California Executive Summary

2017 Q3

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September 15, 2017

The California legislature has declared this to be *the year of housing*. Well over 100 separate housing-related pieces of legislation have surfaced in Sacramento. The goal on the part of elected officials is to use legislative remedies to beat back a housing affordability crisis, which is driving businesses, households and individuals from the State. As we noted in previous forecast publications, every year, more people leave California in search of economic opportunity in one of the other states than come to California to find economic opportunity here. The rate of out migration has accelerated significantly since the Great Recession. The problem has become too obvious even for California legislators to ignore.

The nature of the State's housing shortage and the legislative response to that shortage highlight why the economic growth premium traditionally enjoyed by the State of California is slowly slipping away.

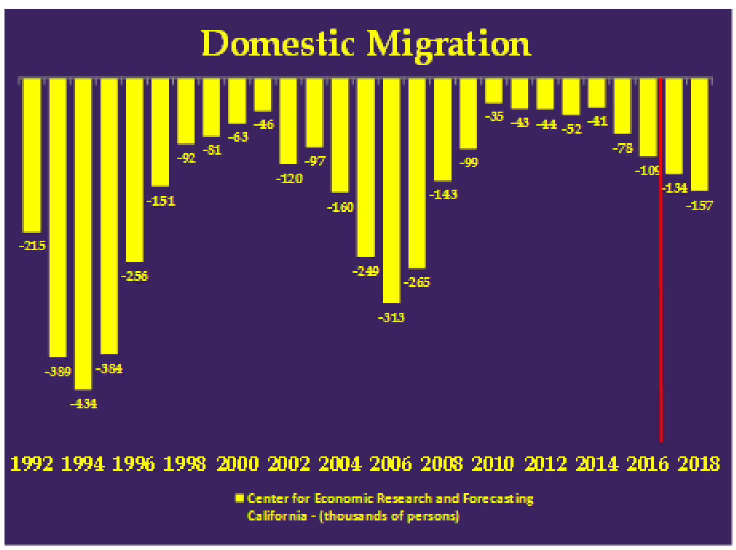
The cause of the housing crisis is simple. Not enough homes are built. According to the California Housing & Community Development Department (HCDD), the magnitude of the housing shortfall is more than one million homes over the past decade. HCDD estimates that the State will need to build an additional 1.8 million homes by 2025 in order to meet current and future demand.

The primary drivers of the lack of housing are scarcity of developable land and burdensome regulation which thwarts most development and increases the cost of what little development actually occurs. The scarcity of developable land is not the result of physical build-out. In all but the most geographically constrained corners of the state, there is still open space available for in-fill development or urban expansion. The problem in most areas is *regulatory* build-out. Building has proceeded up to the point where communities no longer want additional development. Urban growth restrictions, environmental protections, and aggressive Nimby-ism (sometimes cloaked in appealing euphemisms such as *Neighborhood Integrity Initiative*) are more than enough to make in-fill development and even modest expansion of urban areas infeasible.

The lack of home building has consequences. Housing has become staggeringly unaffordable across much of California. A favorite measure of affordability within the CERF team is the so-called *Median*

Multiple. This measure of affordability is calculated by simply dividing the median single-family home price in a region by the median family income. The average median multiple for all metropolitan areas in the nation is currently 3.2. In other words, on average, the value of the median home is 3.2 times the median income. Many metropolitan areas boast multiples less than 3.0. Proverbial affordability champ St. Louis, Missouri currently boasts a Median Multiple of 2.4.

The California Median Multiple currently stands at 7.2. Los Angeles County suffers from a multiple of 7.9. Orange County is 8.6. San Francisco County is an almost incomprehensible 12.3. It is no wonder that California's residents are fleeing the State for more affordable environments. Last year, 108,000 more residents left California for one of the other 49 states than came to California from one of the 49. We are forecasting an increase in the State's net out migration of approximately 20 percent in 2017 followed by an additional 20 percent in 2018.



Businesses are making the move too. Amgen, the world's largest independent biotechnology company recently announced plans to pare its Thousand Oaks, California based workforce by nearly 10 percent. At the same time, it is building a new 136,000 square foot facility in Tampa, Florida. The reason Amgen cited for moving their workforce to Tampa: "affordable cost of living and the potential for growth."

Thousand Oaks and surrounding Ventura County, where Amgen was founded, boasts the most stringent urban containment policies of any County in the United States. The promise made to the residents of the County, including some 10,000 Amgen employees who once called the area home, was that growth restrictions would ensure a singular quality of life that would attract other leading employers to the area. That promise has proved hollow. Like California at large, people and businesses are voting with their feet and leaving behind a wake of lost economic opportunity. According to the Brookings Institution, of the 100 largest metropolitan areas in the United States, Thousand Oaks ranked number 90 for economic growth since the recession—only 10 metro areas suffered slower economic growth. Thousand Oaks ranked number 82 for economic inclusion, a measure of whether economic opportunity and prosperity are widely shared by residents living at various income levels within an area. Strict growth restrictions have contributed to poor economic performance and increased income inequality.

The only thing more disappointing than California's housing affordability crisis and its impacts on California residents is the current legislative response underway. In early September a package of bills were passed through the California assembly after versions of the same bills had already passed the Senate.

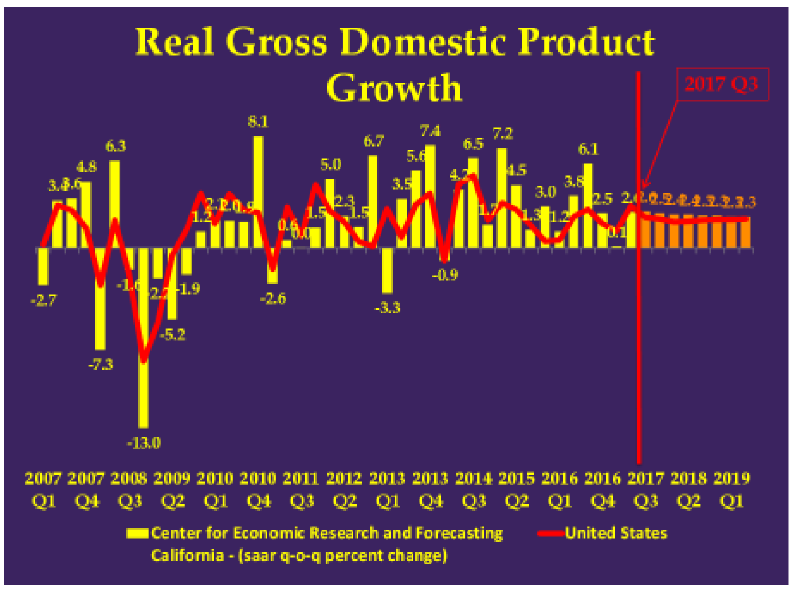
One bill raises $250 million per year in revenue for affordable housing by increasing the price of all other housing through new real estate transaction fees. You can't make housing more affordable by increasing the cost of housing.

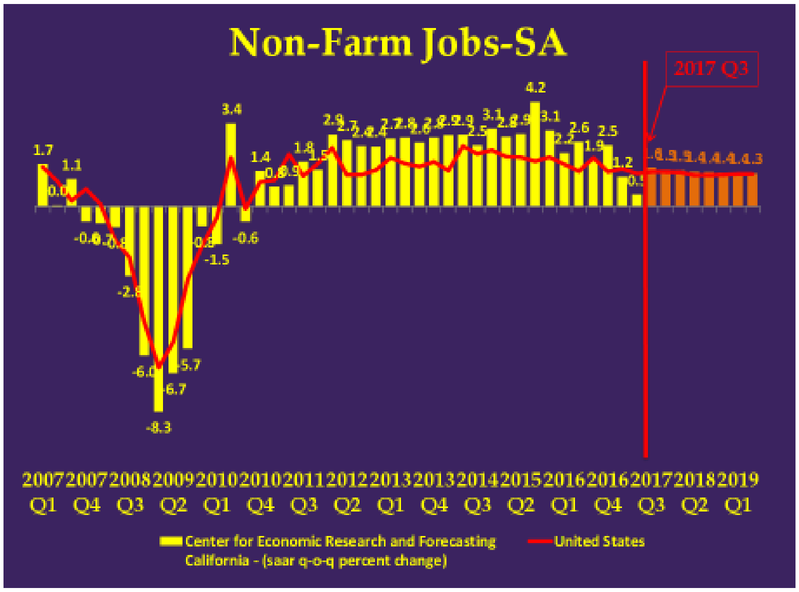
And then there is the insidious political carve out. In order to gain the last few votes necessary for passage, one of the bills which seeks to streamline the entitlement process was modified to require prevailing wages on all construction projects authorized under the bill. A favorite policy of powerful labor unions, a prevailing wage requirement simply heaps more regulation and more expense on whatever development can actually run the entitlement gauntlet.

Once again, you can't make housing more affordable by increasing the cost of housing.

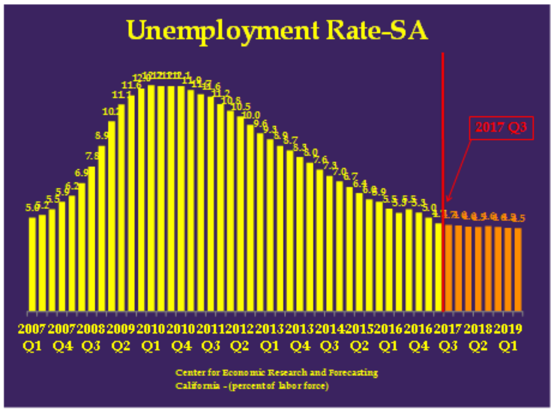
It is in the context of the housing crisis and its far-reaching effects that we release the 2017 Q3 economic forecast for California. As noted in the nearby California highlights essay, California's economic growth has slowed compared to the Nation. The current forecast calls for continued slowing, with California's GDP growth declining to just 2.3 percent over the next eight quarters and just two-tenths of a percentage point higher than the Nation's. Job growth is forecasted to slow to just 1.3 percent within the forecast horizon. If this comes to pass, the gap between California and National job growth will have vanished.

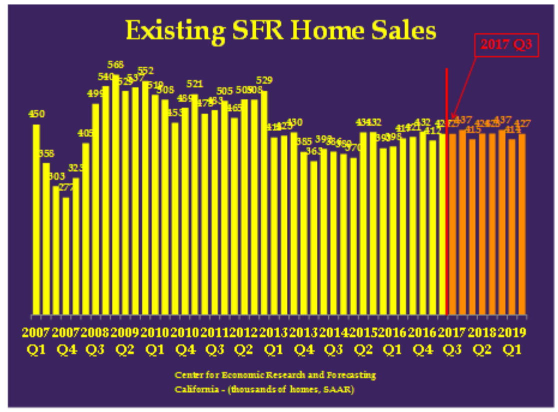
To many residents of California this will come as no surprise. In fact, hundreds of thousands will be watching the spectacle in California from a comfortable distance. The view from St. Louis is particularly nice.

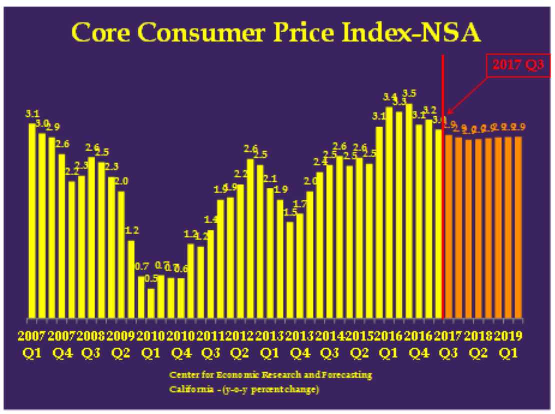


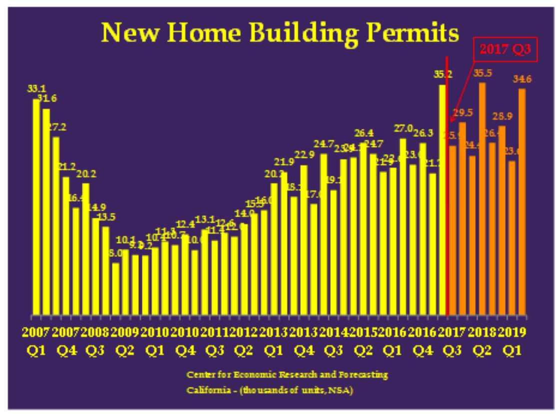


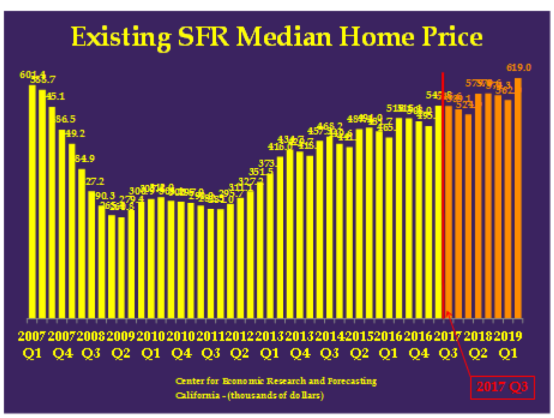
Additional forecast charts are included on the next page.

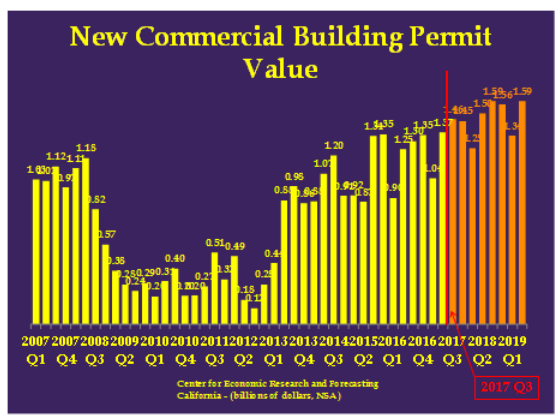

Unemployment Rate-SA
2017 Q3
Center for Economic Research and Forecasting
California - (percent of labor force)


Existing SFR Home Sales
2017 Q3
Center for Economic Research and Forecasting
California - (thousands of homes, SAAR)


Core Consumer Price Index-NSA
2017 Q3
Center for Economic Research and Forecasting
California - (y-o-y percent change)


New Home Building Permits
2017 Q3
Center for Economic Research and Forecasting
California - (thousands of units, NSA)


Existing SFR Median Home Price
Center for Economic Research and Forecasting
California - (thousands of dollars)
2017 Q3


New Commercial Building Permit Value
Center for Economic Research and Forecasting
California - (billions of dollars, NSA)
2017 Q3