NATIONAL UNIVERSITY SYSTEM
INSTITUTE FOR POLICY RESEARCH

SAN DIEGO
Economic Ledger

SEPTEMBER 2013 WWW.NUSINSTITUTE.ORG VOLUME EIGHT | ISSUE THREE

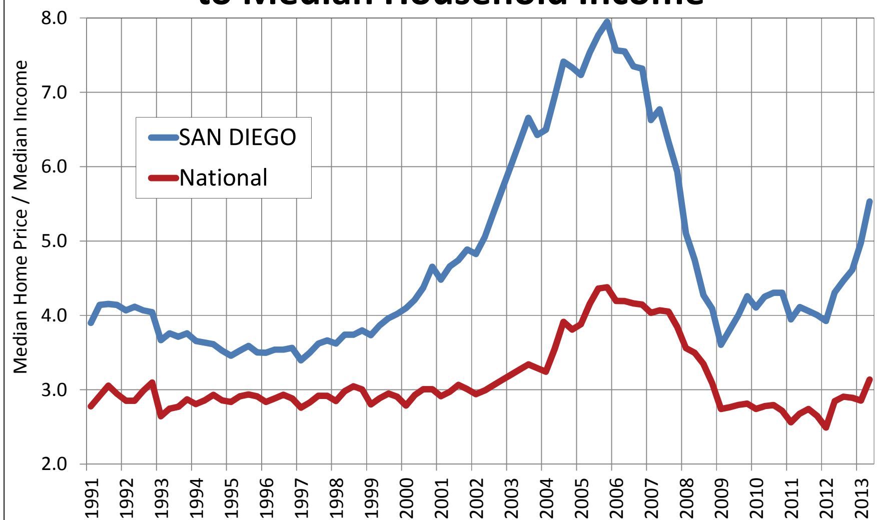
Why San Diego Housing is STILL so Darn Expensive

Even after the historic decline in housing prices during the Great Recession, housing in San Diego remains disproportionately expensive as compared by the ratio of median prices to area incomes. Various reasons account for San Diego's housing distortions, including constraints on supply, wages, and demographic dynamics.

San Diego continues to rank among nation's least affordable housing markets

The 2nd quarter 2013 *National Association of Home Builders* (NAHB) Housing Opportunity Index (HOI) shows San Diego having the 8th lowest rating at 37.1 percent. The HOI measures the percentage of homes sold in a metropolitan area that the area's median household income could afford to buy. It thus takes into account income, housing prices, mortgage rates, and lending standards.[1]

Ratio of Median Selling Home Price to Median Household Income



Source: National Association of Home Builders; National University System Institute for Policy Research.

HOUSING OPPORTUNITY INDEX, 2nd Quarter 2013

Least Afford-able Rank	Metro Area	Housing Oppor-tunity Index+	Median Home Sales Price	Median Family Income	Ratio of Home Price to Income
1	*San Francisco-San Mateo-Redwood City, CA**	*19.3*	*$781,000*	*$101,200*	*7.72*
2	*Los Angeles-Long Beach-Glendale, CA**	*28.3*	*407,000*	*61,900*	*6.58*
3	*Santa Ana-Anaheim-Irvine, CA**	*28.8*	*535,000*	*84,100*	*6.36*
4	New York-White Plains-Wayne, NY-NJ*	29.8	435,000	66,000	6.59
5	*Santa Cruz-Watsonville, CA*	*30.0*	*509,000*	*73,800*	*6.90*
6	*San Jose-Sunnyvale-Santa Clara, CA*	*32.2*	*640,000*	*101,300*	*6.32*
7	*San Luis Obispo-Paso Robles, CA*	*35.0*	*400,000*	*70,900*	*5.64*
8	***SAN DIEGO-CARLSBAD-SAN MARCOS, CA***	***37.1***	***400,000***	***72,300***	***5.53***
9	*Salinas, CA*	*40.5*	*346,000*	*63,100*	*5.48*
10	*Napa, CA*	*40.9*	*430,000*	*80,600*	*5.33*
11	*Santa Rosa-Petaluma, CA*	*42.3*	*385,000*	*74,900*	*5.14*
12	*Santa Barbara-Santa Maria-Goleta, CA*	*43.3*	*426,000*	*71,000*	*6.00*
13	Bridgeport-Stamford-Norwalk, CT	43.8	400,000	87,900	4.55
14	*Oxnard-Thousand Oaks-Ventura, CA*	*46.5*	*423,000*	*86,700*	*4.88*
15	*Oakland-Fremont-Hayward, CA**	*47.3*	*425,000*	*89,200*	*4.76*
16	Laredo, TX	49.9	149,000	40,300	3.70
17	Honolulu, HI	51.6	430,000	86,300	4.98
18	Ocean City, NJ	53.8	320,000	76,600	4.18
19	Santa Fe, NM	54.2	277,000	62,000	4.47
20	Barnstable Town, MA	56.2	317,000	74,900	4.23
	National	69.3	202,000	64,400	3.14

*Indicates Metropolitan Divisions, all others are Metropolitan Statistical Areas. *California areas are in italics*.

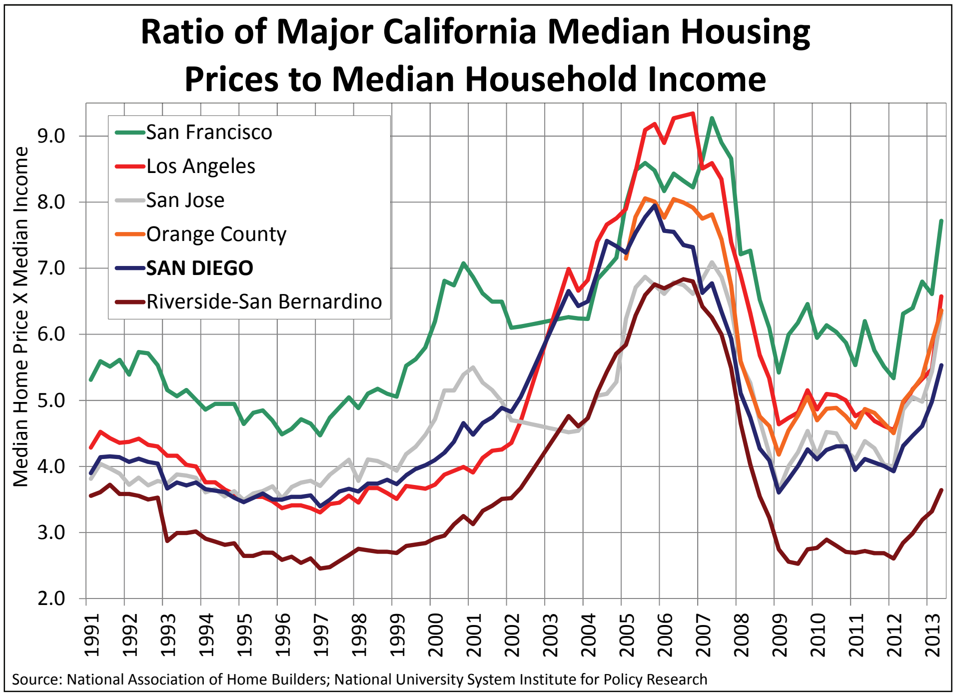
+Share of homes sold during the quarter affordable to median income.

Source: National Association of Home Builders; National University System Institute for Policy Research.

Across all 225 metropolitan areas measured, the NAHB finds 69.3 percent of homes sold were affordable for the nation's median household income of $64,400.

San Diego's low housing affordability is driven by the combination of high home prices and somewhat better-than-middle household incomes. San Diego tied Bridgeport, CT and San Luis Obispo, CA for the 12th highest median price of homes sold ($400,000) during the past quarter. On the other hand, San Diego's median household income of $72,300 ranked 56th.

This isn't just a problem for San Diego. In the latest ranking, California metro areas accounted for 13 of the nation's 15 least affordable housing markets. San Francisco, Los Angeles, and Santa Ana-Anaheim-Irvine (Orange County) metros lead this dubious list. San Diego's median home price was slightly lower than in Los Angeles, for example, but me-



dian household income was much higher (+16.8 percent), making San Diego somewhat more affordable. New York and Bridgeport-Stamford-Norwalk, CT were the only metro areas in the "top" 15 outside of California.

Home price multiples of income

Comparing the ratio of the price of homes sold against median incomes is another affordability measure. Home prices across the U.S. are generally less than or equal to three times median household income. When home prices spiked across the nation to multiples above 4.0 times income, the price bubble eventually collapsed. The ratio of median home price to household income subsequently fell below 3.0 in 2009 until the 2nd quarter of 2013 when the ratio jumped back up to 3.14.

The ratio in San Diego bottomed at 3.5 in the mid-90s, before rising to unprecedented levels peaking at 8.0 in 2005, before falling back down to low of 3.6 in 2009. As the market "recovers", the ratio is climbing again reaching 5.5 as of the 2nd quarter of 2013, the same level reached in 2002.

Perhaps some solace may be taken by other large California metro areas, including San Francisco, Silicon Valley, Los Angeles, and Orange County having even greater housing/income distortions than San Diego.

San Diego shows the highest share of spending on housing among major metropolitan areas surveyed in the *Bureau of Labor Statistics* Consumer Expenditure Survey.[2] Only Los Angeles and New York spent similar percentages of income on shelter as San Diego. By necessity, spending for other consumer goods and services therefore are correspondingly lower.

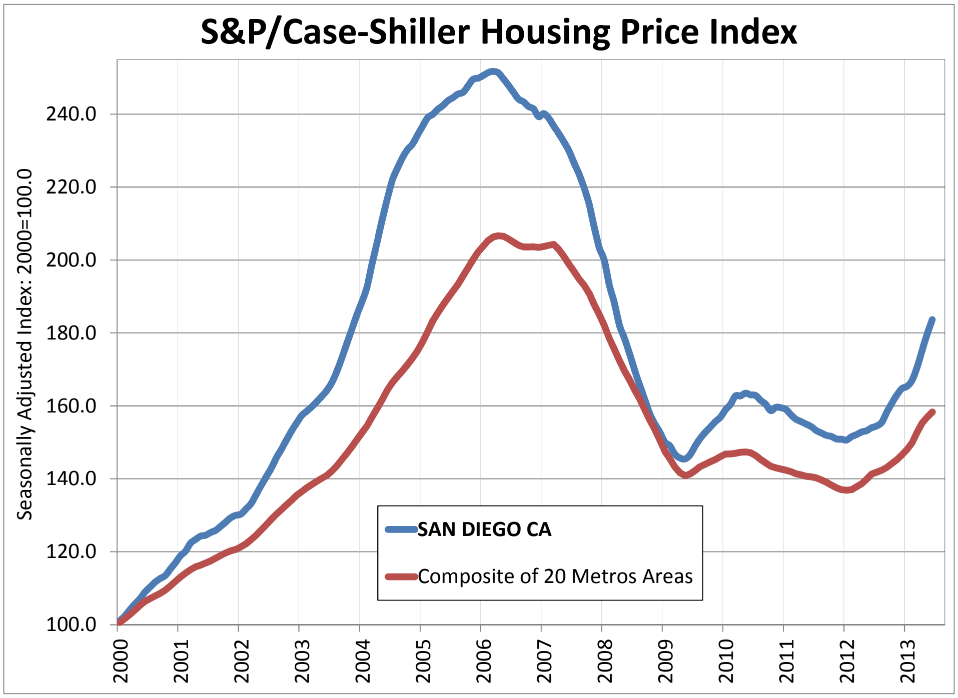
SAN DIEGO HOUSING OPPORTUNITY INDEX

Year	Qtr	Housing Opportunity Index*	Natl Rank +	Median Price	Median Income	Ratio of Home Price to Income	Year	Qtr	Housing Opportunity Index*	Natl Rank +	Median Price	Median Income	Ratio of Home Price to Income
2002	1st	21.6	183	$290,000	$60,100	4.83	2008	3rd	38.7	192	$308,000		4.27
2003	4th	11.1	160	385,000	59,900	6.43		4th	44.6	197	295,000		4.09
2004	1st	10.4	163	412,000	63,400	6.50	2009	1st	58.8	198	270,000	$74,900	3.60
	2nd	8.7	158	440,000		6.94		2nd	56.0	203	285,000		3.81
	3rd	5.4	161	470,000		7.41		3rd	50.2	209	300,000		4.01
	4th	5.3	158	465,000		7.33		4th	48.1	215	319,000		4.26
2005	1st	7.0	153	455,000	62,900	7.23	2010	1st	46.6	214	310,000	75,500	4.11
	2nd	5.1	153	474,000		7.54		2nd	44.0	216	321,000		4.25
	3rd	5.1	154	489,000		7.77		3rd	51.1	215	325,000		4.30
	4th	3.6	154	500,000		7.95		4th	51.7	214	325,000		4.30
2006	1st	5.2	177	491,000	64,900	7.57	2011	1st	55.9	210	298,000	75,500	3.95
	2nd	4.6	194	490,000		7.55		2nd	52.1	213	308,000	74,900	4.11
	3rd	4.9	195	477,000		7.35		3rd	54.0	213	304,000		4.06
	4th	5.0	197	475,000		7.32		4th	57.3	214	300,000		4.01
2007	1st	9.4	207	460,000	69,400	6.63	2012	1st	59.3	216	298,000	75,900	3.93
	2nd	9.6	203	470,000		6.77		2nd	54.3	215	327,000		4.31
	3rd	10.1	200	440,000		6.34		3rd	54.6	214	339,000		4.47
	4th	14.3	205	412,000		5.94		4th	53.5	215	350,000		4.61
2008	1st	25.2	208	368,000	72,100	5.10	2013	1st	46.6	214	360,000	72,300	4.98
	2nd	31.1	203	342,000		4.74		2nd	37.1	218	400,000		5.53

*Share of homes sold during the quarter affordable to median income

+Affordability ranking among metropolitan areas surveyed.

Source: National Association of Home Builders; National University System Institute for Policy Research.



Home prices reaccelerating

San Diego is currently noted among the nation's more resilient housing markets. According to the *S&P/Case-Shiller Home Price Index*, prices in San Diego jumped 19.2 percent over the past year. The double-digit increase exceeds both national and composite averages of the nation's 20 largest housing markets tracked.[3] Only four major metro areas show greater price rebounds, including Las Vegas (24.8 percent), San Francisco (24.4 percent), Los Angeles (19.8 percent) and Phoenix (19.7 percent).

Household income falling

At the same time as housing prices rebound, median household income in San Diego has fallen. According to annual family income data reported by the *Department of Housing and Urban Development* (HUD), San Diego's household income reached a plateau between $74,900 and $75,900 from 2009 to 2012. In 2013 San Diego's median household income fell 4.7 percent.

The trend of rising home prices and faltering income is clearly not the path of a healthy, sustainable housing market. Income is a strong determinant of area home prices as the income/price function for affordability. Although additional factors may impact the housing market, such as independent wealth of retirees or institutionalized investment buyers, household earnings largely constrain or determine price levels attainable within a given housing market

The relaxation of mortgage loan standards over the past decade allowed homebuyers to purchase homes they could not otherwise have afforded. This created excessive demand on new mortgages driving home prices to unprecedented levels far out of balance with area incomes. When mortgage interest rates began rising and prices started falling, homebuyers were no longer able to keep up payments or to refinance causing many to fall into delinquency and foreclosure. The subsequent collapse of housing was a significant contributing factor in the nation's financial crisis.

Restrictive growth controls

The run-up of home prices over the past decade did not occur consistently throughout the nation as considerable variation occurred among metro areas and regions. The greatest housing price increases (and subsequent losses) were overwhelmingly concentrated in the metropolitan areas having more restrictive land use regulations.

This is illustrated in the analysis conducted by the nonprofit, nonpartisan *National Center for Policy Analysis* (NCPA) based in Dallas, Texas. The gross value of the nation's housing stock rose $5.3 trillion relative to household incomes between 2000 and 2007. Increases among just 20 of the nation's major housing markets (including San Diego), however, accounted for an estimated $4.4 trillion or 83 percent of the total escalation in home costs relative to income.[4]

Restrictive land use regulations were found in each of the markets where

Stock options may distort home price/income ratios

A potentially significant factor in San Diego's home prices, buying patterns, and ownership is some purchases are leveraged by employee stock options. Among higher income workers, particularly those employed by new tech companies, stock options are often given as a form of compensation but *not* necessarily reported as income by standard government sources.

According to the *National Center for Employee Ownership* (NCEO), "Employee stock options are no longer exclusively reserved for company executives." From cash-poor technology startups to old-line manufacturing and service firms, more and more companies offer stock options to rank and file employees as well. While management continues to receive the majority of stock option grants, NCEO estimates allocations for non-management increased to an average of 45 percent of company offerings. Among biotech and computer firms, 55 percent of option grants are reportedly distributed to non-managers.

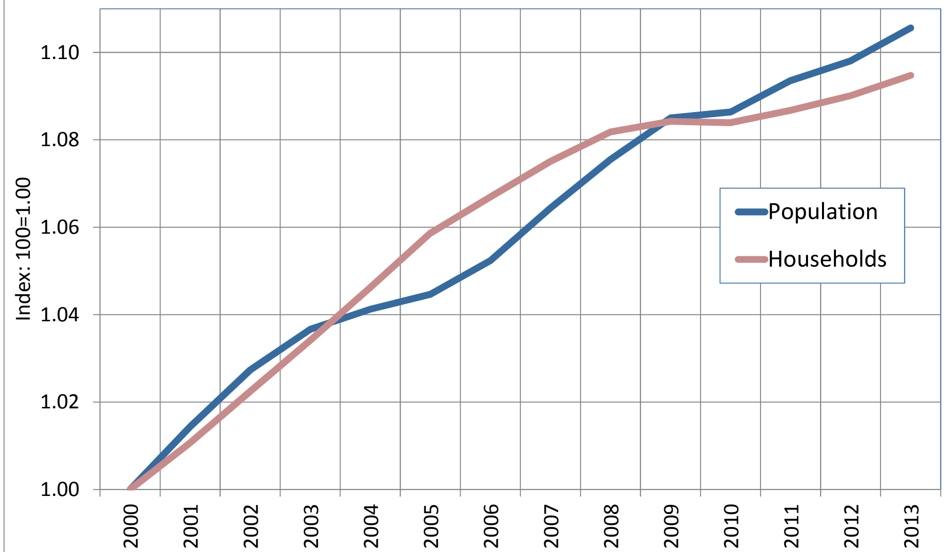
Employees may also access retirement accounts for first-time home purchases without paying the standard 10 percent early withdrawal penalty, although they may still pay income taxes on the distribution itself. The ability to borrow against value of stock ownership and retirement plans at least enhances some home purchases.

The proportion of tech industry workers to total labor force in San Diego is about 11 percent, while average wages nearly double other County jobs. The greater propensity for these workers to make home purchases may distort San Diego's home price to income ratios.

housing prices substantially rose above historic median multiples of income, especially during the housing bubble. NCPA highlighted San Diego as an example of the more heavily (or "prescriptively") regulated metropolitan areas where home prices rose much higher than average.

"If the prescriptively regulated metropolitan areas had instead had responsive land use regulations, prices likely would have escalated at a much lower rate during the housing bubble. This is because the land price premiums that grew during the bubble would have been less likely to develop, at least to the same degree. If the housing markets in the prescriptively regulated markets had replicated the performance of the responsive markets, it is estimated that the house value losses from the peak of the bubble to the start of the financial crisis would have been $0.62 trillion, one-fourth of the actual loss of $2.44 trillion. The average loss per house would have been $17,000 instead of $67,000. These more modest losses might not have set off the financial crisis, or it might have been less severe."[5]

NCPA's research draws a stark contrast from San Diego's highly regulated housing costs to the Dallas-Fort Worth housing market. Both metro areas experienced significant job gains in high-wage sectors during the 2000s. Yet, while San Diego's median household income was 12 percent higher than in Dallas-Fort Worth, median housing prices were 152 percent higher. A median household income in San Diego requires 35 percent of income to pay the mortgage on a median priced house, while in Dallas-Fort Worth only 15 percent goes toward a median home mortgage. After adjusting for the differences in income, a San Diego household would pay $325,000 more than the Dallas-Fort Worth household over the period of a loan (including mortgage and down payment).[6]



Index of Population and Housing Changes
San Diego County
Source: California Department of Finance; National University System Institute for Policy Research.

The only significant reason for California's overly priced housing markets is traced to the strict growth controls and restrictive land use regulations imposed on housing. Even after the price collapse, housing remains considerably more expensive than historic norms among metropolitan areas having more restrictive housing regulations. San Diego, along with other California metro areas, have the nation's *most* restrictive housing markets. Strict zoning laws keep land and housing prices relatively high by adding to the costs of construction and limiting homebuilders from meeting housing demand.

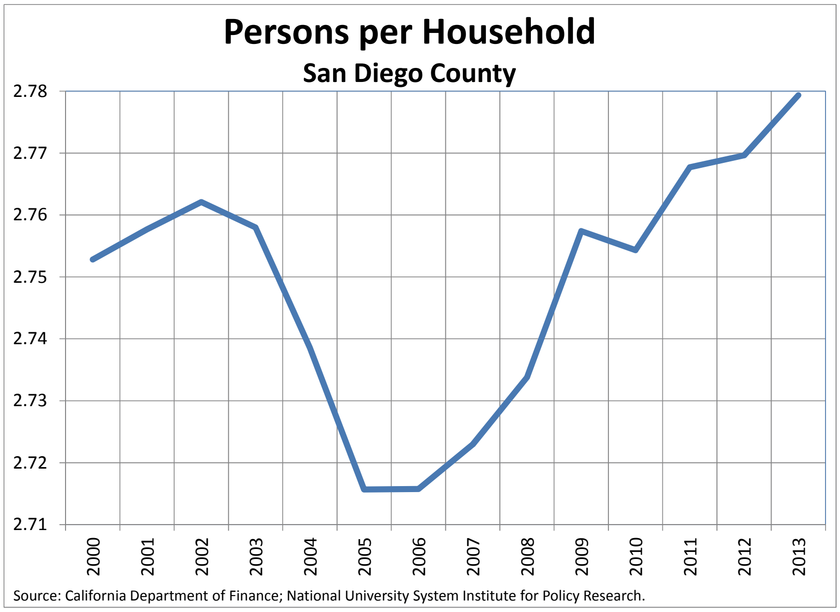
Speculation and inflating of the price bubble went hand-in-hand with constraints on supply according to research conducted by Harvard University's Edward Glaeser and the University of Pennsylvania's Joseph Gyourko. Speculation tends to not be as significant a factor in more responsively regulated markets, principally because the prospect of modest price rises do not yield the short-term profits speculators seek.[7] In markets where there is an expectation of constraints on future supply – speculators are much more likely

SAN DIEGO POPULATION AND HOUSING, January 1 estimates

	POPULATION			HOUSING UNITS				Persons
Date	Total	Household	Group Quarters	Total	Occupied	Vacant Units	Vacancy Rate	Household
2008	3,064,436	2,963,401	101,035	1,158,203	1,083,993	74,210	6.41%	2.73
2009	3,091,579	2,995,716	95,863	1,163,728	1,086,423	77,305	6.64%	2.76
2010	3,095,313	2,991,515	103,798	1,164,028	1,086,113	77,915	6.69%	2.75
2011	3,115,810	3,013,910	101,900	1,166,858	1,088,954	77,904	6.68%	2.77
2012	3,128,734	3,025,242	103,492	1,170,267	1,092,293	77,974	6.66%	2.77
2013	3,150,178	3,048,747	101,431	1,174,866	1,096,933	77,933	6.63%	2.78
Number Change:								
09/08	27,143	32,315	-5,172	5,525	2,430	3,095	0.24%	2.4%
10/09	3,734	-4,201	7,935	300	-310	610	0.05%	-0.3%
11/10	20,497	22,395	-1,898	2,830	2,841	-11	-0.02%	1.3%
12/11	12,924	11,332	1,592	3,409	3,339	70	-0.01%	0.2%
13/12	21,444	23,505	-2,061	4,599	4,640	-41	-0.03%	1.0%
13/08	85,742	85,346	396	16,663	12,940	3,723	0.23%	4.6%
Percent Change:								
09/08	0.9%	1.1%	-5.1%	0.5%	0.2%	4.2%	3.7%	0.86%
10/09	0.1%	-0.1%	8.3%	0.0%	0.0%	0.8%	0.8%	-0.11%
11/10	0.7%	0.7%	-1.8%	0.2%	0.3%	0.0%	-0.3%	0.49%
12/11	0.4%	0.4%	1.6%	0.3%	0.3%	0.1%	-0.2%	0.07%
13/12	0.7%	0.8%	-2.0%	0.4%	0.4%	-0.1%	-0.4%	0.35%
13/08	2.8%	2.9%	0.4%	1.4%	1.2%	5.0%	3.5%	1.67%

Source: California Department of Finance; National University System Institute for Policy Research.

to believe it is possible to extract extraordinary profits as they bet that the supply will not be able to keep pace with short term increases in demand.



San Diego population and housing dynamics

Over the past decade demographics and populations shifts also impacted the region's housing market. These factors will continue to exert considerable influence going forward.

On the one hand, San Diego's population growth significantly slowed the past several years. This tempered some of the demand for new housing in the region. In addition, San Diego saw a shift as more residents moved away than to San Diego. As population growth shifts to "natural increase" (more babies born than residents dying) the need for more housing is somewhat alleviated – at least in the short term.

The rate of household formations particularly impacts housing demand. Households form when individuals move out on their own and when families or unrelated persons move in together. Demographers measure these changes to determine the net rate of household formation over time as well as the calculation of average household size.

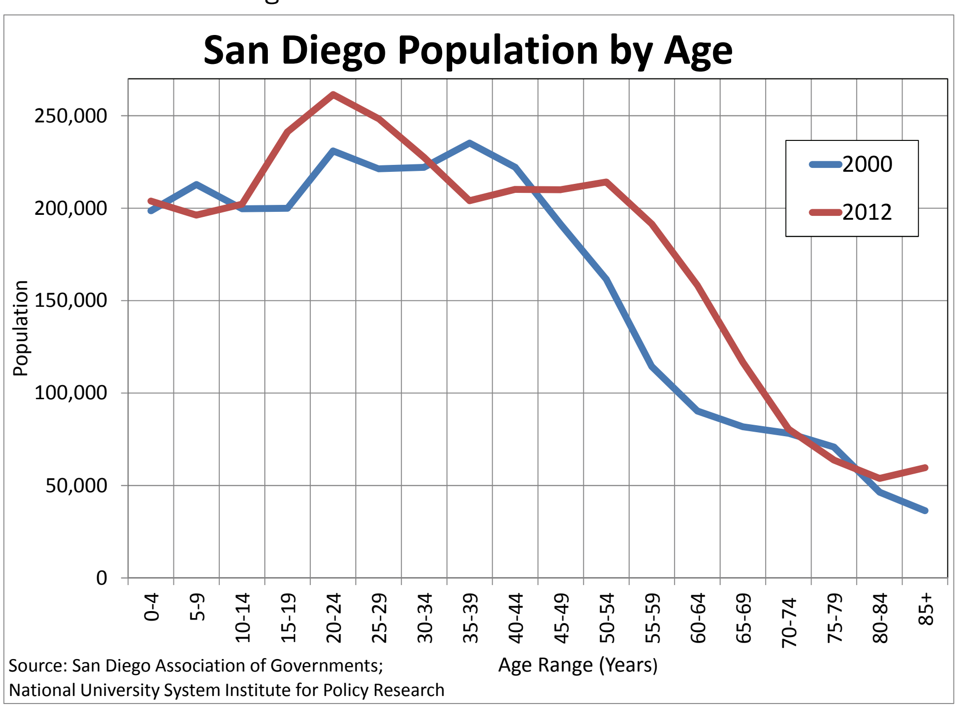
In addition to demographics, economic conditions impact household formations. According to *California Department of Finance* population and housing estimates, between 2008 and 2013 San Diego's population increased 2.8 percent. At the same time households increased only 1.2 percent. As the Great Recession rolled across the region, unemployment rose, incomes faltered, credit tightened, and household formations diminished. The slower rate of formation resulted from households combining or "doubling up", and adult children not separating from parents.

SAN DIEGO POPULATION BY AGE

Year	2000	2012	Change	Percent
TOTAL	2,813,863	3,143,429	329,566	11.7%
0-14	611,119	602,245	-8,874	-1.5%
15-29	652,175	751,133	98,958	15.2%
30-44	679,350	641,634	-37,716	-5.6%
45-64	557,469	773,882	216,413	38.8%
65+	277,343	314,869	37,526	13.5%
Median Age	33.2	34.8	1.6	4.8%

Source: San Diego Association of Governments; National University System Institute for Policy Research.

These effects are apparent in the increase of average household size. The number of persons per household in San Diego, averaging less than 2.72 in 2005-06, rose to modern era high of 2.78 in 2013. While this may not seem much of a difference, the fractional change represents 24,300 fewer households then would have occurred if household size remained at 2005-2006 levels. These changes lessen the demand on housing, suggesting that if the changes had not been present the spike seen in prices since 2011 may have been even greater.

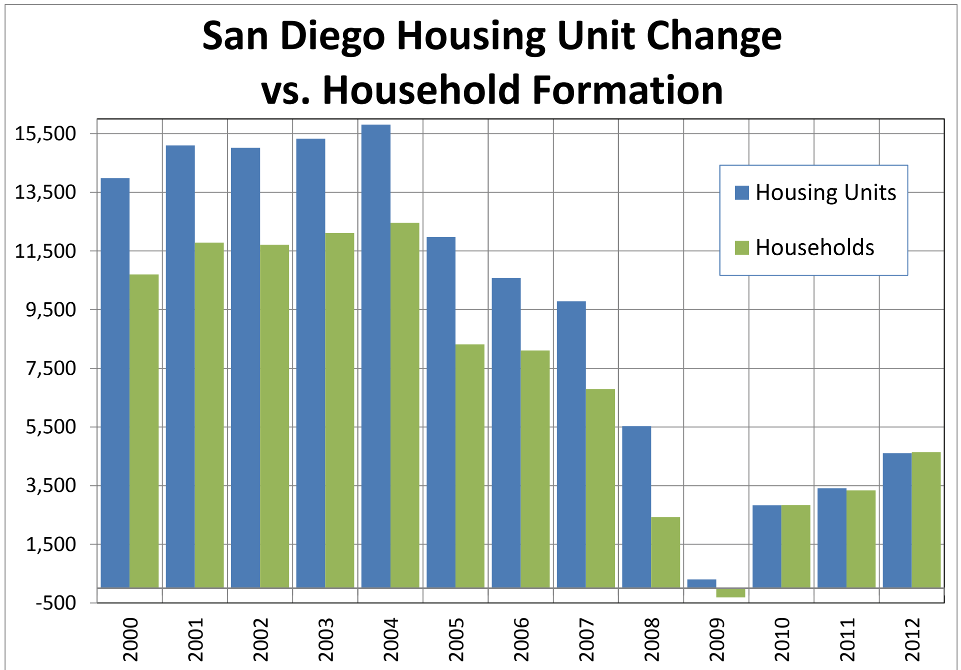


Aging population

San Diego's population is growing older. While the County's overall population increased 11.7 percent between 2000 and 2012, residents over the age of 45 increased 30.4 percent, but those under 45 rose only 3.8 percent.

The number of 30 to 44-year olds actually declined in number and apparently took their children with them as the number of under 15-year olds also declined.

The aging population has at least two important implications on San Diego housing. The conventional wisdom is older consumers typically downsize eventually selling their larger homes and moving into smaller living spaces. Younger families with children would normally be the market to buy those homes, but with fewer of their numbers, demand is likely to lag the supply of these homes, especially among those that can actually afford to buy them. On the other hand, research suggests baby-boomers may be more likely to "retire-in-place," both because of preferences to remain in their current home, as well as from low saving rates and economic necessity. It could be that some of the low supply seen the past three years reflects a "new normal" as new retirees choose not to sell their home, drying up what had been a relatively constant supply of listings in the resale market.



Source: California Department of Finance; National University System Institute for Policy Research.

Residential construction turmoil

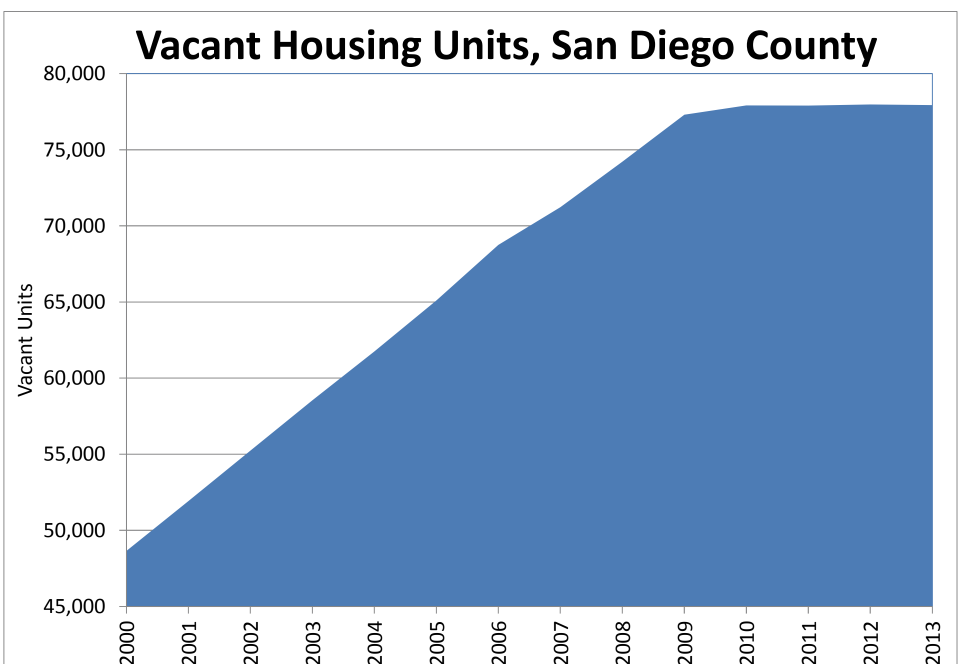
As housing demand softened, new homebuilding was slashed. The number of housing units approved for construction between 2008 and 2012 fell to the lowest number on record in San Diego dating to before World War II. (See Dashboard Indicators, page 7.)

Prior to 2000, household formations consistently exceeded housing additions. Since 2000, however, housing unit increases significantly exceeded household formations every year through 2009.

As household formations softened, and actually declined in 2009, housing unit additions significantly fell off as well. Only since 2010 have new household formations more or less equaled housing unit additions.

San Diego's vacant housing rate steadily climbed from 4.63 percent in 2000 to high of 6.69 percent by 2010, before more recently declining slightly to 6.63 percent in 2013. The inventory of vacant housing units significantly increased until reaching an apparent plateau in 2009 around 77,900 units.

Decreases in construction would normally cause the supply of vacant homes to diminish, but surge in foreclosures kept inventories relatively high. As the number of foreclosures stabilize and diminish, the supply of vacant homes should decline.



Source: California Department of Finance; National University System Institute for Policy Research.

Conclusions

San Diego is likely to continue seeing high housing prices for the foreseeable future. There are just too many constraints on supply to believe we will see a period in which new starts significantly exceed new household formations. This is especially true if economic conditions improve to the point that some of the current constraints on household formations are removed and San Diego household sizes revert to more traditional averages. While some other factors, notably our aging population and net outmigration ameliorate the low supply, it is this relationship that is key to understanding why San Diego housing costs so much.

Spending more on housing has significant economic consequences. The relatively higher share of household income spent on shelter leaves less available for other household expenditures. In turn, this results in a lower standard of living serving to drag down the region's overall economic vitality. The region experiences greater "leakage" from money flowing to pay financing costs for larger mortgages and on rents to institutional owners of large apartment complexes. A more healthy or affordable housing market, in contrast, would leave households

San Diego Housing

(Continued from page 6)

with more discretionary income to spend on services and goods, reducing the rate of leakage and improving overall economic performance.

Historically a significant portion of San Diego's economy depends on the building, buying and selling of real estate. Along with the continuing considerable constraints and challenges this has on the local population, it is difficult to conceive of San Diego's economy fully recovering or thriving without this major driver of regional economic prosperity healthy and thriving. A market in which supply is constrained and prices remain high does not work for a significant share of the region's population base.

[1]The NAHB/Wells Fargo Housing Opportunity Index measures the percentage of homes sold in a given area affordable to families earning the area's median household income during the specified quarter using standard mortgage underwriting criteria. Prices of new and existing homes sold are collected from actual court records by First American Real Estate Solutions, a marketing company. Mortgage financing conditions incorporate interest rates on fixed- and adjustable-rate loans reported by the Federal Housing Finance Board.

[2]"Metropolitan Statistical Area Tables," Consumer Expenditure Survey, U.S. Bureau of Labor Statistics, 2011-12, http://www.bls.gov/cex/csxmsa.htm.

[3]"Home Prices Continue Climbing in June 2013", S&P/Case-Shiller Home Price Indices, August 27, 2013, http://us.spindices.com/index-family/real-estate/sp-case-shiller.

[4]Wendell Cox, "The Housing Crash and Smart Growth", *National Center for Policy Analysis*, June 2011, Policy Report No. 335, http://www.ncpa.org/pdfs/st335.pdf.

[5]Ibid.

[6]Ibid.

[7]Edward Glaeser, Joseph Gyourko, "Rethinking Federal Housing Policy", *American Enterprise Institute*, 2008.

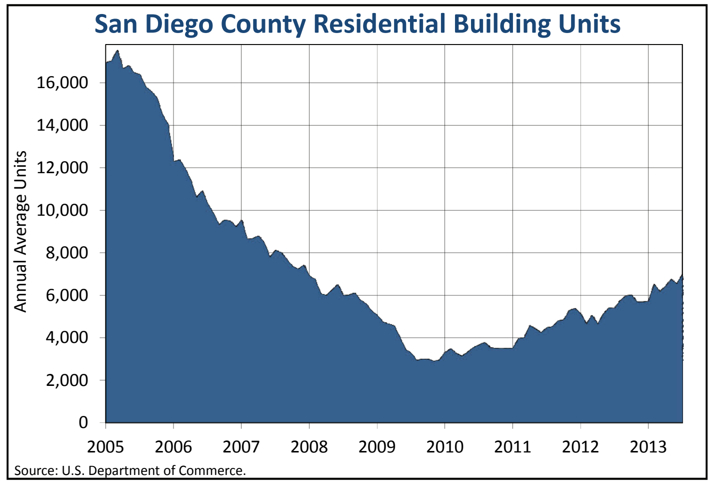
Dashboard Observations– July 2013

By Kelly Cunningham, Economist and Senior Fellow

Nearly all of the San Diego economic dashboard observations show improvement as of July 2013. Although the unemployment rate of 7.8 percent indicated a seasonally adjusted increase from June, the rate significantly improved over the past year from 9.5 percent in July 2012.

The number of business licenses issued by the City of San Diego was up from the previous month and a year ago, although remaining far below pre-recession levels. San Diego's stock index of 146 local, publicly-traded companies continues a five-year gain to record levels.

With four years of increase, residential construction is showing strong gains. The increases remain far below former levels of construction in San Diego County. As recently as 2005, more than 17,000 housing units were approved, and in previous eras 30,000 to 40,000 units were annually recorded.



Indicator	July 2013	Month Change (Sea. Adj.)	Annual Change
Unemployment Rate[1] San Diego County	7.8%	0.2% ▼	-1.7% ▲
Residential Building[2] Units authorized for construction San Diego County	955	203% ▲	88% ▲
New Business Licenses[3] Issued by City of San Diego	1,108	38% ▲	14% ▲
San Diego Stock Index[4] San Diego based companies	152	3.8% ▲	21% ▲

[1]California Employment Development Department.

[2]U.S. Bureau of the Census.

[3]Business Tax Program, City of San Diego.

[4]Second Thursday of month, Bloomberg News, San Diego Daily Transcript.

NATIONAL UNIVERSITY SYSTEM
INSTITUTE FOR POLICY RESEARCH

11355 North Torrey Pines Road
La Jolla, CA 92037
Phone: 858-642-8008
kcunningham@nusystem.org

National University System Institute for Policy Research (NUSIPR) is a nonpartisan organization that formulates and promotes high quality economic, policy, and public-opinion research so as to improve the efficiency and effectiveness of local governments in San Diego County.