

CLOSING CALIFORNIA'S HOUSING GAP

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Access to decent, affordable housing is so fundamental to the health and well-being of people and the smooth functioning of economies that it is embedded in the United Nations Universal Declaration of Human Rights. Yet in developing and advanced economies alike, cities struggle with the dual challenges of housing their poorest citizens and providing housing at a reasonable cost for middle-income households. In October 2016, the McKinsey Global Institute published a paper looking specifically at the U.S. state of California, *A tool kit to close California's housing gap: 3.5 million homes by 2025*.

California faces a major crisis in its housing provision: robust demand, inadequate supply, and rising prices that leave nearly half of the state's households struggling to afford to rent or buy a home. Yet there are many practical ways that communities in the state can increase housing supply and drive down costs. There are opportunities to build: this paper has identified more than five million new housing units that could be built on vacant land, near public transit stations, and even in people's backyards. The challenge is to overcome current barriers—whether regulatory, political, economic, or cultural—to unlock supply and actually build these much-needed homes. Individual communities have the power to act.

As California real estate prices rise three times faster than household incomes, more than 50% of the state's households cannot afford the cost of housing. There are many ways to tackle this crisis. Our findings include:

- From 2009 to 2014, California added 544,000 households but only 467,000 net housing units. States such as New York have added nearly 80 percent more housing units than California relative to population growth. As a result, California's real estate prices have increased by more than 15 percent since 2009, but median income by only 5 percent.
- The state now has a \$50 billion to \$60 billion annual housing affordability gap. Virtually none of California's low-income and very-low-income households can afford the local cost of housing. Nearly 70 percent of these households would have to spend more than half of their income to afford the local cost of housing.
- California ranks 49th among the 50 US states for housing units per capita. Benchmarked against other states on a housing-units-per-capita basis, California is short about two million units. To satisfy pent-up demand and meet the needs of a growing population, California needs to build 3.5 million homes by 2025.
- In dollar terms, California loses \$140 billion per year in output or 6 percent of state GDP due to the housing shortage: more than \$90 billion in missing construction investment and more than \$50 billion per year in missing consumption that is crowded out by housing costs.
- California's communities need to identify "housing hot spots" where large numbers of housing units could be built with attractive returns, change the rules of the game to enable housing development on this high-potential land, cut the cost and risk of producing housing, and ensure that low-income and vulnerable individuals who are priced out of the market have access to housing. MGI has identified 15 tools to achieve this:

1. Build on vacant urban land already zoned for multifamily development
 2. Intensify housing around transit hubs
 3. Add units to existing single-family homes
 4. Add units to underutilized urban land zoned for multifamily development
 5. Develop affordable and adjacent single-family housing
 6. Incentivize local governments to approve already-planned-for housing
 7. Accelerate land-use approvals
 8. Prioritize state and local funding for affordable housing
 9. Attract new investors in affordable housing
 10. Design regulations to boost affordable housing while maintaining investment attractiveness
 11. Raise construction productivity
 12. Deploy modular construction
 13. Accelerate construction permitting
 14. Reduce housing operating costs
 15. Align development impact fees with housing objectives
- California could add more than five million new housing units in “housing hot spots”—which is more than enough to close the state’s housing gap. In aggregate, there is capacity to build as many as 225,000 housing units on vacant urban land that is already zoned for multifamily housing; 1.2 million to three million housing units within a half mile of major transit hubs; nearly 800,000 units by allowing homeowners to add units to their homes; nearly one million units on land zoned for multifamily development but underutilized; and more than 600,000 affordable single-family units on “adjacent” land currently dedicated to non-residential uses.
 - To unlock these units, California needs both public and private sector innovations. Shortening the land-use approval process in California could reduce the cost of housing by more than \$12 billion through 2025 and accelerate project approval times by four months on average. Reducing construction permitting times could cut another \$1.6 billion and raising construction productivity and deploying modular construction techniques up to another \$100 billion. Governments could reallocate \$10 billion a year in developer impact fees to other forms of revenue generation in order to lower housing costs. California could also incentivize local governments to approve already-planned-for housing to achieve 40,000 more units annually.
 - Attracting new sources of capital to affordable housing—such as employers, social impact investors, and financial investors seeking low-risk real assets in one of the world’s most dynamic economies—could finance more than 30,000 affordable units a year. Policy tools such as inclusionary zoning, linkage fees, and tax increment financing can capture some of the value created through market-driven real estate development and channel it into subsidized affordable housing. Regulation needs to take account of developers’ risks and returns to ensure that affordable housing policies do not stifle new market-driven supply.

California’s housing gap can only be solved at the local level, and communities can follow a five-step process to close the local housing gap: create a housing delivery unit; define the local

problem; identify local solutions and map “housing hot spots;” align stakeholders behind a local strategy; and execute the strategy and measure performance.

To read the full report, please visit: <https://www.mckinsey.com/global-themes/urbanization/closing-californias-housing-gap>