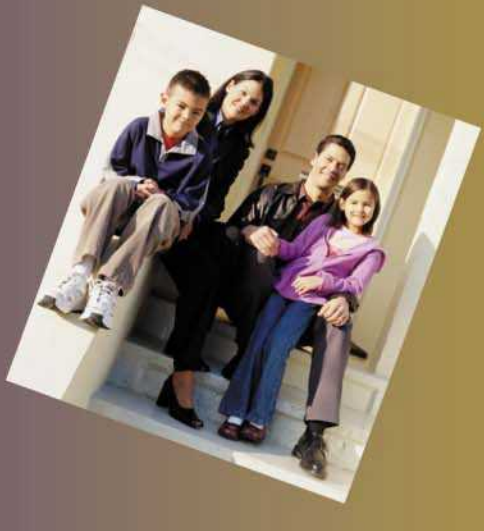



HOUSING CALIFORNIA'S LATINO POPULATION IN THE 21ST CENTURY:

THE CHALLENGE AHEAD



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HOUSING CALIFORNIA'S LATINO POPULATION IN THE 21ST CENTURY:
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"The dream of homeownership for tens of thousands of Latino families in California disappears every year as the state's housing crisis worsens. This important study by TRPI can serve as a road map for a state housing policy that ensures the housing we need gets built and says to all California households: 'Your dreams can come true.'"

Honorable Cruz M. Bustamante
Lieutenant Governor, State of California

"The beacon of opportunity in California for thousands of Latino households is being dimmed by a housing supply and affordability crisis. This important study by TRPI can serve as a starting point for a change in attitude and public policies that restores those disappearing opportunities and, once more, makes homeownership a central part of the California Dream."

Honorable Henry Cisneros
CEO, American City Vista
Former U.S. HUD Secretary

"The TRPI study underscores that the Latino community is especially hard hit by the state's escalating housing crisis. It is not just the cost of housing, but there are also quality of life issues involved like school quality, public safety and access to jobs."

Jack Kyser
Chief Economist
Los Angeles Economic Development Corporation

"Good housing and homeownership are very much part of the Latino dream in America. Unfortunately, the growing gap between housing supply and demand in California is keeping that dream out of reach for many thousands of Latino families. TRPI's study is a reminder that housing must be viewed as a priority issue."

Monica Lozano
President
La Opinión

TABLE OF CONTENTS

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The principal authors assume responsibility for any omissions or errors that remain.

Dr. Waldo Lopez-Aqueres
TRPI Director of Economic Research

EXECUTIVE SUMMARY

California's housing affordability crisis has been well documented and is understood to be a major problem impacting many of the state's residents. Also well documented is the fact that this housing affordability crisis stems from more than a decade of housing production levels that are roughly half of what experts say is needed to meet the state's growing demand for housing.

What has not been so widely documented, however, is the fact that the housing supply shortfall and resulting affordability crisis is having a disproportionately negative impact on California Latino families. Despite their growing economic and social presence in California, Latino families are far less likely to become homeowners and are far more likely to spend a greater portion of their incomes on housing than all other residents in the state.

Latinos represent the fastest growing population segment in the state, are increasingly emerging into the middle class[1], and homeownership is among the most important goals for Latino families. But the barriers that have blocked housing development, especially in the areas populated by Latinos, are squandering the ability of Latinos to find affordable housing.

Only 29% of Latino households could afford a median priced home in California in 1999, 8% lower than the statewide affordability rate of 37% for all households during the same period. Latinos lag 21% behind whites in homeownership. Statewide, only 44% of Latinos are homeowners compared to 65% of whites. And, according to data collected of Southern California families, Latinos were more likely to spend more than 50% of their annual income on housing costs than all other races combined.

The reason is a chronic imbalance between supply and demand that is more acute in the regions where Latinos live—primarily the greater Los Angeles area (where nearly 40% of all California Latinos reside) and in urban markets. In these markets, increases in housing prices far exceed that of incomes, particularly for Latino families.

The lack of housing is shutting the door on first-time homebuyers, and is severely impeding Latino families and individuals seeking to move up the economic ladder. High rents, long commutes and denial of the economic advantages of homeownership are among the burdens placed on California Latinos because of the shortfall in housing supply.

1 See the Tomás Rivera Policy Institute's Report: The Latino Middle Class: Myth Reality and Potential by Frank Bean, Stephen Trejo, Randy Crapps, and Michael Tyler, April 2002.

• At present construction rates, California will fall 40% short of meeting the demand for new housing construction by 2020. In the urban markets and metropolitan regions where Latinos predominantly live, the housing supply shortfall is more severe.

• Vacancy rates—the most important gauge of housing supply and demand—are at an all time low. By 2001, California's rental vacancy rate had declined to 4.2% statewide and the owner-occupied vacancy rate to 1.1%—well below the 5% mark that traditionally signals a housing shortage. In metropolitan and urban areas, vacancy rates have fallen well below 4% and in some coastal areas, like Ventura, the vacancy rate for owner-occupied housing is approaching zero.

Because of their lower purchasing power, Latino households are particularly impacted by regulatory or legislative hurdles that reduce housing supply and/or increase home costs. Based on 1999 data, even a 5% increase in the median price of a detached single family home can lock as many as 44,833 California Latino households out of the market.

Fortunately, there are positive steps that can be taken to address the problem. If the regulatory and government barriers to housing can be reduced, there is every reason to believe that the economic capability and resources will be there to help jumpstart the housing construction that will help build a better future for Latinos and all Californians.

SUMMARY OF FINDINGS

California's Housing Supply Crisis is Particularly Acute Where Latinos Live

• According to the California Department of Finance, for the past decade California's new housing construction rates have covered little more than half of what is actually needed.

Latinos Pay the Price

The result of the housing supply shortfall and escalating home prices is disproportionately impacting Latino families. Latino household income has not kept pace with inflation and California home values have continued to escalate far more rapidly than inflation. Thus, the ability of many Latino families to purchase a home has continued to deteriorate in the last two years:

• Only 29% of Latino households could afford a median priced home in California in 1999, 8% lower than the statewide affordability rate of 37% for all households during the same period.

• Latinos lag 21% behind whites in homeownership. Statewide, only 44% of Latinos are homeowners compared to 65% of whites.

- According to data collected of Southern California families, Latinos were more likely to spend more than 50% of their annual income on housing costs than all other races combined.

- Latinos suffer the most severe overcrowding problem. In the Los Angeles-Long Beach metropolitan area, the overcrowding rate for Latino homeowners is three times greater than for homeowners as a whole. In the same area, overcrowding for Latino renters is twice as high as for the general rental population.

Latino Housing Demand

Latinos are California's fastest growing population. Latinos are willing home buyers and can add considerable benefit to the economy, but are too often being locked out of homeownership.

- Between 2000 and 2020, California's Latino population is projected to grow by 7.2 million—more than two-thirds of the state's growth. By 2020, the majority of Californians will be Latino.

- By 2020, Latinos in California will demand an additional 1.9 million housing units—close to 50% of total market demand.

- During the past decade, Latino demand for owner-occupied housing increased by 400,000 units. Latino share of owner-occupied units rose from 13% to 17%—a trend that is likely to continue if housing supply is available.

- Latino demand for rental housing also soared by almost 350,000 units in the last decade and the Latino share of the rental market rose from 24% to 29%.

- In 2001, the value of resale homes purchased by Latinos was $19.1 billion

Barriers to Building an Adequate Housing Supply in California

Because of their lower purchasing power, Latino households are particularly impacted by regulatory or legislative hurdles that reduce housing supply and/or increase home costs. Based on 1999 data, even a 5% increase in the median price of a detached single family home can lock as many as 44,833 California Latino households out of the market. Following are the most common government barriers to housing and their impact on Latino and all California families:

- LOCAL GOVERNMENT FISCAL STRUCTURE DISCOURAGES HOUSING. The fiscal structure of municipalities in California has contributed to higher development fees and policies that discourage residential construction. With property tax revenues limited and redirected as a result of Proposition 13 and other state measures, cities and counties have been forced to engage in fiscal zoning policies that favor commercial uses over residential uses.

- RESTRICTIONS ON THE SUPPLY OF LAND AVAILABLE FOR HOUSING. The less land there is for residential development, the higher the price. One study indicates that a 10% reduction in the supply of available land in a community can add 20-30% to the purchase price of new homes.[2] Governmental constraints and urban growth boundaries are estimated to diminish California's housing capacity by more than 16 million units.

2 Landis, J. 1986. Land Regulation and the Price of New Housing. Journal of the American Planning Association, V. 52, No. 1, pp.: 9-21.

- EXCESSIVE REGULATORY COSTS AND FEES. No state levies more residential development fees than California. Fees imposed on a single-family infill home add 10% to the unit price and for a 45-unit apartment complex amount to a 21% addition to the price per unit. In some regions of the state fees can amount to as much as $60,000 per unit. These fees literally price thousands of prospective Latino home-buyers out of the market and add to the financial burden of residential tenants.

- EXCESSIVE LITIGATION LIMITS CONSTRUCTION OF CONDOS. California's system of protecting homebuyers against construction defects has backfired and led to costly and excessive class action litigation. As a result, the cost of liability insurance for builders has soared and made town home and condominium projects practically uninsurable. The shortage of condominiums is affecting Latinos most because they are least likely to have the income level required to purchase detached single family homes. In 1999, as many as 43% of California Latino households earned enough to afford the median priced condominium, compared with only 29% who could afford a single family home.

- GROWTH CONTROL ORDINANCES REDUCE SUPPLY AND INCREASE COST OF HOUSING. The form of controls often varies from jurisdiction to jurisdiction. In many cases, limits on density confine construction to single-family homes built on large lots. This practice favors higher end homes and limits the availability of land for condominiums and multi-family housing. Other cities limit the number of units that can be built over periods of time. In both cases, the results are fewer dwellings and more expensive homes built at the expense of higher density and more affordable housing.

- NOT IN MY BACK YARD (NIMBY) SYNDROME CONTRIBUTES TO THE SUPPLY SHORTFALL AND HIGHER COSTS. Increasingly, individuals within communities seek to insulate themselves from unwanted housing through litigation, political intimidation and ballot box planning. More often than not, higher density, affordable housing products are the target of NIMBY opposition.

- BUREAUCRATIC PERMITTING PROCESSES DISCOURAGE HOUSING AND TACK ON COSTS. The process of gaining permits and approvals from local government for housing projects has more than doubled in the last twenty years. According to an earlier study, permitting delays add 14-21% to the sales price of a new home[3], which may force small builders out of the marketplace.

3 Bay Area Council. 1980. Housing: The Bay Area's Challenge of the 80s. San Francisco: The Bay Area Council, p.15

REMEDIES

If the regulatory and government barriers to housing can be reduced, there is every reason to believe that the economic capability and resources will be there to help jump-start the housing construction that will help build a better future for Latinos and all Californians. Following are steps needed to reduce the barriers to housing:

- The public and private sectors should work together to find alternative mechanisms to finance urban public services (e.g., schools, roads, water and sewer treatment).
- Municipalities and government agencies should be required to conduct a cost-benefit evaluation of regulatory and policy requirements that reduce the availability of land for residential construction.
- Rewards and penalties are needed to persuade local governments to allocate sufficient land to meet housing needs.
- Eliminate the fiscal disincentives that discourage municipalities from approving and encouraging residential development.
- Develop alternative funding sources for infrastructure and local public services to reduce reliance on residential development fees.
- Reform zoning, ordinances, residential density restrictions and urban growth boundaries to respond to market needs.
- Restructure the overly-litigious system of dealing with construction disputes.
- Streamline the development approval and permitting process.
- Enact reforms to safeguard the construction of affordable housing against unreasonable and extreme challenges by NIMBY groups.
- Create local housing trust funds.
- Establish and expand tax credit programs for low and moderate income families seeking to buy their first home.

INTRODUCTION AND OBJECTIVES

The economic boom of the last ten years has significantly stimulated employment, income and homeownership in major metropolitan areas across the country. Along with population growth and low mortgage rates, the economic prosperity has fueled the demand for housing while the supply side of the market has been slow to respond. As a result, home prices and rents have increased significantly, placing a burden on many families. According to a recent report, over 14 million U.S. households spend more than 50% of their income on housing (Joint Center for Housing Studies of Harvard University 2001). Predictably, the problem affects low-income households and people of color more than any other group.

The gap between supply and demand has reached critical proportions in California. During the 1980s, the state experienced a housing deficit of 660,000 units, the equivalent of 5.9% of the housing stock (CDHCD 2000). While the 1990-1994 temporary housing surplus helped improve market conditions, the shortfall quickly reappeared by 1995, with housing production running behind demand by about 145,000 units. The shortfall is worse in highly urbanized markets and it is most severe in multi-family housing. From 1990 to 1997, only 24% of building permits went to develop multi-family housing. If tight market conditions continue, the state will fall 40% short of meeting the rise in demand expected during 1997-2020 (CDHCD 2000).

Vacancy rates, which traditionally are used to gauge the disparity between demand and supply, are at an all time low. By 2001, the California rental vacancy rate had declined by one-half to 4.2% and the owner-occupied rate by 50% to 1.1%. This decline occurred from their 1995 peak of 8.5% and 2.1%, respectively. Both numbers also remained well below the national rate (U.S. Bureau of the Census 2002b). Vacancy rates under 5% signal a housing shortage, alert the building industry of profit opportunities, and usually become the wakeup call for planners and policymakers to take action.

As measured by vacancy rates, housing shortages are even more visible and pervasive in some metropolitan areas, particularly those with high population density. Judging by the statistics, one can argue that a state of emergency already exists in some California communities. In 2001, rental vacancy rates below 5% were common in Los Angeles-Long Beach (3.4%), Orange County (3.9%), San Francisco (3.4%), San Bernardino-Riverside (4.1%), and San Diego (4.5%). Homeowner vacancy rates were equally low in these markets, especially in coastal areas, ranging from no vacancy (0.0%) in Ventura County to 1.3% in Orange County (U.S. Bureau of the Census 2002b). The situation has become so bad that some commentators are even questioning the market's ability to provide decent, affordable housing for all income groups.

Lack of affordable housing is the principal manifestation of a housing shortage and one of the most important concerns expressed in the popular press. When housing is in short supply, there is no limit to how fast and how high rents and home values can climb. This raises the issue of incidence or which groups in the community are affected the most. While lack of affordable housing is most severe among low-income renters, it also affects first time homebuyers, especially Latino and African American families. These two minority groups have achieved smaller gains in home ownership than other Californians. The homeownership gap in some minority communities has become a major public issue in California and a set back to the long-standing policy of promoting homeownership.

This report examines the housing affordability crisis in California, its impact on racial and ethnic minorities, especially Latinos and their ability to become homeowners. Factors affecting the aggregate demand for housing among Latinos also are described. In addition, the study discusses how some regulatory barriers are making it harder for the market to provide affordable housing in California. The report concludes with some suggestions on how changes in the regulatory environment can improve the prospects for homeownership and affordable housing in the state.

HOW DOES THE CALIFORNIA HOUSING SHORTAGE IMPACT LATINOS?[4]

To answer this question, the study looks at current housing conditions and recent trends in California. Information for California is used as much as possible in the report. Occasionally, the analysis is limited to selected metropolitan areas, particularly Los Angeles, Orange, Riverside, San Bernardino, and San Diego counties. These areas were selected because:

1. Over 50% of the demand for housing by California Latinos originates in these counties. Of the 11.0 million Latinos who live in the state, 65% reside in these communities. Los Angeles County alone houses 39% of the California Latino population. Thus, the housing crisis and its effect on Latinos is more apparent in these areas; and

2. Since only part of the housing data collected in the 2000 Census of Population and Housing has been released, the new housing information is incomplete. Data from the 1990 census are somewhat outdated. As a result, one has to rely on the American Housing Survey (AHS) to fill the gaps. Nonetheless, the AHS is more current for some metropolitan areas than others. Fortunately, the Bureau of the Census collected information on the Los Angeles-Long Beach metro area as recently as 1999.

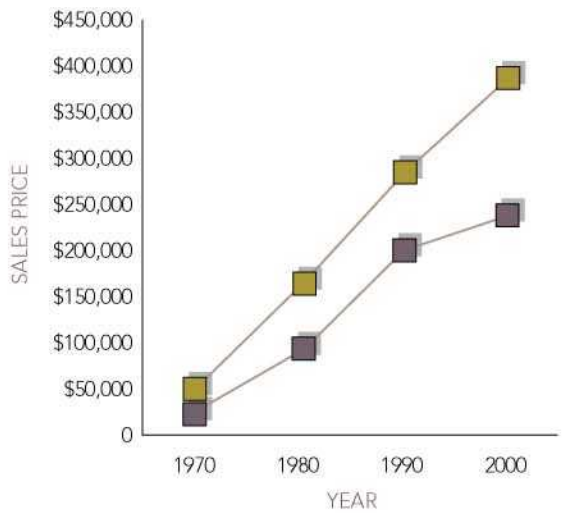
Price Escalation

Since 1970, California home prices have gradually escalated and created a significant gap with U.S. average home prices (Figure 1). In 1970, the annual median sales price of a California home was only 10% higher than the national median. By the year 2000, it was 175% higher. The median sales price for the year 2000 was $243,390, but by July 1, 2001, it had jumped by 10% to $267,810 (CAR 2001a). The median sales price of a condominium, a lower price substitute for a detached home, almost doubled during the last two decades (CAR 2001b). As of July 1, 2001, the average California condo was selling for $207,860, about 26% below the median California home price but still 30% higher than the national median sales price of a detached home (CAR 2001b).

4 While housing and lending discrimination continues to impact Latinos and African Americans, the issue is not discussed in this report because it is not considered to have a direct effect on the current California housing shortage. For a review of the evidence on housing discrmination see John Yinger's 1998 article "Housing Discrimination: Is Still Worth Worrying About?", published in Housing and Policy Debate, V.9, Issue 4, pp. 893-927.

— Figure 1 —

CALIFORNIA AND U.S. ANNUAL MEDIAN SALES PRICE: 1970 TO 2000



California Association of Realtors. 2000 California Existing Single-Family Housing Market Annual Historical Data Summary. Los Angeles, March 2001.

Home prices are subject to significant variation within California. As of July 1, 2001, the highest price for existing detached homes was found in the Santa Barbara South Coast region ($634,090) followed by Santa Clara County ($528,500), and the San Francisco Bay area ($481,280). Median home prices in Southern California were lower, but still exceedingly high by national standards. They ranged from $359,510 in Orange County to $159,760 in San Bernardino-Riverside counties (CAR 2001a).

Escalating home prices have made homeownership less affordable and more difficult for California residents. According to the California Association of Realtors, only 37% of California families were able to afford the median home price in April of 1999 (CAE 2001b). The problem is most serious among Latinos. Compared to white, Asian, and African American households, only 29% of California Latinos were able to purchase the $217,510 state median price home in 1999 (Table 1). Assuming a 20% down payment, a 7.0 % annual mortgage rate and a 30-year term, approximately 1.9 million Latino households were priced out of this market on income criterion alone. This is not surprising since the income of Latinos is lower than that of other groups and it has not been increasing as much as that of the majority population or other minorities (Table 2). The lower household income of Latinos can be partly traced to the presence of a high number of immigrants (Bean et al. 2001). Nonetheless, low income combined with higher home prices constitute formidable barriers to save

— Table 1 —

CALIFORNIA HOUSING AFFORDABILITY BY ETHNICITY: 1999
(BASED ON A MEDIAN HOME PRICE OF $217,510 FOR A RESALE HOME)

California:	
All*	37%
Latinos**	29%
Whites**	49%
Asian and Pacific Islanders**	55%
African Americans**	34%
U.S.	55%

**California Association of Realtors, 2000 California Existing Single-Family Housing Market Annual Historical Data Summary. Real Estate Research Report 2001-2, March 2001, p.26.*

***Computed by TRPI staff using California Association of Realtors' methodology. Assumptions: 7% mortgage rate, 20% down payment, 30-year term, property tax equal to 1% of median price, and Insurance of 0.38% of median price. Median household incomes estimated from the 2000 Current Population Survey March Supplement using grouped data. Information provided by Andrew Ruppenstein, California Department of Finance, Sacramento, California, February 2002.*

— Table 2 —

CALIFORNIA MEDIAN HOUSEHOLD INCOME BY RACE AND ETHNICITY

(NOMINAL DOLLARS)

	1989*	1999**	2001***	Annual Growth Rate
Latinos	$ 28,462	$ 31,906	$ 32,870	1.015
Whites	$ 39,564	$ 49,920	$ 52,294	1.024
African Americans	$ 26,096	$ 33,815	$ 35,617	1.026
Asian and Pacific Islanders	$ 39,820	$ 57,158	$ 61,442	1.037

*U.S. Bureau of the Census. 1990 Census of Population. Social and Economic Characteristics. California. August 1993, Table 93-97.

**Authors' computation based on U.S. Bureau of the Census. 2000. Current Population Survey: March Supplement (Data provided by Andrew Ruppenstein, California Department of Finance, February 14, 2002).

*** Extrapolated from 1989-1999 by using an annual growth factor.

for a down payment ($43,502) necessary to purchase the California median home price in 1999.

It is not only the price of buying a house that is creating problems. California residents are also struggling with the escalation of rents. In 1995, California renters were spending about 33% of their income on rent, compared to 28% for all U.S. renters (CDHCD 2000, Exhibit 44). Latino households in the Los Angeles-Long Beach metropolitan area were devoting 35% of their income to pay for rental housing as compared with 33% spent by all county residents (U.S. Bureau of the Census 2001a). Regardless, of race or ethnicity, low-income households are affected the most: 79% of households with very low income were paying over 50% of their income on rent (CDHCD 1998, Table 23).

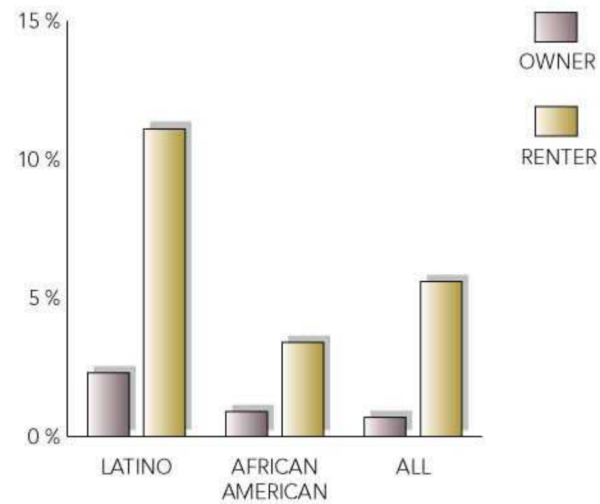
Escalating rents also are having a discouraging effect on government-subsidized units. As of 1999, fewer landlords were accepting Section 8 housing vouchers because of the more profitable alternative of charging higher market rents to families who are not tied to the subsidy. Nationwide, the Section 8 rent subsidy is expiring for many housing units, so some landlords are choosing to exit the federal program. The reduction in the number of subsidized units affects Californians, particularly those living in cities like Los Angeles, where one out of three affordable housing units is subsidized (The Nation 2001).

Overcrowding

As a result of higher home prices and rents, more and more people are living in overcrowded conditions (i.e., 1.5 or more persons per room). For many, the only option is to rent or buy a home often too small to accommodate the family. In addition, many families are forced into sharing a house or apartment since this is the only viable alternative to cope with higher rents. From 1980 to 1990, the number of overcrowded units in California more than doubled, from 0.5 million to 1.2 million (CDHCD 1998, Table 24). In 1990, the proportion of renters (19%) experiencing overcrowding conditions was three times higher than that of owners (5.9%).

— Figure 2 —

PERCENT OF HOMES WITH 1.51 OR MORE PERSONS PER ROOM: LOS ANGELES-LONG BEACH



U.S. Bureau of the Census. American Housing Survey for Los Angeles-Long Beach Metropolitan Area:1999.

March 2001, Tables 2-3, 5-3, and 6-3.

Overcrowding also has increased significantly since 1990, especially in highly populated metropolitan areas. From 1992 to 1996, the percent of households living in overcrowded conditions increased by 42% in San Diego, 11.8% in Los Angeles, 6.4% in the Anaheim-Santa Ana area of Orange County, 5.2% in San Bernardino-Riverside, and 5.1% in San Jose (CDHCD, 1998, Table 26). The measure of overcrowding underestimates the actual number of person per room since kitchen and bathroom facilities are counted as rooms too.

— Table 3 —

HOME TENURE: CALIFORNIA ETHNIC AND RACIAL GROUPS 1990-2000

	1990	2000
Latinos	40%	44%
Whites	60%	65%
African Americans	36%	39%
Asian and Pacific Islanders	55%	55%
All Races	56%	57%

Sources: U.S. Bureau of the Census. Census 2000 Summary File 1. Produced by the California Census Data Center, August 24, 2001.

U.S. Bureau of the Census. 1990 Census of Housing. General Housing Characteristics. California. June 17, 1992, Table 13.

While there is overcrowding amongst all races, there is a higher percentage of Latinos experiencing this problem. The incidence of overcrowded conditions in the Los Angeles-Long Beach metropolitan area was over three times higher for Latinos than for all homeowners. Among renters, the incidence for Latinos was about twice as high as that for all renters (Figure 2). The incidence of overcrowding was also higher among Latinos in the San Diego metropolitan area (U.S. Bureau of the Census 1994).

— Table 4 —

2000 HOMEOWNERSHIP RATE BY RACE AND ETHNICITY: SELECTED COUNTIES

	Latino Owner	African American Owner	White Owner	Asian Owner
California	44%	39%	65%	55%
L.A. County	38%	37%	58%	51%
Orange	42%	38%	66%	58%
Riverside	59%	54%	73%	64%
San Bernardino	60%	45%	69%	67%
San Diego	39%	32%	61%	54%

Source: U.S. Bureau of the Census. Census 2000 Summary File 1. Produced by the California Census Data Center, August 24, 2001.

Disparity in Home Ownership

In spite of the progress made during the past ten years, Latinos and African Americans are less likely to own a home than whites and Asian Americans (Table 3). As of 2000, California Latinos lagged 21 percentage points behind whites and 10 percentage points behind Asian Americans. However, the widest difference in homeownership rates was between African Americans and whites (26 percentage points).

In Southern California, Latinos and African Americans were less likely to own homes than whites and Asian Americans, but the differences vary by county (Table 4). The largest gap between Latinos and whites was found in Orange (24 points) and the smallest in San Bernardino (14 points). African Americans experience the highest gap in San Diego (29 points) and the lowest in Orange (21 points). Regardless of county, homeownership was slightly higher for Latinos than African Americans.

Among California Latinos, homeownership rates vary by country of origin (Figure 3). Cuban Americans have the highest rate of homeownership (73%) and Mexican Americans the lowest (38%). Differences in homeownership rates are probably due to income disparities found among Latinos of various nationalities. For example, according to the 2000 Current Population Survey, Cuban Americans reported the highest average household income ($72,626) in the state, followed by Puerto Ricans ($39,889) and Mexican Americans ($34,428) (U.S. Bureau of the Census 2000).

Empirical studies indicate that lower income and wealth, as well as younger age, consistently account for differences in homeownership among ethnic and racial minorities (Coulson 1999; Gyourko and Linneman 1996; Wachter and Megbolugbe 1992). In a recent study of household movers in the Los Angeles-Long Beach metropolitan areas, Painter, Gabriel, and Myers (2000) found that those who are older, married and have larger household size, income, and levels

of education are more likely to own a home. Eliminating educational and income differences between whites and Latinos closes the homeownership gap almost entirely. The latter study further indicates that recent Latino arrivals are 13% less likely than natives to own a home, but immigrants are more probable than natives to be homeowners after being here for more than 15 years. Thus, income and educational differences, along with immigration status (especially length of stay in the U.S.) go a long way to explain the 21 percentage point divide that separates Latinos and white homeowners.

Standard of Living

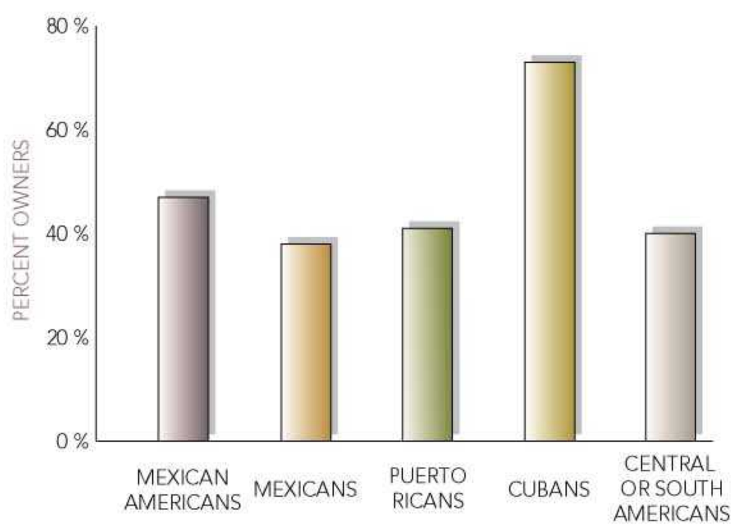
Higher home prices and rents also affect the welfare of many California residents. To cope with higher housing costs, families have to devote a greater proportion of their disposable income to housing. The larger the share of family resources devoted to housing, the less money available to spend on transportation, medical care, education, entertainment and other goods and services. Higher prices lead to some households being priced out of the homeownership market altogether.

The percentage of one's income spent on housing varies from area to area, between homeowner and renter, and across race. In Southern California, Latino homeowners and renters were more likely to spend more than 50% of their income on housing than all races combined (Table 5). This inequality was larger among homeowners than renters, which also implies a stronger preference for homeownership among Latinos. However, in the Los Angeles-Long Beach and San Bernardino-Riverside metro areas, a larger fraction of African American renters spend more than 50% of their income on shelter costs when compared to all the other renters.

Lack of affordable housing is compelling families not only to devote a greater share of their income to housing, but

— Figure 3 —

HOME OWNERSHIP RATES FOR CALIFORNIA LATINOS: SELECTED NATIONAL ORIGINS



U.S. Bureau of the Census. Current Population Survey 2000. March Supplement. http://ferret.bls.census.gov/cgi-bin/ferret. Data accessed March 7, 2001.

Note: Rates should be viewed as approximations subject to sampling errors.

— Table 5 —

PERCENT OF HOUSEHOLDS SPENDING MORE THAN FIFTY PERCENT OF THEIR INCOME ON HOUSING: SELECTED AREAS

	Los Angeles-Long Beach		San Diego		San Jose		San Bernardino-Riverside	
Race	Owner /	Renter	Owner /	Renter	Owner /	Renter	Owner /	Renter
Latino	22.4%	27.2%	17.3%	28.8%	37.9%	26.1%	18.5%	29.8%
African American	21.8%	32.8%	12.7%	26.0%	15.5%	23.6%	17.3%	36.5%
All Races Combined	16.4%	25.6%	10.0%	26.0%	13.1%	19.3%	11.4%	28.5%

Source: U.S. Bureau of the Census. American Housing Survey, Los Angeles Long Beach, 1999; San Jose 1998; San Diego 1994; and San Bernardino Riverside, 1994. Tables 2-13, 5-13, and 6-13.

to live in substandard homes as well. While the problem affects a very small fraction of residents, it appears to be more severe among Latinos than the general population. In the Los Angeles-Long Beach metropolitan area, for example, 3.4% of Latino renters lack adequate plumbing compared with 1.7% of all renters (U.S. Bureau of the Census 2001a).

The preceding statistics understate the number of families living in substandard housing because they exclude "phantom units" such as garages, laundry rooms, and attics illegally converted to living quarters (Stewart, 2001). Since these phantom units are missing from city records, it is difficult to know the exact number of people who are living in substandard conditions. Housing inspectors of the City of Los Angeles, for example, found nearly 4,500 of these illicit units in a period of almost two years (Stewart, 2001). In a report by The Center for the Study of Los Angeles, it was estimated that there are about 100,000 garages used for living space within the city of Los Angeles alone (Center for the Study of Los Angles 2001). Many occupants are illegally partitioning the home into sections and renting them to tenants. While this is clearly an unlawful approach to solve such an important problem, it is much faster and far less costly for landlords than going through local government channels to obtain permits and make physical modifications to the unit in order to accommodate a larger number of residents.

Oftentimes, higher home prices and rents also prevent families from moving to escape overcrowded conditions, inadequate housing, or neighborhoods besieged with crime. In Los Angeles County, 13.5% of Latino renters and 5% of homeowners said that they are so bothered by crime in their neighborhood that they would like to move (U.S. Bureau of the Census 2001a). Latino renters are almost three times as likely (13.5% vs. 4.6%) as all renters and Latino homeowners are twice as likely (5.0% vs. 9.5%) as all homeowners to want to move because of neighborhood crime.

Commuting Distance

With the rise in home prices and rents, it is becoming difficult for many families to live closer to work. Many employees find the length and time of their commute increasing as they move into more affordable housing. One study shows that many workers are attracted to jobs in Orange County, yet find themselves driving long distances from San Bernardino and Riverside Counties where housing is relatively more affordable. It is not just the low-wage worker who is experiencing difficulty in finding affordable housing in high-price areas, such as Orange County, but even those who command annual salaries of $50,000 a year (Los Angeles Times 2000).

As a result of the mismatch between the location of jobs and the location of affordable housing, commuting time and distance for owners and renters within California has continued to climb. In 1985, the average number of commuting miles for homeowners within California metropolitan areas was 12.6 miles, but by 1995 it has risen to 14.7 miles (CDHCD 2000, Exhibit 48). Commuters living in the metropolitan area of Los Angeles, including Latinos, travel more than commuters in any other metropolitan area of the United States. Residents living within metropolitan Los Angeles drive 140 million miles per day, more miles than any other metro area of the United States (Southern California Studies Center 2001, 17). Increasing commuting times increases transport costs, creates more stress, and leaves less time to spend with family and friends or in leisure activities.

Personal Wealth

While it is easy to focus on the negative aspects of the rise in home prices, one needs to remember that the escalation of home prices has increased wealth among many homeowners, creating small fortunes and substantial capital gains. When one purchases a home, there is a very strong likelihood that its value will climb over time. The accumulated equity can be used to purchase a larger or newer home, start a business, finance a child's education or retirement. Thus, a prospective buyer often looks at the expected rise in home values in the area in the hope that the money invested today will reap rewards in the future.

Based on the 2000 Current Population Survey March Supplement, the average home equity owned by California Latinos is about $3,528 (U.S. Bureau of the Census 2000). Since there were about 1.1 million Latino homeowners in California in the year 2000, the equity Latinos have in their home is estimated at approximately $4.0 billion or 16.6% of the total California home equity. This number, however, seems low and it may reflect a very narrow financial interpretation of the word "equity". In real estate finance, equity is the difference between the market price of the house and all the outstanding debts backed by the property, including first and second mortgages as well as equity credit lines issued by banks. To many Latinos, the word "equity" may be associated with the down payment on the property. If this is the case, the number reported may not reflect the true value of the real equity owned in the house.

THE DEMAND FOR HOUSING AMONG LATINOS

Although California housing prices continue to rise, more and more people are purchasing homes. From 1990 to 2000, the number of homeowners increased for racial and ethnic minorities. During this period, Latino demand for owner-occupied housing jumped by close to 400,000 units. Over the same period, white demand for owner-occupied housing declined by 370,000, and that of African Americans and Asians rose by 33,696 and 200,745, respectively (U.S. bureau of the Census 1992, 2001b). These numbers indicate that a significant transfer in homeownership from whites to minorities, primarily Latinos, is taking place in California. During the same time, the Latino market share of owner-occupied units rose from 13% to 17%.

Latino demand for renter-occupied housing also soared by almost 349,000 units, and their market share increased from 24% to 29%. In 2000, Latino share of the California housing market (i.e., owner plus renter occupied units) was 22%, more than two times the share of Asian Americans and three times that of African Americans. Latinos were surpassed only by whites, who accounted for 58% of the market (U.S. Bureau of the Census 2001b).

The Latino demand for housing is having a significant impact on the real estate market and the California economy. In 1999, California Latinos spent about $1.8 billion to cover shelter costs, $931.7 million in rent, and $877.8 million in home-ownership costs, including mortgage, real estate taxes, insurance and utilities.[5]

5 Since 2000 Census estimates for average homeownership cost and rent were not available for California when this report was being prepared, the authors relied on estimates from the Statistical Abstract of the United States for the western states. To obtain total costs, average ownership cost of $801 and average rent of $668 for the year 1999 were multiplied by the number of Latino households in each category (1.1 and 1.4 million approximately). See U.S. Bureau of the Census, Statistical Abstract of the United States: 2001, p. 608.

— TABLE 6 —

CALIFORNIA REAL ESTATE MARKET ACTIVITY AMONG LATINOS: 2001

	All Buyers	Latino Surnamed Buyers	Latino Market Share
Resale Single Family Houses	380,967	83,226	22%
Resale Condominiums or Townhomes	86,085	12,048	14%
Units Not Classified	18,993	3,338	18%
Total Units	486,045	98,612	20%
Average Price (House and Condo)	$ 264,030	$ 193,507	n.a.
Median Price (House and Condo)	$ 210,000	$ 168,500	n.a.
Total Purchases (in billions)	$ 128.3	$ 19.1	15%

Data Quick. Electronic Mail from John Karevol, La Jolla, California, March 13, 2002.
Note: Accuracy of data subject to the Spanish surnamed criterion used to identify Latinos.
n.a.: not applicable.

Based on information provided by Data Quick, a real estate research firm based in California, Latino home buying has been on the rise since 1998. In 2001, Latinos purchased $19.1 billion of resale homes in California, accounting for 15% of total state purchases (Table 6). This information also reveals that the majority of Latinos (87%) favored single-family homes rather than condominiums. In terms of the number of resale properties purchased, Latinos bought 83,226 single-family homes and 12,048 condominiums, accounting for 22% and 14% of total state purchases in both markets, respectively.

WHAT DRIVES THE LATINO DEMAND FOR HOUSING?

Several factors explain the increase in the aggregate demand for housing among Latinos. The most important ones are population growth, household formation, increase in the number of middle class families, low mortgage rates, immigration, and a strong preference for homeownership.

Population Growth

The rapid growth of the Latino population is the most important reason. From 1990 to 2000, the California Latino population grew at an average rate of 379,000 persons per year. Propelled by natural growth and immigration, increases occurred in practically all counties, but Los Angeles experienced by far the largest absolute change (890,971), followed by Orange (310,751), San Bernardino (290,805), Riverside (252,061) and San Diego (241,184). (U.S. Bureau of the Census 2000). Los Angeles County accounted for the largest share (23%) of the total change in the state Latino population and the other four counties absorbed about 29% of the total increase.

The California Latino population will continue to grow over the next twenty years. Based on growth factors developed by the California Department of Finance and using the 2000 Census of Population counts, the authors developed population projections for the largest racial and ethnic groups and for all persons (Table 7). By 2020, Latinos will become the majority in the state, followed by whites, Asians and African Americans. Between 2000 and 2020, Latinos will grow by 7.2 million and will account for over two-thirds of the expected growth in the state population.

It is important to understand that the Latino population is not homogenous but it includes different national origins. According to the 2000 Census Supplemental Survey, people of Mexican descent are the largest group in California (8.7 million) and constitute 82% of all Latinos. Salvadorans (399,616) are a distant second. Much smaller in numbers are individuals of Guatemalan (216,132), Puerto Rican (159,340), and Cuban (64,163) descent (U.S. Bureau of the Census 1993, 2001b).

The unique mixture of different Latino nationalities has changed California forever. Knowing Spanish is a major asset. Financial, insurance and real estate businesses are already changing product advertising and promotion, as well as using Spanish language aggressively, to cater to the burgeoning Latino housing market.

— Table 7 —

POPULATION PROJECTIONS BY RACE AND ETHNICITY: 2010 AND 2020
(IN MILLIONS)

	2000	2010	2020	Change 2000 to 2020 Absolute	Change 2000 to 2020 Percent	Share of Total Change
Latinos	11.0	14.2	18.2	7.2	65%	69%
Whites	15.8	16.3	16.5	0.7	4%	7%
African Americans	2.2	2.4	2.6	0.4	18%	4%
Asian and Pacific Islanders	3.6	4.8	5.8	2.2	61%	21%
Total*	33.9	39.1	44.4	10.5	31%	100%

Note:

Data for 2000 based on the 2000 Census count (see source for Table 4).

Data for 2010 and 2020 are projections based on growth factors assumed by the California Department of Finance (see California Department of Housing and Community Development's "Raising the Roof", Sacramento, California, May 19, 2000, Exhibit 3.)

**Numbers do not add up to totals because certain populations have been excluded from the projection.*

Household Formation

To understand the effect of Latino population growth on the demand for housing, one must translate the population figures into household increments. From 1990 to 2000, the number of Latino households rose by 759,543, an increase almost as large as that experienced by white households (U.S. Bureau of the Census 1993, 2001b). During this time, Latino household size shifted from 3.95 to 4.06, which reduced the total demand for housing by about 3% less than if household size had remained at its 1990 level.

To approximate the potential demand for housing in 2010 and 2020, the authors used household size calculated from the 2000 Census of Population to convert future population projections to household counts. The results are displayed in Table 8. All things being equal, the California housing market would have to provide at least 4.0 million additional units by 2020 in order to satisfy the potential demand for housing. This number excluded an allowance for vacancies and demolitions. By 2020, Latinos will demand an additional 1.9 million units and will account for close to 50% of market demand. Assuming that the 2000 tenure split remains constant, close to 900,000 of these units will be owner-occupied. However, whether the potential demand for owner-occupied housing is translated into effective demand will depend on the growth of incomes, home prices and the availability of mortgage funds.

Increase in the Number of Middle Class Families

Another factor explaining the higher demand for housing among Latinos, especially the growth in homeownership, is the increase in the Latino middle class (Bean et al. 2001).

— TABLE 8 —

PROJECTED DEMAND FOR HOUSING BY RACE AND ETHNICITY: 2010 AND 2020

	Household Size	2000	Number of Households 2010	2020	Change 2000 to 2020 Absolute	Percent	Share of Total Change
Latinos	4.06	2,566,688	3,527,666	4,490,718	1,924,030	75%	48%
Whites	2.38	6,697,480	6,831,790	6,913,771	216,291	3%	5%
African Americans	2.71	793,479	875,186	967,080	173,601	22%	4%
Asian and Pacific Islanders	3.24	1,107,202	1,486,573	1,804,699	697,497	63%	18%
Total*	2.87	11,502,870	13,607,669	15,471,920	3,969,050	35%	100%

Note: Data for 2000 based on the 2000 Census count (see source for Table 4).

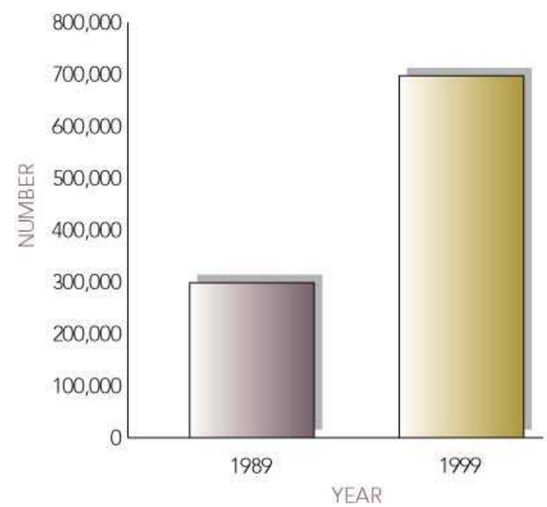
**Numbers do not add up to totals because certain populations have been excluded from the projection.*

Assuming a $50,000 family income as a cut off point for middle class status, the number of middle class families more than doubled from 298,000 in 1989 to 697,000 in 1999 (Figure 4). During this time, the number of families with incomes of $100,000 or more almost quadrupled from 34,000 to 127,000. This additional purchasing power has led to higher rates of homeownership in the Latino community.

Over the last decade, however, the increase in Latino median household income did not increase as much as that of other ethnic groups. Furthermore, the 12% rise in household income was not large enough to outpace the 30% increase in the cost of living index experienced by California urban consumers over the same period (CDF 2002). Average household income increased more (24%), but the rise did not offset the change in the cost of living index either. When prices increase, consumers generally revise their expectations and change their buying habits by either acquiring less expensive items or postponing their buying for some time. In the housing market, this may well mean renting instead of owning, or purchasing a less expensive home, which may be smaller, older, or located farther from work.

— FIGURE 4 —

LATINO FAMILIES EARNING AT LEAST $50,000: 1989 AND 1999



California Department of Finance. California Current Population Survey Report: March 2000 Data. Sacramento, California, March 2001.

U.S. Bureau of the Census. 1990 Census of Population. Social and Economic Characteristics. California. August 1993, Table 96, p. 230.

— Table 9 —

CALIFORNIA LATINO IMMIGRANTS: HOME TENURE BY YEAR OF ENTRY

	Own	Rent
Before 1950	61%	39%
1950 to 1959	58%	42%
1960 to 1969	65%	35%
1970 to 1979	55%	45%
1980 to 1989	37%	63%
1990 to 2000	19%	81%

U.S. Bureau of the Census. Current Population Survey 2000 March Supplement (http://ferret.bls.census.gov/cgi-bin/ferret), accessed March 9, 2002.

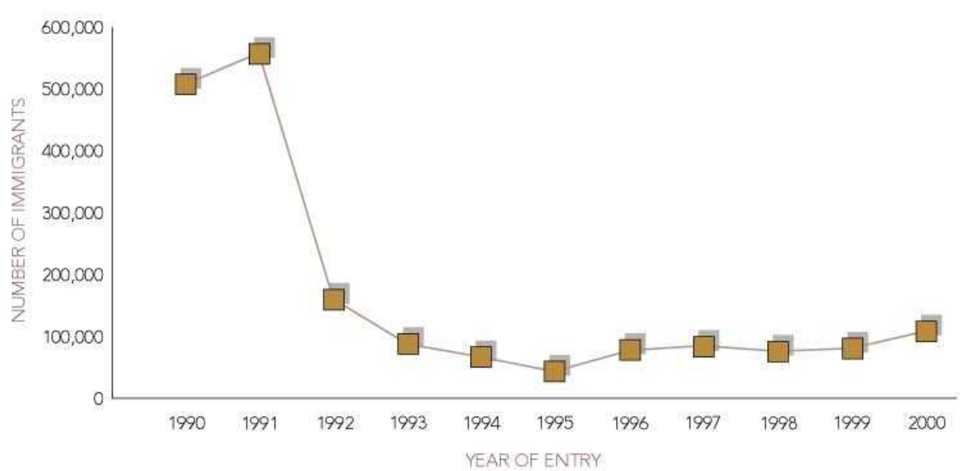
Low Mortgage Rates

One factor that has helped offset the slow growth of Latino household income among prospective homeowners is the steady decline in mortgage rates during the mid and late 1990s and new financial programs (e.g., zero or low down payment, adjustable mortgage rates, etc.). Since 1991, mortgage interest rates have declined by about 34%, from 9.77% to 6.47% (Weston and Strickland, 2002). This significant decline has partially offset the increase in home prices in Southern California. Thus, the drop in interest rates has helped hundreds of thousands of families to purchase their first home.

Fannie Mae and Freddie Mac, the largest operators in the secondary mortgage market, have been instrumental in providing the necessary liquidity to purchase and refinance homes in the United States. Liquidity is maintained by purchasing mortgages from banks and other financial institutions. To finance the purchases, these two agencies issue and sell securities backed by U.S. home mortgages. The securities are sold to investors all over the world, who are attracted by the relatively low risk and reasonable yield associated with this type of financial instrument.

— Figure 5 —

CALIFORNIA LATIN AMERICAN IMMIGRANTS BY YEAR OF ENTRY



U.S. Department of Immigration and Naturalization. 2000. Statistical Yearbook of the Immigration and Naturalization Service, U.S. Department of Justice, Tables 16, Years 1990-2000.

Immigration

Immigration is a major driver of Latino population growth and contributes substantially to the demand for housing in western states, Florida, and New York. From 1990 to 2000, about 1.8 million legal Latino immigrants entered California. This number understates immigrant entry since it does not include undocumented persons. About 84% of these immigrants were from Mexico. As displayed in Figure 5, Latino immigration reached a peak in 1991 and dropped significantly thereafter.

Upon arrival, most immigrants live with relatives and friends. After finding employment, they typically enter the housing market as renters. They usually occupy cheaper housing near or around central cities and in older suburbs, where public transportation is more accessible. For years, Latino immigrants have helped to fill the economic and housing vacuum left by middle class families leaving the cities. They have helped slowdown neighborhood abandonment and stimulate business and commerce in many localities. Landlords and real estate owners in particular have benefited from the influx of Latino immigrants into these communities.

In 1990, about 45% of the California Latino population was born abroad, and that number has not changed much in the last ten years (U.S. Bureau of the Census 1993, 2000). The effect of immigration on the demand for housing is much larger when the younger age cohorts form families and start to bear children. According to the Current Population Survey, foreign-born Latinos (37%) were less likely than their native counterparts (47%) to own a home. (U.S. Bureau of the Census 2000). In general, and as discussed earlier, homeownership among Latino immigrants increases with the number of years living in the U.S. As Table 9 shows, those entering the U.S. before 1970 are three times as likely to own a home as those who arrived in the 1990s. Still, it is surprising to find that as many as 19% of families headed by persons arriving in the last ten years are already homeowners.

Strong Preference for Homeownership

As it is true for most Americans, owning a home is one of the most important goals for Latino families. It is the surest way to avoid increasing rents, evictions, and unreasonable

and culturally insensitive rules set by landlords. It is viewed largely as shelter, the safest investment, and the first step toward long-term financial security. For many Latinos, especially immigrants, owning real estate is highly preferred to stocks or other financial investments. Not only does the property owner benefit from appreciation over the years but he/she also enjoys the tax benefits exclusive of homeownership: a $50,000 annual household income with a mortgage of $100,000 can save as much as $2,475 in taxes. In addition, up to $500,000 of profit on the sale of a principal residence are excluded from the capital gain tax (NAHB n.d.). Homeowners also report higher levels of life satisfaction than renters do (Rohe and Stegman, 1994).

The strong preference for homeownership is apparent in the proportion of household income spent on owning a home. Latinos are more likely than African Americans and all races combined to allocate a greater share of income to owning the dwelling. This is a fact in large urban areas, such as Los Angeles, San Diego, and San Bernardino-Riverside counties. Thus, many Latino families are willing to make significant financial sacrifices to fulfill the American Dream.

BARRIERS TO BUILDING AFFORDABLE HOUSING

The standard economic textbook prescription for reducing the California housing shortage and its concomitant impact on affordability is to increase the supply of housing. If markets were perfectly competitive, housing shortages would be a temporary phenomenon. Stimulated by higher prices, the pace of housing construction would increase to take advantage of new profit opportunities. The housing stock would gradually rise, prices would fall, and all things being equal, housing would become more affordable for everyone, including Latinos. The problem is that many government regulations adopted over the last twenty-five years are hindering the market's ability to quickly and efficiently respond to the current California housing crisis.

Regulatory policies designed with good intentions to promote orderly growth, protect public safety, and preserve the environment have backfired and negatively affected the supply side of the housing market by discouraging housing construction and increasing the cost of home building. The increase in new home prices has spilled over to the resale market, raising prices there too. The cumulative effect of government regulations is hampering the market from meeting the rise in demand. As a result, homeownership has become more difficult for everyone, especially for first time homebuyers in the Latino and African American communities.

Latino households are more impacted due to their lower purchasing power. Based on 1999 data, even a 5% increase in the median price of a detached single family home can force as many as 222,446 households (44,833 Latino) out of the market just in California alone (Table 10). Thus, easing the price effect of government regulations on home building could potentially help a large number of Latino and other families to realize the American Dream. Because Latino household income has not kept pace with inflation and California home values have continued to escalate at a rapid pace, the ability of many Latino families to purchase a home has continued to deteriorate during the last two years.

Following are descriptions of selected government regulations and their resulting adverse impact on the supply of affordable housing in California.

— TABLE 10 —

EFFECT OF A 5% PRICE INCREASE ON HOUSING AFFORDABILITY IN CALIFORNIA:1999

	Latino	African American	White	Asian American*	Total
Households Unable to Afford the Median Home Price	1,937,810	527,904	3,628,552	583,368	6,677,634
Households Unable to Afford the Median Home Price + 5% Price Increase	1,982,643	539,947	3,771,857	605,633	6,900,080
Net Number of Households Excluded From the Market Due to a 5% Increase in Home Price	44,833	12,043	143,305	22,265	222,446

*Includes Pacific Islanders. See Table 1 for assumptions.

THE LOCAL FISCAL CRISIS

Some state policies have severely impacted the financial capacity of cities, and indirectly have contributed to higher development fees and discouraged housing construction. Since the adoption of Proposition 13 in 1978, California cities have been strapped for revenues to finance new roads, schools, and sewer systems, which are necessary to accommodate urban growth. In 1992, the financial capacity of cities was further eroded when the state re-allocated property tax money from local jurisdictions to educational programs. To cope with the shortage of fiscal revenues, cities have been forced to rely on general obligation bonds and developer impact fees to raise capital. Since financing urban infrastructure through general obligation bonds requires two-thirds voter approval, cities have increasingly turned to development impact fees and exactions.

Due to the current shortage of capital, many California cities have no other choice but to favor commercial over residential development, a technique known as fiscal zoning. Commercial development is preferred because it brings in tax revenues, while requiring few public services. In contrast, residential development, multi-family units especially, generates relatively lower revenues but require far more public services such as schools for minority children who are most likely to occupy the apartment complexes.

RESTRICTION ON THE SUPPLY OF LAND

The less land that there is available for residential development, the higher its price. Depending on the location and how tight the housing market is, a 10% reduction in the supply of developable land can add between 20%-30% to the price of new homes (Landis 1986). Thus, higher land prices make new housing less affordable. They also place a premium on older but less expensive homes since discouraged buyers move to purchase what they perceive as close substitutes for the new units.

The California Department of Housing and Community Development (CDHCD) has analyzed the effect of various land use restrictions, especially environmental regulations, on the supply of developable land in 35 counties. Since 1969, public concern with the environmental impact of land development has led to the passage of environmental regulations, such as the National Environmental Policy Act, Clean Air Act, and Endangered Species Act. While environmental regulations yield substantial social benefits, the impact on affordable housing sometimes is not adequately considered. For example, animals and plants are added to the list of endangered species and vast extensions of land are preserved to provide sanctuary to these species without taking into account the social and economic costs on humans.

— Table 11 —

EFFECT OF LAND USE RESTRICTIONS ON THE SUPPLY OF DEVELOPABLE LAND IN 35 CALIFORNIA COUNTIES

	Acres (millions)	Percent	Housing Capacity Lost*
Potentially Developable Land	17.2	100%	None
Exclusions:			
Wetland Areas	0.9	5%	1.9
Prime and Unique Farmlands	3.5	20%	6.1
Floodzones	1.5	9%	3.1
Special Natural Areas	1.4	8%	2.3
Most Suitable to Eight or More Endangered Species	1.8	10%	3.1
Outside Urban Growth Boundaries	5.6	33%	10.3
Total Exclusions	14.7	85%	26.8
Remaining Developable Land**	2.5	15%	-

** In millions of housing units.*

***Includes developable land within one mile of existing urbanization.*

Source: California Housing and Community Development Department. 2000. Raising the Roof. Exhibits 13-15.

Currently, there are about 25 million acres of raw land in these 35 counties. The existing land includes marshlands, hills, and mountains. The number shrinks to 2.5 million after proper adjustments are made, and the effect of environmental laws, flood zones restrictions, and potential urban growth boundaries are considered (Table 11). Protecting prime and unique farmlands removes 3.5 (20%) million acres from the land inventory. Allocating land to preserve special natural areas and eight or more endangered species further reduces the supply of land by 3.2 (18%) million acres. The latter two constraints diminish the housing capacity of these counties by about 5.4 million housing units, a number large enough to accommodate the expected increase in housing demand through the year 2020 and beyond. Latinos households are projected to need about 1.9 million of these units.

Comprehensive adoption of urban growth boundaries to limit urban development to within one mile of urbanized areas would further diminish the supply of developable land by 5.6 (33%) million acres with the associated capacity loss of 10.3 million housing units. Overall, these government regulations could decrease the supply of land by 85% and the housing capacity of these counties by 26.8 million housing units.

Although the quantity of land statewide seems to be adequate to meet projected housing demand through 2020, CDHCD warns that some counties will be more land-constrained than others. Los Angeles, Orange, and Santa Clara counties will run short of vacant land to accommodate the expected increase in the number of households through the year 2010. Thus, land prices and home building costs in these counties are likely to increase even further as the supply of developable land continues to shrink. The CDHCD warns that many more counties would run out of developable land if development were to be further constrained by widespread adoption of urban growth boundaries (CDHCD 2000).

Burdensome Residential Development Fees

No state levies more residential development fees than California. Charges imposed on developers take different forms, including impact fees, land dedication, construction of infrastructure, or cash fee in lieu of land. The fees add substantially to the price of new homes and make housing less affordable, especially for first time buyers with low purchasing power such as Latino and African American families. The incidence of development fees has been a subject of much controversy. According to economic theory, impact fees can be passed on to the homebuyer, shifted backward to the landowner, absorbed by the developer or any combination of these possibilities. In times when housing is in short supply and consumers are buying in anticipation of even higher home prices, homebuyers get stuck with most of the fee.

An extensive study of 89 California jurisdictions reveals that residential development fees in 1999 were relatively high (Landis et al. 2001). They also varied by municipality and the type of residential project being built. As shown in Table 12, a 25-single family home subdivision had the highest fee ($24,325) and a 45-unit apartment complex the lowest ($15,531). On average, infrastructure impact fees were over 80% of total fees, with planning and permit fees accounting for the rest. In terms of the value added to the price of a home, there seems to be a direct relationship between the size of the project and fees as a percent of total unit value. Fees imposed on a single-family infill home added about 10% to the unit value and those levied on a 45-unit apartment complex contributed as much as 21% to the total unit value.

Other information collected in the 1999 study demonstrates the effect of development fees on new home prices. For example:

- Development fees ranged from as little as $4,000 to as much as $60,000 per unit;

— TABLE 12 —

CALIFORNIA RESIDENTIAL DEVELOPMENT FEES: 1999

Development Type	Per Unit Fee	Infrastructure Impact Fees as a Percent	Percent of Unit Value
Single-Family Infill Unit	$ 20,327	82%	10%
25-Unit Single Family Subdivision	$ 24,325	81%	12%
45-Unit Apartment	$ 15,531	84%	21%

Statistics computed from Appendix B-3 of John Landis, Michael Larice, Deva Dawson, and Leng Deng's "Pay to Play: Residential Development Fees in California Cities and Counties, 1999." Institute of Urban and Regional Development, University of California, Berkely, August 2001. (http://www.hcd.ca.gov/hpd/pay2play/pay_to_play.html), accessed March 17, 2002.

- Fees added as much as 10% to the median price of a new single family home;
- Fees as a percent of home prices were larger in communities providing affordable housing and lower in those building more expensive housing;
- In Southern California, where most Latinos live, residential fees were slightly lower than state averages but still high by any standard: $14,360 in a 45-unit apartment building; $21,410 in a 25-unit single family home subdivision; and $19,377 in a single family infill unit.

Case study data obtained from the city of Carlsbad in California reveals that development impact fees are far more pervasive in certain California cities, especially coastal areas, and when indirect effects are considered. For example, the direct and indirect impact of local government regulations can potentially increase the price of an average new home by 19% to 26%, or by $70,413 to $96,301, respectively (Masotti 1999).

The impact of development fees is seldom weighted in terms of the number of households that are priced out of the market. Based on income criteria alone, only 24% of California Latino households could afford the median price of a new home in 1999.[6]

All things being equal, a 5% price reduction would have automatically qualified about 53,000 additional Latino households to purchase these new dwellings. Thus, assuming that 100% of a reduction in development fees is passed to consumers, a modest drop in these fees can help a large number of families to become homeowners.

CONSTRUCTION DEFECT LITIGATION

The mis-application of laws to protect homebuyers against construction defects has led to excessive and costly litigation. While some of these lawsuits may be legitimate, others are traced to frivolous claims and failure by the homeowners' association to maintain the property (LCRI 1996). As a result, the cost of liability insurance to protect developers from class action suits has increased

[6] The 1999 median home price of a new single family home in California was $249,990 (Carolyn Cloud, California Building Industry Association, e-mail to author, July 12, 2001). See Table 1, footnote, for assumptions and methodology used in calculations.

substantially, making town home and condominium projects practically uninsurable and driving many developers away from this market.

A telephone survey of 64 California attached-unit developers conducted in 1996 by the Lusk Center Research Institute shows the specific impacts of construction defect litigation on developers:

- 79% have experienced construction defect litigation;
- 32% reported lawsuits involving town homes;
- 82% reported lawsuits involving stacked units;
- 96% reported average increase of 149% in insurance premiums;
- 69% indicated a reduction on the availability of insurance; and
- 50% responded they no longer build attached units.

Most developers are trying to circumvent the problem by changing the product to detached units, or lower density higher-priced units. According to the Lusk survey, construction defect litigation reduced the number of units built in six projects by about 61%, from 255 units proposed in the original plans to 100. As a result, the price per unit rose by 33%, from $139,168 to $207,500 (LCRI 1996, Table 4).

Thus, increased litigation and higher liability insurance have induced developers not only to curtail production of the most affordable housing segment of the real estate market, but to produce fewer and higher priced units as well. Statewide data on condominium construction show a dramatic drop in the supply of town homes and condominiums. Condominium construction in California fell from 30% of total home construction in 1994 to only 2% in 1999. During this time, the number of units built declined by 84%, from 18,691 to 2,945 units.

The shortage of condominiums is affecting Latino and African American families the most because they are the least likely to have the income level required to purchase the higher-priced single family homes. Since, on average, an existing condominium sells for roughly three-fourths of the price of a single-family home in California (CAR 2001b), this segment of the market is financially more attractive to Latinos. In 1999, as many as 43% of California Latino households could afford to buy a condominium, compared with the much lower 29% eligible to purchase a single family home.[7]

Growth Controls

California counties and cities have long used techniques to manage urban growth. Some communities are more restrictive in their approach than others, but growth management is now universally practiced in California. While these growth controls are used all the time, their benefits are seldom weighted against their impact on affordable housing. While there is little agreement about the magnitude of the effect of growth controls on home prices, an increase is always the result (Feitelson 1993; Downs 1992).

These techniques take many different forms and they can be skillfully maneuvered to prevent rather than manage growth. They include a wide array of measures, such as density controls and land use restrictions. For example, some local jurisdictions confine construction to single-family homes in large lots. Thus, the supply of land available for condominiums and multi-family housing is reduced. Other cities limit the number of housing units to be built to a specific period of time. The results are that fewer dwellings and more expensive homes are built at the expense of higher density but more affordable housing.

7 The 1999 median price of a resale condominium in California was $161,390 (CAR 2001b). See Table 1, footnote, for assumptions and methodology used in calculations.

In recent years, urban growth boundaries or urban limit lines have been increasingly used to slow down development. This relatively new growth management technique consists of encircling the city within a borderline. Little or no urban growth is allowed beyond this boundary. By limiting the supply of vacant land, urban growth boundaries contribute to higher housing costs (CRB, n.d.). In 1992, 5% of cities and 11% of counties had established urban limit lines (CHCDD 2000, Exhibit 23). In general, and based on more recent data, growth control measures in California appear to be on the rise since 1996 (CHCDD 2000).

Not In My Backyard (NIMBY)

Many California residents have taken the position that urban growth is fine as long as it does not happen in their backyard: the NIMBY phenomenon. They equate urban growth with low-income people moving into the neighborhood and depressing property values, the loss of open space, traffic congestion, air pollution and all the other negatives typically used against urban development. These individuals try to insulate themselves from unwanted land uses and growth pressures by organizing politically and sometimes resorting to citizen initiatives to place anti-growth measures in the ballot. While this is a legitimate right of city residents, sometimes it is carried to an extreme to the detriment of new residential construction and housing affordability.

Some citizen groups are able to put pressure on unwanted development without going as far as the ballot box. They resort to the environmental review process sanctioned by environmental legislation and required of new private residential developments with more than four units, except those that are exempted by law or that have been included in an authorized plan (CDHCD 2000). The environmental review process has opened the door for community residents to challenge development projects during the public comment period. In addition, by questioning the methodology used in the report, citizen groups can delay the project, and even stop it by using the threat of litigation against developers. Unreasonable delays triggered by this type of regulation can force the developer to abandon its building plans and move to nearby areas where opposition to growth is less intense but the need for affordable housing is less compelling.

Examples of development projects stopped or delayed by the environmental review process abound. For example, a proposed 3,000 home ranch development in Ventura County is now subject to a follow-up review after ecologists indicated that certain types of frogs and plants were endangered by the project. The original environmental impact report had been reviewed and approved as far back as 1992 (Saillant 2002). Judging by these dates, anti-growth forces have managed to slowdown the project considerably.

A 356-home residential development planned in the city of San Juan Capistrano also has encountered resistance from slow-growth advocates who want the project scrapped because it will threaten wildlife, increase traffic congestion, and ruin open space in the nearby canyons (McKibben 2002). Resident opposition to a 12,350-home community proposed is already underway in the City of Irvine as well (Borgatta 2002). The NIMBY phenomenon has become so pervasive in the state that the California Community Development Department has initiated construction of a website to educate state residents and ameliorate the concern about urban growth and the impact of low and moderate income housing on their communities (CHCDD 2002).

Complexity of the Development Approval Process

Seeking approval of a real estate project from a California local government is complex and can take a long time. Cities have significant latitude in shaping the process and can ultimately decide whether a real estate development project takes place. This decision-making process introduces uncertainty and increases risk for the developer. A recent report describes development and approval practices in California as three processes instead of one:

"The first is the process as set forth in state planning and environmental laws and local codes. It consists of formal requirements, procedures, and steps for reviewing, evaluating, and approving (or denying) project applications. The second is the process as actually administered. It is highly discretionary, is subject to enforcement only through the courts, and provides local governments with tremendous bargaining power over project sponsors. The third process is one that citizens establish for themselves and their communities through the initiative process. The California Supreme Court has been extremely accommodating to citizen-sponsored initiatives in all areas, but especially in the area of land use controls. Overlay on top of each other, these three processes form a planning development and review process that is fundamentally different in every municipality in which it is applied. Depending upon the municipality, it may also be different for every project. Except in rural areas, and even then, rarely, the concept of 'as of right' development no longer exists in California." (CDHCD 2000).

It is not surprising then that the time needed to gain approval for a project in California has more then doubled in the past twenty years (Curtin 1997). The longer the time period preceding construction and the more extensive the permitting process, the more difficult it becomes for small builders to enter this market since they lack the financial resources to cope with long delays. This additional time also raises development costs, and ultimately increases the price of a new home.

Since most developers operate with borrowed funds, longer processing times result in higher interest charges. Delays also increase staff and other fixed costs that have to be retained for a longer period of time. While there is no recent information regarding the impact of longer delays on development costs, an earlier study places the burden between 14% and 21% of the sales price of a new home (Bay Area Council 1980).

Based on data collected on 46 California development projects, the average approval time for a single-family home development was 11 months, but it took more than five years for large projects requiring an environmental impact report. Average approval time for apartment buildings was 6.7 months (CHCDD 2000, Exhibits 30 and 31). Faster average processing times can be partly traced to the interest of some of these communities to promote growth.

Trade Restrictions

Finally, but somewhat less significant, is the effect of trade restrictions on building costs. On March 22, 2002, the U.S. Commerce Department imposed a 29% duty on Canadian lumber shipments to the U.S. The tariff was imposed on the grounds that the Canadian government subsidizes lumber production by underpricing timber harvested in public lands. The 29% includes a 19% countervailing duty and close to 10% of an antidumping duty. Lumber is the primary material used in housing construction. Home construction and remodeling constitute about two-thirds of lumber consumed in the U.S. (NAHB, 2002). The Canadian government has appealed Commerce's decision to the World Trade Organization and the North American Free Trade Agreement.

It is estimated that the 29% tariff to restrict lumber imports from Canada could increase home construction costs and add about $1,500 to the price of a new home (NAHB 2002). While this type of trade restriction is designed to protect domestic lumber producers, its full impact on affordable housing has been neglected, especially in areas, such as California, where there is a housing shortage and the full cost of the tariff is likely to be shifted to new home buyers.

CONCLUSIONS AND RECOMMENDATIONS

The remarkable California economic expansion of the last decade has increased the demand for housing, but the supply side of the market has not been able to keep up the pace. As a result, California is facing an alarming housing crunch. The impact of the housing shortage is multidimensional, but it is more visible on escalating rents and home prices. Significant increases in home prices are making the goal of homeownership exceedingly difficult for first time homebuyers, especially Latino and African American families. Based on income earned, only 29% of California Latinos were able to purchase the state median home price in 1999. This affordability index was significantly higher for white and Asian Americans, and slightly higher for African Americans.

In spite of the housing affordability crisis, the demand for housing among Latinos has continued to increase in the rental and owner-occupied markets. Natural increase plus immigration have driven the demand for rental housing. These demographic factors, along with the rise in the Latino middle class, incredibly favorable mortgage market conditions, and a strong preference to own a home have pushed the Latino homeownership rate in California from 40% in 1990 to 44% in 2000. If recent demographic trends continue, Latinos will demand an additional 1.9 million housing units and will account for about 50% of the California housing market in the year 2020. All things being equal, about 44% of these units will be owner-occupied.

Whether the Latino homeownership gap can be closed, or projected demand for homeownership in 2020 can be met, will depend not only on the growth of incomes and the availability of mortgage money, but also on how decisively California moves to dismantle regulatory barriers that hinder the production of affordable housing. The effect of these policies has been cumulative. Far from helping, they are making it particularly difficult for Latino and African American families to own a home. To address the problem, the following recommendations are suggested as a starting point.

- Frivolous construction defect litigation should be carefully evaluated and proper safeguards introduced to discourage it and ensure that its impact on the construction of condominiums and town homes is minimal. The system should rely more on arbitration than litigation, without jeopardizing product quality. Reforming the system, along with allocating more land to this type of housing, will prompt developers to re-enter and revive this declining segment of the real estate market. Recently enacted reforms contained in SB 800 (Burton) will help improve the current system. But California policy makers should remain vigilant in their efforts to reduce lawsuits and, importantly, help make insurance for condominiums and townhomes plentiful and affordable.

- The public and private sectors should work together to find alternative mechanisms to finance urban public services (e.g., schools, roads, water and sewer treatment). As it stands now, local jurisdictions are forced to rely on development impact fees to cover the cost of expanding the infrastructure needed to accommodate urban growth. Thus, addressing this fiscal crisis should be top priority for policy makers. In the meantime, the state should consider returning property tax revenues to communities in exchange for reducing development fees and building new housing.

- While some government regulations are necessary to safeguard the environment, preserve open space, and protect endangered species, the social benefits of these rules should be carefully assessed against their costs, especially the impact of the reduction on vacant land and its associated long-term effects on the supply of housing and home prices. Because there is no knowledge on the trade off between environmental and housing concerns among Latinos, research should be conducted on this topic.

- The state should institute a system of rewards and penalties to entice local jurisdictions to allocate sufficient land to meet housing needs based on demographic and social changes taking place in the community and population projections.

- Local governments should reform zoning ordinances, residential densities, and urban growth boundaries to respond to market pressures. A more efficient use of land not only can help with the shrinking supply, but it can make housing more affordable since land is a significant component of housing cost. This approach will make cities more compact, and at the same time more amenable to be served by public transportation.

- A system to safeguard the construction of affordable housing from extreme and unreasonable NIMBY challenges should be instituted. One alternative would be to establish arbitration boards to mediate these challenges before they go to court. Citizen education to reduce resistance to NIMBY should continue and, if possible, expanded. Education can help decrease fears of declining property values and other negative effects attributed to disorderly growth. In addition, it can remind local residents of their social responsibility to the larger community, the region or the state.

- The development and planning approval process should be streamlined to prevent unnecessary delays that may increase home prices. State and local government should undertake evaluative studies with the purpose of making such comprehensive planning and regulatory duties more efficient, more consistent, and less time consuming.

- The idea of establishing a national housing trust fund is gaining support and should be considered. Local housing trust funds are being established in California but funding should be obtained from sources other than the real estate market. The City of Los Angeles, for example, is staying away from impact or in lieu fees, and is planning to rely on community redevelopment funds, federal block grants, vehicle license fees, and sale of city property. These funds can be used to assist cities in providing affordable housing to its residents and supplement housing rehabilitation programs.

- State and federal tax credit programs should be created to help low and moderate income working families to buy their first home, especially Latinos and African American families who lag significantly behind their white and Asian American counterparts.

- Local governments should encourage the construction of multi-family housing through proper zoning. The federal government should ensure that Section 8 housing continues to meet the shelter needs of low-income residents and the state should maintain its current efforts regarding the rehabilitation of urban housing. This type of shelter is necessary to meet the needs of many families, Latino immigrants in particular.

- Finally, the federal government can consider reducing lumber tariffs imposed to protect domestic producers from foreign competition. Eliminating import duties will reduce building costs and housing prices.

Implementing some of these ideas is a difficult task but a worthy goal, and it certainly would require a concerted effort by the private and public sectors. Working together, community residents, the housing industry, and various levels of governments could have an enormous influence on the production of affordable housing in the 21st century.

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