require experience with construction or consultation with industry professionals to assess the validity of a case. Attorneys previously viewed construction defects as another subset of torts, but modern law firms often employ a number of attorneys specialized in this area of practice.

Third, the statutory schemes of the 1990's that regulated construction projects and remedies were riddled with ambiguities and loopholes that supported plaintiffs in filing construction defect claims. For example, Nevada passed a statute in 1995 imposing pre-suit requirements and limiting the scope of obtainable damages. However, the statute also contained a "complex matter" exception for planned unit developments (PUDs) and condominiums. Given that PUDs and condominium projects were outside of the statute's notice requirements, builders were forced into large class action settlements. Meanwhile, Nevada courts articulated an "economic loss doctrine" that seemed to contradict the 1995 statute. The Nevada Supreme Court declared that all components of a home were necessary and integrated. Therefore, a construction defects suit would only be available under theories of contract or warranty.[7] The Nevada example typified the uncertain nature of construction defects law—an environment giving homeowners greater bargaining power and increasing the overall threat of construction defects litigation.

The Rise Of "Right To Cure"

While much of the litigation surrounding construction defects likely reflects legitimate concerns with deficiencies in construction projects, it soon became clear that excessive litigation was becoming a problem. With the erosion of the *caveat emptor* ("let the buyer beware") rule, homeowners overcame the prohibitive costs of a lawsuit by bringing suit as part of a condominium, planned unit development, or common interest community group.[8] These large-scale lawsuits forced contractors into costly settlements, which made construction insurance expensive and difficult to obtain. As a result, these costs were often passed on to consumers, and housing shortages, particularly in the fast-growing Sun Belt, became a problem.

Insurers, joined by contractors and other concerned groups, called for a legislative fix to the broken system of defects litigation. The resulting "right to cure" legislation represents an attempt to reconcile homeowners' common law and statutory rights with the need to protect contractors from frivolous or unnecessary lawsuits. As of January 1, 2006, 24 states have enacted some form of a "right to cure" statute, and several states, including Iowa[9] and Pennsylvania[10], are considering similar laws.

"Right to Cure" Statutes — Requirements and Application

One of the key variables in construction defects legislation is how the statutes differ across states. While "right to cure" legislation imposes procedural requirements that could be applied to disputes in any number of construction settings, the influence of special interest groups and the particular needs of the construction industry in a given location result in different versions of the statute in different states. These legislative influences also explain why several states have addressed construction defects issues more quickly than others. There are three categorical

factors that determine the scope of a particular "right to cure" statute: the type of building, the nature of the construction project, and the status of the construction professional.

• *Type of Building*

Generally speaking, "right to cure" laws apply to the construction of a "residence" or "dwelling," but those terms can be defined such that certain building projects are exempted from the law's requirements. For example, the Tennessee law[11] covers damages to all types of "commercial property," but not "residential property" that the statute defines narrowly as a "dwelling unit intended as a residence of a person or family." Thus, single-family homeowners in Tennessee are not subject to any notice requirements before filing a lawsuit.

In other states, however, "residence" and "dwelling" refer not only to single-family homes, but also to duplexes, triplexes, quadraplexes, and other multi-unit residential structures "where title to each individual unit is transferred to the owner under a condominium regime."[12] Mobile homes are occasionally omitted from coverage,[13] particularly if a state has a separate set of laws dealing with manufactured housing defects.[14]

• *Type of Construction Project*

Most construction defects statutes spell out the types of projects to which they apply. For example, the West Virginia law defines a "residential improvement" as "(A) The construction of a residential dwelling or appurtenant facility or utility; (B) an addition to, or alteration, modification or rehabilitation of an existing dwelling or appurtenant facility or utility; or (C) repairs made to an existing dwelling or appurtenant facility or utility." Texas goes into even greater detail, providing that the law applies only to construction of new homes, "material" improvements, or improvements to a home's interior exceeding $20,000 in value.[15]

• *Type of Construction Professional*

Finally, "right to cure" statutes usually define the term "construction professional" in a broad manner to encompass a wide range of defects disputes. Depending on the state, "right to cure" laws might apply to any number of parties involved with a construction project, including "an architect, subdivision owner or developer, builder, contractor, subcontractor, engineer or inspector" who is "performing or furnishing the design, supervision, inspection, construction or observation of any improvement" to real property.[16] Texas has a unique statutory scheme, which requires "builders" to register with a special commission tasked with establishing and governing construction defects disputes.[17] The divergent approach of Texas in establishing the "Texas Residential Construction Commission"[18] will be fully addressed later in this article.

Procedural Requirements of "Right to Cure" Statutes

• *Defect Discovery and Statutory Timelines*

The first event that invokes the "right to cure" procedure is the homeowner's discovery of a defect, which often occurs after the project has been completed and the consumer occupies the premises. While some consumers might voluntarily go to their contractor and use a "carrot and stick" approach to negotiate repairs, many choose to pursue costly litigation and request expenses and punitive damages.

"Right to cure" laws aim to reduce or prevent litigation by forcing compliance with a statutory waiting period designed to encourage negotiation and to facilitate solutions. Usually, the statute will allow 60 to 90 days to pass before the homeowner may file a lawsuit. However, if the contractor fails to comply with the "right to cure" provisions, then the homeowner is allowed to sue at an earlier time. Some states, such as

Kentucky, do not provide a specific time period for negotiation.[19] Kentucky's law regulates the exchange of written notices and responses, but does not stipulate a minimum number of days between the initial notice and the ability to file suit. Rather, lawsuits can be initiated upon the failure of the negotiation process.[20]

One concern of homeowners might be that these pre-litigation procedures will interfere with their ability to commence suit before the statute of limitations lapses. Ohio is one of several states that has addressed this problem through a specific provision tolling the statute of limitations "from the time the owner sends a notice of defect to a contractor...until the owner has complied with this chapter."[21]

• *Written Notice and Contractor's Response*

The language of a "Notice and Opportunity to Repair Construction Dwelling Defects" document is generally provided by the state statute, and service of this notice signals the beginning of the "right to cure" timeline. Regardless of its form, the written notice conveys three important pieces of information from consumer to contractor: "(1) a statement that the claimant asserts a construction defect; (2) a description of the claim or claims in reasonable detail sufficient to determine the general nature of the construction defect; and (3) a description of any results of the defect, if known."[22]

Following notice, the contractor usually has a period of 30 days[23] to respond in one of four ways. First, the contractor may request a formal inspection to assess the validity of the claim and to determine a proper course of action. The inspection must occur within a specified timeframe, and the inspection proposal must indicate that the contractor will use the inspection's results to determine a further course of action.[24] Second, the contractor can offer to make the necessary repairs, and even extend the allotted time for such repairs by agreement, if the statute permits such modification.[25] Third, a monetary settlement can be offered in lieu of repairing the alleged defects. Fourth, the contractor can reject the claim altogether, which allows the homeowner to proceed with arbitration or a lawsuit.

• *Consequences of Not Following the Statutory Requirements*

If the homeowner fails to comply with any of the statutory "right to cure" requirements, any legal action for construction defects filed thereafter will be dismissed without prejudice. In other words, the homeowner will still be able to file suit, but will have to repeat the entire 60-day or 90-day process before being allowed to proceed. However, if the contractor fails to reply to the homeowner's written notice or rejects the claim altogether, the homeowner may go forward immediately with litigation.[26]

Case Studies

In countering the problem of excessive construction defects litigation, several states have stepped forward in generating creative legislative solutions. Two states in particular, California and Texas, have developed aggressive and innovative approaches toward "right to cure" laws.

• *California and SB 800*

California's "right to cure" law[27] is perhaps the most unique and controversial effort in the country to stem the tide of construction defects litigation. Commonly known as "SB 800"—the title of the bill introduced in 2002—much of the statute's pre-litigation procedure is similar to other state efforts. Prior to commencing legal action, the homeowner must provide the contractor with a written notice of claim.[28] The contractor then has a brief 14-day period in which to acknowledge receipt of this notice.[29] At this time, the contractor may request an inspection, which must be completed within 14 days, to assess the validity of the claimed defect.[30] Within 30 days of the initial inspection, the contractor

can offer to repair the defect, and actual repairs must then begin within 14 days, with "every effort" to complete them within 120 days.[31] SB 800 provides: "If the builder fails to make an offer to repair or otherwise strictly comply with this chapter within the times specified, the claimant is released from the requirements of this chapter and may proceed with the filing of an action."[32]

What makes SB 800 unique among "right to cure" statutes, however, is its enumeration of "actionable defects" in Chapter 2.[33] One commentator referred to Chapter 2 as the law's "most ambitious aspect"[34] for its attempt to address "every function or component of a structure."[35] Only the defects considered in Chapter 2 are actionable, as the statute's minimum performance standards have the dual effect of guiding efficient repairs while imposing strict liability for non-compliance.[36] The law also establishes a statute of limitations attached to a series of building warranties. Contractors must provide homebuyers with a one-year written limited warranty for the "fit and finish" of various installed items.[37] A two-year statute of limitations applies to untreated wood posts, defective landscaping, and installed dryer ducts.[38] Plumbing and sewer defects, electrical defects, and problems with exterior pathways and other outdoor improvements have a four-year statute of limitations.[39] Finally, paint or stain decay is covered for a period of five years.[40]

It is simply too early to assess the full impact of SB 800 on California's construction defect disputes. While the law shows promise for reducing problems, it remains to be seen whether the law's complex formula will prove workable in securing repairs, or simply impose more costs on homeowners and builders during the pre-litigation stage.

• *The Texas Residential Construction Commission Act*

In Texas, the approach to construction defect disputes is unique because the "right to cure" legislation creates a state commission responsible for licensing builders and supervising arbitration of defects claims. The "Texas Residential Construction Commission" (TRCC) consists of nine members appointed by the Governor, and it applies to a "dispute between a builder and a homeowner if the dispute arises out of an alleged construction defect, other than a claim solely for personal injury, survival, or wrongful death, or damages to goods."[41] Prior to filing suit, the homeowner may request state-sponsored inspection and dispute resolution by written request outlining each alleged construction defect with "reasonable detail."[42] Within 30 days of this request, the homeowner must also notify the contractor of the alleged defects.[43] The inspector will then examine the premises and make a recommendation based upon the applicable warranty and building performance standards established by the TRCC.[44] While the inspector's findings are not binding on either party, the findings may be used as a "rebuttable presumption" in a later trial.[45]

It should be noted that the creation of the TRCC was largely brought about by the influence of special interest groups, and its composition and complex scheme of warranties and standards might be difficult for the average homeowner to understand.[46] The inspector bases his or her findings on TRCC standards, so it is possible that a homeowner's expectations based on knowledge of applicable building standards might differ substantially from what is ultimately revealed in an inspector's findings. Though different in structure than California's SB 800, the Texas statute could be perceived to create additional procedural hurdles for homeowners by requiring the payment of increased costs during the state-sponsored dispute resolution process. Overall, however, the hope is that the state-sponsored dispute resolution process and the TRCC are successful in reducing or preventing construction defect disputes.

Possibilities for Alternative Dispute Resolution

In addition to encouraging repairs and monetary settlements, "right to cure" legislation might also provide new opportunities for alternative dispute resolution (ADR) in construction defect disputes. Increasingly, contractors are including pre-dispute arbitration provisions in construction agreements, and the American Institute of Architects (AIA) recently updated its standard Design-Build contracts to allow parties to designate an ADR forum of their choice. "Right to cure" laws also allow for the parties to agree to any number of post-dispute resolution methods during the statutory period, including mediation. Some states even require mediation as part of the negotiation and repair process, as discussed below.

• *Mandatory Mediation Programs — California and Hawaii*

Mandatory mediation provisions represent efforts by the states to encourage parties to work out differences face-to-face, rather than suing for a construction defect as soon as one is detected. As noted above, California's SB 800 contains an aggressive mediation requirement upon the contractor's offer to settle a defects dispute.[47] The mediation session must occur within 15 days of the request, and is limited to four hours in duration.[48]

Critics have identified a number of flaws in SB 800's use of mediation. Homebuilders retain the right to repair defects, regardless of mediation, leaving little incentive for them to actively participate.[49] Even if the homebuilder fully cooperates with repairs and mediation, the statute provides no guaranteed insulation from suit. Also, the four-hour limit on mediation sessions is unlikely to produce any real results in a fact-intensive dispute. Mediation may also be counterproductive in some cases, since the homeowner's objective is to have the house repaired, and any resolution efforts aside from attempting repair will be viewed as unacceptable.[50]

The State of Hawaii, perhaps emulating the California plan, also has a mediation requirement.[51] Hawaii's law provides: "If the parties are unable to resolve the claim...all parties shall attempt to resolve the dispute through mediation, even if mediation is not otherwise ordered or mandated by contract or by law."[52] However, Hawaii does not place any time constraints or other procedural requirements on mediation. This "hands-off" approach acknowledges that dispute resolution might only be more effective when the parties are free to control the scope and duration of mediation proceedings.

Criticisms of "Right to Cure" Laws

While many observers agree that the "right to cure" movement "represents a well-intentioned effort at tort reform,"[53] there is a still a great deal of skepticism surrounding the laws' effectiveness and overall fairness. Critics of "right to cure" legislation believe that the laws place a high burden on homeowners, that contractors have not willingly complied with the laws, and that the legislation is biased in favor of the construction industry.

• *Burden on Homeowners*

Many homeowners consider "right to cure" laws to be an unnecessary obstacle to litigation and a tool to potentially frustrate otherwise legitimate defect claims at the hands of the insurance industry and other special interests. These criticisms largely stem from one central argument: if the main objective of a homeowner who discovers a construction defect is to have the defect repaired, a "cooling off" period should not even be necessary in the first place.

The 90-day waiting period elongates defect disputes without any real guarantee that the parties can avoid litigation. Moreover, the "procedural hoops" that most "right to cure" statutes put in place are often equally as complicated as

the pleadings phase of litigation.[54] In these early stages, homeowners often need the assistance of a lawyer merely to interpret their responsibilities, since failure to comply with any of the law's provisions re-starts the process.

A counter-argument to this concern is that homeowners only need to comply with the statutory requirements if they intend to sue in the first place. Cooperative homeowners are still free to pursue mediation or other forms of negotiation, while homeowners determined to seek legal recourse will invariably seek the aid of an attorney and follow the pre-litigation procedures. Given that "right to cure" legislation aims to control rising insurance premiums and provide more affordable housing, proponents of "right to cure" legislation argue that all homeowners benefit from such laws.

• *Lack of Compliance*

Although "right to cure" laws do clearly aim to provide contractors with an opportunity to fix construction defects, there is much concern that builders are failing to comply with statutory requirements, and even using the laws to gain advantages in litigation. For example, nothing prevents a contractor from feigning intent to repair identified defects while using the duration of the "cooling off" period to prepare legal defenses for trial.[55] Other dishonest practices include using the statute to run up legal costs on a vulnerable homeowner, or using mandatory mediation proceedings as an early discovery device to explore the weaknesses of a homeowner's claim.

• *Biased "Tort Reform"*

If "right to cure" statutes are properly viewed as the construction industry's answer to "tort reform," some critics question why the reform is focused only in a direction that is advantageous to a contractor. In other words, why should a contractor be allowed to sue a homeowner for non-payment or other reasons without honoring the statute's pre-litigation procedures, while the homeowner must wait up to 90 days for even the most blatant construction defects?[56]

The answers to these questions relate to the specific harms that brought about a movement toward "right to cure" legislation in the first place. In burgeoning markets such as California and Nevada, the threat of large-scale litigation by condominiums and planned unit developments had threatened the ability of builders to obtain affordable insurance, or any insurance at all. Builders were either forced to pass on these costs to consumers, or elect not to build any new projects.[57]

To the extent that "right to cure" laws affect homeowners disproportionately, they do so because of a need to persuade homeowners to seek other remedies prior to commencing costly lawsuits. In contrast, the vast majority of suits filed by contractors against homeowners are simple contract claims for unpaid sums. "Right to cure" legislation purposefully targets the types of lawsuits that cause the greatest burden on the judicial system and the resources of the parties involved. Nonetheless, by exempting individual litigants with single-family homes from the pre-litigation requirements or by exploring other consumer-friendly amendments, "right to cure" laws could do a better job of focusing on more balanced reform efforts.

Conclusion

"Right to cure" legislation emerged in an attempt to help homeowners and construction professionals resolve disputes in an orderly and amicable fashion. By crafting procedures to clarify the obligations of the parties involved in construction defect disputes, several states have kept insurance costs down for contractors, while still helping homeowners to have access to an adequate supply of affordable building projects and housing. While "right to cure" laws have not been without criticism in their design or implementation, the discussions surrounding the legal issues, procedural

requirements, and alternative means of resolving disputes have generally been positive for homeowners and contractors.

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State-by-State Construction Defect Statutes and Legislation

State	Type	Citation	Effective Date	Coverage
Alaska	Statute	AK ST §§ 09.45.881 et seq.	2003	Applies to "dwellings," including single-family homes, duplexes, multi-family housing units, and the mechanical and other systems, components, and improvements that are part of that unit.
Arizona	Statute	A.R.S. § 12-1363	8/2002	Covers a "person engaged in the business of designing, constructing or selling dwellings" (single- or multi-family housing, including condominiums).
California	Statute	CA Civil Code § 895	2002	Residential construction: developers, contractors, subcontractors, suppliers, architects, engineers, and insurance carriers
Colorado	Statute	C.R.S.A. §§ 13-20-801 et seq.	8/2001	"Construction professionals," including an architect, contractor, subcontractor, developer, builder, builder vendor, engineer, or inspector performing/furnishing the design, supervision, inspection, or observation of any construction or improvement to real property. Not limited to residential construction.
Florida	Statute	F.S.A. §§ 558.001 et seq.	7/2004	Design, construction, or remodeling of dwellings, including condominiums; applies to "residential construction" (single-family homes, condominiums, manufactured homes, modular homes, and multi-family dwellings designed for residential use)
Georgia	Statute	Ga. Code. Ann. §§ 8-2-35 et seq.	5/2004	Applies to "dwellings," including condominiums and other systems, improvements, or recreational features of dwellings
Hawaii	Statute	H.R.S. §§ 672E-1 et seq.	2004	"Dwelling" means a single-family house, duplex, or multi-family unit designed for residential use, including common areas and improvements that are owned or maintained by an individual, association, or other entity. "Premises" means a dwelling, including common areas and improvements that are owned or maintained by any person, firm, partnership, corporation, association, or other organization. "Premises" includes the systems, other component improvements, other structures, or recreational facilities appurtenant to, but not necessarily a part of, the dwelling or facility.
Idaho	Statute	Idaho Code §§ 6-2501 et seq.	7/2003	"Construction professional" means any person with a right to lien pursuant to Section 45-501, Idaho Code, such as an architect, subdivision owner or developer, builder, contractor, subcontractor, engineer or inspector, performing or furnishing the design, supervision, inspection, construction or observation of the construction of any improvement to residential real property, whether operating as a sole proprietor, partnership, corporation, limited liability company or other business entity. "Residence" means a single-family house, duplex, triplex, quadraplex, condominium or a unit in a multiunit residential structure in which title to each individual unit is transferred to the owner under a cooperative system.
Indiana	Statute	I.C. §§ 32-27-3-1 et seq.	5/2003	"Residence" means a: (A) single family house; (B) duplex; (C) triplex; (D) quadraplex; or (E) unit in a multiple unit residential structure in which title to the individual unit is transferred to the owner under a condominium or cooperative system. For purposes of clause (E), the term includes common areas and facilities (as defined in IC 32-25-2-4).
Iowa	Bill	SF 381 (2005)	N/A	"Residence" means a single-family house, duplex, or multifamily unit designed for residential use and shall include other structures appurtenant to the house, duplex, or multifamily unit.
Kansas	Statute	K.S.A. §§ 60-4701 et seq.	7/2003	"Dwelling" means a single-family house, duplex or multifamily unit designed for residential use in which title to each individual unit is transferred to the owner under a condominium or cooperative system and shall include common areas and improvements that are owned or maintained by an association or by members of an association. A dwelling includes the systems and other components and improvements that are part of a single or multifamily unit at the time of construction. For the purposes of this act, "dwelling" does not mean manufactured home as defined in K.S.A. 58-4202, and amendments thereto.
Kentucky	Statute	K.R.S. §§ 411.250 et seq.	7/2003	Applies to "residences," including a single-family house, duplex, triplex, or quadraplex, or a unit in a multiunit residential structure in which title to each individual unit is transferred to the owner under a condominium system.

Minnesota	Statute	M.S.A. Ch. 327A.01 et seq. --- M.S.A. Ch. 541.051	5/2003	"Dwelling" means a new building, not previously occupied, constructed for the purpose of habitation; but does not include appurtenant recreational facilities, detached garages, driveways, walkways, patios, boundary walls, retaining walls not necessary for the structural stability of the dwelling, landscaping, fences, nonpermanent construction materials, off-site improvements, or other similar items. "Home improvement" means the repairing, remodeling, altering, converting or modernizing of, or adding to a residential building. For the purpose of this definition, residential building does not include appurtenant recreational facilities, detached garages, driveways, walkways, patios, boundary walls, retaining walls not necessary for the structural stability of the building, landscaping, fences, nonpermanent construction materials, off-site improvements, and all other similar items.
Missouri	Statute	§§ 436.350 et seq.	2005	Applies to residences, including a single-family house, duplex, triplex, quadraplex, or a unit in a multiunit residential structure in which title to each individual unit is transferred to the owner under a condominium or cooperative system.
Montana	Statute	M.C.A. § 70-19-427	10/2003	Applies to residential construction disputes.
Nevada	Statute	N.R.S. §§ 40.680 et seq.	8/2003	"Construction defect" means a defect in the design, construction, manufacture, repair or landscaping of a new residence, of an alteration of or addition to an existing residence, or of an appurtenance and includes, without limitation, the design, construction, manufacture, repair or landscaping of a new residence, of an alteration of or addition to an existing residence, or of an appurtenance.
New Hampshire	Statute	N.H. Rev. Stat. §§ 359-G:1 et seq.	1/2006	"Residence" means a single-family house, duplex, or multifamily unit designed for residential use in which title to each individual unit is transferred to the owner under a condominium or cooperative system and shall include common areas and improvements that are owned or maintained by an association or by members of an association. A residence includes the systems, other components, improvements, other structures, or recreational facilities that are appurtenant to the house, duplex, or multifamily unit at the time of its initial sale, but not necessarily a part of the house, duplex, or multifamily unit.
New Jersey	Statute	N.J.S.A § 46:3B-3	7/2001	Applies to "new home" construction.
Ohio	Statute	R.C. §§ 1312.01 et seq.	5/2005	"Residential building" means a structure that is a one-family, two-family, or three-family dwelling house or a dwelling unit within that structure, any accessory structures incidental to that dwelling house, and a unit in a condominium development in which the owner holds title to that unit. "Residential building" includes any structure that is used as a model to promote the sale of a similar dwelling house.
Pennsylvania	Bill	H.B. 1467 and S.B. 656, 2005-06 Regular Session (2005)	N/A	Applies to residential construction defect disputes between builders and homeowners.
South Carolina	Statute	SC ST §§ 40-59-810 et seq.	7/2003	"Dwelling" means a single-family house or duplex or a multifamily unit not to exceed sixteen units and not to exceed three stories in height, and that is intended for residential use. A dwelling includes the systems and other components and improvements that are part of a single or multifamily unit at the time of construction.
Tennessee	Statute	T.C.A. §§ 66-36-101 et seq.	5/2004	Unique scope of coverage; includes actions for damages to all types of property, except single dwelling units intended as the residence of a person or family; covers remodeling and new construction of all such structures
Texas	Statute	Texas Property Code §§ 426.001et seq.	9/2003	"Builders" including any business entity or individual who constructs, supervises, or manages the construction of a new home; improves the interior of an existing home at a cost exceeding $20,000; or constructs, supervises or manages the construction of a material improvement to a home (other than a roof repair).
Washington	Statute	R.C.W.A. § 64.50.005	2002	Applies to homeowners and condominium associations.
West Virginia	Statute	W. Va. Code, §§ 21-11A-1 et seq.	6/2003	Applies to dwellings and residential improvements; "Residential improvements" means: (A) the construction of a residential dwelling or appurtenant facility or utility; (B) an addition to, or alteration, modification or rehabilitation of an existing dwelling or appurtenant facility or utility; or (C) repairs made to an existing dwelling or appurtenant facility or utility. In addition to actual construction or renovation, improvements added to residential real property include the designs, specifications, surveys, plans, goods, services and supervision of a contractor's subcontractor, officer, employee, agent or other person furnishing goods or services to a claimant.

Document 7

Right to Repair Reform: Revisions and Proposals to State's "Right to Repair Statutes"

April 1, 2015

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Richard H. Glucksman, Jon A. Turigliatto, and David A. Napper – Chapman Glucksman Dean Roeb & Barger Bulletin

Virtually all of the states in the country have "Right to Repair" statutes. We follow the various states legislatures to determine what trends or developments are occurring. For years, Chapman, Glucksman, Dean, Roeb, and Barger has prepared a compendium that provides the salient points of these Right to Repair statutes. In this extended BULLETIN we provide a discussion of important and very recent developments that are occurring in **Nevada**, **Arizona**, **Florida**, and **Colorado**.

In Nevada, Governor Brian Sandoval very recently signed The Homeowner Protections Act of 2015, representing a massive transformation to Nevada's Right to Repair Act in the builder's favor, including but not limited to removal of the attorney fees provision as part of claimant's damages. ***In Arizona***, Governor Doug Ducey signed House Bill 2578 in March 2015, amending Arizona Revised Statutes § 12-1361 et. Seq. by eliminating a homeowner's statutory opportunity to recover attorney and expert fees and providing a builder the right to repair the alleged defects. ***In Florida***, Bill 87 proposes to shorten the statute of limitations, requires more detail in the Homeowner's notice of defects, and allows a builder to use a prior settlement in lieu of repair as an affirmative defense against subsequent claims. ***In Colorado***, lawmakers are proposing to place additional conditions in front of an HOA board before filing suit and require alternative dispute resolution for HOA Condominium Defect Claims even if the requirement no longer exists at the time the claim is brought.

NEVADA: GOVERNOR SIGNIFICANTLY MODIFIES NEVADA'S RIGHT TO REPAIR ACT WITH THE SIGNING OF ASSEMBLY BILL 125

Nevada's Right to Repair Act has been extensively modified by the signing of Assembly Bill 125 also known as the Homeowner Protections Act of 2015. The Act considerably revises Chapter 40 of the Nevada Revised Statute ("NRS") governing construction defect actions. According to Governor Brian Sandoval, the signing of the first major bill of the legislative session in Nevada "discourages frivolous litigation and strengthens Nevada's rebounding housing market."1 Among other provisions, the Homeowner's Protection Act removes a claimant's ability to recover reasonable attorney fees as part of the claimant's damages, shortens the statutes of repose, defines the duty to defend, and prohibits a claimant from filing a notice of construction defects unless the claimant has submitted a claim under the homeowner's warranty and the insurer has denied the claim. Only claims that have been denied under the homeowner's warranty may be claimed.

Additionally, the term "construction defect" is now defined as a defect "(1) which presents an unreasonable risk of injury to a person or property; or (2) which is not completed in a good and workmanlike manner and proximately causes physical damage to the resident or appurtenance."

Critically, the Act now requires that the notice of construction defects (1) state in "specific detail" rather than reasonable detail, each defect, damage, and injury to each residence or appurtenance that is subject to the notice; (2) state the exact location of each defect, damage, and injury, rather than describe in reasonable detail the location of the defect; and (3) include a statement signed by the owner of the residence or appurtenance in the notice that the owner verifies that each defect, damage and injury exists in the residence or appurtenance.

Although not every revision is set forth above, the passing of The Homeowner's Protection Act appears to be a colossal victory for builders as the majority of the revisions to NRS Chapter 40 are favorable to the builder while additional or heightened requirements have been placed upon homeowners who wish to bring a claim. The following two Right to Repair updates concern proposed bills that also seek to radically change the pre-claim construction defect landscape.

ARIZONA: BUILDERS NOW HAVE THE RIGHT TO REPAIR INSTEAD OF AN OPPORTUNITY TO REPAIR WHILE HOMEOWNERS NO LONGER HAVE A STATUTORY RIGHT TO ATTORNEY FEES AND EXPERT FEES

In March 2015, Arizona Governor Doug Ducey signed into law House Bill 2578, revising key portions of the Right to Repair pursuant to the Purchaser Dwelling Act (Arizona Revised Statute ("A.R.S.") Section 12-1361 et. seq. Important categories of the Act affected by the new law include the builder's right to repair or replace, the process of repair or replacement, dwelling actions, and homeowners' association dwelling actions. Most notably, prior to filing a construction defect suit, or a "dwelling action" as defined in A.R.S. Section 12-1361 et. seq., a homeowner must provide written notice detailing the basis of a dwelling action and must allow the builder to repair or replace the alleged construction defects.

Another significant revision includes the elimination of the prevailing homeowner's statutory right to reasonable attorney fees, witness fees and taxable costs in a dwelling action. Bill 2578 also revised the definitions of "Construction Codes," "Construction Defect," "Construction Professional," and "Material Deficiency." Homeowner Associations now must disclose additional information regarding the claim to its members and must show compliance with procedures set forth in the community documents. Clearly, Arizona's legislature is seeking to reduce the amount of frivolous construction defects suits with the elimination of a prevailing homeowner's right to reasonable attorney fees and expert fees. Moreover, the Legislature now provides builders in Arizona with the right to make repairs to alleged construction defects if they so choose.

FLORIDA: FLORIDA GENERAL CONTRACTORS SEEK AGGRESSIVE AMENDMENT TO PRE-CLAIM CONSTRUCTION DEFECT PROCESS WITH BILL 87

Florida's Right to Repair Act, Chapter 558 of the Florida Statutes, may be extensively revised in the near future. With the help of the South Florida Chapter of the Associated General Contractors of America, House of Representatives Bill 87 will be presented as an amendment to the Pre-Claim Construction Defect requirements set forth in Chapter 558.

The proposed bill is aggressive and seeks to address issues in the current statute. These deficiencies have seemingly prevented construction defect claims from being resolved without the filing of a civil suit. Notably, the statute of limitations period for a property owner to file suit for construction defects would be shortened based upon the revision of the term "completion of a building or improvement" to include issuance of a temporary certificate of occupancy. Additionally, property owners would be subject to additional requirements for issuing a notice of claim, including specific identification of locations of each alleged construction defect as well as the specific provisions of the building code, project plans, project drawings, project specifications, or other documentation, information or authority that serve as the basis of the claim for each alleged construction defect.

Perhaps most importantly, the bill provides that if a construction defect is settled by repairs offered by the contractor during the Chapter 558 claims process but the repairs fail to fully correct the defects and the owner or association then files suit because the issue was not resolved, the defendant may claim that the issue was previously resolved and the plaintiff owner may face sanctions. Even if the bill as proposed does not pass in its current form, on the heels of Nevada's Right to Repair Act overhaul, it may serve to encourage other states, including California, to take another look at their Right to Repair Act procedures.

COLORADO: UPDATE FROM CGDRB SEPTEMBER 2014 BULLETIN: COLORADO PROPOSED LEGISLATION RE: HOA CONDOMINIUM DEFECT CLAIMS

In September 2014, we provided an important discussion of potential significant tort reform legislation presented in Colorado regarding construction claims by homeowner associations for condominiums. This Bulletin serves as an update to that discussion as intense debate over legislative reform to provide condominium builders in Colorado more legal protections has heated up again.

On October 13, 2014, the city of Lakewood became the first Colorado municipality to pass a "right to repair" measure with respect to common interest communities. The Lakewood measure gives builders a right to repair construction defects before homeowner associations take legal action and requires a homeowner majority approval before legal action is taken.

On February 10, 2015, two bipartisan Senators introduced Senate Bill 177, a bill proposing changes to the prerequisites for a homeowner association to file a construction defect action under the Colorado Common Interest Ownership Act. SB 177, if passed in its current form, would require:

1. That when the governing documents of a common interest community require mediation or arbitration of a construction defect claim and the requirement is later amended or removed, mediation or arbitration is still required for a construction defect claim;
2. That the mediation or arbitration take place in the judicial district in which the common interest community is located;
3. That the arbitrator (1) be a neutral third party; (2) make certain disclosures before being selected; and (3) be selected as specified in the community's governing documents or, if not specified, in accordance with the Uniform Arbitration Act;
4. That before a construction defect claim is filed on behalf of the homeowner association: (1) the parties must submit the matter to mediation; and (2) the board must give advance notice to all unit owners, together with a disclosure of the projected costs, duration, and financial impact of the construction defect claim, and **must obtain the written consent of a majority of the unit owners.**
5. That the disclosures required prior to the purchase and sale of property in a common interest community a notice that the community's governing documents may require binding arbitration of certain disputes.

As explained in our previous Bulletin, currently, in Colorado, homeowner association boards are only required to obtain two condominium owners' consent to file a construction defect suit. Similar to SB 220, which proposed a number of the same requirements, SB 177 would likely have the potential effect of reducing the number of lawsuits filed against builders and decrease the treat of frivolous claims; and allow the parties an opportunity to resolve their issues short of litigation.

On March 18, 2015, the Colorado Senate Committee on Business, Labor, and Technology voted 6-2 to forward SB-177 to the full Senate with four minor amendments. The amendments provide:

1. The homeowner association's attorney can prepare the disclosures that must be presented to unit owners prior to filing a construction defect claim;
2. Voting may be done by proxy;
3. The parties must agree on an arbitrator. If they cannot agree, they may petition the court to appoint one. Preference will be given to the arbitrator designated in the community's governing documents; and
4. A different list of disclosure topics is required.

Also introduced this year is SB 091, a bill to shorten the Colorado's construction defect statute of repose to a homeowner from bringing an action after three years. On March 16, 2015, the Colorado Senate Committee on State, Veterans & Military Affairs voted to

pass SB 091 to the full Senate with two substantive amendments. The first amendment excludes any multifamily developments from being effected by the shortened statute of repose. The second amendment proposes the statute of repose only be shortened to five years, plus an additional year if the defect manifests in year five. Currently, in Colorado, if a homeowner does not discover a construction defect within six years of a house's completion, the homeowner may forfeit all legal rights to seek repair. Again, SB 091 would protect builders from frivolous or untimely claims by homeowners.

We will continue to monitor development of these bills and others that may be proposed in the future. If we can provide any further information concerning these developments or you are interested in receiving our compendium of the various right repair statutes please let us know.

1 As reported by KTVN-TV in Reno, Nevada:
http://www.ktvn.com/story/28163519/senate-passes-constructiondefect-bill....

Reprinted courtesy of Chapman Glucksman Dean Roeb & Barger attorneys Richard H. Glucksman, Jon A. Turigliatto and David A. Napper
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Document 8

Construction Defect Notice To Owners Of New Residential, Single-Family Dwellings

Should you discover a defect in the construction of your home, prior to pursuing legal action or responding to a construction defect solicitation, you must first contact your home builder. Under SB 800 (Burton, 2002), homebuilders are given the opportunity to repair your home prior to a legal action being filed. Construction defects could be problems such as water intrusion into the home or cracks in the foundation.

These Pre-Litigation Procedures for Construction Defects only apply to new residential homes purchased after January 1, 2003. These laws provide the homebuilder with a right to attempt a repair of the defect prior to litigation, inspections and exchanges of documentation under certain circumstances, and mediation at various points, all according to various time frames. These laws also provide that if the homebuilder fails to follow any of the procedures, the homeowner is entitled to proceed with the filing of an action. The laws regarding Pre-Litigation Procedures for Construction Defects can be found in California Civil Code Sections 910-938.

Document 9

A Subcontractor's Guidebook For SB800 The "Fix It" Right to Repair Law

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SB 800—A Subcontractor's Guide

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SB 800—A Subcontractor's Guide

Introduction

Governor Gray Davis signed SB 800 into law on September 20, 2002. The product of intense negotiation by the California Consumer Attorneys and the California Building Industry Association, the bill replaces, in its entirety, existing law regarding construction defects for new homes that are first sold after January 1, 2003.

The law applies to all new residential construction, including detached and attached homes. It does not apply to remodeling contracts or condominium conversions.

The bill contains two primary sections. The first consists of 45 definitions of actionable conditions or defects. These standards are designed to allow a consumer to recover for construction problems that actually affect the usability or functionality of the home. If a problem is not addressed in the 45 standards, or in a newly required one-year fit-and-finish warranty for traditional "punch list" items, there is no liability.

The functionality standard section also codifies several affirmative defenses, including relief for defendants if the homeowner did not properly maintain his or her home. Also, each functionality standard has a different time limit for homeowner claims.

The second main section of SB 800 contains a very specific and time-sensitive process for dealing with complaints prior to litigation. This section mandates that each alleged violation of the functionality standards be presented in writing to the builder, and that the builder has the right to inspect the problem and offer to repair it. If a builder offers to repair the problem, the homeowner must allow the builder to do so prior to instituting any litigation stemming from a violation of any of the 45 standards.

The details of SB 800 are too numerous to list in this guide. For specific information, we encourage you to read "SB 800, The Homebuilder 'FIX IT' Construction Dispute Resolution Law," available through the California Building Industry Association (CBIA).

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SB 800—A Subcontractor's Guide

Section 1: An Opportunity for Increased Partnership

The proponents of SB 800 look upon this bill as an opportunity, not a panacea. Unless full advantage of the bill is taken, SB 800 may do little to reduce the number of lawsuits filed, and may not improve the relationships between subcontractors and builders.

SB 800 provides an opportunity for builders and trade contractors, along with their insurers, to create a better partnership. This opportunity begins at the contracting stage, with a clearer mutual understanding of which entity is taking responsibility for compliance with the standards, how the parties will work together in the event of a claim, and how the parties will resolve their own internal disputes. Each of these opportunities will be discussed fully in this guide.

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Section 2: Subcontractors' Liability Under SB 800

As discussed in more detail in the accompanying guide, "SB 800, The Homebuilder 'FIX IT' Construction Dispute Resolution Law," this legislation replaces existing tort law with new definitions or standards of liability. In order for a builder to be held liable under SB 800, a claimant must demonstrate that there is a violation of one of the standards and that the violation arises out of the original construction. In addition, builders may be held liable for any breach of express contracts or warranties.

If a builder intends to hold a subcontractor liable for a violation of the functionality standard, it must give the trade contractor the right to attend inspections pursuant to Chapter 4 of the law. If a builder does not give notice to the trade contractor, the builder may not pursue the trade contractor in subsequent litigation.

However, a claimant, after having gone through the Chapter 4 process (either through completion of the process or by ending the process based upon a builder's non-compliance), may sue the trade contractor directly. Most likely, a builder that did not give notice to the trade contractor during Chapter 4 may not enforce contractual indemnity provisions.

The standard for holding a trade contractor responsible for a construction defect states that the homeowner must first show a violation of the particular standard and then must show that a trade contractor's act or omission contributed in whole or in part to the violation. Under this process and existing law, a trade contractor can be held liable jointly and severally for violations of a particular standard with other culpable trade contractors.

A trade contractor has all of the SB 800 affirmative defenses available to it, plus any other common law and contract defenses, i.e. outside the scope of work of the trade contractor, contractual exclusions, etc.

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Section 3: SB 800 Requirements of Trade Contractors

If the builder intends to hold the trade contractor responsible for a violation of a functionality standard, it must give the trade contractor the opportunity to participate in the inspections under Chapter 4. Beyond this procedural protection in Chapter 4, there is no other required role for the trade contractor. Under a strict interpretation, the builder does not have to consult with the trade contractor before taking any action, including opting out of the pre-litigation process.

The only other requirement under SB 800 is that the trade contractor must provide the builder with a location for sending a notice of the impending inspection for 10 years after the homes are first sold (not after completion of the trade contractor's work).

Under the statute, the builder may offer a repair to the claimant. While one would expect that the builder would give the original trade contractor the opportunity to perform the repair, it has no obligation to do so. Even if the builder elects to use the original trade contractor, the claimant has the right to object to the original trade contractor performing the work, and request that the builder provide three other subcontractors paid for by the builder.

Trade contractors should expect to be held responsible under the contractual indemnity provisions for the costs of the repair, regardless of whether the original trade contractor agrees to perform the work or whether one of the three alternative subcontractors does so. This is no different from today's system where there is usually no chance for the original trade contractor to do the work, and the settlements are used to pay another contractor, or the work never gets done.

Repair work does not extend the statute of limitations for the builder or trade contractor unless the statute of limitations would otherwise have run during the SB 800 process. In that case, the time to file an action is 100 days after the SB 800 process is completed.

As noted in the negotiating points section that follows, subcontractors should consider seeking the contractual right to be involved in the decisions regarding handling claims under SB 800. This includes participating in the decision-making process, the repair, or the selection of the three alternative contractors.

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Section 4: Making the Most of SB 800

Under the statute, the builder has the obligation to ensure full compliance. There are no subcontractor obligations under Chapter 4, the dispute resolution process. However, trade contractors have a large stake in the success of the builder's SB 800 compliance. The following summarizes the efforts required of builders under SB 800.

In order for a builder to take advantage of SB 800, it first needs to comply with the statutory requirements for document changes, the official recording of documents and internal claims procedures. These efforts are required prior to the sale of any new residences, and involve considerable detail in the documentation process.

SB 800 allows the builders to make certain business decisions in the set up of SB 800. These decisions are fully described in the CBIA booklet, and pertain to whether the builder wants to substitute its own definitions of the standards (referred to in the statute as an Enhanced Protection Agreement (EPA), whether it wants to substitute its own pre-litigation claims procedure (referred to as an "Alternative Non-Adversarial Procedure") and what type of one-year fit-and-finish warranty it wants to supply. Additionally, a builder may choose the maintenance program to supply to its customers.

Aside from these basic decisions, the builder also is in control of each claim, and has the ability to directly influence the way the pre-litigation claim is handled. For example, it can choose to ignore a notice of an SB 800 claim and allow it to go directly to suit or binding arbitration, it can inspect the residence and elect not to offer a resolution, or it can, by choice or omission, not comply with the myriad deadlines contained in Chapter 4. All of these decisions are, by statute, within the province of SB 800 and not within the direct control of trade contractors.

A builder should consciously make decisions on setting up a good SB 800 compliance program, looking at each claim presented and making every attempt to resolve the claim short of litigation. A builder should also involve the trade contractors in a meaningful way, and allow the partnership to jointly make decisions geared towards avoiding litigation and saving money.The only way for a subcontractor to influence the builder's actions is to do so via contract. This booklet provides guidance for identifying these issues and attempting to negotiate favorable provisions that give subcontractors the ability to similarly benefit from SB 800. The intent of this information is not for the subcontractor to gain an economic advantage over the builder, but rather to inject itself into the benefits of SB 800 for the common goal of early claims resolution and claims savings.

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Section 5: Area of Negotiation Between Builders and Trade Contractors–Transferring the Risk for the Functionality Standards

There are two areas in a construction contract that are affected by SB 800. The first, covered in this section, is determining which party is responsible for the home's performance under the functionality standards. The second, covered in Section 6, deals with ensuring that the trade contractor is involved in the Chapter 4 process.

As discussed more completely in the main guide, available through the CBIA, the 45 functionality standards were developed to ensure that each home operates properly. Certain standards, such as water intrusion items, by necessity, involve the construction activities of multiple trade contractors. For example, window leaks (Section 896 (a) (2)) may involve the framing contractor, the stucco contractor, the window installer, etc. Certain standards, such as Section 896 (b) (3), which ensures that slabs meet design criteria for chemical deterioration, may involve only the concrete contractor and the design professional.

Builders may attempt to transfer responsibility for meeting the standard entirely to one or more trade contractors. Thus, by contract, the trade contractor is taking full responsibility for items beyond its control. For example, if a trade contractor accepts full contractual responsibility for window leaks, but is only one of four contractors who have control over the installation process, the trade contractor may be accepting too much liability.

On the other hand, since trade contractors are often responsible for all other trade contractors involved in a component of a home under the doctrine of joint and several liability, the trade contractor may wish to accept full responsibility for one or more functionality standards. This is a business decision that must be evaluated and priced. In addition, if a trade contractor accepts responsibility for a functionality standard, it must also contract for sufficient control over that part of the construction process.

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SB 800—A Subcontractor's Guide

The following are examples of various scope-of-work provisions that a trade contractor may find in a new SB 800 contract. These alternatives change, to varying degrees, the allocation of risk under the construction contract. The decision about which type of provision to use is a business and pricing one for each party to the contract, as a result of the relative bargaining power of the parties.

Alternative 1, Scope of Work:

Trade contractor acknowledges being fully aware of the provisions of SB 800. Trade contractor hereby warrants and agrees to be fully responsible for all violations of functionality standards connected to or arising out of trade contractor's work.

This section is very broad. It requires, by contract, that the trade contractor be responsible for all functionality standards, regardless of whether the trade contractor has control over the ultimate performance of the home. Also, the term, "connected to or arising out of" is very broad and may further extend the responsibility of the trade contractor.

Alternative 2, Scope of Work:

Trade contractor hereby agrees to be fully responsible for any act or omission that may cause a breach of any SB 800 standard that applies to its work. Trade contractor must bring to builder's attention any site condition or design decision that may lead to a breach of any SB 800 functionality standard related to trade contractor's scope of work.

This section starts out with a recitation of the liability standard for SB 800. However, it then imposes an obligation for the trade contractor to notify the builder of any condition that may lead to any breach of standard related to its work. Under some circumstances, this type of provision may be very appropriate and lead to better quality construction, since the trade contractor has the experience to know what works and what does not. In some cases, the trade contractor may have so little control over the circumstances so as to make this an unreasonable clause.

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Alternative 3, Scope of Work:

Trade contractor and builder have reviewed the scope of work and the SB 800 standards. Both parties agree that trade contractor is fully responsible for the home performing to Section 896 (a) and that trade contractor accepts the obligation to notify builder if any act by a third party may prevent the home from fulfilling this standard(s). As to any other SB 800 standard, trade contractor agrees to be fully responsible for its acts or omissions that lead to, in whole or in part, a violation of a standard.

This type of provision, while being more time consuming to negotiate, is more precise and may lead to a more accurate acceptance of risk under this contract. It allows for the trade contractor to take more control over those areas it accepts liability for and to abide by the general SB 800 liability standards for all else.

Alternative 4, Scope of Work:

Trade contractor and builder have reviewed the scope of work and the SB 800 standards. Both parties agree that trade contractor is fully responsible for the home performing to Standards XX and that trade contractor agrees to be proportionately liable with other trade contractors for any failure of the functionality standards connected in any way with their work.

As with the third alternative, this is more precise, but holds the trade contractor responsible along with others who would be jointly responsible if the matter proceeded to court.

Alternative 5, Scope of Work:

Trade contractor and builder are aware of the standards contained in SB 800. Both parties acknowledge that these standards will be used in determining liability for any potential problems with the work of improvement. However, because trade contractor does not have full control over any particular standard, both parties agree that the scope of work for trade contractor does not include any obligation to ensure that any standard under SB 800 is achieved. Trade contractor shall perform its scope of work according to the standard of care in the industry and the specifications contained in this contract.

This type of provision does not shift any responsibility to the trade contractor, nor does it include compliance within the scope of work. Trade contractor should ensure that it is not obligating itself to follow each applicable building code or technical specification in the remainder of the contract.

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Section 6: Areas of Negotiation – Participation in the Chapter 4 Procedures

In this area of the contract, there are two related items to discuss. The first is for the contractor to understand the builder's intent in implementing SB 800. The second is to encourage the builder to include the trade contractor in the SB 800 process and to provide incentives to both sides for the trade contractor's involvement.

As noted in Section 4, the builder has to make many choices in implementing SB 800. The variations of how to implement SB 800 are too numerous to list here, and the practices will be evolving over time. The key is for the trade contractor to fully understand the builder's position and how the builder's choices may affect the trade contractor's liability, ability to take advantage of the early claims resolution process and ultimately secure insurance.

What follows are some of the key points a builder may consider and how the choices may affect the trade contractor.

1) Whether to make any decisions regarding SB 800.

SB 800 is mandatory, but requires builder action to implement it. If the builder fails to implement SB 800, the definitions of the 45 standards will apply to the trade contractor's liability, but without any of the protections and early claims resolution opportunities.

2) Whether to create an Enhanced Protection Agreement (EPA), establishing new liability standards in lieu of the SB 800 definitions.

This decision impacts the liability standards for the trade contractors. Trades must understand the specifics of the EPA and realize that these standards are over and above the functionality standards. Also, as discussed in the main booklet, these standards are subject to attack and increased litigation by the homeowner and may also impact coverage.

3) Whether to impose a separate non-adversarial procedure.

This decision impacts the ability of a trade contractor to be involved in an early resolution claims procedure. The trade contractor must be fully apprised of the details of the alternative procedures, including whether there is a notice requirement for the trade contractors. As discussed in the main book, if an

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alternative procedure fails, the particular housing tract will never have the protection of Chapter 4. There may also be insurance ramifications.

4) How much to prepare for Chapter 4.

While the builder may intend to take full advantage of Chapter 4, what is the level of preparation? How successful will the builder be? As described throughout this booklet, the trade contractor is in the hands of the builder. The trade contractor should be fully aware of the builder's attitude towards Chapter 4 and make its decision accordingly.

5) How much influence the trade contractor will have.

As with #4, this issue is of great importance to the trade contractor since, by law, it has no power to direct or even influence the process. As will be discussed below, it is important for the trade contractor to be fully aware of the builder's intention.

Planning for Incentives

The second contractual issue relating to Chapter 4 is providing incentives for trade contractor participation. There are many incentives available to both parties for doing something good in a partnership. This booklet focuses on two of the more dynamic areas of the trade contractor/builder relationship: the indemnity provision and additional insured endorsements.

Indemnity agreements and additional insured endorsements often transfer risk from the builder to the trade contractor beyond the actual fault of the trade contractor. This topic has evolved into one that creates great controversy. From the trade contractor's perspective, the object is to use these two provisions as incentives for the builder to effectively utilize SB 800, to allow the trade contractor to assist in the claims resolution process, and to make it easier for a builder to carry out a reasonable risk-transfer strategy.

As noted above in items one through five, a builder is making representations regarding its commitment to SB 800 and involving the trade contractors. Assuming that a builder has agreed to make full use of the system, what are the consequences of its failure to do so, especially if the trade contractor and its carrier have relied upon these representations in taking the job? Obviously, if a builder states its intention to not utilize SB 800 or use a different form of it, and the trade contractor agrees to this, no incentive is needed.

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The following contractual language may illustrate this concept.

SB 800 Compliance:

The builder represents that it is aware of all of the provisions of SB 800 and that it intends to fully utilize the Chapter 4 provisions allowing the builder to receive notice, conduct inspections and make repair offers, if appropriate. Trade contractor considers this representation material and relies upon it in accepting this contract.

In the event of a claim under SB 800, builder agrees to provide notice to trade contractor, and trade contractor agrees to provide builder with a method of providing timely notice. Failure of trade contractor to provide an accurate method of providing notice relieves builder not only of the obligation to provide notice under SB 800, but also invalidates the incentive discussed herein.

Builder agrees to accept claims under SB 800 and to process claims through the inspection process set forth therein. Builder agrees to involve the trade contractor in any decision to end the SB 800 process or in any decision on whether to offer a repair. Builder agrees to allow trade contractor the opportunity, assuming no objection from the homeowner, to perform any repairs as part of its contribution to resolving the claim.

In the event that builder and any involved trade contractor fail to agree on a decision or repair offer, including allocation of fault or monetary obligation, the parties agree to proceed with the disputed decision and be subject to binding arbitration to resolve any disputes. Trade contractor agrees that if for any reason, including the actions of its insurance carrier, trade contractor fails to participate or agree to fund a disputed repair or settlement offer, the following incentive becomes invalid.

Incentive:

The incentive is triggered for one of three reasons: 1) If the builder fails to abide by the SB 800 Chapter 4 proceedings according to the representations made herein; 2) If the builder fails to put the trade contractor on notice and the claimant ultimately sues the trade contractor directly; 3) If the trade contractor and its carrier agree to fully cooperate with a repair decision or settlement offer, along with the proposed allocation of responsibility and financial allocation, and actually pay the agreed-upon monies or make the agreed-upon repairs.

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If the incentive is triggered, the indemnity obligations contained in Paragraph ___ of the subcontract is hereby modified as follows:

"Trade contractor agrees to protect and indemnify builder for any and all claims arising out of the negligent acts or omissions of the trade contractor, including, but not limited to, damages, attorney's fees and costs. Trade contractor is not responsible for any acts or omissions of the builder or any other trade contractor not under the direct contractual control of the trade contractor."

If the incentive is triggered, regardless of what type of additional insured endorsement is issued by any carrier for the trade contractor, the builder and its carriers agree to only seek defense and indemnity obligations in line with the indemnity provisions as modified by this incentive."

The idea of this incentive is to not only ensure that the builder will live up to the material representations set forth in this agreement, but also encourage trade contractors to participate, even under protest, in the expedited claims procedure. If this program works, both parties have a reasonable allocation of risk and a timely participation in the claims process. Obviously, these provisions are for illustration only. There are many variables that affect the actual language of this type of provision or the willingness of the parties to enter into this type of agreement. Any such agreement should be reviewed by counsel and by all parties' insurance carriers.

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Section 7: Maintenance Obligations

As noted, one of the main benefits of SB 800 is the ability of builders to provide their homeowners with maintenance requirements. Part of the partnership opportunity is to have the trade contractors work with the builder to develop trade-specific recommendations based upon the trade's expertise. The trade contractor should review the materials utilized by the builder, and make suggestions to enhance the ability of the home to meet the standards. A trade contractor may feel strongly enough to insist upon the use of these materials as part of the subcontract agreement.

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Statute of Limitations for Functionality Standards

Function	Time Limit	Code Section
Operation of plumbing and sewer systems, electrical	4 years from COE	869(e)
Cracks in exterior pathways, driveways, hardscape, sidewalks, sidewalks, and patios	4 years from COE	896(g)(1)
Manufacture products, including windows, doors, roofs, plumbing products and fixtures, fireplaces, electrical fixtures, HVAC units, countertops, cabinets, paint, appliances, and any other product that is completely manufactured offsite	1 year unless manufacturer specifies a greater period	896(g)(3)
Noise for attached units	1 year from original occupancy of adjacent unit	896(g)(6)
Operation of irrigation and drainage system	1 year from COE	896(g)(7)
Decay of untreated wood posts	2 years from COE	896(g)(8)
Unreasonable corrosion of untreated steel fences and adjacent components	4 years from COE	896(g)(9)
Deterioration of building surfaces due to paint or stain	5 years from COE for filing action, however, deterioration may be limited to a shorter period if manufacturer specifies	896(g)(10)
Landscaping	2 years from COE for filing an action, however, survival period is 1 year	896(g)(12)
Dryer ducts	2 years from COE	896(G)(14)

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Fit and finish warranty	1 year	900

Conclusion

SB 800 requires a new education and awareness of the risk-transfer issues between trade contractors and builders. If handled with full information, this effort will greatly increase the quality of construction, the ease of claims handling and the opportunity to resolve claims more efficiently.

This booklet is designed to raise awareness and identify issues. Please consult with your legal, risk-management and insurance advisors before implementing any changes to your contracting practices.

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Document 10

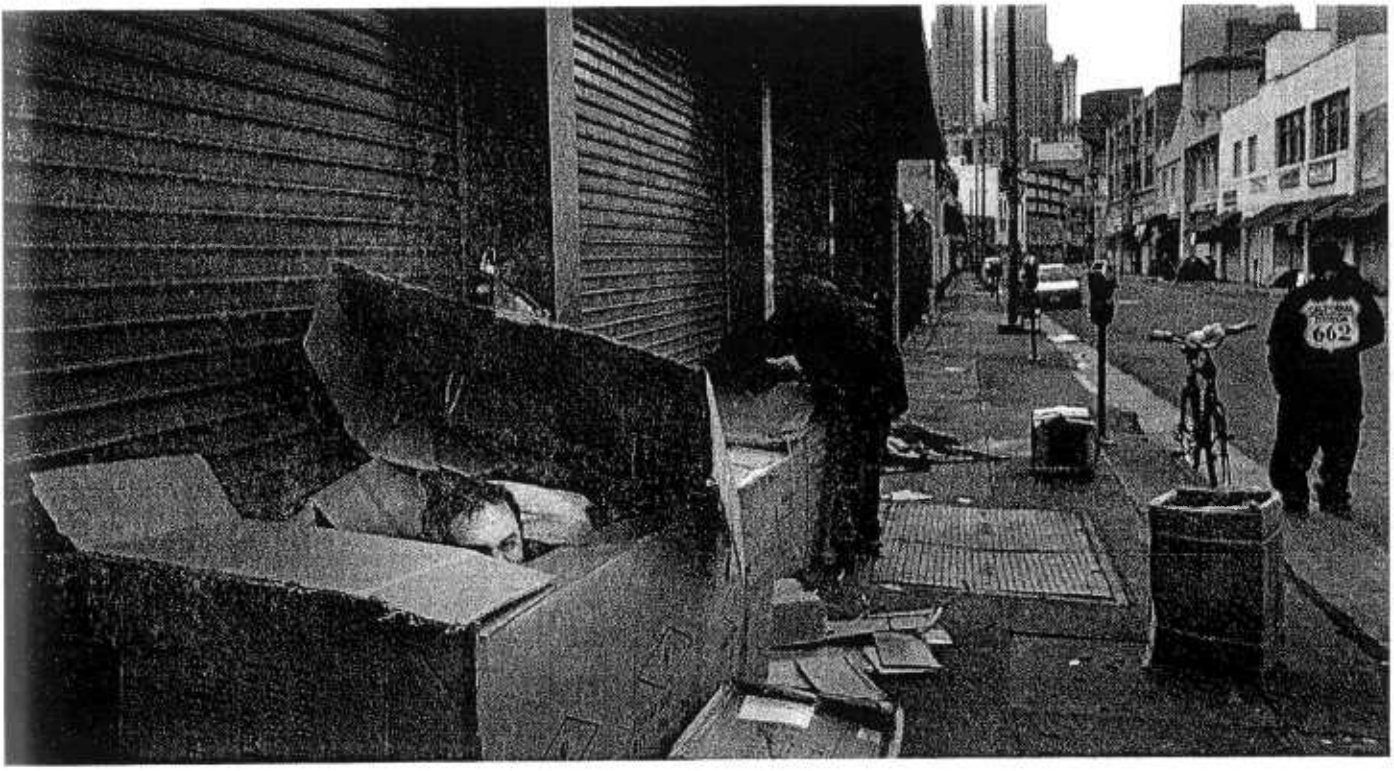
California Housing Units 1954-2015

Year	Single Family Units	Multi Family Units	Total Units
1954	168,970	38,933	207,903
1955	188,434	33,391	221,825
1956	145,462	39,078	184,540
1957	115,449	60,193	175,642
1958	126,778	76,901	203,679
1959	161,399	83,872	245,271
1960	124,698	75,538	200,236
1961	122,115	95,444	217,559
1962	122,975	128,051	250,926
1963	131,546	190,472	322,018
1964	113,425	155,430	268,855
1965	95,690	82,426	178,116
1966	65,406	33,969	99,375
1967	67,842	43,603	111,445
1968	86,816	72,931	159,747
1969	80,119	104,111	184,230
1970	71,362	124,306	195,668
1971	113,348	143,328	256,676
1972	123,990	156,861	280,851
1973	102,734	114,130	216,864
1974	76,205	53,321	129,526
1975	89,823	41,913	131,736
1976	140,051	81,061	221,112
1977	174,845	95,911	270,756
1978	143,088	101,570	244,658
1979	127,478	82,555	210,033
1980	86,650	58,327	144,977
1981	60,278	44,316	104,594
1982	51,160	34,486	85,656
1983	102,509	70,060	172,569
1984	112,839	112,006	224,845
1985	114,202	158,115	272,317
1986	146,569	168,000	314,569
1987	136,128	117,043	253,171
1988	162,167	93,392	255,559
1989	162,651	75,096	237,747
1990	103,819	60,494	164,313
1991	73,809	32,110	105,919
1992	76,187	21,220	97,407
1993	69,901	14,755	84,656
1994	77,115	19,932	97,047
1995	68,689	16,604	85,293
1996	74,923	19,360	94,283
1997	84,780	26,936	111,716
1998	94,298	31,409	125,707
1999	101,711	38,426	140,137
2000	105,595	42,945	148,540
2001	106,902	41,855	148,757
2002	123,865	43,896	167,761
2003	138,762	56,920	195,682
2004	151,417	61,543	212,960
2005	155,322	53,650	208,972
2006	108,021	56,259	164,280
2007	68,409	44,625	113,034
2008	33,050	31,912	64,962
2009	25,046	11,163	36,209
2010	25,526	19,236	44,762
2011	21,641	25,702	47,343
2012	27,560	31,665	59,225
2013	36,991	48,481	85,472
2014	37,089	48,755	85,844
2015	44,896	53,177	98,073

Document 11

How California should fight poverty: Add housing stock

By The San Diego Union-Tribune Editorial Board | 6 a.m. March 6, 2016



FILE - In this March 29, 2013 file photo, Antonio Garcia, 54, left, who introduced himself as a mathematician, peeks through the opening of his makeshift shelter made of cardboard boxes in the Skid Row area of Los Angeles. Reducing poverty has emerged as the key theme in California after state lawmakers moved closer to raising the minimum wage, expanding health care to immigrants and allowing child care providers to unionize. (AP Photo/Jae C. Hong, File) *The Associated Press*

Three new studies (http://next10.org/publications) commissioned by Next 10 — a San Francisco think tank that focuses on quality of life in California — make a powerful case that extreme housing costs threaten to make much of the state like Malibu and Santa Barbara, where only the wealthy can afford to live and most of the workers who support them have long commutes from cheaper inland areas. The analyses — prepared by Beacon Economics, a respected Los Angeles-based consultant — make a powerful case that the focus of state anti-poverty efforts should be bringing down housing costs.

Beacon reports that from 2005 to 2015, California ranked 49th out of 50 states in building new housing per capita. According to the latest data, it ranks 49th in homeownership and last in overall housing affordability. California renters also spend a higher percentage of their income on housing than their counterparts in all but one other state — even though Californians are far more likely to share apartments with non-family members than Americans in general.

These high costs are not daunting to the affluent. Net migration data show that from 2007 to 2014, 80,000 families with a household income of $150,000 or more moved to the Golden State. But during that span, 563,000 families with income of less than $50,000 left the state, as did 139,000 families with income from $50,000 to $99,999.

These trends are likely to continue, according to Beacon, unless state leaders change state laws — starting with the California Environmental Quality Act (CEQA) — to make it easier to build new housing and less easy for opponents to tie up developers with demands and prolonged court battles. Without such changes, Beacon warned that the state could face worker shortages, depressed demand for goods and services, and increased welfare costs.

These reports should serve as a wake-up call to California's political establishment. After seeing similar circumstances in his city, New York Mayor Bill de Blasio — one of the nation's leading progressive politicians — launched a push to add 80,000 new housing units. Vox executive editor Matthew Yglesias — one of the nation's leading progressive journalists — has expressed astonishment for years that there's not a broader appreciation of how much restrictive housing regulations hurt the poor and middle class. In his 2012 e-book (http://www.goodreads.com/book/show/13513173-the-rent-is-too-damn-high), "The Rent Is Too Damn High," Yglesias wrote that high rent is "bad for the environment; it promotes long commutes, traffic jams, misery and smog. What's more, high rent is not a fact of nature. It's the result of bad public policy, and it deserves to be taken seriously as one of the critical problems we face."

Especially in California. New Census Bureau measures that include cost of living show the state to be America's poverty capital, with nearly one in four residents barely able or unable to make ends meet. But to date, attempts to address poverty have focused on raising the minimum wage and adding money to affordable housing programs that amount to lotteries in which select few families gain access to subsidized homes.

These are policies that allow the state's most powerful forces to show sympathy for the impoverished without addressing the biggest cause of mass poverty. The millions of Californians who feel stricken by their monthly housing bills deserve far better.

Next editorial: Thanks, San Diego police, for mandatory dog training (http://www.sandiegouniontribune.com/news/2016/mar/05/police-mandatory-dog-training/)

Document 12

(/)

Publications

- Economy & Governance (/programs/economy-governance)

Current State of the California Housing Market

March 3, 2016

Despite having the third highest rate of low-wage job creation in the nation, California could face a shortage of low-wage workers as housing costs push residents out in search of affordability. According to a trio of new studies, low- and middle-wage workers are leaving California even as large numbers of higher-wage earners continue to arrive. And all together, more people are moving out than moving in.

California's current housing market suffers from a shortage of supply and the lingering effects of the housing crash and the Great Recession. California currently ranks near the bottom in terms of its supply of housing relative to population growth. Add that to the increasing demand to live near the coast, to be close to tech hubs, and to be near downtowns, and it's not too surprising that home prices throughout the state continue to rise. Additionally, the cost of development and stringent regulations imposed on developers has contributed to the lack of homebuilding in California.

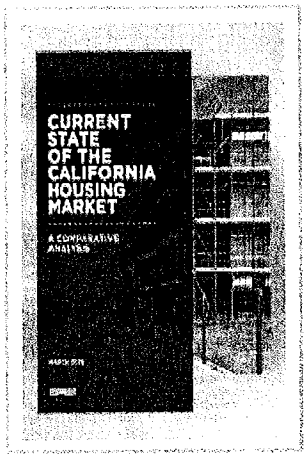
To alleviate the housing affordability crisis that plagues low-income and middle-income households in the state, more housing construction needs to take place. One such way would be by streamlining the permitting process and finding a way to reduce concerns about environmental protection policies, in addition to encouraging more residential development along California coastal cities and, if possible, an increase in the residential density of such developments.

The report's main findings include:

- Homeownership rates, which have historically been low compared to rates in other states, have been declining throughout California, as many residents - especially those with recent foreclosures on record - remain unqualified for mortgage loans. In 2014, California ranked 49th in terms of homeownership, as only 53.8% of homes were owner-occupied.
- Housing costs are high relative to incomes and have been increasing in recent years for both homeowners and renters. California's average homeowner spent 25.4% of their household income on housing costs in 2014, more than homeowners in any other state.
- Housing remains overcrowded as the proportion of renter-occupied housing units with more than one person per bedroom grew from 12.7% in 2007 to 13.2% in 2014.

- Home prices are more expensive than in all other states, particularly in major metropolitan areas. Diminishing levels of affordability have already driven many low-income and middle-income households to migrate to more affordable states.
- Housing remains in short supply, placing upward pressure on home prices and reducing levels of affordability. From 2005 to 2015, permits for only 21.5 housing units were filed for every new 100 residents in California, less than any other state except Alaska.

More information on California housing compared to other states available at Compare50.org (http://www.compare50.org/pages/home?utm_source=next10&utm_medium=referral&utm_campaign=housing).



Downloads

Full Report (/sites/next10.huang.radicaldesigns.org/files/current-state-ca-housing-market.pdf)

Press Release (/sites/next10.huang.radicaldesigns.org/files/beacon-press-release.pdf)

COMPARE 50
Comparing Economic Performance Across the United States

(http://www.compare50.org/pages/home?utm_source=next10&utm_medium=referral&utm_campaign=housing)

Related Press Coverage

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LA Times, April 14, 2016

Report: High Housing Costs Responsible for California's Economic Woes, Not Taxes (/node/683)
Planetizen, March 7, 2016

How to fight poverty in California: Add housing stock (/node/682)
The San Diego Union-Tribune, March 6, 2016

Here's How Serious California's Housing Shortage Has Gotten (/node/676)
Curbed Los Angeles, March 4, 2016

Why poorer, uneducated people are leaving California (/node/678)
KPCC, March 4, 2016

High Housing Costs Are Driving Californians Out in Droves (/node/680)
Curbed Los Angeles, March 4, 2016

Are high-wage jobs squeezing lower earners out of Bay Area? (/node/681)
San Francisco Business Times, March 4, 2016

High Housing Prices Spur Migration Out of California (/node/679)
Los Angeles Business Journal, March 3, 2016

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Sacramento Business Journal, March 3, 2016

How housing prices are driving low, middle-income families out of California (/node/670)
Daily Bulletin, March 3, 2016

CALIFORNIA WATER CHALLENGE *(http://www.cawaterchallenge.org/pages/overview)*

Did you know?

The City of Los Angeles just released the Los Angeles Budget Challenge (http://la.budgetchallenge.org/pages/overview)!

What Was The Most Important Thing You Learned?

It is really hard to balance the budget as a government.
- Butte, CA

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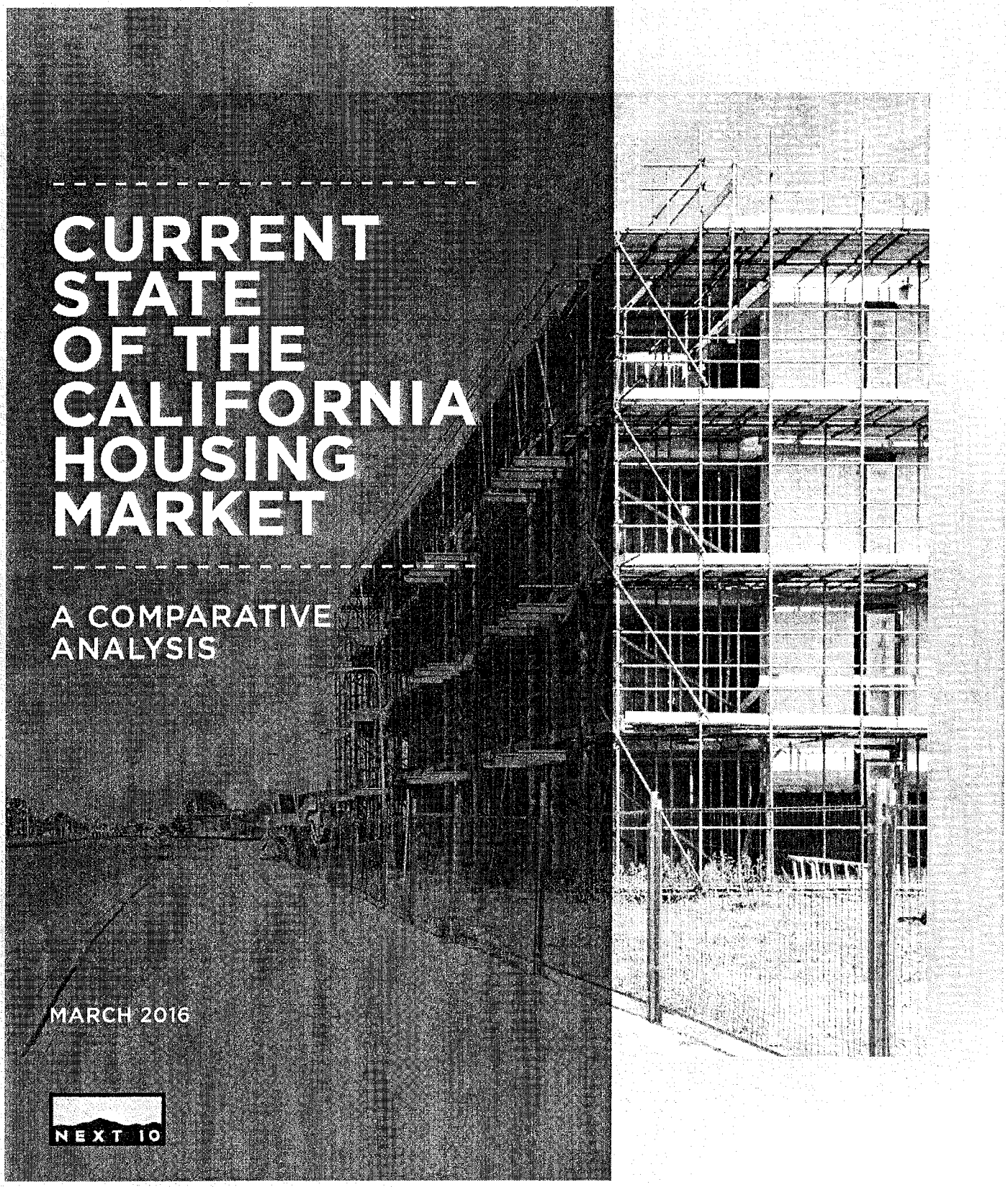
Document 13

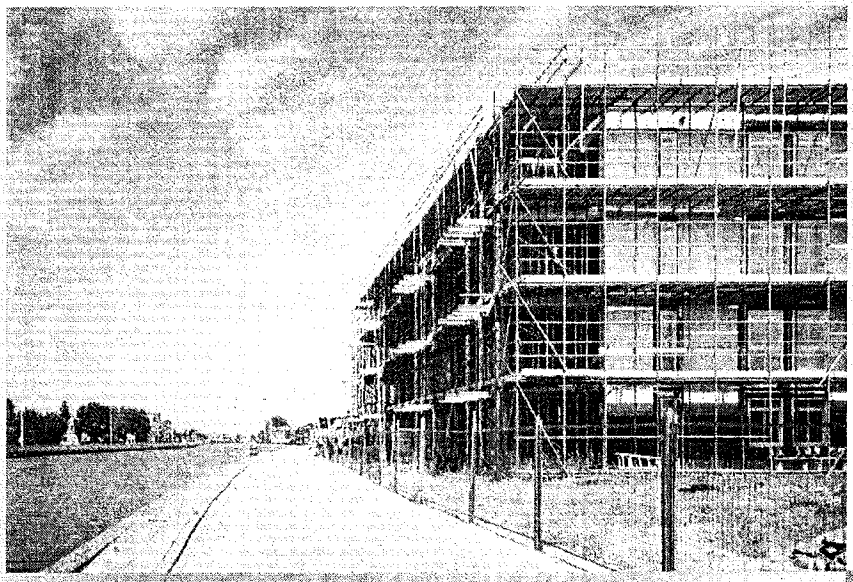


CURRENT STATE OF THE CALIFORNIA HOUSING MARKET

A COMPARATIVE ANALYSIS

MARCH 2016

NEXT 10



Next 10 is an independent nonpartisan organization that educates, engages and empowers Californians to improve the state's future.

Next 10 is tracking both the trends and the interaction between the economy, the environment, and quality of life issues for all Californians. We provide critical data to help inform the state's efforts to grow the economy and reduce greenhouse gas emissions. Next 10 was founded in 2002 by business and civic leader and philanthropist F. Noel Perry.

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Data in this report can be accessed on www.Compare50.org, where users can chart and compare all 50 states on over 150 indicators.

Overview

California's current housing market suffers from a shortage of supply and the lingering effects of the housing crash and the Great Recession.

- Homeownership rates, which have historically been low compared to rates in other states, have been declining throughout California, as many residents - especially those with recent foreclosures on record - remain unqualified for mortgage loans. In 2014, California ranked 49th in terms of homeownership, as only 53.8% of homes were owner-occupied[1].
- Housing costs are high relative to incomes and have been increasing in recent years for both homeowners and renters. California's average homeowners spent 25.4% of their household income on housing costs in 2014, more than homeowners in any other state.
- Housing remains overcrowded as the proportion of renter-occupied housing units with more than one person per bedroom grew from 12.7% in 2007 to 13.2% in 2014.
- Home prices are more expensive than in all other states, particularly in major metropolitan areas. Diminishing levels of affordability have already driven many low-income and middle-income households to migrate to more affordable states.
- Housing remains in short supply, placing upward pressure on home prices and reducing levels of affordability. From 2005 to 2015, permits for only 21.5 housing units were filed for every new 100 residents in California, less than any other state except Alaska.

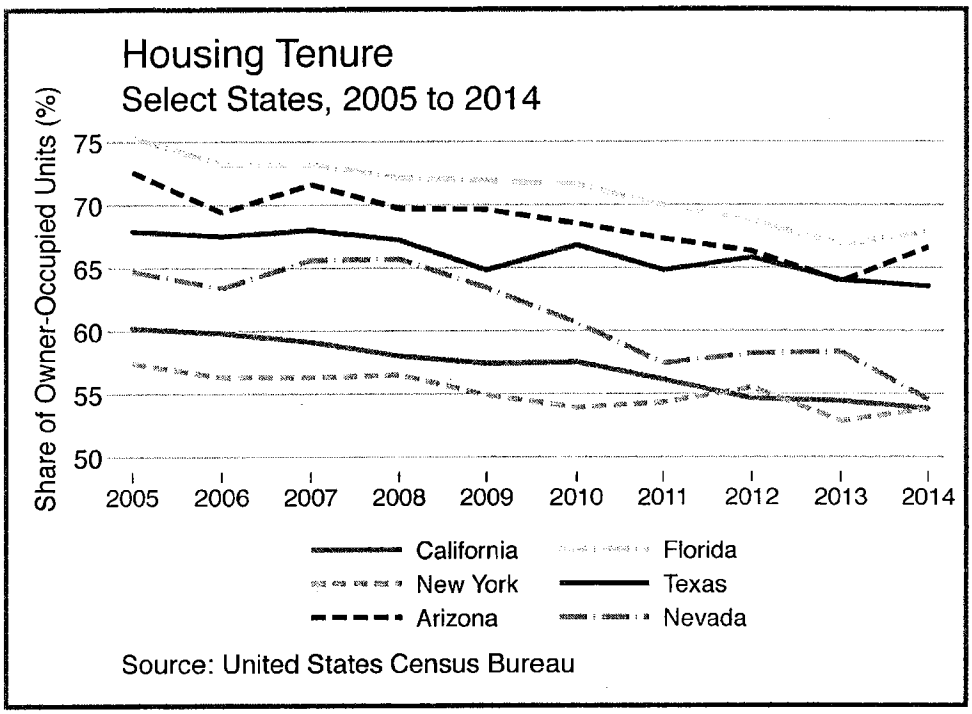
Indeed, California currently ranks near the bottom in terms of its supply of housing relative to population growth. Add that to the increasing demand to live near the coast, to be close to tech hubs, and to be near downtowns, and it's not too surprising that home prices throughout the state continue to rise. In the years to come, the dearth of new homes could exacerbate the problem, making housing even less affordable for many of California's residents.

The cost of development and stringent regulations imposed on developers has contributed to the lack of homebuilding in California. Tough environmental and zoning laws sometimes create an obstacle for homebuilders that are seeking approval for development activities, especially along California's coastal cities. Although these laws reflect good intentions and were enacted to preserve the state's

[1] Unless otherwise noted, all statistics in this report are attributed to the U.S. Census.

natural land, they are well past due to be reevaluated, as they are often poorly implemented and abused.[2]

This report will provide further evidence that California's residential real estate market needs more housing by showing how the state stacks up against other states. Taken together, these key housing trends explain the economic fundamentals of the housing market and why housing is becoming too expensive for many California residents, laying the groundwork for the decisions and policy changes that need to be made to improve the lives of those living in the Golden State.



[2] A few examples include the Sacramento Senior Homes in the City of Berkeley (2001), the East County Transitional Living Center in the City of El Cajon (2003), the Wagon Wheel Village in the City of Oxnard (2009), and the Parkmerced Development Project in the City of San Francisco (2014).

Next 10

Structure of Housing Occupancy

Many households in the state rent rather than own. This is common in states like New York and Massachusetts, where major metropolitan areas attract young professionals who prefer to live near their jobs rather than own homes in more affordable suburbs. Areas like San Francisco, the South Bay, Los Angeles, and San Diego have been attracting more young professionals from out of state in recent years. Migration patterns from 2007 to 2014 indicate that over 52,700 persons over 25 years of age with bachelor's degrees moved to California from other states on net. In contrast, 469,800 persons without bachelor's degrees moved out of California on net.

In 2014, California ranked 49th among all states in homeownership. Proposition 13 has had a negative effect on the homeownership rate because it encourages properties to remain under the same ownership for longer periods of time, making it difficult for new homeowners to enter the market. Move-up buyers can rent out their prior homes and maintain the lower costs associated with the lower assessed values, in comparison to the costs and assessed values for would-be owners were they to sell their homes.

Not only is the homeownership rate in California low, it has also been falling over the last ten years for

Housing Affordability in Select Metropolitan Areas

MSA	Housing Affordability Index		Median Home Price($)
	2014	Rank	
Youngstown, OH	369.0	1	78,600
Toledo, OH	368.1	2	87,200
Rockford, IL	353.5	3	86,300
Decatur, IL	343.5	4	89,700
Elmira, NY	320.0	5	100,800
Cleveland, OH	285.5	18	122,600
Cincinnati, OH	257.4	33	140,500
Amarillo, TX	230.2	58	144,500
Atlanta, GA	221.7	70	159,500
Tampa, FL	205.6	85	151,500
Dallas, TX	197.7	92	188,300
Chicago, OH	190.3	103	205,900
Albuquerque, NM	182.3	118	177,600
San Antonio, TX	180.4	120	182,100
Houston, TX	180.4	121	198,400
Austin, TX	169.9	134	240,700
Tucson, AZ	169.6	135	175,800
El Paso, TX	168.9	136	140,800
Orlando, FL	168.8	137	180,000
Phoenix, AZ	166.7	140	198,500
Las Vegas, NV	158.8	144	198,000
Washington, DC	147.1	154	383,800
Sacramento, CA	**136.9**	**157**	**268,700**
Denver, CO	135.9	158	310,200
Portland, OR	134.7	160	286,000
Seattle, WA	125.3	163	355,800
Boston, MA	125.3	164	389,800
Inland Empire, CA	**117.9**	**165**	**273,900**
Miami, FL	111.8	167	266,000
New York, NY	108.2	168	1,984,000
San Diego, CA	**77.6**	**171**	**497,900**
Los Angeles, CA	**73.0**	**172**	**449,500**
San Francisco, CA	**70.5**	**173**	**737,600**
Honolulu, HI	67.7	174	682,800
Orange County, CA	**65.0**	**175**	**687,900**
South Bay, CA	**64.3**	**176**	**860,000**

Source: National Association of Realtors
Based on 176 Metropolitan Statistical Areas

various reasons related to the economic cycle. California residents suffered greatly during the housing crash, and the effects of the crash continue to linger. Subprime mortgages were very prevalent in inland regions throughout the state, which caused massive numbers of foreclosures in these areas. An overcorrection of home prices between 2009 and 2013 created bargains for investors, providing them an advantage further fueled by the lack of competition from the many traditional buyers who held foreclosures on record. Many investors converted these homes to rentals and will benefit from low tax rates due to Proposition 13 until they decide to sell.

With few distressed properties now available on the market, residents in middle-income households, many of whom were subprime borrowers during the downturn, are finding it increasingly difficult to become homeowners. In addition to the introduction of much tighter lending standards, metropolitan areas in both the Bay Area and Southern California continue to rank at the bottom in terms of affordability when compared to metropolitan areas throughout the nation. Even inland metropolitan areas such as Sacramento and the Inland Empire are estimated to be less affordable than metropolitan areas in other states, such as Las Vegas, Phoenix, Chicago, Washington, D.C., San Antonio, and Houston.

CoreLogic estimates that 11.4% and 8.7% of homeowners with mortgages in the Inland Empire and Sacramento region, respectively, were still underwater, with negative equity, as of the third quarter of 2015. Housing costs in the Golden State continue to remain elevated for both homeowners and renters when compared to housing costs in other states. Approximately 40.6% of households living in owner-occupied housing units with a mortgage spend 30% or more of their income on housing. Apartment renters in California are also struggling, as 56.8% of households living in rental units spend 30% or more of their income on housing- second only to Florida (57.9%).

Average Percentage of Household Income Spent on Housing

State	Owner-Occupied				Renter-Occupied			
	Income Spent (%)		Rank		Income Spent (%)		Rank	
	2000	2014	2000	2014	2000	2014	2000	2014
Texas	18.0	19.3	16	24	25.0	30.3	15	15
Arizona	21.0	20.4	40	33	27.2	30.9	42	19
Nevada	22.6	21.6	48	39	26.8	30.0	38	13
Florida	21.4	22.4	43	43	28.8	35.5	50	46
New York	21.7	23.0	45	46	28.0	36.4	47	49
California	23.8	25.4	50	50	28.1	36.0	48	48

Source: U.S. Census Bureau

Indeed, California continues to have expensive apartment rental rates as well. In 2014, the average apartment rental rate was 35.7% above the national average. In comparison, the State of New York, despite the significantly high rental rates in Manhattan, has an average apartment rental rate that is only 22.9% above the national average.

The high cost of housing has contributed to two notable trends among California households. First, household sizes, which were steeply declining prior to the recession, started to grow larger over the last five years as young adults are living with their parents for longer periods of time. This trend made national headlines during the recession because it affected every state. However, the issue continues to affect California households even as the economy is expanding, particularly with respect to renter-occupied housing units. California had the highest share of renter-occupied housing units with more than one resident per bedroom in 2014 (13.2%).

Proportion of Homes with More than 1 Resident per Bedroom

State	Owner-Occupied				Renter-Occupied			
	2000 (%)	2007 (%)	2014 (%)	2014 Rank	2000 (%)	2007 (%)	2014 (%)	2014 Rank
Florida	3.7	1.3	1.6	37	12.9	5.2	5.5	40
New York	2.6	1.7	2.0	43	13.6	7.6	8.5	48
Nevada	4.7	1.8	2.2	44	14.5	5.6	6.4	43
Arizona	5.4	3.0	2.4	45	15.4	7.7	7.6	46
Texas	6.3	3.2	3.2	47	15.0	7.3	7.3	45
California	8.6	4.1	3.9	48	23.9	12.7	13.2	50

Source: U.S. Census Bureau

The second notable trend stemming from the high cost of housing is a trend in domestic out-migration: more residents are leaving California than are moving in from other states. An analysis of California's aggregate domestic net migration between 2007 and 2014 shows a net outflow of approximately 625,000 residents (excluding migrants who are enrolled in college and universities, as they may be only temporary residents). This is compared to net positive domestic migration for Texas (975,700), Arizona (261,400), Florida (558,500), and Nevada (102,000) over the same time span. New York also experienced a net domestic out-migration, with a net outflow of 967,400 residents.

Net Domestic Migration, 2007–2014 (in thousands)

Component	California	Arizona	Florida	Nevada	New York	Texas
Total	-625.0	261.4	558.5	102.0	-967.4	975.7
By Household Income Group						
Under $50,000	-563.0	157.5	294.3	73.2	-476.5	432.0
$50,000 to $99,999	-138.9	70.0	175.5	15.2	-292.0	312.6
$100,000 to $149,999	-3.3	15.6	54.5	20.9	-105.2	149.3
$150,000 and Over	80.1	18.3	34.3	-7.3	-93.7	81.8
By Age Group						
Under 36	-292.6	38.5	45.2	37.0	-484.7	641.3
36 to 65	-309.8	138.7	324.8	47.3	-361.6	276.7
Over 65	-22.6	84.1	188.5	17.8	-121.1	57.7
By Education (25 Years and Over)						
Less than Bachelor's Degree	-469.8	169.3	324.5	54.6	-480.4	407.3
Bachelor's Degree or Higher	52.7	72.2	163.5	11.0	-204.6	196.9

Source: U.S. Census Bureau

Migration patterns confirm that middle-income households are being driven out of the local housing market. Persons in households with incomes of between $50,000 and $100,000 constituted 22.2% of domestic migrants leaving California between 2007 and 2014. Meanwhile, in other states, such as Arizona, Florida, and Nevada, households in this income group represented a high share of the positive net domestic migration over the same period. And while more middle-income households are leaving the state, the opposite can be said about high-income households. Net domestic migration of persons in households with incomes of more than $150,000 was 80,100 persons between 2007 and 2014.

Further declines in homeownership and levels of home affordability could carry serious consequences and affect the future economic growth of the State of California. Homeowners are more likely to invest in their homes and communities than renters, an important reason to encourage homeownership. Furthermore, households that spend high proportions of their incomes on housing will spend less on goods and services. High costs for housing increase the likelihood that lower-income households will be reliant on government welfare, which in turn puts undue fiscal pressure on state and local governments. Yet these concerns only exist because homes are in short supply.

Owner-Occupied Housing Statistics, 2014

Component	California	Texas	Arizona	Florida	Nevada	New York
Total Persons Living in Owner-Occupied Housing	6,855,688	5,674,241	1,484,857	4,693,821	547,905	3,857,906
Share of Owner-Occupied Households (%):						
With Income of less than $50,000	28.1	35.4	40.0	43.2	36.4	29.2
With Income of $150,000 or More	22.6	15.3	11.8	10.7	10.8	20.1
With Householder in Retirement Age	30.1	25.9	35.3	39.0	31.4	29.7
Whose Householder has a Bachelor's Degree	42.5	35.3	36.0	35.1	31.8	42.0

Source: U.S. Census Bureau

Housing Supply Constraints

California ranks near the bottom in terms of the number of residential permits issued on a per capita basis. From 2005 to 2015, only 21.5 new units have been permitted for every 100 new residents, compared to 33.4 new units nationwide. Housing statewide has favored multifamily structures more than single-family structures, a trend that sets California apart from many other states. From 2005 to 2015, only 59.1% of housing units permitted were for single-family homes, a category in which California ranks 46th. While the city centers of the largest cities in the state are fairly built out, and thus mainly receive permits for multiunit properties, construction of new single-family homes in suburban areas has lacked significant growth.

Permitting by State, 2005-2015

Rank	State	Permits per 100 New Residents
1	Michigan	166.0
2	Rhode Island	92.2
3	Maine	74.2
4	Vermont	69.7
5	Louisiana	58.6
6	Ohio	56.3
7	New Hampshire	53.7
8	Illinois	47.6
9	Mississippi	47.2
10	North Dakota	46.8
11	South Dakota	46.5
12	Wisconsin	45.3
13	Iowa	42.8
14	New York	42.3
15	New Jersey	40.7
16	Nebraska	40.2
17	South Carolina	39.8
18	Delaware	37.4
19	Alabama	37.4
20	North Carolina	36.7
21	Indiana	36.1
22	Idaho	36.1
23	Pennsylvania	36.0
24	Florida	35.3
25	Kansas	34.7
26	Tennessee	34.7
27	Missouri	34.6
28	Minnesota	34.5
29	Oregon	33.3
30	Washington	33.1
31	Georgia	33.0
32	Nevada	32.0
33	Arizona	31.5
34	Virginia	31.2
35	Arkansas	31.2
36	West Virginia	31.1
37	Maryland	30.7
38	Utah	30.0
39	Colorado	29.9
40	Texas	29.4
41	Kentucky	29.2
42	Massachusetts	28.9
43	Montana	28.5
44	New Mexico	28.5
45	Connecticut	27.9
46	Oklahoma	27.6
47	Wyoming	25.3
48	Hawaii	25.1
49	California	21.5
50	Alaska	16.2
	United States	33.4

Source: U.S. Census Bureau

The deficient amount of homebuilding in California is in part the result of a number of regulatory changes. Among these regulatory factors is the California Environmental Quality Act (CEQA). Following CEQA, local governments require new developments (either residential or nonresidential) to conduct environmental reviews for potential environmental effects, which may lead to either limiting developments or stopping them altogether. According to the 2012 Annual Planning Survey Results published by California's Governor's Office of Planning and Research, 21% of respondents indicated that the primary barrier to implementing infill projects was community opposition/CEQA/lawsuits, while another 24% of respondents attributed a lack of funding/high costs, which can be impacted by the fear of a CEQA lawsuit.[3]

[3] State of California, Governor's Office of Planning and Research, "Annual Planning Survey Results, 2012". Available at https://www.opr.ca.gov/docs/2012_APSR.pdf

The scarcity of developable land has also made any form of homebuilding along the coast difficult. The Legislative Analyst's Office (LAO) reports that just under two-thirds of the area surrounding urban centers on California's coast is undevelopable due to mountains, hills, ocean, and other water.[4] The 1976 passing of the California Coastal Act, which was enacted to protect and maintain the overall quality of the coastal zone environment, has played a role in limiting how much coastal land can be developed for residential construction.[5]

On multiple occasions, local communities have blocked homebuilding by utilizing land use authority to either slow or stop projects. The resistance to new developments often stems from the desire to maintain current home values or from the perception that the land should not be developed for various reasons.

Also concerning to developers, especially those that handle fewer properties, are the costs associated with tearing down existing buildings and addressing the environmental concerns that may arise during the redevelopment phase. The State of California has some of the toughest zoning laws in the country, requiring developers to adhere to multiple state and local ordinances. The fees associated with development also put more financial strain on homebuilders, resulting in these fees being passed along to homebuyers. These fees include the building permit, utility connection, environmental impact assessment, and zoning and subdivision fees. These items were all key issues discussed at a recent House L.A. 2015 Summit hosted by the Building Industry Association's Los Angeles and Ventura Chapter, which featured a number of local and national developers along with local political representatives.[6]

Some developers assert that many local governments have favored commercial projects over residential, as these projects provide a larger financial upside than residential projects. Cities and counties are aware that sales taxes collected by potential commercial and retail establishments far outweigh the property taxes homeowners would pay. Some local governments have also remained cautious toward homebuilding because the accompanying population growth is sometimes costly, leading to an increased need for funding to facilitate infrastructure development and for policing.

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[4] Mac Taylor, *California's High Housing Costs, Causes and Consequences*, Legislative Analyst's Office, March 2015, available at www.lao.ca.gov/reports/2015/finance/housing-costs/housing-costs.pdf.

[5] See the 2003 State of California General Plan Guidelines, p. 174.

[6] For more information, see www.bialav.org.

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Conclusion

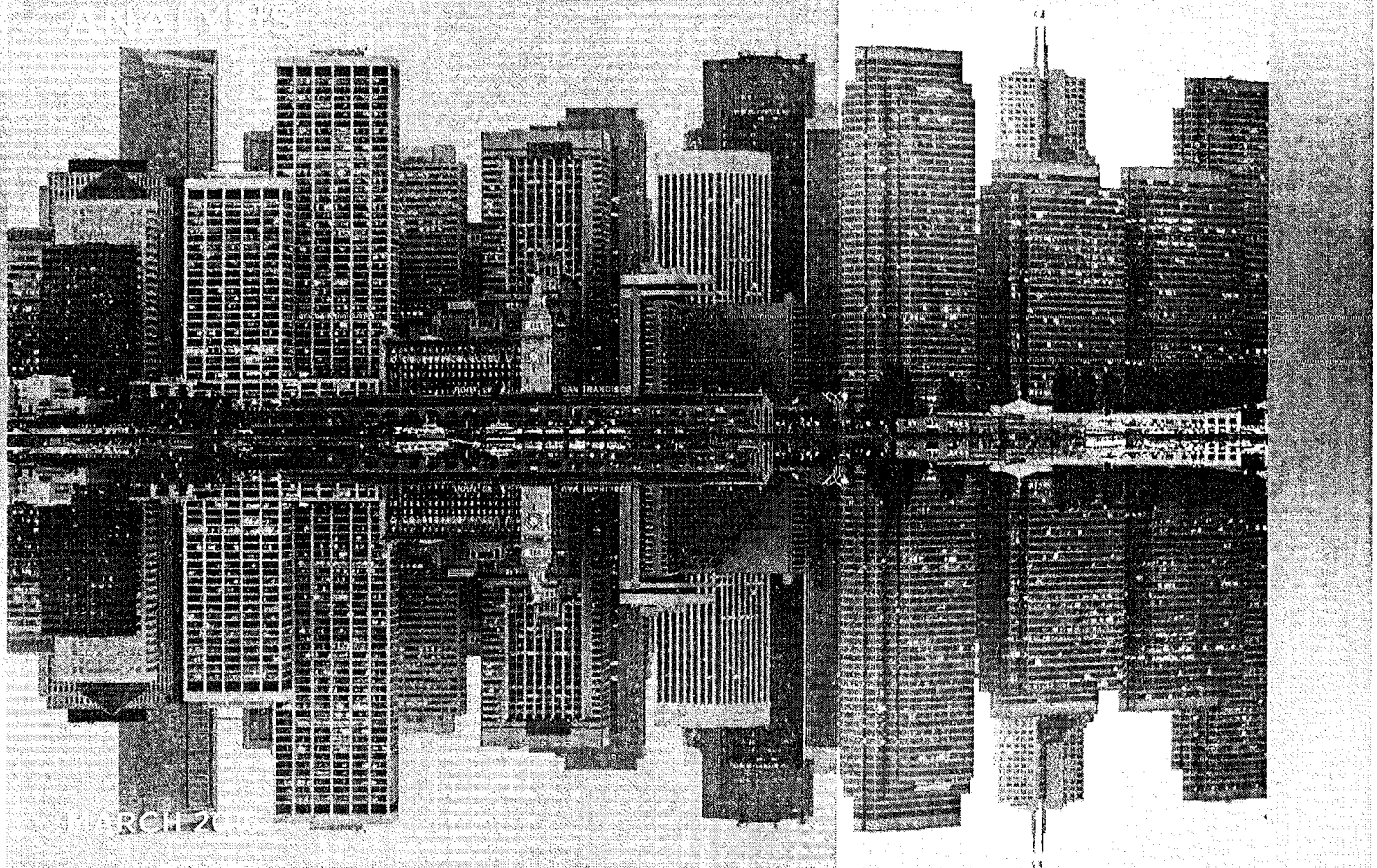
California's current housing climate is not able to support its growing population. The low levels of residential construction could result in further increases in home prices, such that fewer and fewer California residents will be able to afford homes. It is true that home prices have increased throughout the country, but California remains the most expensive state for purchasing a home. Rental rates have also continued to climb, and residents who usually flock to the rental market to avoid unaffordable home prices find little relief. The state's lower-income residents suffer the most; they are burdened with having to spend a higher proportion of their incomes on housing and are forced to cut back on other discretionary, but oftentimes necessary, purchases. However, diminishing levels of affordability are also reducing the ability for middle-income residents to own a home, which is discouraging for residents of both low-income and middle-income categories. Indeed, the current state of housing has led many to leave California in the hope of finding more affordable living circumstances elsewhere.

To alleviate the housing affordability crisis that plagues low-income and middle-income households in the state, more housing construction needs to take place. Homebuilders should be encouraged to build in California. One such way would be by streamlining the permitting processes and finding a way to reduce concerns about environmental protection policies. The LAO report references a few solutions that may help alleviate the housing affordability crisis that California currently faces, including encouraging more residential development along California coastal cities and, if possible, an increase in the residential density for such developments.

Document 14

EMPLOYMENT BY INCOME

A COMPARATIVE ANALYSIS



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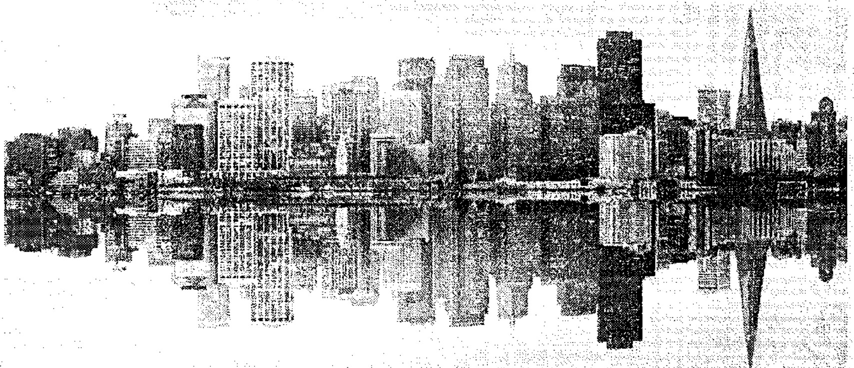

Next 10 is an independent nonpartisan organization that educates, engages and empowers Californians to improve the state's future.

Next 10 is focused on innovation and the intersection between the economy, the environment, and quality of life issues for all Californians. We provide critical data to help inform the state's efforts to grow the economy and reduce greenhouse gas emissions. Next 10 was founded in 2003 by businessman and philanthropist F. Noel Perry.

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Data in this report can be accessed on www.compare50.org, where users can chart and compare all 50 states on over 150 indicators.

Overview

In June 2014, California's labor market finally recovered all of the jobs it had lost during the Great Recession. It was a landmark achievement and a testament to the resilience of the state's economy. California, after all, was one of the nation's hardest hit locations in the wake of the housing collapse, and had more ground to make up than most.

Many new jobs in California are in low-wage industries. Indeed, the post-recession period favored low-wage job growth over middle-wage and high-wage job growth throughout the state by a wide margin. However, California continues to contain a significant amount of jobs in middle-wage and high-wage industries as well. In fact, California has been leading the nation in both middle-wage and high-wage job creation during the post-recession recovery.

The main findings in this analysis include:

- Low-wage jobs in California are concentrated in a small number of high-level industries, such as Leisure and Hospitality, Retail, Health Care, and Agriculture. High-wage employment, on the other hand, is represented by a larger variety of smaller industries.
- Over the years, the share of employment in low-wage industries has risen in California and the nation overall.
- Low-wage job growth in California during the post-recession period ranked third highest in the nation. However, California was not the only large state to rank high in low-wage job growth: Florida and Texas were also in the top five.
- California is home to some of the leading high-wage industries in the nation, including the Professional and Technical Services industry. California ranked 11th highest amongst all states in terms of post-recession job growth in this sector. Additionally, compensation in high-wage industries in California is growing faster than the nation overall.
- California ranked 11th in terms of job growth in middle-wage industries from the fourth quarter of 2009 to the fourth quarter of 2014.

Overall, California, like other populous states, is a large producer of low-wage jobs. However, California is also a major job creator in a variety of middle-wage and high-wage industries.

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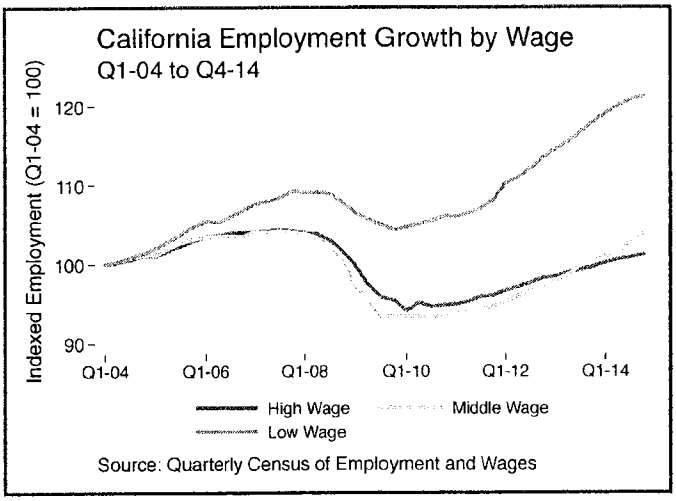

High-, Middle-, and Low-Wage Industries in California

This analysis is based on the U.S. Bureau of Labor Statistics' Quarterly Census of Employment and Wages (QCEW). Industries within the QCEW are organized according to the North American Industry Classification System (NAICS). The QCEW program publishes a quarterly count of employment and wages, as reported by employers, covering 98% of U.S. jobs by industry, and provides the most comprehensive picture of industry job growth available.

In this analysis, low-wage industries are those in the bottom 30% of jobs ranked by wage at the national level during 2014. Similarly, high-wage industries represent the top 30% of jobs ranked by wage. Those jobs between the 30th to 70th percentiles are considered middle-wage jobs.

High-wage employment in California spans a wide range of diverse industries. Indeed, the top ten grossing high-wage industries at the three-digit North American Industry Classification System (NAICS) level span across eight distinct super sectors: Professional, Scientific, and Technical Services; Health Care Services; Wholesale Trade; Government, Durable Goods Manufacturing; Finance and Insurance; Management of Companies and Enterprises; and Construction. Overall, this study estimates that there are roughly 5.4 million high-wage jobs in California—34% of all nonfarm jobs.

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Top Ten High Wage Industries by Employment, Q4-14

Industry	Employment	Average Annual Wage
Professional and Technical Services	1,020,380	103,906
Hospitals	548,092	74,318
Merchant wholesalers, durable goods	312,444	76,662
Justice, public order, and safety activities	306,706	83,727
Computer and electronic product manufacturing	279,600	145,107
Credit intermediation and related activities	244,324	83,500
Merchant wholesalers, nondurable goods	243,099	61,492
Insurance carriers and related activities	204,500	83,720
Management of companies and enterprises	198,536	118,858
Construction of buildings	146,744	63,200

Source: Quarterly Census of Employment and Wages

In California, as of the fourth quarter of 2014, the Professional and Technical Services sector employed roughly one million Californians according to the QCEW, making up 19% of the state's high-wage employment. Drilling down to the four-digit NAICS level within the Professional and Technical Services industry presents a more detailed picture of the types of jobs that make up this sector. For instance, the top four-digit industries within the Professional and Technical Services sector are: computer systems design and related services; management and technical consulting services; and architectural and engineering services. Examples of jobs in these sectors include software engineers, managers, and architects.

Hospitals are the second largest of the state's high-wage sectors at the three-digit NAICS level. This sector represents 10% of high-wage employment in California with 548,100 employees. At the four-digit NAICS level, this sector is comprised of: general medical and surgical hospitals; psychiatric and substance abuse hospitals; and other hospitals.

Beacon Economics estimates that there are roughly 6.1 million middle-wage jobs in California—38% of all nonfarm jobs. The bulk of middle-wage jobs are in Educational services, which includes teachers, professors, and instructors, as well as education support staff. The QCEW data indicates that this industry includes more than 1.4 million employees, making up 24% of the state's middle-wage employment. Other major middle-wage industries include Administrative and support services, ambulatory health care services, and specialty trade contractors.

Top Ten Middle Wage Industries by Employment, Q4-14

Industry	Employment	Average Annual Wage
Educational services	1,452,719	51,545
Administrative and support services	794,123	38,584
Ambulatory health care services	578,297	65,364
Specialty trade contractors	410,141	54,600
Executive, legislative and general government	226,581	64,012
Real estate	189,142	59,644
Membership associations and organizations	165,203	40,768
Motor vehicle and parts dealers	161,344	50,596
Food manufacturing	144,091	45,032
Repair and maintenance	140,869	39,572

Source: Quarterly Census of Employment and Wages

Conversely, low-wage employment is less diverse, spanning fewer top-level sectors, as can be seen by the list of top ten low-wage industries in the table below. Overall, this study estimates that there are roughly 4.6 million low-wage jobs in California—29% of all nonfarm jobs. Furthermore, the bulk of low-wage jobs can be found in five primary sectors: Leisure and Hospitality; Private Households; Health Care Services; Retail Trade; and Agriculture. It is worth noting that the Health Care Services sector contains three-digit NAICS industries in both the high- and low-wage categories—underscoring the importance of drilling down into more detailed data rather than just looking at average wages at the super sector level.

Top Ten Low Wage Industries by Employment, Q4-14

Industry	Employment	Average Annual Wage
Food services and drinking places	1,064,936	18,785
Food and beverage stores	328,943	28,010
Private households	317,810	28,094
General merchandise stores	283,611	24,102
Nursing and residential care facilities	242,279	31,150
Amusements, gambling, and recreation	234,660	26,832
Social assistance	226,470	17,689
Accommodation	208,863	32,023
Agriculture and forestry support activities	198,638	25,621
Crop production	186,150	31,473

Source: Quarterly Census of Employment and Wages

The Food Services and Drinking Places three-digit industry makes up the bulk of employment at the low end of the wage spectrum and includes jobs such as waiters and kitchen staff. The QCEW data indicates that this industry is home to 1.1 million employees, making up 23% of the state's low-wage employment. This industry is comprised of restaurants and bars, which provide some of the lowest average annual wages in California at $18,785 per year. Among the largest low-wage industries by jobs is the Social Assistance Services industry. With an average annual wage of $17,689, it is the lowest wage industry in the state.

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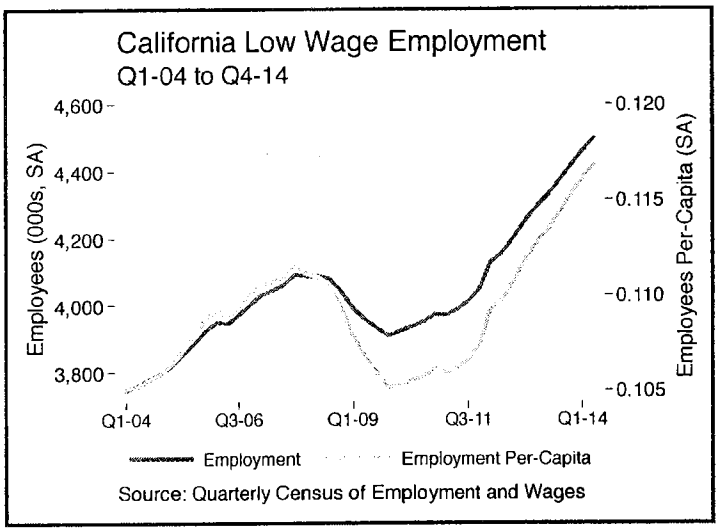
Low-Wage Industry Growth in the United States

In the time since the Great Recession, from the fourth quarter of 2009 to the fourth quarter of 2014, low-wage employment in California has expanded by 16.1%. This represents the third highest growth rate in the nation over this time period. North Dakota held the number one rank with a 20.7% increased over the same time period.



Although California ranks high among the fifty states for low-wage employment growth since the recession, it is not the only large state experiencing these trends. Florida ranks number two in low-wage job growth since the fourth quarter of 2009 and Texas, a state often compared to California, comes in at number four for fastest low-wage job growth. New York was eighth on the list.

One important consideration for low-wage job growth is the Tourism industry, which is doing quite well across the nation. Food Service and Accommodation employment are some of the largest low-wage industries, and labor demand among these establishments stems primarily from tourism and recreational activities. Business travel will also support these industries, but the fact that these jobs are expanding is an indication of a growing economy where individuals and businesses are able to increase travel spending. Ultimately, this is a sign of strength for the economy.

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Top Ten States for Low Wage Growth

State	Q4-14 Employment	Post-Recession Growth (%)	Population Growth (%)
North Dakota	116,568	20.7	11.2
Florida	2,350,387	16.2	6.7
California	4,560,546	16.1	5.0
Texas	2,748,083	15.1	8.7
Oregon	507,254	13.6	4.2
Colorado	633,040	13.2	7.7
Delaware	116,577	12.8	4.9
New York	2,293,686	12.6	2.3
Massachusetts	883,135	12.0	3.5
Utah	299,613	11.2	8.1

Source: Quarterly Census of Employment and Wages

Low-Wage Share of Industries in California

The share of employment in low-wage industries has gradually risen over the years in both California and the nation overall. In 1999, the share of employment in low-wage industries was 23.9% in California and 23.7% in the nation overall. As of 2014, the shares have risen to 28.6% and 26.2%, respectively.

Share of Total Employment (%)

	1999	2004	2009	2014
United States				
Low Wage	23.7	24.6	25.6	26.2
Middle Wage	39.9	40.5	39.6	39.7
High Wage	36.4	34.9	34.8	34.1
California				
Low Wage	23.9	25.3	27.0	28.6
Middle Wage	38.8	39.1	37.8	37.7
High Wage	37.3	35.6	35.2	33.8

Source: Quarterly Census of Employment and Wages

As mentioned previously, low-wage jobs in California are concentrated in fewer industries than are high-wage jobs. Out of the 100 industries at the three-digit NAICS level, 19 are classified as low-wage. Thirty-seven industries are classified as middle-wage, and 44 are considered high-wage.

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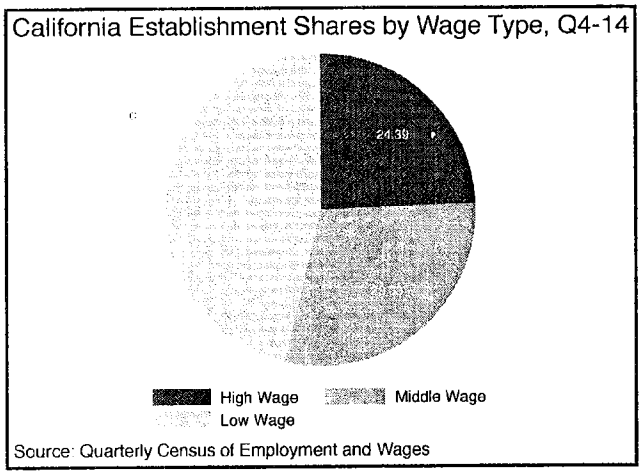
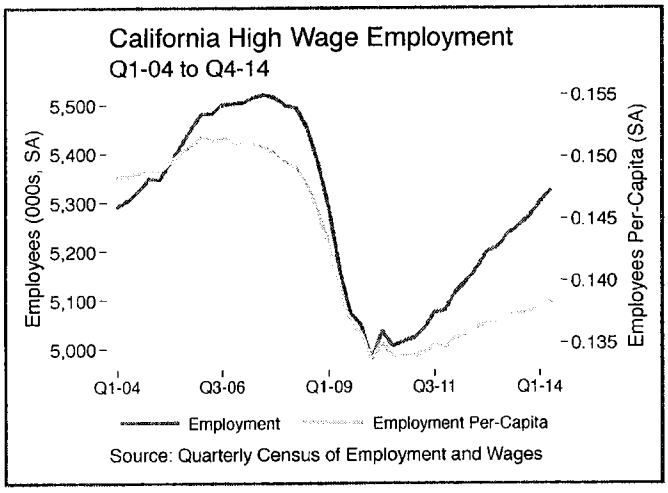


While low-wage jobs are found in a narrower spectrum of industries in California, the same cannot be said for the number of establishments in the state. As of the fourth quarter of 2014, the number of business establishments in low-wage industries made up 46.3% of all establishments. California ranks highest in the nation in its share of establishments in low-wage industries. The national average is 29.8%, with Utah having the lowest share at 20.1%.

Leading High-Wage Industries in California

California is a leader in high-wage job creation. Not only does it have some of the fastest growing high-wage industries, but compensation for these jobs has grown faster in California than in the nation overall. Over the last ten years compensation growth in high-wage industries averaged 3.7%. In contrast, compensation in high-wage industries in the nation overall grew by 3.3%.



First and foremost among leading high-wage industries is California's Professional and Technical Services sector. Since the labor market hit bottom in the fourth quarter of 2009, employment in this industry has grown by 18.1%—the eleventh fastest growth rate in the nation over that time period. The state with the fastest growth for Professional and Technical Services employment was North Dakota, where jobs in this sector grew by 38.0% over the same time period.

California's growth ranking for the Professional and Technical Services industry is more impressive when considering the states ranked at the top. With the exception of Texas at number four and Michigan at number six, the others are relatively small states.

California has by far the largest Professional and Technical Services industry in the nation. As of the fourth quarter of 2014, this industry had 1.2 million employees, representing 13.9% of the national industry. In fact, California has produced more Professional and Technical Services jobs post-recession than the top five growth states combined—including Texas.

Top Eleven States for Professional/Technical Growth

State	Q4-14 Employment	Post-Recession Growth (%)
North Dakota	18,158	38.0
Utah	86,201	32.5
Oregon	88,443	25.0
Texas	701,765	24.9
Delaware	28,821	21.3
Michigan	270,418	21.3
Georgia	261,349	21.2
Colorado	202,481	20.5
South Carolina	87,794	18.6
North Carolina	215,496	18.2
California	1,192,591	18.1

Source: Quarterly Census of Employment and Wages

California's third largest high-wage industry, Merchant Wholesalers of Durable Goods, has also been leading the nation in job growth since the fourth quarter of 2009. During the post-recession period employment in Merchant Wholesalers of Durable Goods grew by 10.1%, greater than the 7.5% growth seen nationwide. The industry in California ranked 16th in growth out of the 50 states. North Dakota again ranked number one with a 57.1% growth rate over the same time period. Much like the Professional and Technical Services industry, the higher-ranked states had smaller bases to begin with and are seeing faster growth rates from those smaller bases. California already had a sizeable employment base in these industries.

The Management of Companies industry, the ninth largest high-wage industry in California, has also done well post-recession—expanding by 16.4% since the fourth quarter of 2009. For this industry, California ranked 31st in growth amongst the 50 states and trailed the nation overall at 18.2%. Texas took the number one spot with a 50% rate of increase over the same time period.

One of the main reasons California is not higher in the rankings for high-wage job growth is due to the Hospitals industry, the second largest high-wage industry in the state, and one that has lagged the rest of the nation significantly. From the fourth quarter of 2009 to the fourth quarter of 2014, California employment in the Hospitals industry has contracted by 4.3%. In contrast, Hospital industry employment in the nation overall grew by 2.3%. This places California 48th in the growth rankings.

A handful of California's other large, high-wage industries have lagged other states during the post-recession period and have dragged down overall high-wage employment growth. In particular, employment growth in the Credit Intermediation and the Insurance Carrier industries has trailed the national average, contracting by 1% and 5.1%, respectively. This largely reflects the fact that mortgage lending has yet to resume at a faster pace.

Middle-Wage Industries in California

Similar to high-wage industries, California's middle-wage industries have experienced rising employment counts that surpass the nation overall accompanied by faster growing compensations. Over the last ten years, the average wage in middle-wage industries rose by 2.9% in California versus 2.6% in the nation, leaving the average wage in California 12.4% higher than the national average. Higher wages in California reflect employers' willingness to pay a premium, either because the local workforce is more productive or because there is a shortage of workers in these industries.

The Education services industry is one of the middle-wage industries that appears to have a shortage of workers. The average wage in the industry was $51,545 in 2014, 12.4% more than the national average wage in the industry. California is rich in high-ranking universities that attract students from all over the world. Apart from hiring well-known professors, these universities pay respectable salaries to their support workers. In all, the average wage at colleges and universities in California is 18.5% greater than in the nation.

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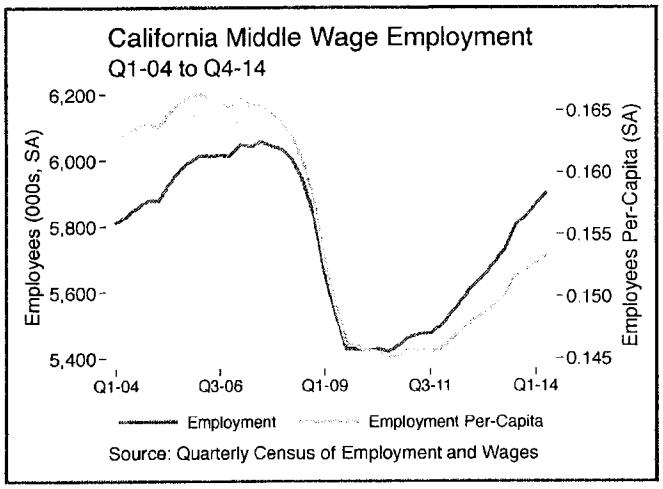

Summary

This report examined low-, middle-, and high-wage industry growth in California and illustrated how that growth compares to the rest of the nation. While California does rank high in low-wage job creation post-recession, it is also home to numerous high-wage industries that are leading the country in high-wage job creation. Additionally, compensation in high-wage and middle-wage industries in California are growing faster than in the nation overall.

The trend of low-wage job creation is not unique to California. Both Florida and Texas were among the top ten states for low-wage job growth during the post-recession period. In fact, there were so many large population states in the rankings that the national average for low-wage job growth fell just behind twelfth-ranked New York, rather than in the middle of the pack.

In California, and throughout the United States, there have been a large number of low-wage jobs created during the post-recession period. And while this has not helped to raise household incomes over the last few years, it is not necessarily a sign of a weak economy. Several of the low-wage industries experiencing major employment increases are part of the broader tourism and travel industry. Recreation and business travel have increased over the years as the overall economy has recovered from the recession. Demand for these types of services is ultimately a sign of strength. Perhaps, more importantly, is that the state and nation overall are also creating high-wage jobs for skilled workers.

Ultimately, wages are a function of skills and the demand for those skills. Given California's role as a leader in both tourism and technology, the state should expect to continue creating a mix of high-, middle- and low-wage jobs as businesses invest, construction picks up, consumers increase spending, and tourists continue to travel. California needs to maintain its focus on growing the most skilled and educated workforce in the nation in order to unlock high-wage opportunities for more of its

residents and enable the high-tech sectors that have become synonymous with the state to flourish. However, California also needs to provide jobs for those who have yet to seek higher-skilled training opportunities. With jobs growing across the spectrum of wage categories and general economic conditions continuing to improve, there is now breathing room available to begin tackling that challenge strategically.

Document 15

CALIFORNIA MIGRATION

A COMPARATIVE ANALYSIS

MARCH 2016

NEXT 10

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Data in this report can be accessed on www.Compare50.org, where users can chart and compare all 50 states on over 150 indicators.

Overview

In recent years, California has experienced negative domestic migration, meaning more people are moving from California to other states than the number of residents moving to California from other parts of the country. The increase in the number of residents moving out the Golden State to other parts of the United States is often blamed on California's high personal income taxes. However, data from the U.S. Census Bureau show this perceived connection between out-migrants and the state's income tax is overblown at best, and non-existent at worst.

In fact, statistics on the characteristics of California's inbound and outbound migrants suggest patterns in migration over the past decade are more related to housing costs in the state than to tax structure. That's not to say California's tax structure does not require reform—indeed, streamlining the tax code, broadening the tax base, and lowering tax rates would likely bolster the state's economy further. However, that does not implicate the tax regime as the sole, or even the primary, source of out-migration from California.

While it is true domestic migration into California has continued to be negative in recent years, it is important to look at who is leaving the state and where they going. This report analyzes data on:

1. Where California ranks among other states in terms of net domestic migration
2. The income, educational attainment levels, and occupations of California's inbound and outbound migrants
3. The reasons that migrants are opting to leave the state

Additionally, it is important to consider the characteristics of those entering the state from other countries.

This analysis is based on the most current data available from the U.S. Census Bureau's American Community Survey (ACS). The ACS details if an individual moved in the past year, where they moved to, where they moved from, their income, their educational attainment, and their occupation. This data will give insight into not only the number of people who are migrating in and out of California, but key demographic features about these migrants. Additionally, this dataset allows us to exclude the migration of college students who often only move temporarily.

The main findings in this analysis include:

- California experienced a negative net domestic migration of 625,000 from 2007 to 2014. In other words, 625,000 more people moved out of California to other states than moved into California from other states.
- The vast majority of out-migrants went to just five states: Texas, Oregon, Nevada, Arizona, and Washington.

- California was a net importer of residents from 15 states and the District of Columbia from 2007 to 2014.
- Californians 25 years of age and over that do not possess four-year college degrees accounted for over 469,800 out-migrants. However, California was actually a net importer of nearly 52,700 residents with a bachelor's degree or higher.
- California remains the top state attracting international migrants, many of which are low-income earners and those that have obtained a bachelor's degree.

Despite seeing an overall negative net domestic migration, California is continuing to attract new residents to the state. Despite the rhetoric regarding California's oppressive tax regime or its overall hostility to business, individuals coming to California are primarily concentrated in high-wage occupations, which enable them to better absorb the state's high housing costs and cost of living. In contrast, the majority of California's outbound migrants tend to earn less than $30,000 annually.

Migration trends also show that the middle-class is being priced out of the state. Net migration of those earning between $30,000 and $49,999 accounted for 43,100 residents leaving California. Meanwhile, low-income earners from other countries are replacing low-income earners leaving California for other states.

High housing costs have made California an increasingly difficult place for lower-income residents with less education to maintain their quality of life, while many middle-income residents are having trouble moving from renting to homeownership. Meanwhile, those with higher education and high-wage occupations continue to find the state an attractive place to live. Ultimately, the choice of where to live is one of consumption and reflects a variety of preference factors. Based on the data, it appears that despite a high cost of living, individuals who can afford to live in California will, because of all the state has to offer.

Where are Californians Migrating To?

From 2007 to 2014, California saw 625,000 more U.S. residents migrate out of the state than in. The vast majority of these migrants went to only a handful of states. The state seeing the largest net migration from California was Texas, which saw over 212,600 net domestic migrants from California between 2007 and 2014. Other states that were primary destinations of California-outbound migrants were concentrated in the western United States, with Oregon, Nevada, Arizona, and Washington rounding out the top five. Together, the top five states for California's net outbound domestic migrants accounted for over 550,800 (or 88%).

California was not the only state to see net outbound domestic migration from 2007 to 2014. Indeed, 23 other states saw negative net domestic migration over the same period. Besides California, which had the second largest outbound migration, the states seeing the largest amount of net outbound migration were concentrated in

the northeast, with New York seeing the largest number of net outbound domestic migrants (967,400). Illinois, Michigan, and Alaska also saw domestic migration turn negative over the period, however losses were not as steep in absolute terms as losses in New York.

Importantly, California saw *positive* net domestic migration from 15 states and the District of Columbia, despite an overall negative, from 2007 to 2014. The states accounting for the largest inflows to California include New York, Illinois, Michigan, New Jersey, and Alaska. Together these states accounted for a net inflow of over 119,600 migrants to California from 2007 to 2014. California attracted many residents from some states that do not have an income tax, including Alaska (20,700) and Florida (18,000). As will be discussed below, this counters the perceived link between migration and tax rates, and suggests other factors are driving migration trends.

In 2014, California saw out-migration fall, with just over 52,000 residents leaving California, on net. That puts California third in net negative domestic migration behind New York and Illinois. Florida attracted the most domestic migrants, with net in-migration totaling over 136,300 in 2014. What's more, half the states in the nation saw negative net domestic migration over the period, indicating that this is not a California-specific trend.

California Net Domestic Migration by State, 2007 to 2014

State	Rank	Net Domestic Migration (000s)
Total		-625.0
Texas	1	-212.6
Oregon	2	-96.2
Nevada	3	-95.2
Arizona	4	-90.3
Washington	5	-56.5
Alaska	46	20.7
New Jersey	47	27.8
Michigan	48	29.7
Illinois	49	41.4
New York	50	46.5

Source: American Community Survey

Who are California's Migrants?

While California has seen a significant number of residents leave the state in recent years, it is important to look at who is opting to leave the state, and conversely what the demographic make-up is of those still moving into the state. A common theme is to look at the migration out of California and blame it on a poorly performing economy or income taxes without looking at who the people migrating actually are,

or, ultimately, why they are leaving the state. This is especially important from a public policy perspective in that having the right diagnosis is critical to overcoming challenges. Indeed, if tax rates are the drivers of out-migration, the policy recommendation that logically follows is to lower the tax rate. However, if, as the data suggests, there are other more important drivers, then the reduction of tax rates will do little to stem the tide of those leaving the state.

Looking at the income levels of domestic migrants undermines the assertion that California's progressive tax system is driving residents from the state. In fact, from 2007 to 2014 California has actually seen a net positive domestic migration of individuals who earn over $50,000 annually. This means there are factors other than income taxes impacting migration decisions, since the majority of out migration can be attributed to residents who earn less than $30,000 and are not subject to California's higher upper-income tax brackets. This also follows the earlier finding that California *gains* residents from states with no income taxes. Indeed, it appears that California's high cost of living and housing costs, particularly for middle- and lower-income residents, is playing a larger role in the decision to move into or out of the state.

Educational attainment levels of California's migrants provide perhaps some of the best insight into the underlying nuances of migration in the state. To illustrate, from 2007 to 2014, California residents 25 years of age and over with a bachelor's degree or higher had the lowest propensity to leave the state, with this demographic actually seeing a net inflow of nearly 52,700 domestic migrants over the period. In contrast, California residents who do not possess a bachelor's degree had the highest propensity to leave the state, with this demographic seeing a net outflow of over 469,800 domestic migrants over the period. This should not come as a surprise given that education is a primary driver in income disparities and the concentration of out-migrants in the lower-income categories.

California Net Domestic Migration by Personal Income, 2007 to 2014

Annual Income	Net Domestic Migration (000s)
Under $30,000	-458.9
$30,000 to $49,999	-43.1
$50,000 to $99,999	36.2
$100,000 to $149,999	13.4
Over $150,000	0.6
Total	-451.8

Note: Includes only persons that earned wages or salary.
Source: American Community Survey

The data on out-migration from California by occupation tells a similar story as when analyzed according to educational attainment and income levels. The vast

majority of outbound migrants were concentrated in lower-skilled, lower-paying fields—namely Sales, Office Administration, Transportation, and Food Preparation, which together accounted for a net outflow of over 192,700 domestic migrants over the period. In contrast, California continues to attract workers in high-skilled, high-wage fields like Computer/Mathematical, Healthcare Practitioners, Science, and Architecture/Engineering occupations, attracting 54,200 net inbound migrants.

These occupational patterns support the argument that high housing costs rather than income taxes are impeding positive net domestic migration to the state. Since California is a relatively progressive tax state in terms of income taxes, increases in the income tax burden are less likely to affect workers in low- and middle-wage occupations than those in higher-wage jobs. Yet, it was lower-wage and middle-wage workers who left the state in greater numbers while there was actually an influx of higher-wage workers.

Why are Californians Migrating?

Ultimately, the choice of where to live is one of consumption, and reflects a variety of preference factors. High housing costs have made California an increasingly difficult place for lower-income residents with less education to maintain their quality of life, while those with higher education in high-wage occupations continue to find the state an attractive place to live.

For years, California has suffered from a chronic undersupply of housing despite rising population and increased demand. For example, although home to more than 12% of the nation's population, California has consistently accounted for just 8% of residential permitting for almost twenty years. In fact, between 2007 and 2015, California accounted for just 9% of the new residential permits in the nation. The state simply has not built enough new housing to keep pace with its expanding population over the long term.

Indeed, the lack of permitting does not appear to be a demand issue. According to the California Association of Realtors, inventory levels averaged just over four months of supply in 2015 in California, while the nation overall saw inventory levels average over five months of supply. This means at the average rate of sales in 2015 the stock of available homes in California would dry up in just four months, while the stock of available homes in the nation overall would last five months.

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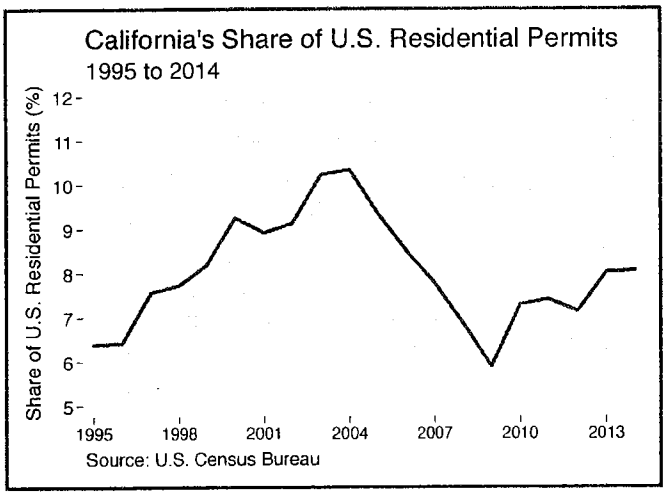


What's more, vacancy rates in California are well below the nation overall, where the homeowner vacancy rate was 1.9% in 2014, compared to just 1.1% in California. The story is similar for renters, with the rental vacancy rate at 7.6% in the United States overall compared to just 4.5% in California. This suggests homes in California are more in-demand relative to the nation overall.

Homes in California also tend to be more expensive than in other states. For example, homes in Austin (the most expensive metro area in Texas) sold for a median price of just over $261,000 in 2015, compared to nearly $395,000 in California as a whole, according to the National Association of Realtors. Prices are even higher near the coast with homes in the Bay Area selling for a median price of over $700,000 in 2015. This puts the dream of home ownership out of reach for many residents, especially for those who are not in high-wage occupations.

The rental market in California is also expensive compared to other metropolitan areas. According to REIS, the cost to rent an apartment in the United States averaged $1,227 in 2015, while the cost to rent in California's major job centers, like San Francisco ($2,557), San Jose ($2,109), Los Angeles ($1,602), and San Diego ($1,545), was well above this rate. With these figures, an individual opting to live in an area with rents near the national average could save over $10,000 annually compared to the San Francisco and San Jose areas.

It is important to note that these price differences are not just a result of California being a more desirable place to live relative to other areas. Our research suggests that a litany of fees, CEQA, NIMBYism, and the fact that Proposition 13 forces municipalities to look to permit and development related fees for revenue, all contribute to California's affordability issue. So, to solve the out-migration issue, the focus should be put on these roadblocks, rather than the state's personal income tax rate.

Based on the data, it appears that despite a high cost of living, individuals who can afford to live in California will. However, it is important to look closely at how affordability has impacted migration, and why it has been a persistent issue in California over the years.

International Migrants

Counter to the trends observed in domestic migration, California continues to be the most popular destination for international migrants. Between 2010 and 2015, 835,000 net international migrants moved into California – more than any other state during that period. New York (630,800), Florida (610,500), and Texas (463,400) have also been popular states for international migrants.

Furthermore, unlike patterns in domestic migration, the majority of international migrants moving into California earned very low incomes. More than 80% of migrants entering California between 2007 and 2014 earned less than $30,000 per year, which is not much different from international migrants entering in New York (78%), Florida (85%), or Texas (78%).

Despite earning low wages, many international migrants enter the nation with an advanced education. Approximately 33% of California's international migrants 25 years of age and above had obtained a bachelor's degree, similar to the rate in New York and greater than the 27% rate in both Florida and Texas. The majority of international migrants entering California with a bachelor's degree come from Asia.

Share of International Migration into California by Educational Attainment and by Region of Origin, 2007 to 2014

Educational Attainment	Africa	Asia	Australia	Canada	Europe	Mexico	South America
Less Than High School	32.5	37.1	34.3	29.6	30.8	71.4	57.7
High School Graduate	15.6	13.5	11.5	11.1	11.5	14.3	12.5
Some College	16.8	12.2	16.7	15.6	11.7	7.1	12.3
Bachelors Degree	22.3	22.4	24.6	22.2	19.6	3.5	11.5
Grad./Prof. Degree	12.8	14.8	13.0	21.4	26.5	3.8	6.0

Source: American Community Survey

Conclusion

Although California experienced a negative net domestic migration of 625,000 from 2007 to 2014, it appears that despite high housing costs and a high cost of living, individuals who can afford to live in California will and international migrants destined for the Unites States will continue to start their search for a better quality of life in California. This is in contrast to the common talking point that individuals are deciding to move from the state because of high personal income taxes. In fact, California has seen a net inflow of residents who earn over $50,000 annually, have bachelor's degrees and/or advanced degrees, and work in high-skilled occupations.

California still has plenty of room for improvement. The state's permitting rules and its building regulatory environment could be eased and streamlined to address California's real enemy: the high cost of housing. High housing costs have made California an increasingly difficult place for lower-income residents with less education to maintain their quality of life, while those with higher education and who work in high-wage occupations continue to find the state an attractive place to live.

Appendix

States with Negative Net Domestic Migration into California, 2007 to 2014

State	Net Domestic Migration (000s)
Texas	-212.6
Oregon	-96.2
Nevada	-95.2
Arizona	-90.3
Washington	-56.5
Colorado	-45.1
Oklahoma	-44.5
North Carolina	-31.9
Utah	-28.8
Georgia	-28.2
Idaho	-25.4
Tennessee	-18.4
Iowa	-12.1
Kansas	-12.1
Montana	-11.9
Virginia	-11.6
South Carolina	-11.1
New Mexico	-10.4
Indiana	-7.8
Nebraska	-7.4
Arkansas	-7.3
Wyoming	-6.4
South Dakota	-5.2
Hawaii	-4.3
Missouri	-2.8
New Hampshire	-2.8
Kentucky	-2.5
Vermont	-2.4
Maine	-2.3
Delaware	-1.3
North Dakota	-1.2
Mississippi	-0.6
Rhode Island	-0.4
Louisiana	-0.1

Source: American Community Survey

States with Positive Net Domestic Migration into California, 2007 to 2014

State	Net Domestic Migration (000s)
New York	46.5
Illinois	41.4
Michigan	29.7
New Jersey	27.8
Alaska	20.7
Florida	18.0
Pennsylvania	18.0
Connecticut	10.2
Maryland	7.3
Wisconsin	6.4
Minnesota	5.1
Massachusetts	5.0
Ohio	4.4
Alabama	2.2
District of Columbia	1.0
West Virginia	0.6

Source: American Community Survey

California Net Domestic Migration by Occupation, 2007 to 2014

Occupation	Net Domestic Migration (000s)
Computer/Mathematical	18.0
Healthcare Practicioners	17.1
Arts/Entertainment	15.2
Science	11.7
Architecture/Engineering	7.4
Legal	1.6
Farm./Fish./Forrestry	-1.8
Business/Financial	-6.7
Military	-6.7
Protective Service	-11.6
Community/Social Service	-13.2
Personal Care	-13.2
Healthcare Support	-16.3
Install./Maint./Repair	-18.2
Management	-20.6
Education	-22.2
Cleaning/Grounds Keeping	-27.8
Construction	-39.4
Production	-41.1
Food Prep./Serving	-41.3
Office/Administrative	-45.4
Transportation	-46.7
Sales	-59.3
Total	-360.5

Note: Includes only persons that were in the labor force.
Source: American Community Survey

California Net Domestic Migration by Personal Income, 2007 to 2014

Annual Income	Net Domestic Migration (000s)
Under $10,000	-329.3
$10,000 to $19,999	-74.0
$20,000 to $29,999	-55.6
$30,000 to $39,999	-27.2
$40,000 to $49,999	-15.9
$50,000 to $74,999	20.2
$75,000 to $99,999	16.1
$100,000 to $149,999	13.4
$150,000 to $199,999	-2.0
$200,000 to $250,000	9.0
Over $250,000	-6.5
Total	-451.8

Note: Includes only persons that earned wages or salary.
Source: American Community Survey

California Net Domestic Migration by Education, 2007 to 2014

Educational Attainment	Net Domestic Migration (000s)
Less Than High School	-192.4
High School Graduate	-111.6
Some College	-165.8
Bachelors Degree	11.8
Grad./Prof. Degree	40.9
Total	-417.1

Note: Includes only persons 25 years of age and over.
Source: American Community Survey

California Net Domestic Migration by Age, 2007 to 2014

Age	Net Domestic Migration (000s)
Under 18	-205.4
18 to 25	-4.5
26 to 40	-141.2
41 to 50	-110.9
51 to 65	-140.5
Over 65	-22.6
Total	-625.0

Source: American Community Survey

Document 16

California's High Housing Costs

Causes and Consequences

MAC TAYLOR • LEGISLATIVE ANALYST • MARCH 17, 2015

LAO

EXECUTIVE SUMMARY

California's Home Prices and Rents Higher Than Just About Anywhere Else. Housing in California has long been more expensive than most of the rest of the country. Beginning in about 1970, however, the gap between California's home prices and those in the rest country started to widen. Between 1970 and 1980, California home prices went from 30 percent above U.S. levels to more than 80 percent higher. This trend has continued. Today, an average California home costs $440,000, about two-and-a-half times the average national home price ($180,000). Also, California's average monthly rent is about $1,240, 50 percent higher than the rest of the country ($840 per month).

Building Less Housing Than People Demand Drives High Housing Costs. California is a desirable place to live. Yet not enough housing exists in the state's major coastal communities to accommodate all of the households that want to live there. In these areas, community resistance to housing, environmental policies, lack of fiscal incentives for local governments to approve housing, and limited land constrains new housing construction. A shortage of housing along California's coast means households wishing to live there compete for limited housing. This competition bids up home prices and rents. Some people who find California's coast unaffordable turn instead to California's inland communities, causing prices there to rise as well. In addition to a shortage of housing, high land and construction costs also play some role in high housing prices.

High Housing Costs Problematic for Households and the State's Economy. Amid high housing costs, many households make serious trade-offs to afford living here. Households with low incomes, in particular, spend much more of their income on housing. High home prices here also push homeownership out of reach for many. Faced with expensive housing options, workers in California's coastal communities commute 10 percent further each day than commuters elsewhere, largely because limited housing options exist near major job centers. Californians are also four times more likely to live in crowded housing. And, finally, the state's high housing costs make California a less attractive place to call home, making it more difficult for companies to hire and retain qualified employees, likely preventing the state's economy from meeting its full potential.

Recognize Targeted Role of Affordable Housing Programs. In recent decades, the state has approached the problem of housing affordability for low-income Californians and those with unmet housing needs primarily by subsidizing the construction of affordable housing through bond funds, tax credits, and other resources. Because these programs have historically accounted for only a small share of all new housing built each year, they alone could not meet the housing needs we identify in this report. For this reason, we advise the Legislature to consider how targeted programs that assist those with limited access to market rate housing could supplement broader changes that facilitate more private housing construction.

More Private Housing Construction in Coastal Urban Areas. We advise the Legislature to change policies to facilitate significantly more private home and apartment building in California's coastal urban areas. Though the exact number of new housing units California needs to build is

uncertain, the general magnitude is enormous. On top of the 100,000 to 140,000 housing units California is expected to build each year, the state probably would have to build as many as 100,000 additional units annually—almost exclusively in its coastal communities—to seriously mitigate its problems with housing affordability. Facilitating additional housing of this magnitude will be extremely difficult. It could place strains on the state's infrastructure and natural resources and alter the prized character of California's coastal communities. It also would require the state to make changes to a broad range of policies that affect housing supply directly or indirectly—including policies that have been fundamental tenets of California government for many years.

INTRODUCTION

Living in decent, affordable, and reasonably located housing is one of the most important determinants of well-being for every Californian. More than just basic shelter, housing affects our lives in other important ways, determining our access to work, education, recreation, and shopping. The cost and availability of housing also matters for the state's economy, affecting the ability of businesses and other employers to hire and retain qualified workers and influencing their decisions about whether to locate, expand, or remain in California.

Unfortunately, housing in California is extremely expensive. Many households struggle to find housing that is affordable and meets their needs. Amid this challenge, many households make serious trade-offs in order to live here. Because of the important role housing plays in the lives of Californians, the state's high housing costs are a major ongoing concern for state and local policy makers.

The purpose of this report is to provide the Legislature an overview of the state's complex and expensive housing markets, encompassing both single-family homes and multi-family apartments. We pay particular attention to identifying what has caused housing prices to increase so quickly in recent decades, and provide information to assist the Legislature in making decisions that will affect the future performance of the state's housing markets. The report covers four main questions:

- How expensive is housing in California?
- What has caused housing prices to increase so quickly over the past several decades and what would it take to moderate this trend?
- What are the consequences of California's high housing costs on the state's households and the economy generally?
- What steps should the Legislature take in the near term as it considers how to address the state's high housing costs?

High Housing Costs Are Not California's Only Housing Challenge. Though this report focuses on high housing costs, California also faces other significant housing challenges meriting legislative consideration, including: (1) facilitating housing options for the state's homeless individuals and families; (2) mitigating adverse health effects related to living in substandard housing or housing near sources of pollution; and (3) removing noneconomic barriers to housing, such as race, ethnicity, gender, and disability status. These challenges are beyond the scope of this report. However, addressing the state's high housing costs, as a broad goal, could help mitigate other housing-related problems and thus improve the lives of many Californians.

Information Online. Additional information on housing in California will be posted on our California Economy and Taxes blog (www.lao.ca.gov/LAOEconTax) in the days following this report's release.

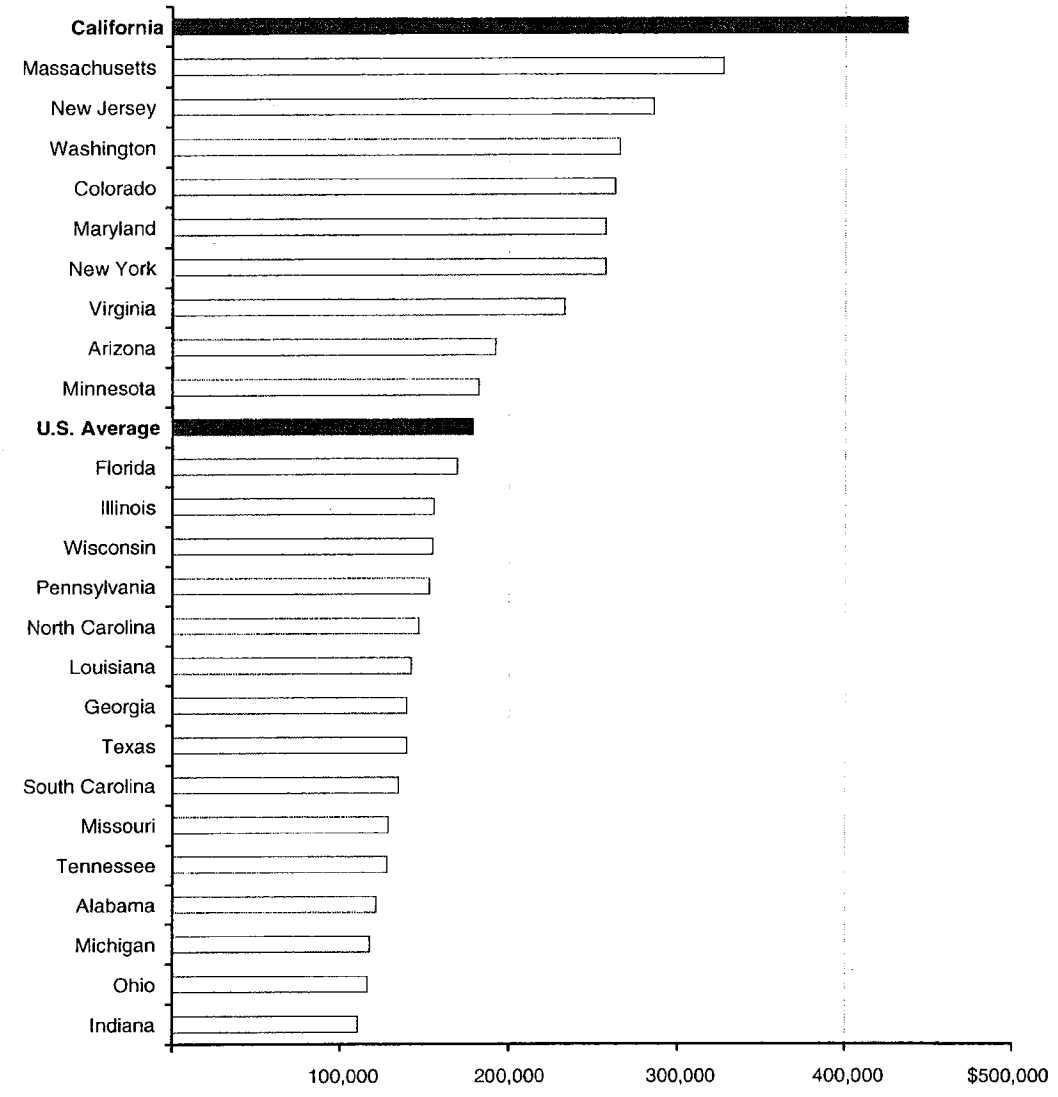
HOW EXPENSIVE IS HOUSING IN CALIFORNIA?

Housing Is More Expensive in California Than Just About Anywhere Else. As shown in Figure 1 (see next page), home prices in California are much higher than they are in other large states. (Among all states, only Hawaii is more expensive, on average, than California.) As of early-2015, the

Figure 1

Home Prices Higher in California Than in Other Large States[a]

Median Home Value, January 2015



[a] Figure shows largest 25 states according to population.

typical California home cost $437,000, more than double the typical U.S. home ($179,000). California renters also face higher costs. In 2013, median monthly in California was $1,240, nearly 50 percent more than the national average.

Home Prices and Rents Vary Widely Within California. In a state as large and economically diverse as California, some areas have much higher home prices and rents (and other areas much lower) than the statewide average. As shown in

Figure 2 (see next page), for example, home prices in California's most expensive metropolitan area (or "metro"), San Francisco, are more than double the state average and about six times higher than Bakersfield, the state's least expensive metro. (Throughout our report we use the U.S. census definitions of metropolitan areas—or metros. Census metros are comprised of counties—or, in some cases, a single county—that share similar socio-economic characteristics and surround a common urban core.) Rents vary throughout the state as well. The average monthly rent for a two-bedroom apartment in San Francisco ($2,000) was two and a half times greater than the average in Fresno or Bakersfield (both about $800).

Even California's Least Expensive Housing Markets Are More Expensive Than Average. Single-family home prices and apartment rents in less costly areas of the state, such as Fresno and Bakersfield, though considered inexpensive by California standards, are about average compared with the rest of the country. Each of the state's other major metros are well-above the rest of nation, even California's other major inland metros, Riverside-San Bernardino and Sacramento.

California's Home Prices and Rents Have Risen Faster Than U.S. Average Since the 1940s. Figure 3 (see page 9) shows how average U.S. and California home prices have changed over time. In 1940, the average California home cost about 20 percent more than the average U.S. home. By the end of the 1940s, the state's home prices were 30 percent higher than average. Over the next 20 years—1950 through 1970—California home prices increased about as quickly as the national average. Beginning in about 1970, however, home prices throughout the state began to accelerate. Prices were 80 percent above U.S. levels by 1980, and by 2010, the typical California home was twice as expensive as the typical U.S. home. As of 2015, average California home prices were two-and-a-half times higher than average national home prices.

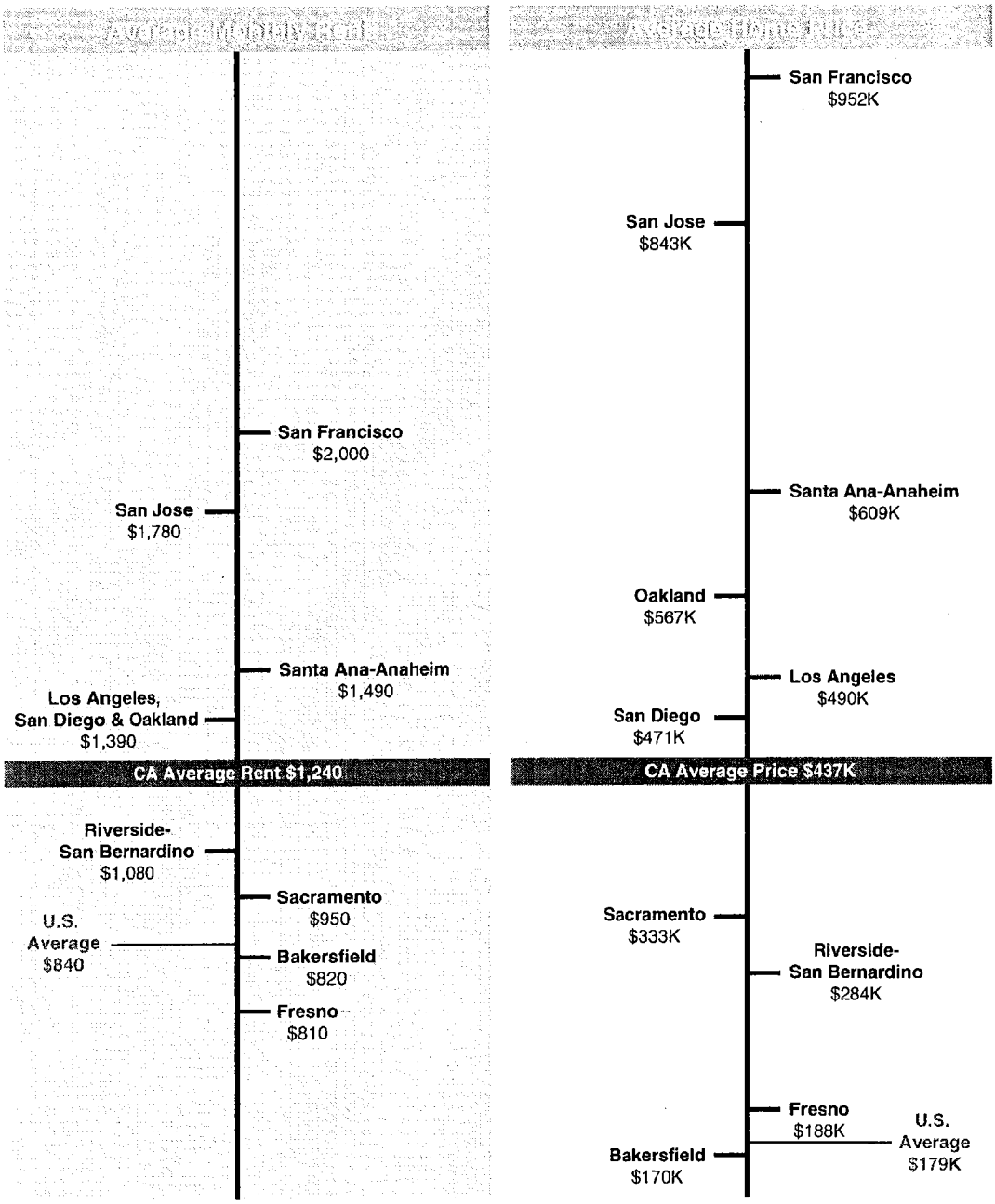
Many Households Have Difficulty Affording Housing in California. As we describe in more detail later in this report, California's high housing costs force many households to make serious trade-offs. In most instances, these trade-offs are particularly challenging for households with low incomes. Notable and widespread trade-offs include (1) spending a greater share of their income on housing, (2) postponing or foregoing homeownership, (3) living in more crowded housing, (4) commuting further to work each day, and (5) in some cases, choosing to work and live elsewhere.

Government Housing Programs Ease Housing Costs for Some. Federal, state, and local government housing programs generally work in one of two ways, by: (1) increasing the supply of moderately priced housing or (2) reducing housing costs for some households.

- ***Programs That Build New Housing.*** Federal, state, and local governments provide direct financial assistance—typically tax credits, grants, or low-cost loans—to housing developers for the construction of new rental housing. In exchange, developers reserve these units for lower-income households. (Until recently, local redevelopment agencies also provided this type of financial assistance.) Data suggests these programs together have subsidized the new construction of about 7,000 rental units annually in the state—or about 5 percent of total public and private housing construction—since the mid-1980s. In addition to direct subsidies, some local governments increase the supply of affordable housing by requiring developers of market-rate housing to set

Figure 2

California's Housing Prices Vary, but Most Are Well Above U.S. Levels



Note: Rents based on 2013 American Community Survey. Prices reflect Zillow data, January, 2015.

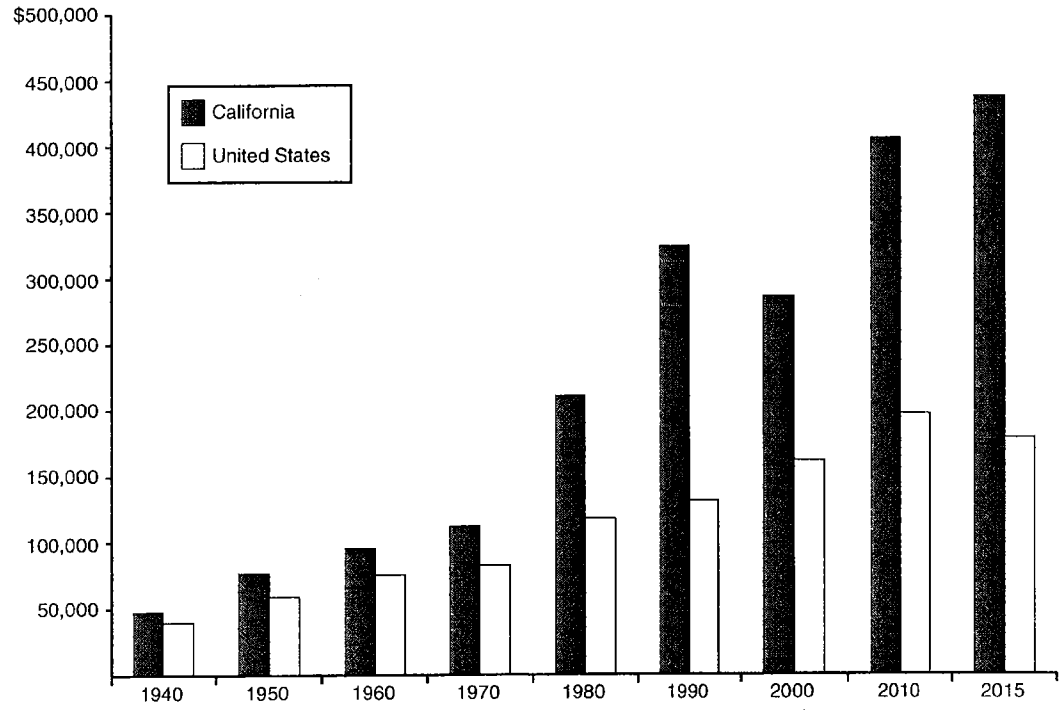
aside some of the units they are building for low- and moderate-income households, a policy called "inclusionary housing."

- ***Programs That Help Households Afford Housing.*** In addition to constructing new housing, governments have also taken steps to make existing housing more affordable. In some cases, the federal government makes payments to landlords—known as housing vouchers—on behalf of low-income tenants for a portion of a rental unit's monthly cost. About 400,000 California households receive this type of housing assistance. In other cases, local governments limit how much landlords can increase rents each year for existing tenants. About 15 California cities have these so-called rent controls, including Los Angeles, San Francisco, San Jose, and Oakland.

Figure 3

California Home Prices Have Grown Much Faster Than U.S. Prices

Inflation-Adjusted Median Home Prices in 2015 Dollars



WHY IS HOUSING EXPENSIVE IN CALIFORNIA?

A collection of factors drive California's high cost of housing. First and foremost, far less housing has been built in California's coastal areas than people demand. As a result, households bid up the cost of housing in coastal regions. In addition, some of the unmet demand to live in coastal areas spills over into inland California, driving up prices there too. Second, land in California's coastal areas is expensive. Homebuilders typically respond to high land costs by building more housing units on each plot of land they develop, effectively spreading the high land costs among more units. In California's coastal metros, however, this response has been limited, meaning higher land costs have translated more directly into higher housing costs. Finally, builders' costs—for labor, required building materials, and government fees—are higher in California than in other states. While these higher building costs contribute to higher prices throughout the state, building costs appear to play a smaller role in explaining high housing costs in coastal areas. This section describes how each of these factors increase home prices and rents in California.

Building Less Housing Than People Demand Drives High Housing Costs

California Is Building Too Little Housing in Coastal Areas. California is a very desirable place to live, with temperate weather, long stretches of coastline, and highly educated and culturally diverse economic centers. Many households wish to live in California. However, some of California's most sought after locations—its major coastal metros (Los Angeles, Oakland, San Diego, San Francisco, San Jose, and Santa Ana-Anaheim), where around two-thirds of Californians live—do not have sufficient housing to accommodate all of the households that want to live here. The lack of housing on the California coast means households wishing to live there compete for limited housing. This competition bids up housing costs.

Rising home prices and rents are a signal that more households would like to live in an area than there is housing to accommodate them. Housing developers typically respond to this excess demand by building additional housing. This does not appear to be true, however, in California's coastal metros. Building activity during the recent housing boom demonstrates this. During the mid-2000s, housing prices were rising throughout the country and, in most locations, developers responded with additional building. As Figure 4 shows, however, new housing construction, as measured by building permits issued by local officials, remained flat in California's coastal metros. We also find that building activity in California's coastal metros has been significantly lower than in metros outside of California that have similar desirable characteristics—such as temperate weather, coastal proximity, and economic growth—and, therefore, likely have similar demand for housing. For example, Seattle—a coastal metro with economic characteristics and average temperatures that are similar to California's Bay Area metros—added new housing units at about twice the rate as San Francisco and San Jose over the last two decades. (Specifically, Seattle's housing stock—its total number of housing units—grew at an average annual rate of 1.4 percent per year while San Francisco and San Jose's housing stock grew by only 0.7 percent per year.)

Between 1980 and 2010, construction of new housing units in California's coastal metros was low by national and historical standards. During this 30-year period, the number of housing units in the typical U.S. metro grew by 54 percent, compared with 32 percent for the state's coastal metros. Home building was even slower in Los Angeles and San

Francisco, where the housing stock grew by only around 20 percent. As Figure 5 shows, this rate of housing growth along the state's coast also is low by California historical standards. During an earlier 30-year period (1940 to 1970), the number of housing units in California's coastal metros grew by 200 percent.

Jump in California Housing Costs Occurred as Building Slowed. A look at housing costs in California's coastal metros in recent decades shows a connection between the slow rate of building and higher housing costs. The slowdown in building in California's coastal metros corresponded with a substantial rise in housing costs relative to the rest of the country. In 1970, home prices in the

Figure 4
Housing Construction on California Coast Was Flat During National Housing Boom
Average Number of Building Permits in Major Metros

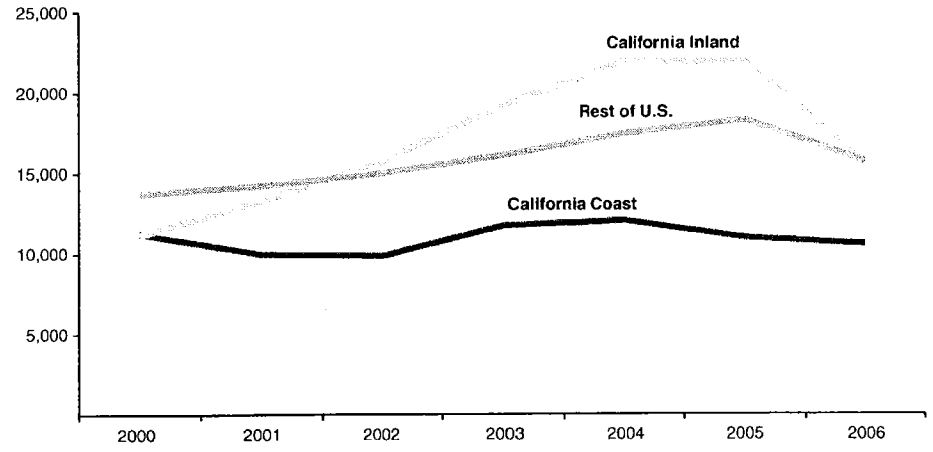
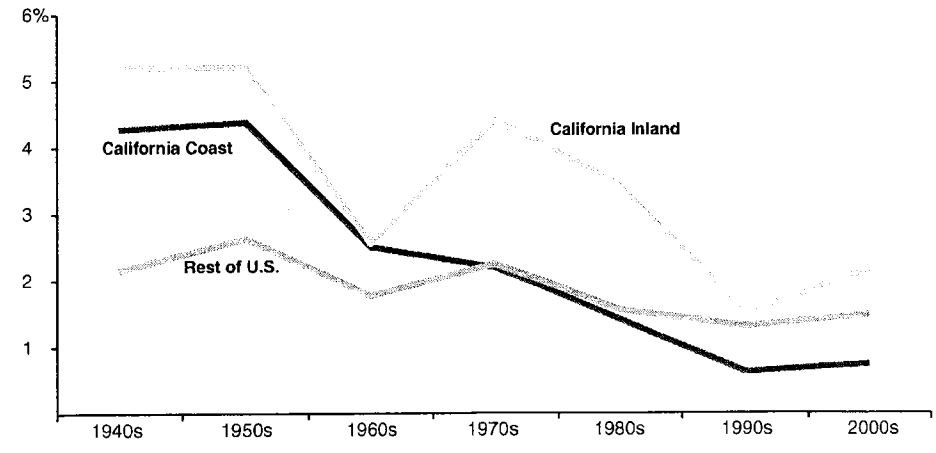


Figure 5
Housing Construction Has Slowed in California's Coastal Metros
Annual Growth in Housing Units in Major Metros



state's coastal metros were about 50 percent more expensive than in the rest of the country. This gap has widened considerably since that time. Homes in the coastal metros are now more than three times more expensive than the rest of the country. Similarly, rents have grown more expensive, with the gap between the coastal metros and the rest of the country increasing threefold since 1970 (from 16 percent more expensive to around 50 percent more expensive).

Link Between Development and Housing Costs Exists Elsewhere Too. The same relationship between growth of housing supply and housing costs exists throughout the country, suggesting that what has occurred in California is not coincidental. Looking broadly at major metropolitan counties (counties comprising metros with a population of 500,000 or greater) throughout the country, places with slower housing growth generally have more expensive housing. Based on U.S. Census data, the median home price in 2010 was just over $300,000 in the fifth of counties that grew the slowest between 1980-2010, compared with $195,000 in the fifth of counties that grew the fastest.

Our review indicates that that the relationship between growth of housing supply and increased housing costs is complex and affected by other factors—such as demographics, local economies, and weather. Nonetheless, using common statistical techniques to account for the influence of these other factors, there remains a strong relationship between home building and prices. For example, our analysis suggests that—after controlling for other factors—if a county with a home building rate in the bottom fifth of all counties during the 2000s had instead been among the top fifth, its median home price in 2010 would have been roughly 25 percent lower. Similarly, its median rent would have been roughly 10 percent lower.

Spillover of Demand to Live on the Coast Affects Housing Costs in Inland California. In contrast to the coast, more home building has occurred in California's inland metros (Bakersfield, Fresno, Riverside-San Bernardino, and Sacramento) than typical U.S. metros. California's inland metros added housing at about twice the rate of the typical U.S. metro between 1980 and 2010. Yet housing costs in much of inland California are above average relative to the rest of the country. High housing costs in the state's inland metros appear to result largely from their proximity to California's coast. Some households and businesses that want to locate on California's coast but find housing too expensive there locate in California's inland metros instead. This displaced demand places pressure on inland housing markets and results in higher home prices and rents there. Examining the relationship between housing costs in neighboring counties throughout the country using U.S. Census data from 1980 and 2010, we find that this spillover effect is substantial. Our analysis suggests that—after accounting for a variety of other factors that can affect housing costs—a 10 percent increase in housing costs in a county is associated with a roughly 5 percent increase in housing costs in its neighboring counties.

High Land Costs and Low Density Development Make Housing Expensive

Land Costs Are High on the California Coast. Land prices on the California coast are among the highest in the country. In contrast, land prices in inland California typically are at or below the national average. Comparing land prices across metropolitan areas can be difficult, largely due to data limitations. Nonetheless, several estimates of land values are available in the economics literature and they find that land is considerably more expensive on California's coast. One analysis of land sales between 2005 and 2010 found that land prices in California's metros ranged from twice as expensive as the average U.S. metro (Oakland and San Diego) to more than four times as expensive (San Francisco). We also examined existing data to better understand

the value of single-family home lots in different areas. Using American Housing Survey data from 2011, we found an even greater divergence between California and the rest of the country. Residential land in an average U.S. metro was valued at around $20,000 per acre, compared with over $150,000 in California's coastal metros. Land values were highest in San Francisco, where an acre of land was valued at nearly $400,000.

High Land Costs Can Be Offset Through Dense Development. Although high land costs can translate into higher home prices and rents, it is possible to offset the effects of high land costs through more dense development. (The density of housing refers to the number of housing units per unit of land—typically measured in units per acre. Higher-density housing, such as an apartment building, has more housing units per acre.) Building more units on the same plot of land allows a developer to spread land costs across more units, lessening the impact of land costs on the cost of each unit. This is because land costs are fixed and do not increase if a developer builds additional units. For example, if a developer builds five homes on a plot of land that costs $100,000, the land cost per unit is $20,000. Alternatively, if the developer builds ten homes on the same plot of land, the land cost per unit is only $10,000. Builders faced with high land costs, therefore, generally will build more dense housing. When this occurs, the effect of high land costs on home prices and rents is reduced.

Little Increase in Housing Densities in Coastal Metros. While developers typically respond to high land costs by building more dense housing, this response appears to be somewhat limited in most of California's coastal metros. As a result, high land costs in these areas have translated more directly into higher housing costs. We examined U.S. Census data to compare changes in housing densities during the 2000s in California's coastal metros to changes in metros elsewhere in the country. Our initial review of California's coastal metros found that housing densities rose significantly faster in San Francisco than the other California coastal metros, which is unsurprising given that San Francisco's land prices are higher than just about anywhere else in the U.S. Because San Francisco appeared to be exceptional, we focused the rest of our review on California's other coastal metros. We compared changes in density in these other California coastal metros with metros that have land prices and existing housing densities similar to those found on California's coast. We selected Boston, Las Vegas, Miami, Seattle, and Washington D.C. as our comparison group of metros. Our review found that, during the 2000s, the housing density of a typical neighborhood in California's coastal metros rose by 4 percent. This increase in density was considerably less than the 11 percent average increase in our comparison group. Furthermore, we estimate that the new housing built in these comparison metros was about 40 percent more dense than housing built in California's coastal metros. New housing in the comparison metros had an average density of about 14 units per acre, compared with about ten units per acre in California's coastal metros.

Building Costs Increase Housing Costs

Building Costs Are Higher in California. Aside from the cost of land, three factors determine developers' cost to build housing: labor, materials, and government fees. All three of these components are higher in California than in the rest of the country. Construction labor is about 20 percent more expensive in California metros than in the rest of the country. California's building codes and standards also are considered more comprehensive and prescriptive, often requiring more expensive materials and labor. For example, the state requires builders to use higher quality building materials—such as windows, insulation, and heating and cooling systems—to achieve certain energy efficiency goals.

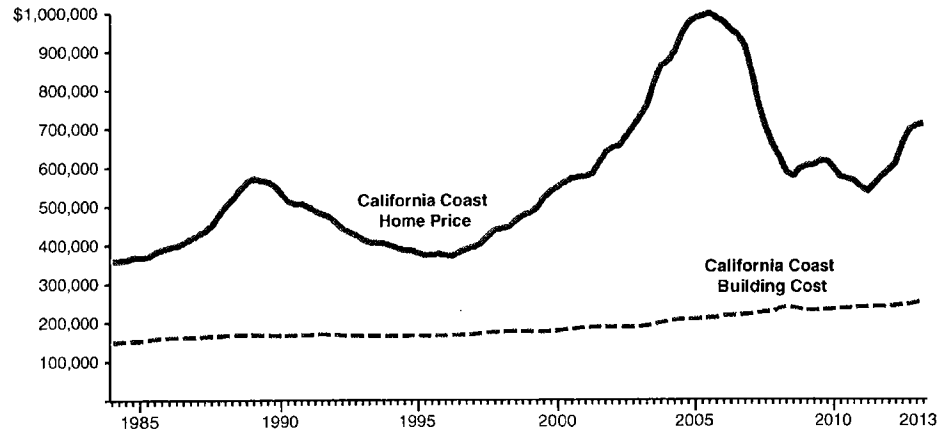
Additionally, development fees—charges levied on builders as a condition of development—are higher in California than the rest of the country. A 2012 national survey found that the average development fee levied by California local governments (excluding water-related fees) was just over $22,000 per single-family home compared with about $6,000 per single-family home in the rest of the country. (This survey reflects school facilities fees imposed during this period and not the higher so-called "Level 3" fees that school districts may impose in the future if the State Allocation Board makes certain declarations about the availability of school construction funds.) Altogether, the cost of building a typical single-family home in California's metros likely is between $50,000 and $75,000 higher than in the rest of the country.

Effect of Building Costs on Prices and Rents Varies Across Regions of the State. Higher building costs contribute to higher housing costs throughout the state. The relationship between building costs and prices and rents, however, differs across inland and coastal areas of the state. In places where housing is relatively abundant, such as much of inland California, building costs generally determine housing costs. This is because landlords and home sellers compete for tenants and homebuyers. This competition benefits renters and prospective homebuyers by depressing prices and rents, keeping them close to building costs. In these types of housing markets, building costs account for the vast majority of home prices. In two major inland metros—Riverside-San Bernardino and Sacramento—building costs account for over fourth-fifths of home prices. In contrast, in coastal California, the opposite is true. Renters and home buyers compete for a limited number of apartments and homes, bidding up prices far in excess of building costs. Building costs account for around one-third of home prices in California's coastal metros. Under these circumstances, as Figure 6 shows, building costs explain only a small portion of growth in housing costs. Instead, increasing competition for limited housing is the primary driver of housing cost growth in coastal California.

Figure 6

Home Prices on California Coast Have Risen Much Faster Than Construction Costs

Prices and Building Costs of Median Homes in Major Metros, 2014 dollars



WHY DO COASTAL AREAS NOT BUILD ENOUGH HOUSING?

As we discussed in the last section, California's home prices and rents have risen because housing developers in California's coastal areas have not responded to economic signals to increase the supply of housing and build housing at higher densities. A collection of factors inhibit developers from doing so. The most significant factors are:

- ***Community Resistance to New Housing.*** Local communities make most decisions about housing development. Because of the importance of cities and counties in determining development patterns, how local residents feel about new housing is important. When residents are concerned about new housing, they can use the community's land use authority to slow or stop housing from being built or require it to be built at lower densities.

- ***Environmental Reviews Can Be Used to Stop or Limit Housing Development.*** The California Environmental Quality Act (CEQA) requires local governments to conduct a detailed review of the potential environmental effects of new housing construction (and most other types of development) prior to approving it. The information in these reports sometimes results in the city or county denying proposals to develop housing or approving fewer housing units than the developer proposed. In addition, CEQA's complicated procedural requirements give development opponents significant opportunities to continue challenging housing projects after local governments have approved them.

- ***Local Finance Structure Favors Nonresidential Development.*** California's local government finance structure typically gives cities and counties greater fiscal incentives to approve nonresidential development or lower density housing development. Consequently, many cities and counties have oriented their land use planning and approval processes disproportionately towards these types of developments.

- ***Limited Vacant Developable Land.*** Vacant land suitable for development in California coastal metros is extremely limited. This scarcity of land makes it more difficult for developers to find sites to build new housing.

We discuss these factors in more detail below.

Community Resistance Is Heightened

Local Communities Make Most Decisions About New Housing. Cities and counties generally decide when, where, and to what extent housing development will occur (cities make these decisions within their boundaries and counties in unincorporated areas). Local zoning laws and building codes specify where housing may be built, as well as its density, quality, and style. Housing developers are required to obtain building permits from city and county planning departments and typically must gain approval from local planning commissions and city councils or county boards of supervisors. Cities and counties also prepare General Plans that shape their communities' long-term development patterns.

Local Resident Concerns About New Housing Are Common Throughout the U.S. In general, many potential or perceived downsides of new housing accrue to existing residents, while many of the benefits of new housing accrue to future residents. As a result, existing residents sometimes take steps to slow or stop development.

There are many possible reasons residents may be hesitant about new housing. Some residents may see new housing as a threat to their financial wellbeing. For many homeowners, their home is their most significant financial investment. Existing homeowners, therefore, may be inclined to limit new housing because they fear it will reduce the values of the homes.

Residents also may feel that new housing reduces their nonfinancial wellbeing. Many people, as they become accustomed to their lifestyle and the character of their neighborhood, naturally are hesitant about change and future unknowns. It is unsurprising then that they would be concerned about adding new housing to their community because it presents uncertainty and possibilities of change. Expanded development can strain existing infrastructure—such as streets and roads, schools, and parks—requiring residents to change the way they use these public goods. For example, new development may increase traffic on existing streets and roads, forcing some residents who commute via car to take public transportation instead. Strains on existing infrastructure also may require state and local governments to make new investments in infrastructure to expand capacity. New housing also can alter the character of a community, shifting it from a rural to an urban setting or from a traditional single-family home neighborhood to a neighborhood with a mix of densities and land uses. In addition, new housing can place strains on natural and environmental resources, in some instances making it more difficult to ensure adequate air and water quality or to protect natural ecosystems.

Opposition to New Housing Appears to Be Heightened on the California Coast. Hesitance about new housing can lead residents to pressure local officials to use their land use authority to slow or block new development or may result in residents directly intervening in land use decisions via the initiative and referendum process. Compared with the rest of the country, these types of activities appear to occur more often in California's coastal communities, suggesting that community opposition to housing is heightened in these areas.

Many Coastal Communities Have Growth Controls. Over two-thirds of cities and counties in California's coastal metros have adopted policies (known as growth controls) explicitly aimed at limiting housing growth. Many policies directly limit growth—for example, by capping the number of new homes that may be built in a given year or limiting building heights and densities. Other policies indirectly limit growth—for example, by requiring a supermajority of local boards to approve housing projects. Research has found that these policies have been effective at limiting growth and consequently increasing housing costs. One study of growth controls enacted by California cities found that each additional growth control policy a community added was associated with a 3 percent to 5 percent increase in home prices.

Project Reviews Along Coast Often Are Slow and Cumbersome. Cities and counties often require housing projects to go through multiple layers of review prior to approval. For example, a project may require independent review by a building department, health department, fire department, planning commission, and city council. Each layer of review can increase project approval time. Additional complexity in review processes also creates avenues for concerned residents to slow building or reduce its size and scope, as the story in the nearby box shows. One

survey of city and county officials nationwide suggests that communities in California's coastal metros take about two and a half months longer, on average, to issue a building permit than in a typical California inland community or the typical U.S. metro (seven months compared to four and a half months). Divergence from the rest of the country was more significant in some communities—for example, typical approval time was over a year in San Francisco and over eight months in the City of Los Angeles. If a project required a change in local zoning laws—as is common among large projects—approval time was much longer. The average time to approve a rezoning was just under a year in California's coastal metros, about three months longer than in a typical California inland community or a typical U.S. metro. Researchers have linked additional review time to higher housing costs. A study of jurisdictions in the Bay Area found that each additional layer of independent review was associated with a 4 percent increase in a jurisdiction's home prices.

Local Ballot Measures on Coast Have Limited Development. Many significant land use decisions in California's coastal communities are made by voters. More often than not, voters in California's coastal communities vote to limit housing development when given the option. Our review of local elections data between 1995-2011 found that voters in California's coastal metros took a position that limited housing growth—either by voting "yes" for a measure constraining growth or voting "no" for a measure that would allow growth—about 55 percent of the time. On average, coastal communities as a whole approved five measures per year limiting housing growth (or rejected measures allowing new building). While most major local jurisdictions throughout the country have some form of an initiative and referendum process, California's high degree of voter involvement in land use decisions appears to be unique. One review of election results across the country during the November 2000 election found that just under half of all measures related to land use planning and growth management were in California.

Community Challenged Recent Housing Project in Southern California

The story of a housing project in an expensive area of Southern California—according to various media reports—shows the potential effects of community resistance on housing development. In 2008, a Southern California local government approved construction of a condo tower in its jurisdiction. Following the approval, a local homeowner's association filed a lawsuit attempting to overturn the approval on grounds that the project was too far out of compliance with the city's land use standards. During the lawsuit, which lasted around two years, the developer defaulted on its loan for the project site and plans for development were abandoned. In 2011, a second developer purchased the project site and continued efforts to build a condo tower. The project was completed in 2014. However, in late 2014, in response to a second lawsuit from the local homeowner's association, a judge ruled the project's building permits were invalid because the developers had failed to preserve a historical building on the project site. As a result, some households were prevented from moving into the completed condos. At the time this report was prepared (early 2015), this issue has not been resolved.

Why Is Community Resistance to New Housing Heightened on California Coast? A collection of factors come together on the California coast to create a particularly heightened level of community resistance to new housing. High demand to live on California's coast results in constant pressure for additional housing. At the same time, residents of California's coast have much at stake in decisions about housing growth, as their communities have very high home values and desirable natural amenities. As a result, residents often push back against proposals for new housing. In addition, there is very little vacant land for new housing, meaning that development often takes the form of redevelopment in established neighborhoods. Redevelopment changes these neighborhoods, creating additional concerns for existing residents.

CEQA Can Be Used to Delay or Reduce Building Activity

CEQA Requires Environmental Review for New Housing. CEQA was enacted in 1970 in order to ensure that state and local agencies consider the environmental impact of their decisions when approving a public or private project. Under CEQA, before approving new housing (or other development), cities and counties usually must conduct a preliminary analysis to determine whether a project may have significant adverse environmental impacts. If it is determined that a project might create significant impacts, then an environmental impact report (EIR) must be prepared. An EIR provides detailed information about a project's likely effect on the environment, considers ways to mitigate significant adverse environmental effects, and examines alternatives to the project. Where an EIR finds that a project will have significant adverse environmental impacts, a city or county is prohibited from approving the project unless one of the following two conditions is met: (1) the project developer makes modifications that substantially lessen the adverse environmental effects or (2) the city or county finds that economic or other project benefits override the adverse environmental effects. This level of environmental review for private housing development is uncommon among U.S. states. Only four other states have comparable requirements.

CEQA Can Be Used to Reduce New Housing Development. The CEQA process can provide valuable information to decision makers and help to avoid unnecessary environmental impacts. The CEQA review process also provides many opportunities for opponents to raise concerns regarding a project's potential effects on a wide array of matters, including parking, traffic, air and water quality, endangered species, and historical site preservation. A project cannot move forward until all concerns are addressed, either through mitigation or with a determination by elected officials that benefits of the project outweigh the costs. In addition, after a local governing board approves a project, opponents may file a lawsuit challenging the validity of the CEQA review. As a result of these factors, CEQA review can be time consuming for developers. Our review of CEQA documents submitted to the state by California's ten largest cites between 2004-2013 indicates that local agencies took, on average, around two and a half years to approve housing projects that required an EIR. The CEQA process also, in some cases, results in developers reducing the size and scope of a project in response to concerns discovered during the review process.

Limited Local Government Fiscal Incentive to Approve Housing Development

Local Governments Weigh Fiscal Impacts of Land Use Decisions. When property is developed, communities usually:

- ***Receive Increased Tax Revenues.*** Many developments, for example, generate increased property and/or sales tax revenues for the communities in which they are located.

- ***Face Increased Demand for Public Services and Infrastructure.*** For example, developments can trigger increased demand for local governments to provide police and fire services to new residents or to expand streets and roads to accommodate increased vehicle traffic.

Because different types of developments yield different amounts of tax revenues and service demands, local governments throughout the nation commonly examine these fiscal effects when considering new developments or planning for future development. As a matter of fiscal prudence, development that does not generate sufficient revenues to fund a local government's new costs often is revised or rejected.

California Communities Often Benefit More From Commercial Development. In California, cities and counties typically find that commercial developments—particularly major retail establishments, auto malls, restaurants, and hotels—yield the highest net fiscal benefits. This is because the increased sales and hotel tax revenue that a city (or, in the case of a development in an unincorporated area, the county) receives from these developments often more than offsets the local government's costs to provide them public services. As a result, cities and counties often encourage these types of commercial developments to locate within their jurisdictions—for example by zoning large sections of land for these purposes and by offering subsidies or other benefits to the prospective business owners.

In contrast, many California cities and counties find that housing developments lead to more local costs than offsetting tax revenues. This is because these properties do not produce sales or hotel tax revenues directly and the state's cities and counties typically receive only a small portion of the revenue collected from the property tax. In addition, lower-density luxury housing often "pencils out" more favorably from a local government standpoint than higher-density moderate cost housing. This is because the luxury housing generates higher levels of property tax revenues per new resident.

Not surprisingly given these incentives, many cities and counties have oriented their land use planning and approval process disproportionately towards the development of commercial establishments and away from higher-density multifamily housing.

Limited Developable Land

Topography Limits Developable Land. Topography is the primary constraint on developable land in California's coastal metros. Just under two-thirds of the area surrounding the urban centers on California's coast is undevelopable due to mountains, hills, ocean, and other water. This compares to less than a quarter of land lost due to topography in a typical U.S. metro.

More Extensive Development Has Left Limited Vacant Land. Another constraint on development in California's coastal metros is the extent to which land already has been developed. Land in the center of California's major metros (defined as land within a 25 mile radius of the city hall of the metro's largest city) contains housing built at densities similar to metros in the rest of the country. By comparison, land in the outlying areas of California coastal metros (land beyond the 25 mile radius) has housing at about twice the density as outlying areas in metros elsewhere in the country (four housing units per acre in California versus about two units per acre elsewhere in

the country). More development in outlying areas typically leaves less vacant land for future development.

Redeveloping Land Possible, but More Difficult and Expensive. Overall, one survey of land in California's urban areas conducted in 2006 found that less than 1 percent of land in California's coastal urban areas was developable and vacant. Limited vacant land, however, does not mean that development must cease. Previously developed but abandoned or underutilized parcels can be redeveloped. Older, lower-density housing can be replaced with new higher-density housing. These types of redevelopment activities can yield increased housing supply even in areas where little or no vacant land exists. Redevelopment, however, often is more cumbersome and expensive than development on vacant land. Developers must demolish old buildings and often are required to address environmental pollutants and toxic substances leftover from previous uses. New construction, therefore, is likely to proceed at a slower pace where land must be redeveloped.

Community Decisions Can Exacerbate Land Scarcity. City and county land use policies can alleviate pressures created by limited vacant land by encouraging redevelopment and allowing developers to build more housing on each parcel. In many California communities, however, for reasons discussed earlier the opposite is true. Zoning laws often require developers to build housing at densities that are common elsewhere in the community, preventing developers from building at higher densities to counter high land costs. In addition, local communities sometimes pressure developers to reduce a project's planned density during approval processes. Cities and counties also can magnify the effect of scarce land on housing costs by choosing to allocate a large share of available land to nonhousing uses, such as retail and hotel development.

HOW BIG IS CALIFORNIA'S HOUSING SHORTAGE?

In recent decades, California has built new housing at a slower rate than the rest of the country and much of this new housing has been built in relatively underdeveloped inland areas. As a result, California's supply of housing has not kept pace with demand to live in the state and housing costs have grown faster than the rest of the country. To give the Legislature an estimate of the magnitude of this housing shortfall, we developed a quantitative model of California's housing market. This section begins with a description of this model and its findings and then assesses the likelihood of similar-sized housing shortfalls continuing in the future.

Estimating California's 1980-2010 Housing Shortage

Our Model. As described more fully in this report's technical appendix, our model uses standard statistical tools to examine housing price and supply changes in major metropolitan counties throughout the United States and control for various factors. A key element of our model is its ability to estimate the number of housing units that needed to be built to satisfy demand and keep housing prices within certain ranges. We used the model to estimate the amount of housing that—had it been built between 1980 and 2010—would have kept California's median housing price from growing faster than the nation's. Under this approach, California's median housing prices

still would have grown between 1980 and 2010, but the rate of growth would have been slower and comparable to that in the rest of the country. Under this housing supply scenario, California's housing prices would have been 80 percent higher than the U.S. median in 2010, instead of reaching twice the U.S. median (as actually occurred).

Key Findings. As we discuss further below, our model estimates that keeping California home prices from growing faster than the nation between 1980 and 2010 would have required the state to have:

- Built substantially more new housing—in the range of 70,000 to 110,000 additional units each year.
- Shifted more home building to coastal areas.
- Built denser housing, concentrated in central cities.

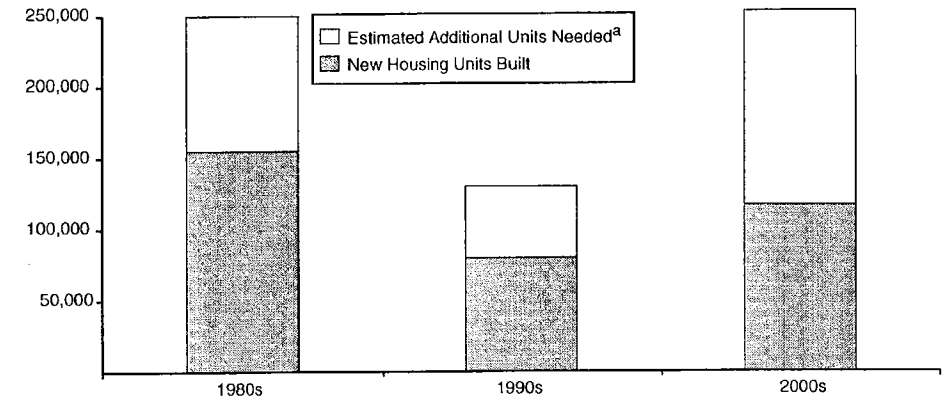
More Housing in Total. Between 1980 and 2010, California's major metros added about 120,000 new housing units each year. Our analysis suggests that between 190,000 units per year and 230,000 units per year were needed to keep California's housing cost growth in line with cost escalations elsewhere in the U.S. (Our midpoint estimate—which represents our single best guess at California's housing need—is slightly above 210,000 units per year. For the remainder of this section, we discuss our midpoint estimates.) Figure 7 shows our estimate of additional housing construction needed in each of the past three decades. These statewide estimates, however, mask significant variation across regions of the state, as well as across cities within those regions.

More Building on Coast, Less Inland. Our estimates suggest that, to contain price growth, the geographical distribution of new housing over the past three decades needed to be different, with significantly more building in coastal areas and somewhat less building in inland areas. Figure 7 compares actual home building in California's largest counties between 1980 and 2010 to the levels of building that we estimate would have kept home price growth in line with the rest of the country. As Figure 8 on the next page shows,

Figure 7

Building More Housing Would Have Slowed Rising Housing Costs

Average Annual Number of New Housing Units Built by Decade, 1980-2010



[a] Estimated new housing construction needed to prevent home prices from growing faster than the rest of the country.

most of California's coastal counties needed to build three times as much (or more) housing as they did, while inland counties built more housing than our estimates suggest was needed to contain price growth.

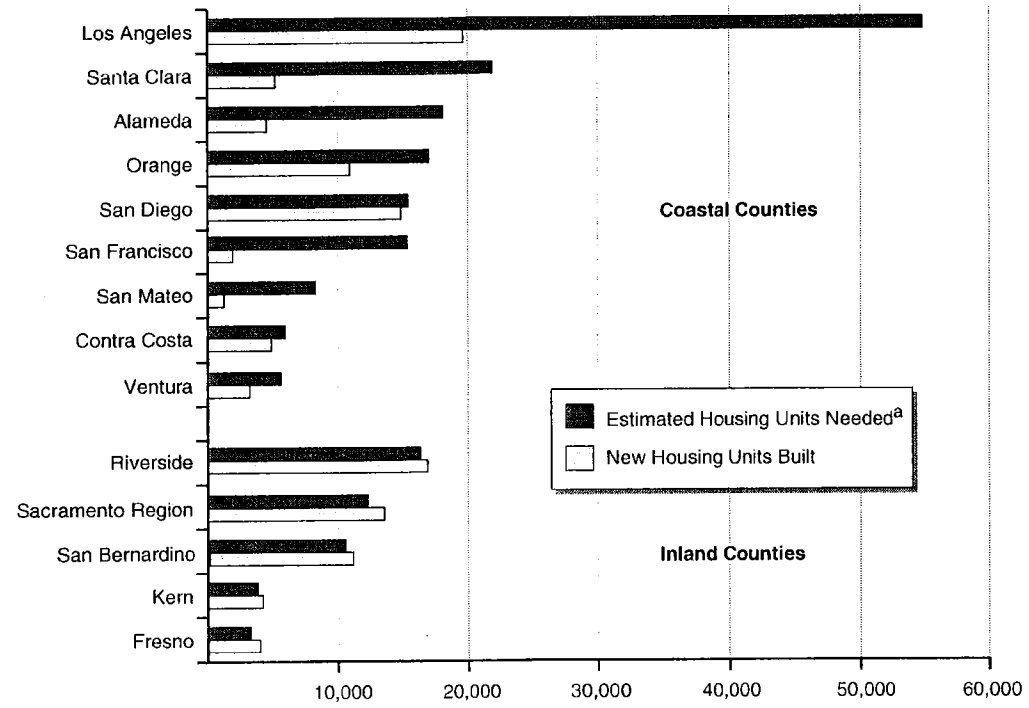
More Building in Central Cities, Less in Outlying Areas. As we discussed above, insufficient housing was built in California's coastal counties, causing demand to spill over into inland areas. A similar situation appears to have occurred within the coastal counties. Insufficient housing was built in the central cities of coastal counties to satisfy demand for housing, driving development into suburban and rural areas. As Figure 9 shows, between 1980 and 2010, home prices in most of California's largest cities grew faster than home prices in surrounding areas within the same county. In general, because unmet demand results in competition for housing and rising costs, home prices and rents are highest where unmet demand is greatest. These price trends, therefore, suggest that unmet demand for housing is greater in central cities relative to surrounding areas. More housing development was needed in central cities relative to surrounding areas to contain growth in housing costs.

Denser Housing. Much of the buildable land in California's coastal metros has been developed. Because of this, adding more housing to these

Figure 8

Housing Needs Vary Considerably Across Counties

Average Annual Number of New Housing Units Built by County, 1980-2010



[a] Estimated new housing construction needed to prevent home prices from growing faster than the rest of the country.

metros would have required housing to be built more densely. Figure 10 shows our estimates of how dense housing would be in California's coastal metros if they had grown over the last 30 years at the rate necessary to keep their prices in line with the rest of the country. Housing densities in many coastal counties would be more than two-thirds higher under the LAO growth scenario than they are today. Despite these sizeable increases, housing densities in California's coastal metros under our growth scenario would not be unprecedented. As Figure 10 shows, there are other metropolitan counties throughout the country that currently are as dense as California's coastal metros would be under our growth scenario.

More Housing Would Mean More Californians. If California had added 210,000 new housing units each year over the past three decades (as opposed to 120,000), California's population would be much greater than it is today. We estimate that around 7 million additional people would be living in California. In some areas, particularly the Bay

Figure 9

Home Prices Generally Grew Faster in Central Cities Than Outlying Areas

Growth in Inflation-Adjusted Home Prices Between 1980-2010

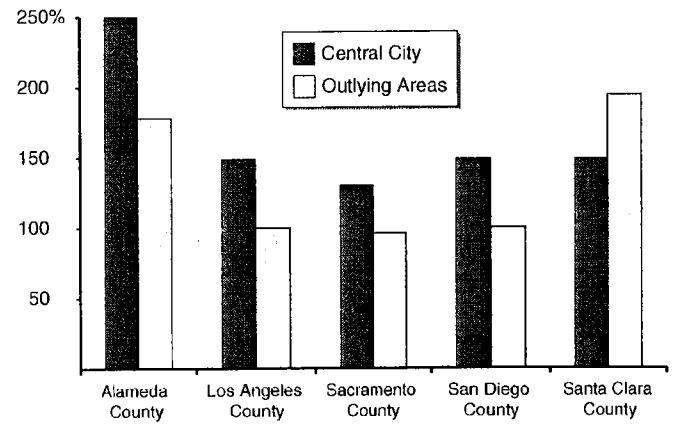


Figure 10

Building More Housing in Coastal Metros Would Require Denser Development

Housing Density in a Typical Neighborhood in California Counties, 2010

Actual	LAO Growth Scenario[a]	Counties Similar to LAO Growth Scenario
Orange		
4 units per acre (typical homes)	5 units per acre (typical homes)	Cook County (including Chicago), Illinois Denver, Colorado
Los Angeles, Alameda, San Mateo, Santa Clara		
4 to 5 units per acre (typical homes)	7 to 9 units per acre (small lot homes and duplexes)	Washington D.C. Baltimore, Maryland
San Francisco		
18 units per acre (two to three story townhomes)	35 to 40 units per acre (midrise apartments and condos)	Brooklyn, New York Bronx, New York

[a] Legislative Analyst's Office (LAO) growth scenario = estimated new housing construction needed to prevent home prices from growing faster than the rest of the country.

Area, population increases would be dramatic. For example, San Francisco's population would be more than twice as large (1.7 million people versus around 800,000). In other areas of the state, where significant housing development occurred due to spillover demand in the state's coastal metros, population would likely be about what it is today or potentially smaller.

What Does This Estimate Tell Us About the Future?

As we have discussed, a collection of barriers have prevented California's housing developers from responding to high demand to live on California's coast by building more housing there. Our analysis in this section suggests that these barriers have created a major disconnect between the demand for housing and its supply. Looking forward, there are many reasons to think this dynamic will continue. Many of the primary factors that make California desirable—moderate weather, natural beauty, and coastal proximity of its major metros—are ongoing. At the same time, we see no signs that coastal community resistance to new housing construction is abating. In addition, many state and local policies that have slowed or stopped development in recent decades remain in effect today. We therefore think that, in the absence of major policy changes, California's trend of rapidly rising housing costs is very likely to continue in the future. Our analysis suggests that building substantially more housing in coastal urban areas—possibly as much as 100,000 additional units each year—could prevent California's housing costs from continuing to grow faster than the U.S. In our view, this major finding that demand for housing in California substantially exceeds supply should inform discussions and decision making regarding state and local government housing policies.

We do, however, recognize that any attempt to estimate the state's future housing needs faces significant uncertainties. Unforeseeable changes in demographics, economic conditions, or technology could shift dramatically the dynamics of California's housing markets. Readers, therefore, should focus less on our specific estimates and more on the simple story they tell: to contain rising housing costs, California would have to build significant more housing, especially in coastal urban areas.

WHAT ARE THE CONSEQUENCES OF CALIFORNIA'S EXPENSIVE HOUSING?

Housing costs are the largest component of most households' spending. Because housing is such a large financial consideration, households make careful decisions about the location, cost, and amenities of their home. Faced with high home prices and rents, California households must decide: how much income can they spend on housing (and therefore what must they consume less of); where can they find housing of this sort; and how far is this housing from work, school, and local amenities? Each household finds its unique answers to these questions, typically responding to high housing costs with a combination of trade-offs. In the following section, we review five significant trade-offs households make when faced with high housing costs. These include: (1) spending a larger share of income on housing, (2) postponing or foregoing homeownership, (3) living in more crowded housing, (4) commuting further to work each day, or (5) sometimes, choosing to work and live elsewhere. We also discuss how these serious trade-offs affect the state's economy.

Households Spend More of Their Income on Housing

Housing Costs Are a Major Consideration for Most Households. Housing costs are the largest component of most household's spending each month. For homeowners, these costs include monthly principal and interests payments; property taxes and homeowner's insurance; and household utilities like water, gas, and electricity. For renters, housing costs are their monthly rent and any utilities the tenant pays. On average, American households spend about one-quarter of their gross monthly income on housing. (More information on this data is available in the box on the next page.)

Despite Relatively Higher Incomes, Californians Devote Larger Share to Housing. Median household income in California is about $9,000 more annually than the national median. Median California housing costs, however, are about $5,300 greater as well. For most California households, therefore, higher housing costs consume a large portion of their higher income. Specifically, the median California household spends about 27 percent of their monthly income on housing. The median household in the rest of the country, on the other hand, spends about 23 percent. This above-average trend exists throughout California. As shown in Figure 11, households in each of the state's major metros spend an above-average share of their income on housing. In the state's largest metro, Los Angeles, the average household spends 30 percent of their income on housing, 7 percent more than the national average.

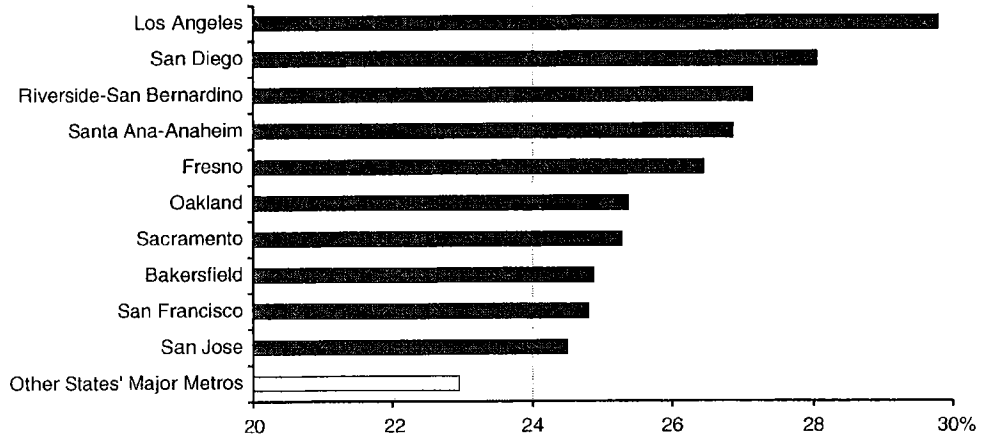
The figures discussed above are median housing costs as a share of income; that is, the amount of income spent on housing where one-half of households spend a smaller share and one-half spend a larger share. In this way, they best reflect the typical household's experience. For other types of households, however, differences between Californians and the rest of the country may be more or less pronounced.

Low-Income Californians Spend Greater Share of Income on Housing. Households with low

Figure 11

California's Major Metros Are All Less Affordable Than the Average U.S. Metro

Median Share of Household Income Spent on Housing, 2013



incomes spend a smaller amount of money each month on housing than do households with higher incomes. Lower-income households nevertheless spend a much larger share of their total income on housing, leaving fewer resources leftover for other spending and savings priorities. As shown in Figure 12, California households in the bottom quarter of the income distribution—the poorest 25 percent of households—report spending four times more of their income (67 percent, on average) than households in the top quarter of the income distribution (16 percent, on average).

Gap Between California and U.S. Largest for Low-Income Households. The difference between what California households spend and what U.S. households typically spend—a difference that is the byproduct of the state's high housing costs—is largest for low-income households and smallest for upper-income households. As shown in Figure 12, California households with incomes in the bottom quartile report spending 67 percent of their income on housing, about 11 percent more than low-income households elsewhere. This "gap" persists across most income groups but becomes smaller as income increases. For higher-income households, as shown in the figure, California households and households in other areas spend a similar, much smaller, share of their income on housing. These findings suggest that California's high housing costs are particularly challenging for the state's low-income households.

Renters Spend a Much Larger Share of Income on Housing. Nationwide, renter households spend a significantly larger share of their income on housing. The median renter spends about 30 percent of his or her income on housing,

How Do We Calculate These Figures?

Analysis Based on Responses to the American Community Survey. The data in this section are from individual and household responses to the Census Bureau's 2013 American Community Survey, which recently replaced the long-form decennial census. The survey asks a sample of all households detailed questions about their finances, employment, demographics, location, and housing characteristics.

What Is Household Income? In the American Community Survey, household income is the total of incomes earned by each member of the household who is at least 16 years old. Income includes wages and salaries; business income; interest; public assistance payments; Supplemental Security Income; and social security and other retirement, disability, or survivor income. It does not include capital gains income, money from the sale of a property, gifts, lump-sum inheritances, or money that was borrowed during the year.

What Are Housing Costs? For owners, monthly housing costs include principal and interest payments on their mortgage(s); homeowner's fire, hazard, or flood insurance; property taxes; utilities (electricity, gas, water, and sewer) and fuel costs; as well as monthly condominium fees or mobile home costs when applicable. For renters, monthly housing costs include what they pay for rent and any additional utilities or fuel costs in addition to their rent payments that are not paid by the landlord on behalf of the tenant. Household rent payments are recorded as rent paid, even if rent is paid by someone that does not reside in the household—a situation that could occur, for example, if a university student's rent was being paid in full or in part by his or her parents.

whereas the median homeowner spends 20 percent. Primarily, this occurs because renter households have notably lower incomes, on average, than owner households. In addition to generally lower income levels, renters spend more on housing, on average, because a portion of homeowners have owned their homes for many years and therefore have very low monthly mortgage costs or no mortgage costs whatsoever.

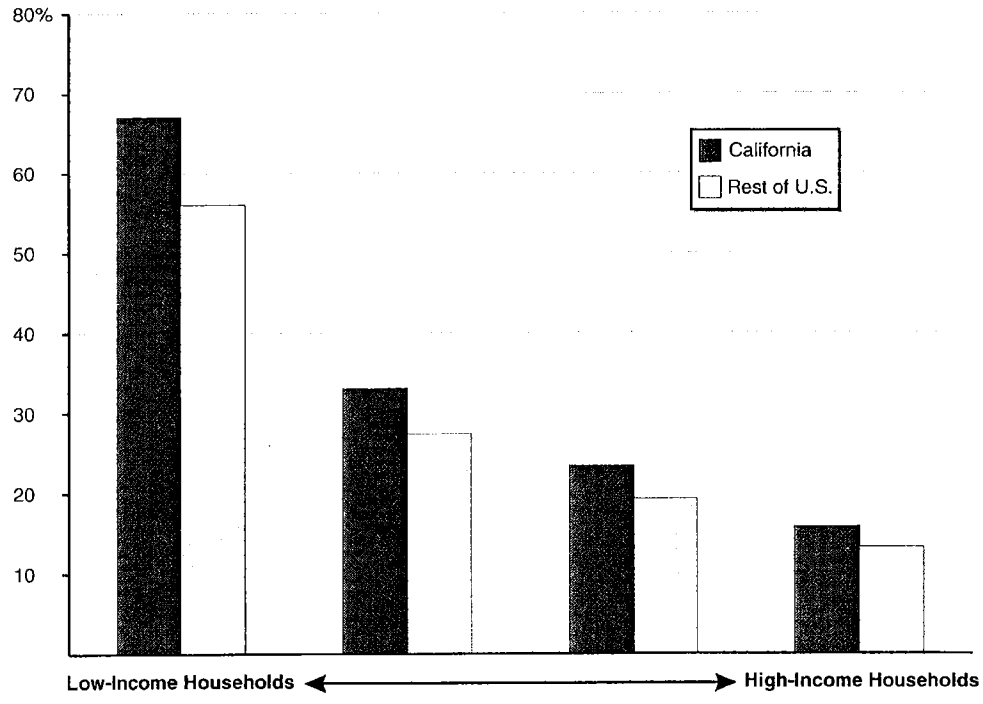
Low-Income Households That Spend More on Housing Spend Less on Essentials. In high cost areas, households typically spend a larger share of their income on housing. As a result, households have less money available for other types of spending. For households with above-average incomes, higher housing costs may mean they spend less on other items, but these households typically have sufficient resources to purchase regular household necessities. For low-income households, though, high housing costs cut into spending considered more necessary. According to Harvard's Joint Center for Housing Studies, low-income households who spent more than half of their income on housing spent 39 percent less on food than other low-income households that spent less than half their income on housing.

High Housing Costs Contribute to Poverty in California. The federal government each year calculates what share of each state's population lives in poverty. Typically, poverty is calculated

Figure 12

State's Low-Income Households Spend Much More on Housing

Median Share of Income Spent on Housing by Income Quartile



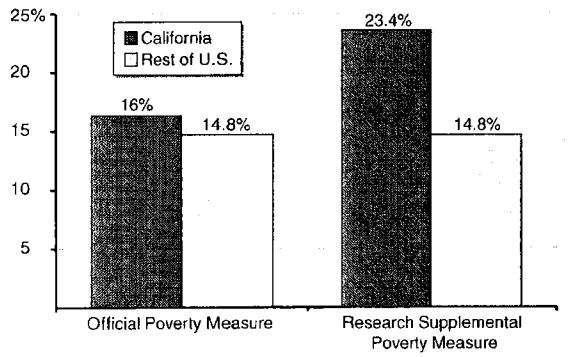
by the Official Poverty Measure, which defines a family as poor if their pretax cash income is less than a poverty threshold that is standard across the nation. Based on this measure, California's poverty rate is slightly higher than the rest of the United States, as shown in Figure 13. The federal government also reports poverty levels using an alternative measure, the so-called Supplemental Poverty Measure, which adjusts poverty thresholds based on local costs of living. Primarily because of California's high housing costs, the state's alternative poverty level is 23.4 percent, the highest in the nation and almost 9 percentage points higher than average.

High Housing Costs May Make Personal Finances More Fragile. One byproduct of spending a large share of one's income on housing is that personal finances may be more fragile—meaning a smaller share of a household's income is available for nonhousing goods and services, including savings. As a result, these households may find it more difficult to accommodate a drop in household income because they have a smaller amount of nonhousing disposable income and likely have smaller available savings.

Figure 13

Alternative Poverty Measure Much Higher in California Due to High Housing Costs

Percentage of Population Living Below Poverty Threshold From 2011 Through 2013



Fewer Households Own Their Homes

Homeownership Helps Households Build Wealth. The federal government has actively promoted homeownership since it restructured the housing finance system during the Great Depression. As a result, beginning in 1940s, the U.S. homeownership rate rose steadily and substantially, peaking at 70 percent just before the recent housing crisis. (Since then, it has fallen 64 percent, a low not seen since the 1990s.) Homeownership helps households build wealth, requiring them to amass assets over time. Among homeowners, saving is automatic: every month, part of the mortgage payment reduces the total amount owed and thus becomes the homeowner's equity. For renters, savings requires voluntarily foregoing near-term spending. Due to this and other economic factors, renter median net worth totaled $5,400 in 2013, a small fraction of the $195,400 median homeowner's net worth. For many households in high housing cost areas, though, homeownership's benefits remain out of reach, as higher home prices (relative to area incomes) mean fewer and fewer households can afford to become homeowners.

California's Homeownership Rate Among Lowest in Nation. About 64 percent of U.S. households own their homes, but only 54 percent of California households do. (Only New York State and Nevada have lower homeownership rates.) In areas with high housing prices, including those in California, homeownership tends to lag behind more affordable areas. Figure 14 shows that, across the country, metro areas where home prices are high relative to average income levels tend to have lower homeownership rates. Most of California's major metros, and all of California's coastal metros, fall into this category.

Households That Do Buy Purchase Later and Take on More Debt. An additional byproduct of higher home prices is that young people delay purchasing their first home, possibly because saving for a down payment takes longer or households are not able to generate qualifying income levels until later in their careers. According to National Association of Realtors data, the median first-time homebuyer in California in 2013 was 34 years old, three years older than the median first-time homebuyer nationwide.

In addition, households that are able to purchase a home typically take on more mortgage debt because home prices are higher here. Urban Institute data shows that the average California homeowner had $55,000 in mortgage debt outstanding as of 2013, about $17,000 more than the average U.S. homeowner ($38,000).

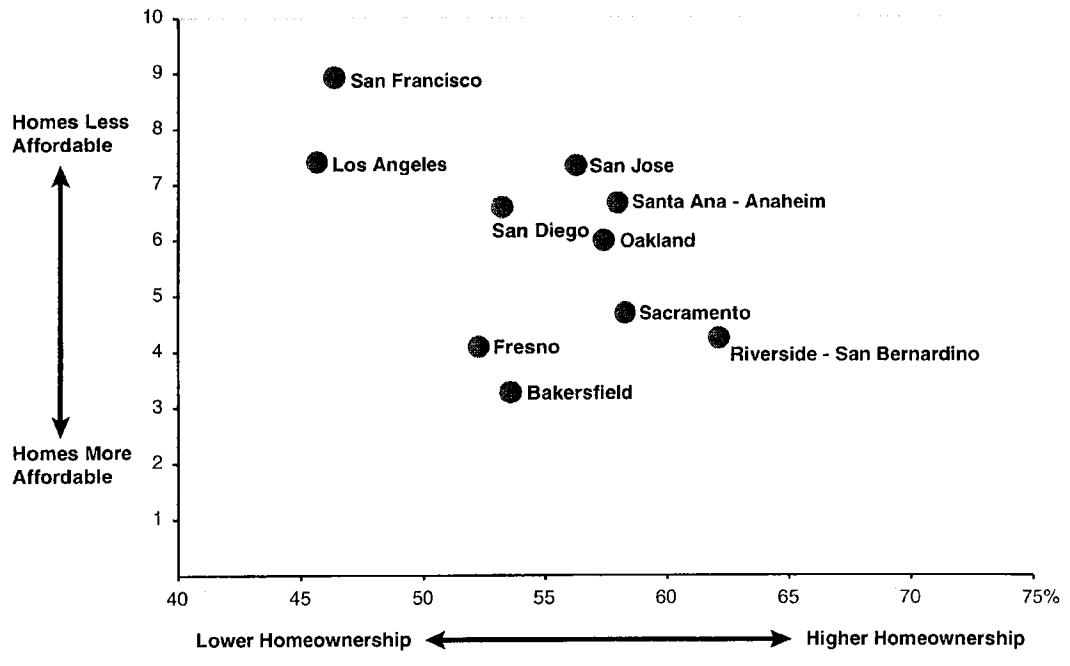
Households More Likely to Be Crowded

What Is Crowded Housing? Housing experts measure crowding by comparing the number of people in a household to the number of rooms in their home, including bedrooms and common rooms but excluding bathrooms. Although several definitions exist, we consider a household crowded if there is more than one adult per room, counting two children as equivalent to one adult. Under this definition, a three room apartment (with a kitchen, living room, and one bedroom) is crowded if more than three adults live there. It is also considered crowded if more than two adults and two children live there. Researchers who study crowding report that it leads to a wide range of negative outcomes, which we describe below. Researcher find these outcomes even after they account for other

Figure 14

Areas With Less Affordable Housing Tend to Have Low Homeownership Rates

Homeownership Rates and Ratio of Median Home Values to Median Incomes in Major U.S. Metros, 2013



socioeconomic factors that might affect well-being, like income and educational level.

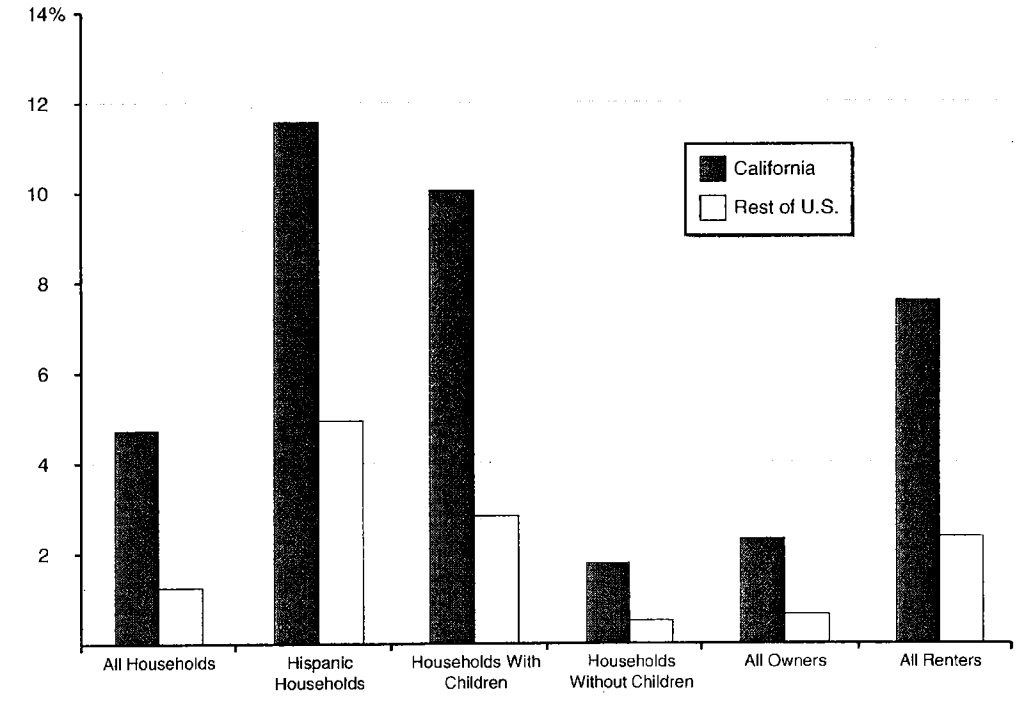
Crowded Housing Affects Well-Being and Educational Achievement. Individuals who live in crowded housing generally have worse educational and behavioral health outcomes than people that do not live in crowded housing. Among adults, crowding has been shown to increase stress and aggression, lead to social isolation, and weaken relationships between parents and their children. Crowding also has particularly notable effects on children. Researchers have found that children in crowded housing score lower on standardized math and reading exams. A lack of available and distraction-free studying space appears to affect educational achievement. Crowding may also result in sleep interruptions that affect mood and behavior. As a result, children in crowded housing also displayed more behavioral problems at school.

LAO Analyses of Crowding. In our analysis, we examined the relationship between California's high housing costs and overcrowding. Because California has many households types that commonly live in larger, multigenerational households (such as households with foreign-born members), we examined different household types separately, as shown in Figure 15. Specifically, in our first analysis, we calculated crowding rates—the share of households that are crowded—for different types of households. We do this for California and the rest of the U.S. Then, we examined how likely each of these household types

Figure 15

Crowding Rates Higher in California, Even Among Same Household Types

Percentage of Each Household Type Living in Crowded Housing, 2013



is to be crowded based on the cost of housing in their metro.

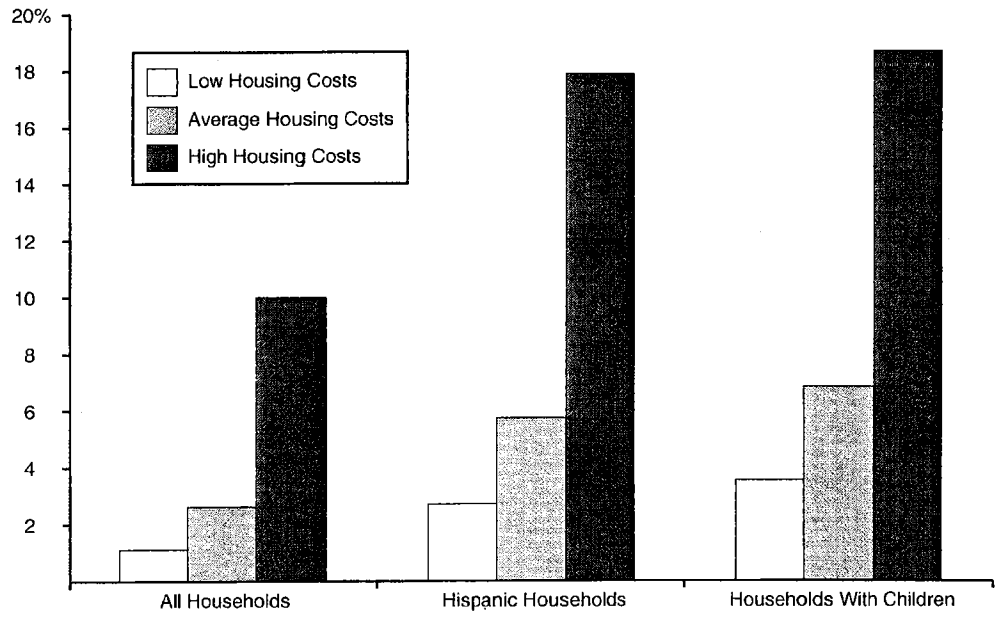
California Households Four Times More Likely to Live in Crowded Housing. Certain household types are more likely than average to live in crowded housing, such as households headed by foreign-born adults, Hispanics, and those with children. California has a higher share of these household types than the rest of the U.S. Because of this, we would expect California to have a higher crowding rate. A review of the data, however, shows that California's crowding rate is higher than one would expect based solely on its larger share of these household types. This is because crowding rates for each household type (including those most likely to live in crowded housing) are higher in California than they are elsewhere. As a result, California's overall crowding rate is four times higher than the U.S. average, partly due to demographics and partly to other factors, including higher housing costs, as discussed below.

Crowding Appears Associated With High Housing Costs. Determining whether housing costs affect crowding is challenging because areas with the high housing costs tend to have fewer households types that are likely to be crowded. Using statistical analysis, however, we found that living in a high housing cost area is associated with a higher likelihood of living in crowded housing, after accounting for other factors that also affect crowding rates. Figure 16 shows that the likelihood of being crowded increases when the area's median

Figure 16

Housing Costs Affect a Household's Likelihood of Living in Crowded Housing

Estimated Probability of Living in Crowded Housing in California, 2013



Note: Low housing cost area equal to housing costs in state's least expensive metro. Average housing cost is the statewide average, and high cost is equal to housing costs in the state's most expensive metro.

home price increases (moving from left to right). For example, the average household's likelihood of being crowded in a metro with average home prices (about $440,000) is about 3 percent, but the same household's likelihood of being crowded increases more than threefold—to 10 percent—if they live in an expensive metro with median home prices of $900,000.

Households Commute Further to Work

Each Household Makes Its Own Decisions About Commuting. Housing's geographic location has lasting and important consequences. Ideally, each household could choose housing in their preferred neighborhood, near good schools and welcoming amenities, with only a short work commute. In practice, though, not only are ideal locations relatively sparse, those that do exist are desirable and therefore expensive. In response, households balance their preferences and resources, selecting trade-offs among housing costs, commute times, and neighborhood characteristics.

Complex Metro Characteristics Influence Commute Times. Each major metro area in the country has unique characteristics that influence whether it has above- or below-average commute times. Most factors are straightforward—for instance, natural geography, existing transportation infrastructure and the availability of public transit, and the spatial distribution of jobs relative to that of housing. Other factors are less straightforward. A metro's land area and its density affect commute times, but in complex ways. For example, up to a point, commute times generally increase as areas become denser because transportation options become more congested. After densities reach a certain level, however, the viability of public transportation options improves. In some circumstances, this can relieve pressure on other transportation options and reduce average commute times.

California's Coastal Metros Have Long Commutes. In 2013, workers in large metros throughout the country spent, on average, 55 minutes commuting each day. Workers in California's coastal metros averaged 60 minutes, about 10 percent more than the national average. Commute times in Los Angeles, the state's largest metro, averaged 62 minutes, 12 percent longer than the U.S. average. San Francisco has the state's longest average commutes—72 minutes per day—about 30 percent longer than the U.S. average.

How Might Housing Costs Affect Commute Times? The relationship between metropolitan characteristics, including its housing costs, and average commute times is complex. Assuming neighborhood characteristics and other preferences are unchanged, housing costs should decline as one moves further from job centers. This is because commuting involves monetary and nonmonetary costs that must be offset somehow. Neighborhood characteristics and preferences change across metropolitan areas, however, making the analysis of commute times and metro characteristics additionally complex. To find housing at a price they are willing to pay, households in more expensive metros might choose to live further from work than they would if housing were less expensive. This could lead average commute times to be longer in areas with higher housing costs. Not surprisingly, we found that metro areas with higher housing costs tend to have longer average commute times.

Do High Housing Costs Lead to Longer Commutes? Our analysis found that many important factors have statistically significant effects on commute times. These include: whether the commuter drives, walks, or takes public transit to work; the metro's land size, population, and density; the metro's median income; and weather. After controlling for these factors—in essence isolating the effect of housing costs on

commute times—a 10 percent increase in a metro's median rent is associated with a 4.5 percent increase in individual commute times. The fact that California's average commute times are only moderately above average (despite notably higher housing costs) suggest that other California-specific factors reduce average commute times. These factors may include weather conditions, widespread development and availability of freeway systems, and an above-average share of commuters who drive to work. (Driving commutes are generally fast, and therefore metros with higher shares of driving commuters tend to have shorter commute times.) Despite these mitigating factors, however, our analysis suggests that California's high housing costs cause workers to live further from where they work, likely because reasonably priced housing options are unavailable in locations nearer to where they work.

Housing Costs Influence Where Households Live and Work

Decisions About Where to Live and Work Are Complex. Understanding how housing costs affect a household's decision about where to live and work is challenging. This is because regional and state economies are complex and numerous interconnected factors influence housing costs (as well as other costs of living) and economic opportunities in these areas. Despite this complexity, economists and other researchers have identified ways that housing costs affect migration—and, in some instances, have attempted to quantify the magnitude of these effects. Below, we summarize the aspects of this work we believe are most helpful when considering how housing costs affect migration and the state's economy.

High Housing Costs Discourage People From Living in California. Housing costs are a significant driver of migration to and from California, and changes in the state's housing costs (relative to other areas of the country) influence migration trends. The ratio of in-migration to out-migration, a measure of population flow, is lowest when California's home prices are high relative to other places. On the other hand, this flow is highest when California housing becomes relatively more affordable compared to other states. Our analysis of these trends, which we discussed in the preceding section, suggests that about 7 million additional people would live in California if more housing had been built here and the state's housing prices had therefore grown about as quickly as those in the rest of the country since 1980.

High Housing Costs May Make it Difficult to Recruit Employees. For most businesses, labor costs are their largest operating cost. In areas with higher costs of living, businesses generally must pay employees higher wages because they require additional income to offset the cost of living differences. California's cost of living is among the highest in the nation, largely because California's housing costs are so high. As a result, businesses in California's coastal metros may find it challenging (and expensive) to recruit or retain qualified employees. In a 2014 survey of more than 200 business executives conducted by the Silicon Valley Leadership Group, 72 percent of them cited "housing costs for employees" as the most important challenge facing Silicon Valley businesses. Employee recruitment and retention, closely related to housing costs, was the second most frequently identified challenge. Similarly, other important sectors of the state's economy may find recruitment challenging and labor costs expensive. For example, some higher education institutions in high housing cost areas provide housing subsidies in order to recruit successfully top administrators and academic specialists. Stanford University recently announced plans to lease a 167-unit apartment complex for their staff and faculty, noting that providing housing helps

them "compete to recruit the best faculty from other parts of the country, where they experience very different real estate markets."

High Housing Costs Mean Fewer Californians Work in State's Most Productive Cities. In general, businesses and employees in large cities are more economically productive than those in other areas. (Economists use the term "agglomeration economies" to describe these areas. Agglomeration economies are areas where worker productivity increases as population density increases.) Higher productivity leads to more economic output per employee, and thus greater economic growth in the region. Under normal circumstances, these economic opportunities attract new workers from other areas. Historically, this has led to significant population growth in the state's cities. However, in recent decades, high housing costs have slowed this trend. This is because the expected wage gains (from moving to a city) are not large enough for many prospective workers to make up for their higher housing costs. California's major productive cities have therefore grown less quickly than they otherwise would.

Fewer Workers in State's Most Productive Cities Hinders Economic Growth. The slowing flow of workers to productive cities likely has constrained economic growth because potential workers, unable to move to productive cities due to high housing costs, do not benefit from the productivity gains occurring in cities. If more workers lived in the state's highly productive cities (and therefore reaped these cities' productivity benefits), per capita economic activity in the state would be greater than it is today. Estimating the magnitude of this impact involves considerable uncertainty. Recent research, however, may provide a helpful guide as to this impact's order of magnitude. Economists at the University of California, Berkeley and the University of Chicago recently estimated that annual U.S. economic output—the total value of goods and services produced each year—is 13 percent lower today than it otherwise would be due to "increased constraints to housing supply in highly productive cities."

LOOKING AHEAD: WHAT IS NEEDED TO CONTAIN CALIFORNIA'S HIGH HOUSING COSTS?

California's high housing costs present many difficult issues for policy makers, residents, and businesses to consider. On the one hand, California's constraints on housing supply—the primary factor driving the state's high housing costs—show no signs of abating. If California continues on its current path, the state's housing costs will remain high and likely will continue to grow faster than the nation's. This, in turn, will place substantial burdens on Californians—requiring them to spend more on housing, take on more debt, commute further to work, and live in crowded conditions. Growing housing costs also will place a drag on the state's economy.

On the other hand, addressing California's constraints on housing supply would be extremely challenging and involve major trade-offs. Though the exact number of new housing units California needs to build is uncertain, the general magnitude is enormous. On top of the 100,000 to 140,000 housing units California is currently expected to build, our analysis suggests that the state probably

would have to build as many as 100,000 additional units annually—almost exclusively in its coastal communities—to seriously mitigate the state's problems with housing affordability. Adding this many new homes, however, could place strains on the state's infrastructure and natural resources and could alter the longstanding and prized character of California's coastal communities. Facilitating this housing construction also would require the state to make changes to a broad range of policies that affect housing supply directly or indirectly—including many policies that have been fundamental tenets of California government for many years.

Despite these challenges, California's housing problems warrant attention from state leaders. These difficult issues could require years of legislative deliberation, including discussions with all major stakeholders: the administration, local governments, environmental groups, affordable housing developers and advocates, and housing policy experts. In its deliberations, we recommend that the Legislature:

- ***Aim to Build More Housing in Coastal Cities, Densely.*** The greatest need for additional housing is in California's coastal urban areas. We therefore recommend the Legislature focus on what changes are necessary to promote additional housing construction in these areas.

- ***Put All Policy Options on the Table.*** Given the magnitude of the problem, the Legislature would need to take a comprehensive approach that addresses the problem from multiple angles and reexamines major policies. Major changes to local government land use authority, local finance, CEQA, and other major polices would be necessary to address California's high housing costs.

- ***Recognize Targeted Role of Affordable Housing Programs.*** These programs play an important role in assuring housing access for many Californians with unmet housing needs. We note, however, that the scale of these programs—even if greatly increased—could not meet the magnitude of new housing required that we identify in this report. Accordingly, we recommend the Legislature consider how targeted programs could supplement more private housing construction by assisting those with limited access to market rate housing, such as people experiencing homelessness, those with mental and/or physical health challenges, and those with very low incomes.

- ***Understand That Some Factors Are Beyond Policy Makers' Control.*** Much can be done by state and local governments to promote additional housing construction and therefore slow down growth in home prices and rents going forward. Some factors, however, such as high demand to live in the state and natural limitations on developable land, largely are beyond the control of policy makers. As a result, home prices and rents in California likely will remain above-average for the foreseeable future, even if public policies highly favorable to new housing construction were instituted that slowed future growth in housing costs.

TECHNICAL APPENDIX

How Did We Estimate California's Need for Additional Housing?

California's housing costs have risen faster than the rest of the country for several decades. This is largely because the state has built too little housing to accommodate all of the households that would like to live here. In general, home prices and rents are determined by the interaction between demand for housing and its supply. Home prices and rents help balance the number of households looking for housing and the number of new housing units constructed. When the number of households looking for housing exceeds the number of units available, households compete for housing and prices and rents rise. High prices and rents, in turn, discourage some households from entering the market, bringing demand and supply into balance. Conversely, if construction of housing increases, more housing units are available and therefore competition among households is reduced, causing prices and rents to fall.

How Much Additional Housing Was Needed? Our analysis attempts to estimate the amount of additional housing needed to prevent California's housing costs from growing faster than the rest of the country in recent decades. In approaching this issue, we first recognized that if California's housing costs had grown only as fast as the rest of the country, home prices and rents would have been lower and more households would have desired to live here. To maintain these lower housing costs, additional housing would have been needed to be built to accommodate these new households. Therefore, to answer our question, we considered a similar one: if California's home prices and rents had risen only as fast as the rest of the country during the past three decades, how many additional households would have wished to live here (and, consequently, how much additional housing construction would have been needed)?

Developing a Model of Supply and Demand for Housing. To answer this question, we developed an econometric model to estimate the number of households that would demand to live in California at a range of home prices. Because demand for housing varies throughout California, we conducted our analysis at the county level. Our model attempts to estimate a county's housing demand based on the county's home prices, its neighboring counties' home prices, and various other factors that also affect the desirability of a location—incomes, population levels and growth rates, unemployment rate, education levels, and weather. While most of our analysis centered around the relationship between housing demand and home prices, we also conducted a similar analysis using rents instead of home prices. Our analysis using rents yielded similar results.

For our dependent variable, we used ten-year growth in the number of housing units (both single-family and multifamily housing) from the U.S. Census, corresponding to housing growth in the 1980s, 1990s, and 2000s.We also obtained data on home prices, incomes, population, and education levels from the U.S. Census. For each of these variables, we averaged the values at the beginning and end of each decade to obtain a decade average value. Data on unemployment rates was obtained from the Bureau of Labor Statistics. Weather data was obtained from the National Climatic Data Center.

Estimating Our Model Presents Challenges. Empirically estimating our model of housing demand presented two major challenges. First, as we discussed above, home prices and construction levels are determined by the interaction of demand and supply. Home prices generally tend toward a level at which the number of households looking for new housing equals the number of new housing units constructed. In this way, home prices and building levels are set simultaneously. Similarly, demand for housing in one county and its neighbors (and consequently the prices for these homes) often are determined by common factors. For example, major regional shifts in employment can affect many counties simultaneously. As a result, traditional statistical techniques, such as ordinary least squares, would give inaccurate estimates of the relationship between demand and prices for housing in a county and neighboring counties. To estimate this relationship more accurately, we used two-stage least squares, instrumenting for both a county's home prices and neighboring counties' prices using factors that affect home prices by influencing the supply of housing. Specifically, we use: the county's land area, a measure of topographical constraints to development, and construction labor wages. Changes in these supply factors can result in changes in home prices but typically are not clearly related to changes in housing demand, making them suitable instrumental variables to estimate our model. Data on land areas was obtained from the U.S. Census, while topographical constraints were taken from research conducted by economist Albert Saiz. Construction wage data was taken from the Bureau of Labor Statistics.

Our second major challenge was a limited number of observations for California counties. Because of data limitations, our analysis was constrained to counties comprising metropolitan areas (metros) of 850,000 or more people—roughly the size of the state's tenth largest metro, Bakersfield. With this limited number of observations, it was difficult to obtain precise estimates of our model's parameters. We therefore expanded our dataset to include all U.S. counties comprising metros of 850,000 or more people, giving us over 1,000 observations. The inclusion of non-California counties, however, comes with a trade-off: we must assume that households' demand for housing responds to home prices changes the same way in California as in the rest of the country. This is a potential limitation of our analysis.

Results From Our Analysis. The results of our regression are shown in Figure A-1. As these results show, we found a strong and statistically significant relationship between a county's housing demand and its home prices: when a county's home prices increase 10 percent, demand for new housing (the number of new housing units demanded as a share of existing housing) decreases by around

Figure A-1

Housing Demand Regression Results

Dependent Variable: Ten-Year Growth in Housing Units

Independent Variable[a]	Coefficient	Standard Error
Home price	-0.83[b]	0.10
Average of neighboring counties' home prices	0.16[b]	0.05

[a] Control variables were also included, but are not reported here. All independent variables, except for dummy variables, are in logs.

[b] Statistically significant at 1 percent level.

8 percent. Similarly, we find a significant relationship between housing demand and neighboring counties' home prices: when neighboring counties home prices increase by 10 percent, demand for new housing increases by about 2 percent.

Using Analysis to Estimate Number of Units Needed. The next step in our analysis was to use these findings to answer the question: how many additional units would California have needed to build in order for its home prices and rents to have risen only as fast as the rest of the country during the past three decades? To do this, we used the coefficient estimates in Figure A-1 to determine how much housing demand would change in California's counties if home prices had grown only as fast as the rest of the country. The best way to illustrate these calculations is to walk through an example. We use San Francisco during the 1980s for this illustration. Our calculation proceeded in two main steps:

- ***Step 1: Within County Price Changes.*** During the 1980s, home prices in the average major U.S. metro grew by 28 percent. In San Francisco, home prices increased 80 percent. If San Francisco's home prices had grown 52 percentage points slower (equal to the national average), our regression results suggest that demand for new housing in San Francisco would have increased by 43 percent (-52 percent multiplied by -0.83, our estimated coefficient for within county home price changes).

- ***Step 2: Neighboring County Price Changes.*** Similarly, home prices in counties neighboring San Francisco grew by 53 percent during the 1980s, compared to 33 percent for the rest of the country. If home price growth in San Francisco's neighbors had been 20 percentage points lower (equal to the national average), our analysis suggests that demand for new housing in San Francisco would have decreased by 3 percent (-20 percent multiplied by 0.16, our estimated coefficient for neighboring county home price changes). Because of this, our calculation from step 1 must be adjusted. We therefore adjust downward our estimate from step 1 by 3 percentage points, arriving at a final estimate of 40 percent additional housing growth.

As is often true with econometric studies, our analysis is limited by several factors, including the availability and quality of data, potential misspecification of our model, and the inherent difficulty of drawing conclusions from nonexperimental data. Because of this, we recommend that elected leaders and residents focus less on our specific estimates and more on the overall story they tell (as discussed in the body of this report): to contain rising housing costs, California would have to build substantially more housing, especially in coastal urban areas.

How Do We Estimate How Housing Costs Affect a Household's Likelihood of Crowding?

Our analysis of state and national crowding trends is based on 2013 1-year American Community Survey microdata. Microdata are large data files that include individual-level responses to the survey questions. Using them, we can study household-level crowding conditions and how those conditions are affected by a metro area housing costs.

A First Look at Crowding. Upon initial review of the data, we found that, throughout the country, renters, households with children, and households headed by first-generation individuals or Hispanic individuals are all more likely than average to live in crowded housing. Also, the likelihood of living in crowded housing is much higher for low-income households than for wealthier households. We also found that these types of households make up a larger share of all households in the state's inland metro areas (where housing is inexpensive) than they do in the state's coastal metros (where housing is expensive). As a result, comparing crowding rates at the metro level to housing costs at the metro level would inaccurately suggest that higher housing costs are associated with lower crowding rates and vice-versa. (Some element of this may actually occur, but only insofar as lower-income households move to less expensive parts of the state to avoid crowding.) A closer examination of household level data, however, shows that the opposite is true—higher housing costs are associated with higher crowding rates.

Developing a Model to Investigate What Factors Lead to Crowding. To examine the relationship between households' likelihood of crowding and housing costs, we developed a simple econometric model to estimate the probability of a household living in crowded housing. We use a probit regression analysis, which asks: how do various economic and demographic factors affect the probability of a household being crowded? This type of model holds constant each of the economic and demographic factors so that we are able to isolate them individually and assess how they impact crowding. For instance, we are able to ask the question: how much more likely is the statistically-mean California household to live in crowded housing if they moved from a low housing cost area of the state to a more expensive one (holding all of their other economic and demographic characteristics constant)? The results of the probit regression analysis are summarized in Figure A-2.

Interpreting Our Findings. The coefficient estimates from probit analyses are not easily interpretable. To make these results easier to understand, we use the regression results to compare the probability of being crowded for the mean California household (as well as Hispanic-headed households and households with children) when metro area median home prices are low ($167,000, equal to the state's least expensive metro), average ($433,000, the statewide average), and high ($934,000, equal to the state's most expensive metro). The results from this analysis are included in Figure 16 on page 31 of the report. These results show the probably of living in crowded housing increases as median home prices increase, and that this increase occurs for all household types.

How Do We Estimate How Housing Costs Affect Commute Times?

We also use responses from the 2013 one-year

Figure A-2
Crowding Regression Results

Dependent Variable: Probability That a Household Resides in Crowded Housing

Independent Variable[a]	Coefficient	Standard Error
Metro area median home price (1,000s)	0.001[b]	0.000

[a] Control variables were also included, but are not reported here. They include Hispanic head of household, foreign-born head of household, new arrival to the U.S., household income, household income relative to area median income, ownership, and presense of children.
[b] Statistically significant at 1 percent level.

American Community Survey to review how housing costs affect commute times in different metro areas. For our analysis, we calculated each workers commute time by looking at all the individuals who commuted to work in that metro, and not just the individuals who live and work in that metro. In some cases, an individual may live outside a metro area and commute each day into a metro area for work. For our analysis, those individuals are included in that metro's commute times. For example, many individuals commute from the Los Angeles metro into the Santa Ana-Anaheim metro (Orange County) and vice-versa.

What Factors Affect Commute Times? Various metro area characteristics affect commute times for workers in that metro. These include physical and geographic factors, such as the metro's land size, the number of people who live there (related to its density), and the share of land in the metro that is available for development. For example, metros with a large share of their area occupied by mountains or water tend to have longer commute times because these features may make transportation options more challenging. Other factors also affect a metro's average commute times, such as the area's median income and what share of the metro's commuters drive, take public transportation, or walk.

How Do We Estimate How Housing Prices Affect Commute Times? We develop an econometric model to estimate how home prices and rents affect commute times. Similar to our other regressions, this model holds constant factors that affect commute times, allowing us to isolate the relationship between average housing prices and commute times in a metro. We developed several models, using both rents and home prices. We also tested commute times at the metro level and at the individual level. Our main model is shown and discussed in more detail below.

Interpreting Results From Our Analysis. The results of our regression are shown in Figure A-3. As these results show, we found a strong and statistically significant relationship between individual commute times and several other factors, including metro average rent. (We used rents in this case, instead of home prices, though the choice of which price measure to use has little effect on the results of the analysis.) The coefficient for median rent, 0.45, suggests that a 10 percent increase in metro median rent is associated with a 4.5 percent increase in average commute time. Also, notably, the coefficient for California metros is significant and negative, suggesting that California's metro areas have some factors (beyond housing costs, income, density, and commute type) that lowers overall commute times. We discuss earlier several possible explanations, including widespread development and availability of freeway systems throughout the state, which likely reduce commute times overall.

Figure A-3

Commuting Regression Results

Dependent Variable: Individual Commute Time, One Way[a]

Independent Variable[a]	Coefficient	Standard Error
Metro average rent[b]	0.45[c]	0.01

[a] In log form.

[b] Independent variable is the metro average rent in the metro where the commuter works, even if the individual lives in a different metro area or outside the metro area where he or she works.

[c] Control variables were also included, but are not reported here. They include age, ownership, mode of transportation, metro population, metro density, metro median income, annual precipitation, and an indicator variable for California. All dependent variables are statistically significant at the 1percent level.

ACKNOWLEDGEMENTS

Over the course of several months, we consulted with numerous individuals and organizations about housing in California. This report benefited greatly from these conversations. We know that they do not always agree with our findings or endorse our conclusions. We nevertheless gratefully acknowledge their willingness to discuss these topics with us, provide feedback, and share their valuable experience.

We consulted many local governments in the development of this report, including the California Association of Counties and the League of California Cities; the Cities of Mountain View, Santa Monica, Riverside, San Jose, and Yucaipa; and Marin and Sacramento Counties.

We also received significant guidance and feedback from academic economists and other housing experts, including experts from the Economic and Demographic Research Units at the California Department of Finance, the Public Policy Institute of California, and the Center for Real Estate Finance Research at New York University. Housing California was particularly helpful as we considered the role that affordable housing initiatives play within California's broader housing market. The California Building Industry Association provided important information and context about building costs in California.

LAO Publications

This report was prepared by Chas Alamo and Brian Uhler, and reviewed by Marianne O'Malley. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

To request publications call (916) 445-4656. This report and others, as well as an e-mail subscription service, are available on the LAO's website at www.lao.ca.gov. The LAO is located at 925 L Street, Suite 1000, Sacramento, CA 95814.

Document 17

HousingEconomics.com NAHB

State and Metro Area House Prices: the "Priced Out" Effect

Special Studies, August 1, 2014

by Natalia S. Siniavskaia, Ph.D.

One of the often overlooked impacts of building regulations is their effect on housing affordability. Every time a local or higher level government issues a new construction regulation it raises construction costs by, for example, increasing the price of construction permits or impact fees. Higher costs invariably translate into higher home prices and higher prices in turn disqualify more households from being able to afford new homes. NAHB Economics relies on its Priced Out model to evaluate effects of pending new regulations on housing affordability in local markets. The model estimates how many households can qualify for a mortgage before and after a house price increase. The resulting difference is the number of priced out households.

NAHB regularly updates the Priced Out model to account for changing economic environment. This article presents and discusses the new 2014 priced out estimates for the United States and 324 metro areas. The 2014 estimates show that nationally a $1,000 increase in the home price leads to pricing out about 206,269 households. The size of the impacts varies across states and metro areas and largely depends on their population, income distribution and new home prices.

The Priced Out Methodology and Data

Most home buyers take out a mortgage to finance a purchase of a new home, so the Priced Out model uses ability to qualify for a mortgage as an affordability standard. To qualify for conventional loans, housing expenses should not exceed 28 percent of homebuyers' gross monthly income. Monthly housing costs include principal and interest on the mortgage, property taxes and homeowner's Insurance – often abbreviated as "PITI". The affordability standard is thus a ratio of housing expenses to income, and the number of households that qualify for a mortgage to buy a home of a given price will depend on the income of households in an area and current mortgage rates.

The American Community Survey (ACS) which replaced the decennial Census long form provides the detailed income distribution for the United States and all states and metro areas with population of 65,000 people or more annually. The most recent income estimates are now available for 2012. To adjust for expected 2012-2014 income growth, NAHB uses the annual estimates of median family income published by the Department of Housing and Urban Development (HUD) for every state and county. The 2014 estimates were made available in December 2013[1]. To adjust for population growth, NAHB relies on annual household estimates reported by the ACS and extrapolates the most recent household growth into 2014. Table below shows the projected US household income distribution that underlies the 2014 priced out estimates.

[1] In cases, where counties comprising a metro area are estimated to have different median incomes, an estimate for the county containing the core urban area listed first in the name of the metro area is set to represent the median family income for the entire metro area.

US Household Income Distribution for 2014				
Income Range:			Households	Cumulative
$0	to	$10,219	9,037,576	9,037,576
$10,220	to	$15,328	6,661,937	15,699,513
$15,329	to	$20,438	6,469,445	22,168,958
$20,439	to	$25,548	6,640,002	28,808,960
$25,549	to	$30,658	6,039,287	34,848,247
$30,659	to	$35,768	6,199,590	41,047,837
$35,769	to	$40,877	5,664,673	46,712,511
$40,878	to	$45,987	5,635,887	52,348,398
$45,988	to	$51,097	4,943,760	57,292,157
$51,098	to	$61,317	9,372,913	66,665,070
$61,318	to	$76,646	11,849,492	78,514,562
$76,647	to	$102,195	14,015,339	92,529,901
$102,196	to	$127,744	9,281,283	101,811,184
$127,745	to	$153,293	5,330,786	107,141,970
$153,294	to	$204,391	5,436,702	112,578,672
$204,392	to	More	5,371,513	117,950,185

Other assumptions used in the priced out calculations are a down payment equal to 10 percent of the purchase price and a 30-year fixed rate mortgage. The mortgage interest rate is set at 4.5 percent with zero points. For this typical loan, the model also assumes lenders require private mortgage insurance with an annual premium of 45 basis points[2]. Effective local property tax rates come from the 2012 ACS. The ACS reports both median home values and real estate taxes paid and, thus, allows estimating the effective property tax rates for all metro areas. For the US, the median rate is $12 per $1,000 of property value. Property hazard insurance rates are constructed based on the 2007 ACS Public Use Microdata Sample (PUMS)[3]. For the US as a whole, the insurance rates work out to $5 per $1,000 of property value.

House Prices

The priced out analysis requires a representative house price as a starting point. Data availability pretty much limits the choices to basic summary statistics, like the median or average home price. Of the two, the median usually makes a better starting point for priced-out calculations, as the average tends to be skewed upward by a handful of expensive homes, while the median typically lies in the center of the price range where more new homes are built. To analyze changes in regulatory or other construction costs, prices of new homes are most relevant, since new homes are the ones directly affected by new regulations.

The median new home price for the United States is set at $275,000 for 2014. It is based on monthly median new home prices reported by the Census Bureau over 2013 and the first four months of 2014. First, the average of monthly

[2] In the PITI formula, mortgage insurance is essentially treated as part of the interest payment. Like interest on the loan, it is a percentage of the declining mortgage balance.

[3] Producing metro level estimates from the ACS PUMS involves aggregating PUMA level data according to the latest definitions of metropolitan areas. Due to complexity of these procedures and since metro level insurance rates tend to remain stable over time, NAHB revises these estimates only periodically.

medians is estimated over 2013. It is then adjusted for expected inflation based on price appreciation that took place over the first four months of 2014.

To estimate median new home prices for states and metropolitan areas, NAHB relies on data reported by the 2013 Census Bureau's Building Permits Survey and Survey of Construction (SOC). The Permits Survey provides both the number and aggregate value of new housing units authorized by building permits and, thus, allows calculating average permit values for all states and metro areas. For metro areas where average permit values are highly volatile and likely to have a large margin of error, the averages are smoothed out across most recent years.

Permit values, however, do not include brokerage commissions, marketing/finance costs, the cost of raw land and may not include the cost of lot's development. These additional costs are likely to differ across geographic areas but not available for metro areas. Nevertheless, the SOC provides enough data to tabulate median new home prices for all nine Census divisions and, consequently, division-wide ratios of median new home prices to average permit value. The ratios are then used as scaling mark-ups to convert state and metro average permit values into median new home prices. The resultant median new home prices range from less than $116,704 in Brownsville-Harlingen, TX to more than $878,625 in Bridgeport-Stamford-Norwalk, CT (see Table 2).

Metro Priced Out Results

Table 1 and Table 2 present the priced out results and data that underlie the estimates for all states and 324 metropolitan areas. In addition to median new home prices, the tables display income needed to qualify for a mortgage to buy a median price new and the number of households that will be priced out of the market for a new home if its price increases by $1,000.

A typical household in Brownsville-Harlingen, TX, where half of all new homes are sold for less than $116,704, needs an annual income of $35,831 to qualify for a mortgage, while a household in Bridgeport-Stamford-Norwalk, CT will need to earn $240,996 to qualify for a new home loan. Clearly, these differences are driven by large divergences in new home prices across metropolitan areas. The more expensive new homes, the higher monthly principal and interest payments, the higher income required to qualify for a mortgage. But the relationship is not always linear as property tax and insurance payments also affect monthly housing costs. For example, even though Brownsville-Harlingen, TX metro area has the lowest median price new homes, the income needed to qualify for a mortgage to buy these homes are not the lowest in the nation. Sumter, SC, Florence-Muscle Shoals, AL, Valdosta, GA, Clarksville, TN-KY all have new homes that are more expensive but require a lower income to qualify for a mortgage. This is a result of higher property tax and insurance payments in Texas.

Next, the priced out model estimates how many households in each state and metro area actually earn enough income to qualify for new home loans. Not surprisingly, in Bridgeport-Stamford-Norwalk, CT metro area where new homes largely target the high income households, only 1 percent of all households residing in this metro area earn enough money to qualify for a new home loan. Among other metro areas with least affordable new homes are Buffalo-Niagara Falls, NY, Barnstable Town, MA, Sebastian-Vero Beach, FL, and Napa, CA where less than 15 percent of all households can afford a median price new home. In sharp contrast stand metro areas like Dover, DE and Jacksonville, NC where two out of three households residing in these metros can afford a median-priced new home.

These differences translate into different effects of adding $1,000 to a new home price. When starting affordability of new homes is low the priced out effects will be small since they would only affect a few households at the thin end of the household income distribution. On the contrary, if new homes are widely affordable, rising home prices would affect a bigger slice of households in the thicker part of the income distribution and the priced out effects will be larger.

Increasing a price of a new home in New York-Northern New Jersey-Long Island, NY-NJ-PA, by $1,000 disqualifies 5,742 households from buying a new home. This is by far the largest priced out effect among metropolitan areas, mainly as a result of being the most populous metro area with more than 7 million households. The second largest number of priced out households is in Chicago-Naperville-Joliet, IL-IN-WI, where more than 5,325 households are priced out. The Chicago metro is half the size of the New-York metro area but the priced out effects are similarly large. This is because the Chicago area is relatively more affordable to begin with. Close to a third of all local households are able to afford new homes here while in the New-York area only 19 percent of households can qualify for new home mortgages before any price hikes.

Los Angeles-Long Beach-Santa Ana, CA - the second most populous metro area with more than 4 million households but low affordability – registers only the sixth highest number of priced out households, 3,813. Ahead of Los Angeles on the priced-out effects list are three large metro areas with more affordable new homes. In Houston-Sugar Land-Baytown, TX and Atlanta-Sandy Springs-Marietta, GA, where almost half of all households can afford new homes, the priced out effects exceed 4,000 households. In Philadelphia-Camden-Wilmington, PA-NJ-DE-MD where 41 percent of households can afford new homes an increase in new home price of $1,000 disqualifies 3,914 households.

At the other end of the spectrum are small and often unaffordable high new home priced metropolitan areas. In Barnstable Town, MA where half of all new homes sell for more than $616,381, adding another thousand to a price, affects only 24 households, since there were only a few of them who could afford such expensive new homes in the first place. In Napa, CA, where new homes are similarly unaffordable the priced out effects are only limited to 19 households. Looking at the affordable metro areas, where close or more than fifty percent of households can afford new homes, the priced out effects are typically large and can often disqualify thousands of new home buyers, as in case of Houston-Sugar Land-Baytown, TX, Atlanta-Sandy Springs-Marietta, GA , Las Vegas-Paradise, NV MSA, Baltimore-Towson, MD among other metro areas.

Among the states, Texas registers the highest priced out effects where more than 18,000 households can be pushed out of the market for a median-priced new home here if its price increases by $1,000. California that is more populous but has less affordable new homes register the second highest priced out effects – 14,423 households.

Conclusion

Quite frequently and often unintentionally local regulations raise construction costs and trigger hikes in home prices. NAHB consistently relies on the priced out model to estimate the impacts of price changes. Even though the model does neither answer all questions nor estimate effects of regulation on new home sales or housing starts, it highlights often overlooked effects of regulation on affordability of new homes. The new 2014 estimates show that, in relatively affordable metro areas, hundreds and sometimes thousands of households can be priced out of the new home markets as a result of prices rising by $1000.

Note: Regulatory Costs Boost Home Prices by up to 39 Percent More than Building Fee Increases

Hidden in median new home prices is the cost of government regulations. NAHB research shows that, on average, regulations imposed by government at all level account for 25 percent of the final price of a new single family home built for sale[4]. Every time a local or regional government raises construction costs by, for example, increasing the price of construction permits or impact fees, the cost of building a house rises. In fact, the final price of the home to the buyers will usually go up by more than the increase in the government fee. This is because each time construction costs

[4] See P. Emrath "How Government Regulation Affects the Price of a New Home", Housing Economics Online, July 2011

increase other costs such as commissions and financing charges automatically rise as well. As a result, most cost increases are passed on to the buyers with additional charges. The size of these charges depends both on the type of fee/cost increase and when it is imposed in the development/construction process. NAHB estimates that the add-on charges range from 0 percent if a fee is imposed directly on buyers to 39 percent if cost is incurred when applying for site development approval (see Table 3). So that for every $1 increase in fees incurred, for example, when acquiring a building permit, the final price of a new home to its final customer rises by $1.20. Alternatively, every $833 increase in fees results in a $1,000 increase in house prices.

Table 3: Additional Charges on Building Fees

Building Costs/Fees	Add-on Charges
Imposed directly on buyer	0%
During construction	16%
At start of construction	18%
When building permit acquired	20%
During development	37%
When applying for site development approval	39%

NATIONAL ASSOCIATION OF HOME BUILDERS

Table1. Households Priced Out of the Market by a $1,000 Price Increase, 2014

Metropolitan Statistical Area	Median New Home Price	Income Needed to Qualify	Households	
			All	Priced Out
Abilene, TX MSA	240,384	71,059	62,311	144
Akron, OH MSA	269,153	75,822	293,691	407
Albany, GA MSA	140,973	38,181	56,249	160
Albany-Schenectady-Troy, NY MSA	401,105	117,214	336,867	369
Albuquerque, NM MSA	225,407	57,214	344,294	659
Alexandria, LA MSA	207,636	51,993	69,543	178
Allentown-Bethlehem-Easton, PA-NJ MSA	307,829	87,794	318,081	513
Altoona, PA MSA	349,984	92,322	48,629	44
Amarillo, TX MSA	272,883	83,203	94,499	142
Ames, IA MSA	284,375	78,675	37,083	53
Anchorage, AK MSA	373,186	98,659	131,380	192
Anderson, IN MSA	259,819	70,209	47,967	105
Anderson, SC MSA	230,499	56,789	71,988	110
Ann Arbor, MI MSA	270,400	78,181	143,994	233
Anniston-Oxford, AL MSA	171,771	43,116	48,622	117
Appleton, WI MSA	251,328	72,245	87,202	212
Asheville, NC MSA	240,017	58,015	173,969	333
Athens-Clarke County, GA MSA	228,491	58,608	70,685	128
Atlanta-Sandy Springs-Marietta, GA MSA	221,742	56,955	1,980,222	4,135
Atlantic City-Hammonton, NJ MSA	299,539	90,537	100,674	136
Auburn-Opelika, AL MSA	314,741	78,066	54,042	74
Augusta-Richmond County, GA-SC MSA	208,798	52,477	198,133	407
Austin-Round Rock-San Marcos, TX MSA	232,454	69,043	667,355	1,285
Bakersfield-Delano, CA MSA	241,976	62,459	258,396	479
Baltimore-Towson, MD MSA	228,013	57,989	1,060,179	2,014
Barnstable Town, MA MSA	616,381	151,432	80,879	24
Baton Rouge, LA MSA	226,874	56,548	306,517	530
Battle Creek, MI MSA	241,340	72,350	56,027	114
Bay City, MI MSA	240,615	70,478	45,788	79
Beaumont-Port Arthur, TX MSA	183,574	55,775	142,970	349
Bellingham, WA MSA	293,969	72,746	77,203	145
Bend, OR MSA	326,459	81,842	68,995	101
Billings, MT MSA	247,752	63,972	67,882	153
Binghamton, NY MSA	255,988	82,431	103,527	164
Birmingham-Hoover, AL MSA	263,064	64,348	447,016	681
Blacksburg-Christiansburg-Radford, VA MSA	210,790	52,204	67,158	141
Bloomington, IN MSA	205,783	51,066	77,320	147
Bloomington-Normal, IL MSA	207,654	62,994	71,053	172
Boise City-Nampa, ID MSA	269,591	66,056	239,837	474
Boston-Cambridge-Quincy, MA-NH MSA	430,296	111,855	1,749,426	1,829
Boulder, CO MSA	310,031	74,378	128,370	191
Bowling Green, KY MSA	202,515	52,107	53,579	93
Bremerton-Silverdale, WA MSA	293,074	74,090	90,100	167
Bridgeport-Stamford-Norwalk, CT MSA	878,625	240,996	339,772	186
Brownsville-Harlingen, TX MSA	116,704	35,831	126,119	478
Brunswick, GA MSA	289,183	73,721	40,866	59
Buffalo-Niagara Falls, NY MSA	395,105	128,302	469,199	266
Burlington, NC MSA	155,202	38,966	56,995	154
Canton-Massillon, OH MSA	220,267	60,406	165,387	326
Cape Coral-Fort Myers, FL MSA	292,932	80,100	259,094	279
Carson City, NV MSA	343,367	84,201	22,243	30
Cedar Rapids, IA MSA	146,885	41,106	99,047	218
Champaign-Urbana, IL MSA	254,760	76,429	93,065	141
Charleston-North Charleston-Summerville, SC	288,677	72,424	269,643	491
Charlotte-Gastonia-Rock Hill, NC-SC MSA	243,499	62,366	683,782	1,181
Charlottesville, VA MSA	262,901	63,558	78,144	128
Chattanooga, TN-GA MSA	182,679	46,376	210,567	510

NATIONAL ASSOCIATION OF HOME BUILDERS

Table1. Households Priced Out of the Market by a $1,000 Price Increase, 2014

Metropolitan Statistical Area	Median New Home Price	Income Needed to Qualify	Households	
			All	Priced Out
Chicago-Joliet-Naperville, IL-IN-WI MSA	308,424	92,108	3,473,022	5,325
Chico, CA MSA	274,636	67,806	89,007	128
Cincinnati-Middletown, OH-KY-IN MSA	244,344	66,318	865,663	1,623
Clarksville, TN-KY MSA	140,513	35,802	103,093	306
Cleveland, TN MSA	159,148	39,165	49,234	138
Cleveland-Elyria-Mentor, OH MSA	272,149	79,010	830,043	1,103
Coeur d'Alene, ID MSA	250,758	60,527	55,100	100
College Station-Bryan, TX MSA	192,998	56,025	88,453	198
Columbia, MO MSA	214,130	54,865	76,589	128
Columbia, SC MSA	213,026	52,771	291,253	670
Columbus, GA-AL MSA	188,924	47,549	114,070	247
Columbus, IN MSA	270,724	69,587	30,780	66
Columbus, OH MSA	254,712	72,249	725,749	1,452
Corpus Christi, TX MSA	192,237	59,548	163,365	405
Dallas-Fort Worth-Arlington, TX MSA	289,824	89,627	2,412,714	3,676
Dalton, GA MSA	168,738	42,291	48,593	122
Danville, IL MSA	130,985	39,651	32,323	106
Danville, VA MSA	167,278	41,519	49,204	168
Davenport-Moline-Rock Island, IA-IL MSA	220,693	64,422	158,920	363
Dayton, OH MSA	291,432	84,249	333,881	411
Decatur, AL MSA	179,407	45,017	61,915	106
Decatur, IL MSA	225,354	69,191	52,324	109
Deltona-Daytona Beach-Ormond Beach, FL M	357,650	96,058	213,555	214
Denver-Aurora-Broomfield, CO MSA	306,315	74,688	1,049,652	1,791
Des Moines-West Des Moines, IA MSA	269,083	76,308	245,972	507
Detroit-Warren-Livonia, MI MSA	294,783	91,235	1,666,009	2,434
Dothan, AL MSA	238,111	58,693	53,913	93
Dover, DE MSA	158,002	37,589	65,290	148
Duluth, MN-WI MSA	214,426	56,782	117,200	287
Durham-Chapel Hill, NC MSA	252,354	65,845	216,839	353
Eau Claire, WI MSA	223,405	63,094	64,452	158
El Centro, CA MSA	234,495	59,418	42,914	68
El Paso, TX MSA	171,999	51,310	267,497	694
Elizabethtown, KY MSA	178,046	45,538	48,608	175
Elkhart-Goshen, IN MSA	218,863	57,199	70,981	161
Erie, PA MSA	300,781	88,158	111,662	188
Eugene-Springfield, OR MSA	286,284	73,007	147,425	227
Evansville, IN-KY MSA	183,817	47,332	149,798	256
Fairbanks, AK MSA	228,035	61,929	33,892	98
Fargo, ND-MN MSA	223,606	62,807	91,187	195
Farmington, NM MSA	254,662	62,485	35,965	90
Fayetteville, NC MSA	203,097	53,953	147,433	393
Fayetteville-Springdale-Rogers, AR-MO MSA	271,763	67,378	182,509	276
Flagstaff, AZ MSA	229,039	54,724	49,607	94
Flint, MI MSA	225,094	71,795	171,869	342
Florence-Muscle Shoals, AL MSA	138,411	34,354	54,083	175
Fond du Lac, WI MSA	244,900	71,637	41,020	105
Fort Collins-Loveland, CO MSA	289,367	70,156	128,382	199
Fort Smith, AR-OK MSA	190,863	48,139	124,807	289
Fort Wayne, IN MSA	238,403	62,176	167,061	338
Fresno, CA MSA	293,061	73,897	304,713	456
Gadsden, AL MSA	170,888	43,165	36,353	62
Gainesville, FL MSA	202,516	53,567	94,526	184
Gainesville, GA MSA	207,524	51,934	61,424	152
Glens Falls, NY MSA	269,828	77,148	51,033	75
Goldsboro, NC MSA	188,687	49,767	45,559	106
Grand Junction, CO MSA	258,995	60,551	56,846	88

NATIONAL ASSOCIATION OF HOME BUILDERS

Table1. Households Priced Out of the Market by a $1,000 Price Increase, 2014

Metropolitan Statistical Area	Median New Home Price	Income Needed to Qualify	Households	
			All	Priced Out
Grand Rapids-Wyoming, MI MSA	253,115	71,378	297,890	641
Greeley, CO MSA	269,681	64,966	96,568	189
Green Bay, WI MSA	231,028	65,732	124,309	224
Greensboro-High Point, NC MSA	288,492	74,552	295,059	445
Greenville, NC MSA	184,839	48,872	90,674	204
Greenville-Mauldin-Easley, SC MSA	277,468	67,903	254,703	380
Gulfport-Biloxi, MS MSA	162,576	44,342	108,125	270
Hagerstown-Martinsburg, MD-WV MSA	206,117	51,465	106,312	238
Hanford-Corcoran, CA MSA	189,803	47,603	39,541	114
Harrisburg-Carlisle, PA MSA	323,166	87,531	219,380	310
Harrisonburg, VA MSA	175,588	41,958	47,538	122
Hartford-West Hartford-East Hartford, CT M	319,298	91,708	477,064	723
Hattiesburg, MS MSA	243,791	64,017	52,169	88
Hickory-Lenoir-Morganton, NC MSA	252,219	62,967	150,672	276
Holland-Grand Haven, MI MSA	247,807	67,911	97,057	222
Honolulu, HI MSA	393,669	87,662	307,228	420
Hot Springs, AR MSA	262,134	65,875	46,326	66
Houma-Bayou Cane-Thibodaux, LA MSA	271,420	69,031	72,220	115
Houston-Sugar Land-Baytown, TX MSA	195,144	60,997	2,167,245	4,234
Huntsville, AL MSA	165,823	40,142	171,081	384
Idaho Falls, ID MSA	161,729	40,306	41,575	108
Indianapolis-Carmel, IN MSA	260,699	67,557	697,114	1,312
Iowa City, IA MSA	271,832	76,239	67,287	132
Ithaca, NY MSA	280,564	89,282	36,575	40
Jackson, MI MSA	188,708	52,506	63,934	190
Jackson, MS MSA	244,997	63,545	192,760	370
Jackson, TN MSA	193,808	49,633	47,158	84
Jacksonville, FL MSA	280,185	73,490	508,999	856
Jacksonville, NC MSA	148,170	37,704	66,124	233
Janesville, WI MSA	213,437	64,369	62,636	152
Jefferson City, MO MSA	224,583	57,677	59,464	126
Johnson City, TN MSA	163,973	40,268	83,177	239
Johnstown, PA MSA	301,932	84,153	60,029	66
Joplin, MO MSA	144,861	37,416	72,896	245
Kalamazoo-Portage, MI MSA	254,025	72,309	135,068	243
Kankakee-Bradley, IL MSA	191,793	58,765	41,504	111
Kansas City, MO-KS MSA	292,243	80,318	814,964	1,194
Kennewick-Pasco-Richland, WA MSA	328,527	85,647	92,841	129
Killeen-Temple-Fort Hood, TX MSA	169,434	50,058	146,822	367
Kingsport-Bristol-Bristol, TN-VA MSA	179,999	45,171	122,105	323
Kingston, NY MSA	377,249	114,249	72,871	74
Knoxville, TN MSA	213,424	52,723	294,901	537
Kokomo, IN MSA	215,884	54,403	39,545	70
La Crosse, WI-MN MSA	219,155	62,946	57,652	92
Lafayette, IN MSA	231,863	58,658	80,628	156
Lafayette, LA MSA	187,491	47,716	110,350	217
Lake Charles, LA MSA	234,773	60,482	81,131	147
Lakeland-Winter Haven, FL MSA	236,300	64,659	235,702	358
Lancaster, PA MSA	269,950	74,049	196,147	413
Lansing-East Lansing, MI MSA	254,683	75,840	184,760	390
Laredo, TX MSA	164,186	50,884	72,117	196
Las Cruces, NM MSA	231,803	57,551	71,069	130
Las Vegas-Paradise, NV MSA	182,564	46,013	755,412	2,044
Lebanon, PA MSA	262,028	71,597	53,811	115
Lewiston, ID-WA MSA	255,924	65,790	26,662	59
Lexington-Fayette, KY MSA	175,954	44,491	194,617	509
Lima, OH MSA	213,974	58,512	40,561	100

NATIONAL ASSOCIATION OF HOME BUILDERS

Table1. Households Priced Out of the Market by a $1,000 Price Increase, 2014

Metropolitan Statistical Area	Median New Home Price	Income Needed to Qualify	Households	
			All	Priced Out
Lincoln, NE MSA	229,995	66,939	123,808	266
Little Rock-North Little Rock-Conway, AR M	207,826	52,753	283,816	636
Logan, UT-ID MSA	223,458	53,659	42,138	82
Longview, TX MSA	155,971	44,591	72,341	218
Longview, WA MSA	246,663	65,225	35,426	77
Los Angeles-Long Beach-Santa Ana, CA MS/	445,105	107,294	4,292,536	3,813
Louisville/Jefferson County, KY-IN MSA	229,997	59,226	533,456	1,140
Lubbock, TX MSA	250,013	76,069	111,958	173
Lynchburg, VA MSA	223,782	54,240	102,347	196
Macon, GA MSA	198,624	52,472	84,446	169
Madera-Chowchilla, CA MSA	271,959	67,513	41,538	73
Madison, WI MSA	293,258	83,743	244,625	381
Manchester-Nashua, NH MSA	323,009	95,042	159,493	230
Mansfield, OH MSA	222,557	61,861	48,355	103
McAllen-Edinburg-Mission, TX MSA	137,758	42,748	237,476	656
Medford, OR MSA	272,536	69,332	74,464	156
Memphis, TN-MS-AR MSA	194,193	52,811	493,575	1,183
Merced, CA MSA	351,321	88,213	79,793	92
Miami-Fort Lauderdale-Pompano Beach, FL M	342,099	97,050	2,058,718	1,953
Midland, TX MSA	240,632	69,973	51,972	111
Milwaukee-Waukesha-West Allis, WI MSA	346,831	100,111	641,192	943
Minneapolis-St. Paul-Bloomington, MN-WI M	336,496	89,372	1,327,842	2,009
Mobile, AL MSA	163,596	42,440	154,719	327
Modesto, CA MSA	255,320	64,669	166,773	281
Monroe, LA MSA	196,501	50,170	70,146	106
Monroe, MI MSA	227,025	62,366	57,536	106
Montgomery, AL MSA	199,530	48,515	150,721	276
Morgantown, WV MSA	208,761	51,142	51,113	107
Morristown, TN MSA	203,473	50,167	50,289	100
Mount Vernon-Anacortes, WA MSA	245,286	62,316	42,494	77
Muncie, IN MSA	208,458	55,525	48,842	103
Muskegon-Norton Shores, MI MSA	205,803	60,633	65,952	129
Myrtle Beach-North Myrtle Beach-Conway, S	203,843	50,379	137,484	283
Napa, CA MSA	580,197	142,369	44,979	19
Naples-Marco Island, FL MSA	413,389	105,952	123,245	75
Nashville-Davidson--Murfreesboro--Franklin,	261,290	65,354	622,873	1,096
New Haven-Milford, CT MSA	318,180	93,482	337,231	514
New Orleans-Metairie-Kenner, LA MSA	248,612	65,357	476,731	750
New York-Northern New Jersey-Long Island,	407,805	113,408	7,040,717	5,742
Niles-Benton Harbor, MI MSA	355,099	96,306	67,997	80
North Port-Bradenton-Sarasota, FL MSA	290,155	78,160	294,796	371
Ocala, FL MSA	226,250	60,413	134,869	333
Ocean City, NJ MSA	448,406	118,716	39,273	35
Odessa, TX MSA	216,022	62,359	48,352	108
Ogden-Clearfield, UT MSA	285,382	69,601	182,900	391
Oklahoma City, OK MSA	230,816	63,382	487,440	935
Olympia, WA MSA	290,425	74,854	103,069	207
Omaha-Council Bluffs, NE-IA MSA	219,334	65,366	356,329	731
Orlando-Kissimmee-Sanford, FL MSA	323,141	85,927	805,830	955
Oshkosh-Neenah, WI MSA	249,872	72,679	66,752	154
Oxnard-Thousand Oaks-Ventura, CA MSA	391,706	94,599	272,711	343
Palm Bay-Melbourne-Titusville, FL MSA	359,862	98,315	221,973	257
Panama City-Lynn Haven-Panama City Beach	187,641	48,955	66,256	123
Pascagoula, MS MSA	162,073	44,932	55,327	161
Pensacola-Ferry Pass-Brent, FL MSA	171,995	45,705	187,473	489
Peoria, IL MSA	279,063	83,796	154,710	283
Philadelphia-Camden-Wilmington, PA-NJ-DE	270,854	75,346	2,240,167	3,914

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Table1. Households Priced Out of the Market by a $1,000 Price Increase, 2014

Metropolitan Statistical Area	Median New Home Price	Income Needed to Qualify	Households	
			All	Priced Out
Phoenix-Mesa-Glendale, AZ MSA	299,444	74,110	1,594,811	2,670
Pittsburgh, PA MSA	383,844	110,558	1,012,323	934
Port St. Lucie, FL MSA	346,618	99,486	183,423	199
Portland-South Portland-Biddeford, ME MSA	321,500	84,074	218,046	281
Portland-Vancouver-Hillsboro, OR-WA MSA	324,988	83,386	873,789	1,190
Poughkeepsie-Newburgh-Middletown, NY M	315,346	93,615	231,194	383
Prescott, AZ MSA	271,476	65,766	98,451	184
Providence-New Bedford-Fall River, RI-MA I	314,448	84,389	623,169	805
Provo-Orem, UT MSA	289,202	68,850	149,368	309
Pueblo, CO MSA	212,056	54,060	62,804	182
Punta Gorda, FL MSA	255,458	72,257	79,495	189
Racine, WI MSA	283,360	83,396	75,451	110
Raleigh-Cary, NC MSA	239,300	60,054	477,113	986
Reading, PA MSA	255,169	74,361	143,350	309
Redding, CA MSA	242,398	60,089	66,329	109
Reno-Sparks, NV MSA	302,827	75,485	173,013	295
Richmond, VA MSA	220,984	54,604	481,937	1,003
Riverside-San Bernardino-Ontario, CA MSA	294,917	74,642	1,269,021	2,050
Roanoke, VA MSA	247,589	61,709	138,319	310
Rochester, MN MSA	289,029	76,208	74,890	139
Rochester, NY MSA	363,279	119,792	421,843	418
Rockford, IL MSA	161,275	52,310	132,629	402
Rocky Mount, NC MSA	197,825	52,868	52,983	107
Rome, GA MSA	233,496	60,762	33,306	73
Sacramento--Arden-Arcade--Roseville, CA M	368,853	92,854	796,644	1,004
Saginaw-Saginaw Township North, MI MSA	220,475	64,958	81,456	155
Salem, OR MSA	278,962	72,881	149,861	271
Salinas, CA MSA	336,843	81,481	125,003	156
Salisbury, MD MSA	172,707	43,739	44,757	78
Salt Lake City, UT MSA	286,243	69,358	389,439	777
San Antonio-New Braunfels, TX MSA	227,539	68,643	774,537	1,712
San Diego-Carlsbad-San Marcos, CA MSA	443,256	106,876	1,117,831	912
San Francisco-Oakland-Fremont, CA MSA	441,837	106,571	1,665,167	1,597
San Jose-Sunnyvale-Santa Clara, CA MSA	447,432	107,821	647,818	729
San Luis Obispo-Paso Robles, CA MSA	419,878	100,466	103,348	137
Sandusky, OH MSA	243,727	66,843	32,955	68
Santa Barbara-Santa Maria-Goleta, CA MSA	427,335	101,612	143,151	120
Santa Cruz-Watsonville, CA MSA	287,744	68,260	90,282	151
Santa Fe, NM MSA	180,544	42,743	65,157	119
Santa Rosa-Petaluma, CA MSA	325,692	79,106	191,860	262
Savannah, GA MSA	205,157	53,207	139,421	311
Scranton--Wilkes-Barre, PA MSA	345,255	96,513	222,523	274
Seattle-Tacoma-Bellevue, WA MSA	368,710	94,273	1,397,266	1,775
Sebastian-Vero Beach, FL MSA	433,676	117,492	61,928	37
Sheboygan, WI MSA	295,862	85,947	48,035	79
Shreveport-Bossier City, LA MSA	199,792	51,275	151,106	284
Sioux City, IA-NE-SD MSA	269,059	78,691	50,974	72
Sioux Falls, SD MSA	180,932	49,784	89,630	283
South Bend-Mishawaka, IN-MI MSA	275,678	72,826	119,914	222
Spartanburg, SC MSA	169,499	42,354	115,152	317
Spokane, WA MSA	358,134	93,874	192,335	244
Springfield, IL MSA	248,178	74,317	87,129	142
Springfield, MA MSA	357,528	97,210	259,426	343
Springfield, MO MSA	210,300	53,752	184,137	450
Springfield, OH MSA	245,947	68,424	53,722	95
St. Cloud, MN MSA	238,803	62,543	71,849	136
St. George, UT MSA	218,646	52,782	52,381	121

NATIONAL ASSOCIATION OF HOME BUILDERS

Table1. Households Priced Out of the Market by a $1,000 Price Increase, 2014

Metropolitan Statistical Area	Median New Home Price	Income Needed to Qualify	Households	
			All	Priced Out
St. Joseph, MO-KS MSA	212,137	55,439	50,925	103
St. Louis, MO-IL MSA	263,137	72,040	1,115,669	2,071
State College, PA MSA	261,048	69,018	53,699	88
Stockton, CA MSA	311,589	78,983	219,842	252
Sumter, SC MSA	131,871	33,549	38,919	124
Syracuse, NY MSA	299,007	95,900	268,267	387
Tallahassee, FL MSA	220,666	56,798	137,300	279
Tampa-St. Petersburg-Clearwater, FL MSA	376,565	103,652	1,177,086	842
Terre Haute, IN MSA	203,506	54,299	73,531	173
Toledo, OH MSA	255,682	73,852	260,186	362
Topeka, KS MSA	216,320	62,215	91,646	221
Trenton-Ewing, NJ MSA	446,961	136,243	134,536	88
Tucson, AZ MSA	287,021	73,702	399,026	660
Tulsa, OK MSA	223,880	60,536	375,628	867
Tuscaloosa, AL MSA	248,394	59,158	79,981	120
Tyler, TX MSA	232,175	65,966	74,360	129
Utica-Rome, NY MSA	298,972	94,627	118,949	169
Valdosta, GA MSA	137,268	35,630	54,958	196
Vallejo-Fairfield, CA MSA	255,570	64,307	143,461	259
Vineland-Millville-Bridgeton, NJ MSA	177,370	55,125	50,779	104
Virginia Beach-Norfolk-Newport News, VA-I	234,587	59,056	648,268	1,370
Visalia-Porterville, CA MSA	253,824	63,209	134,074	272
Waco, TX MSA	201,313	60,613	87,319	163
Warner Robins, GA MSA	232,089	60,349	53,293	116
Waterloo-Cedar Falls, IA MSA	232,706	64,308	65,726	166
Wausau, WI MSA	243,269	70,353	49,835	111
Wenatchee-East Wenatchee, WA MSA	239,422	60,552	42,564	94
Wichita Falls, TX MSA	223,899	70,763	64,542	159
Wichita, KS MSA	226,945	64,818	245,039	586
Williamsport, PA MSA	289,987	79,994	43,826	70
Wilmington, NC MSA	266,712	66,865	152,944	282
Winchester, VA-WV MSA	233,050	56,203	51,402	62
Winston-Salem, NC MSA	189,420	48,459	201,425	445
Worcester, MA MSA	296,995	79,168	307,142	428
Yakima, WA MSA	276,602	72,065	75,369	135
York-Hanover, PA MSA	265,832	74,801	170,288	352
Youngstown-Warren-Boardman, OH-PA MS/	232,467	65,474	224,983	405
Yuba City, CA MSA	246,352	63,666	57,492	115
Yuma, AZ MSA	178,173	46,100	69,720	187

NATIONAL ASSOCIATION OF HOME BUILDERS

Table 2. Households Priced Out of the Market by a $1,000 Price Increase, 2014

State	Median New Home Price	Income Needed to Qualify	Households	
			All	Priced Out
United States	275,000	73,649	117,950,185	206,269
Alabama	216,824	54,196	1,846,416	3,459
Alaska	325,180	86,106	240,666	365
Arizona	287,001	71,864	2,466,063	4,157
Arkansas	219,523	56,290	1,177,040	2,568
California	365,167	89,309	12,722,186	14,423
Colorado	342,690	82,957	2,038,141	2,540
Connecticut	491,425	140,012	1,370,235	1,018
Delaware	152,017	36,066	354,999	720
Florida	319,174	86,902	7,384,825	8,296
Georgia	217,402	56,242	3,610,908	7,302
Hawaii	384,693	85,981	446,122	594
Idaho	252,325	62,339	588,976	1,088
Illinois	278,778	85,014	4,836,857	7,578
Indiana	247,100	64,441	2,506,214	4,683
Iowa*	192,500	54,379	1,247,875	3,126
Kansas	264,152	75,540	1,138,738	2,263
Kentucky	191,386	49,975	1,778,941	3,927
Louisiana	222,820	57,406	1,754,897	3,189
Maine	305,742	81,351	559,561	679
Maryland	236,366	60,421	2,204,876	4,077
Massachusetts	432,724	111,864	2,503,159	2,506
Michigan	262,479	76,700	3,914,075	5,158
Minnesota	299,182	79,693	2,143,218	3,172
Mississippi	181,372	48,929	1,109,834	2,338
Missouri	241,663	64,150	2,395,676	4,160
Montana	252,007	64,633	418,478	806
Nebraska	224,127	67,330	753,507	1,632
Nevada	203,067	51,139	1,056,922	2,470
New Hampshire	351,646	103,152	524,545	632
New Jersey	320,667	95,594	3,262,062	4,897
New Mexico	232,383	58,481	760,438	1,389
New York	411,169	113,548	7,341,977	6,794
North Carolina	236,763	60,597	3,829,129	7,913
North Dakota	228,691	64,894	306,553	628
Ohio	254,742	71,471	4,587,078	8,724
Oklahoma	221,891	60,090	1,454,571	3,157
Oregon	308,706	79,240	1,516,913	1,839
Pennsylvania	318,277	88,292	5,000,347	6,820
Rhode Island	315,209	87,044	414,736	549
South Carolina	264,082	65,971	1,824,935	2,880
South Dakota	200,313	56,488	324,868	752
Tennessee	217,429	55,269	2,505,609	5,227
Texas	222,052	68,010	9,217,089	18,250
Utah	277,172	67,170	919,013	1,838
Vermont	341,178	95,924	260,860	383
Virginia	225,747	55,851	3,137,955	5,779
Washington	331,450	85,484	2,645,229	3,469
West Virginia	199,156	50,250	753,970	1,629
Wisconsin	260,618	75,572	2,314,606	4,912
Wyoming	335,960	82,560	225,474	313

**New home price provided by a local HBA*

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Housing costs push commuters outward, expanding definition of Bay Area, study says

By Erin Baldassari, ebaldassari@bayareanewsgroup.com
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OAKLAND -- Over the past decade or more, the Bay Area's boundaries have been bleeding into surrounding counties as skyrocketing housing prices push residents farther from jobs centered in Silicon Valley and San Francisco.

Those residents are still employed in the Bay Area though, leading to longer commutes and mounting pressure on the region's roads and rails. While that trend has been ongoing for some time, the problems resulting from it have become particularly acute, according to a new report released Thursday by the Bay Area Council, a business-sponsored public policy advocate.

"All these people are moving around on the most congested corridors," said Jeff Bellisario, the research manager for the Bay Area Council Economic Institute, "and there's no great transit options for these commuters."

Approximately 602,000 vehicles enter and exit the nine-county Bay Area from other parts of what the council has dubbed the "Northern California Megaregion," an area comprising six counties in and around Sacramento, three Northern San Joaquin Valley area counties, and three Monterey Bay area counties.

The Northern San Joaquin Valley area is leading the region in the number of workers it is sending to Bay Area companies. Between 1990 and 2013, the number of people commuting from the valley to job centers in the Bay Area more than doubled, growing around 32,000 commuters to nearly 65,000, according to the report.

"Silicon Valley really likes our labor force, but our labor force really doesn't like the Silicon Valley's housing costs," said Mike Ammann, president and CEO of San Joaquin Partnership, a nonprofit economic development corporation.

San Joaquin Valley was also one of the hardest hit in the housing market crash that spurred the Great Recession, but Ammann said the double-digit unemployment numbers in the area have since come down. Manufacturing has picked up, as has the county's distribution and transportation industries, and more housing is being built in the region again, he said.

However, this uneven growth in jobs and housing has caused gridlock on Interstate 580, and while the Altamont Corridor Express train, or ACE, is not yet at capacity, it soon will be, said Dan Leavitt, the transit agency's manager of regional initiatives.

The agency's ridership has roughly doubled in the past five years, and ACE is looking for ways to expand, Levitt said. It's currently in the process of drafting an environmental impact report, set to be released in the fall, that would study an increase in the number of round trips from four to six, and within the next decade, Leavitt said the agency hopes to offer 10 round trips.

To do that, the passenger service needs to add a second set of railroad tracks in some places, as well as make other improvements, Leavitt said, a roughly $200 million investment for the first phase and another $200 million for the second. ACE already has funding for the planning and preconstruction phase of the project, but not the actual construction, he said.

"In order for us to (expand service), we would need more infrastructure along our lines, but also other things like equipment and more parking," Leavitt said. "First and foremost, the biggest hurdle is funding."

While the state has some cap-and-trade funds available for commuter rail projects, Leavitt said the project will require investment from counties along the rail line serves.

Encouraging local governments to think regionally has never been easy, said Randy Rentschler, the legislation and public affairs director of the Metropolitan Transportation Commission, but encouraging municipal and county governments to do so has never been more critical, he said.

He pointed to the express lane on Interstate 580, which opened earlier this year, as an example of regional collaboration that provided some relief to drivers stuck in gridlock.

"The planning and the fight ... to get that money on those lanes; we had to take on most of the rest of the state to make sure that these congested areas were prioritized," Rentschler said. "We succeeded in part because we worked closely with our friends in the San Joaquin Valley area."

As people continue to move further from job centers in search of cheaper housing, Rentschler said the problems will only get worse.

"Being the repository for your neighbor's housing stock can only go so far," he said.

The report recommends, among other things, investing in regional rail lines, streamlining permitting for housing construction so it can be built closer to job centers, and encouraging job growth in the San Joaquin Valley and Sacramento areas to help relieve the daily migration to the Bay Area. Coupled with that is a long-term strategy to invest in education in places like Sacramento and Merced, so that companies can more readily access a high-skilled labor pool, Bellisario said.

"Part of the conversation is about transportation, part is about the economy, but really, they both go together," Bellisario said. "We need to spread the economic footprint more evenly across the entire megaregion."

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