Measuring the Prospects of Newsom's Newest Housing Laws

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INTRODUCTION

Housing affordability nationwide has reached historic lows in the past decade, and homeownership in West Coast states is almost completely inaccessible to Americans of median income or lower (California Association of Realtors 2022). California Gov. Gavin Newsom has taken a number of initiatives to grow the state's housing stock, pledging to create 3.5 million new housing units by 2025. Although, by his administration's admission, California will likely fall short of this goal, two new laws passed in September 2022 will create three potential pathways for new affordable developments in the state's housing market (Beam 2022).

The two laws, titled the Affordable Housing and High Road Jobs Act of 2022 (AB 2011) and Middle Class Housing Act of 2022 (SB 6), streamline local building approval processes at sites currently zoned for commercial and retail uses to incentivize residential construction. If effective, the policies would increase the supply of Market Rate (MR) and Below Market Rate (BMR) multi-family units along dense commercial corridors.

Two decades of research strongly suggests these policies will be effective at countering the causes, rather than the symptoms, of housing unaffordability and inequity (Gray 2018).

CAUSES OF UNAFFORDABILITY

Rising mortgage rates, high inflation, low existing inventory and elevated home prices have contributed to housing affordability falling to its lowest point since the Great Recession (California Association of Realtors 2022). Of the top five least affordable markets nationwide, all were Californian localities: Los Angeles-Long Beach-Glendale and Salinas were rated least affordable in the major and small market categories, respectively (Thompson 2022). A mere 16% of California home buyers could afford to purchase a median-priced, existing single-family home in the second quarter of 2022.

Researchers have found that the more restrictive the regulations on residential land use, the greater the impact on housing costs (Quigley and Raphael 2005). This effect was seen most prominently during the 2000s housing bubble and subsequent 2008 crash, where greater price increases during the boom were associated with more restricted environments and subsequently bigger losses (Huang and Tang 2012). Journalist Scott Lucas drew on such sources to examine the disparity between the West Coast and Midwest housing prices, and argued there is an association between metropolitan population growth and the incidence of the very land-use regulations that are believed to drive up prices (Lucas 2019).

“Create rules around land use, and it pushes up costs. The reality is most of Ohio’s cities have not seen dramatic employment or population growth. When there is not that growth, they don’t have to make those tough decisions [to create land use regulations],” Aaron Terrazas, a senior economist at Zillow told Lucas. The tech boom in Silicon Valley drove major population growth in California, and either prompted more land use regulations or strained the market against existing regulations.

Zoning is the most commonly used land-use regulation; in 2019, building anything other than a detached single-family home was illegal on 75% of residential land in American cities (Badger and Bui 2019). Other land-use regulations include various density restrictions such as building height caps, minimum lot sizes and parking requirements.

Creating affordable housing is, by nature, expensive and high-risk for developers in the current environment. Developers must field, and then pass on to homebuyers, high costs for low returns due to density restrictions and protracted ministerial processes (Glaeser and Ward 2009), and lenders are unlikely to provide loans to projects that are profit-insecure (Tilsley, Blumenthal, and Handelman 2016). Even nationwide policies such as tariffs on critical construction materials and impediments to cheap migrant labor can have cascading effects on consumer prices. Based on this research, Newsom’s new laws may be a holistic solution to the affordability problem.

LEGAL MECHANISMS OF REFORM

Since taking office, Newsom has signed a number of laws targeting known drivers of development costs such as parking minimums (Christopher 2022), though none have been as ambitious as AB 2011 and SB 6.

Due to political compromise between the State Building & Construction Trades Council and the Carpenters Union, the bills differ significantly, predominantly in the degree of deference they provide to local ministerial approvals, zoning and density requirements (Frattin and Turner 2022). This is not necessarily counterproductive. As the market responds, the policies will reveal how effective their differing mechanisms comparatively combat unaffordability over the 10-year period of implementation.

AB2011 creates two pathways for generating BMR housing: one for developments with 100% BMR units and one for mixed-income developments (between 8% and 15% of units must be BMR), located specifically on “commercial corridors” (Golub et al. 2022). The mixed-income projects mandate that BMR and MR units have no substantive differences in design. Instead of receiving subsidies or tax credits to offset development costs, developers who commit to the BMR to MR ratios will be guaranteed a streamlined approval process. Approval processes can become costly for developers as they navigate protracted design reviews, environmental impact studies and conflicting interests between residents and city councils (Beyer 2020). The imposed costs can slow down projects or kill them entirely. Under AB 2011, the maximum approval period will be 180 days, regardless of project size. These exemptions lift cost burdens on developers and investors and expedite the construction progress, which may aid in alleviating the housing crisis (Calder 2017).

Instead of directly streamlining the approval process, SB 6 allows developers who commit to higher labor quality standards to appeal in court when local governments reject or modify their projects to the point that affordable housing can no longer be created. So long as the projects meet that locality's "objective general plan and zoning standards," the project should be approved on a time-frame similar to AB 2011, per the law's text. While this process is not as efficient as AB 2011's, the housing projects under SB 6 are not restricted to commercial corridors, though they still must be on land zoned for commercial or retail purposes. As such, some developers expect the policy "to be used most frequently in lower-cost areas of the state and on sites where AB 2011 is not available" (Golub et al. 2022).

In short, while the SB 6 process may take longer and have higher labor costs, developers can take advantage of far more commercially zoned areas in the state. Furthermore, where AB 2011's location requirements are focused on high-density, transit-accessible commercial corridors and urban areas, SB 6 opens the door for developers to build in regions of the state such as suburbs and exurbs that have high demand for affordable housing.

ENACTMENT AND EXPECTATIONS

The laws will be in effect from July 1, 2023, through January 2033, according to the laws' text. Over the laws' lifetime, cities with approved projects must submit annual reports to the state legislature, and California's Department of Housing & Community Development is required to provide two reports prior to the sunset date. Such documents will provide valuable insight into the new policies' effectiveness at boosting housing production, increasing affordability and advancing blue-collar wages.

Because construction of multifamily housing takes approximately 12 months being authorized, the earliest the new laws will show empirical results may be mid-2024 into 2025 (Zhao 2015). Policymakers, academics and prospective homeowners alike will surely be watching the results of these policies. The coming years will test the mettle of this academically supported, strategic deregulation to achieve equitable outcomes.

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