



# California's housing sector: Five ways to accelerate home-building

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America's biggest state needs to build 3.5 million homes by 2025. Here are some approaches that can help.

**California is America's** largest state by population ([38.5 million](#)). If it were a country, it would have the world's sixth-biggest economy ([almost \\$2.5 trillion](#)). But it faces a \$50 billion to \$60 billion housing-affordability gap each year. Half the state's households cannot afford the cost of housing. An undersupply of housing units costs \$140 billion per year in lost economic output.

Housing is critical to human health and well-being. But in many places around the world, in both developing and advanced economies, access to affordable housing falls short. In October 2014, the McKinsey Global Institute published [A blueprint for addressing the global affordable housing](#)

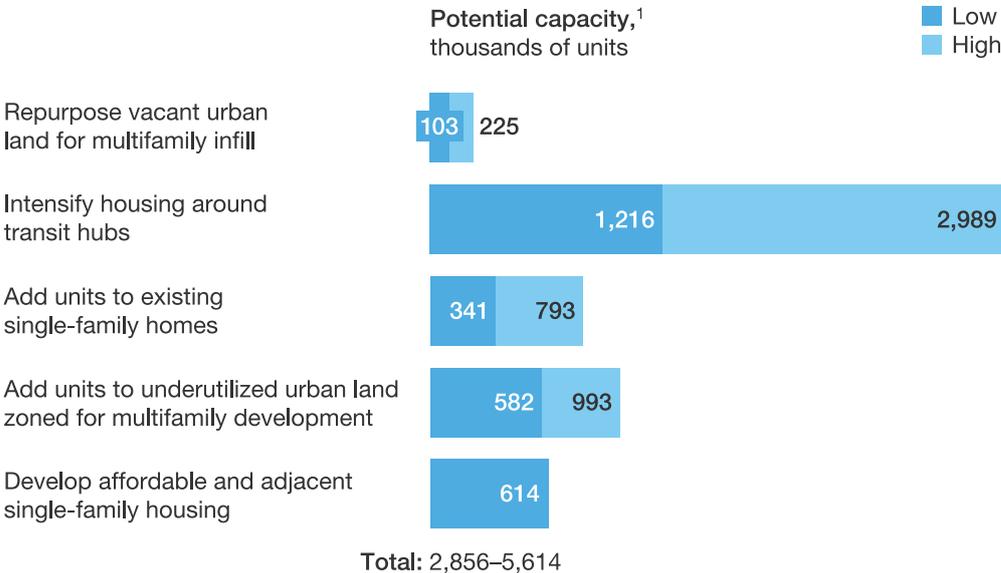
[challenge](#). In October 2016, MGI released a new report that focuses specifically on California, [A tool kit to close California's housing gap: 3.5 million homes by 2025](#). This article summarizes the main findings of that report. We have also written [an op-ed on the subject for the Los Angeles Times](#).

To understand the nature of the problem, we built a quantitative model to identify California's housing-affordability gap by household and location. Among our findings: 50 percent of California's households cannot afford the cost of housing in their local market. This problem is most acute among the poor and near-poor, but it also squeezes the middle class. In Anaheim, Long Beach, and Los Angeles, households earning up to 115 percent of area median income, or \$69,800 per year, are unable to afford local housing costs. Nor is it just an urban problem. In rural communities such as Watsonville and Salinas, up to 60 percent of households are stressed. Of America's 50 states, California ranks 49th in housing units per capita. From 2009 to 2014, the state added 544,000 households but only 467,000 net housing units; that helped drive up housing costs. To satisfy pent-up demand and meet the needs of a growing population, California must build 3.5 million homes by 2025 (exhibit).

After quantifying California's affordability gap, we analyzed land across the state, parcel by parcel, to identify "housing hot spots" where large amounts of housing could be

Exhibit

California has room to build more than five million new units in 'housing hot spots.'



<sup>1</sup>Highly conservative estimate, based on only 3 counties: Contra Costa, Sacramento, and San Bernadino.

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developed with attractive returns. We identified physical capacity to add more than five million units in these hot spots—more than enough to close the state’s housing gap. Up to three million units could be built within a half-mile of high-frequency public-transit stations. More than 600,000 could be added by homeowners to existing single-family homes.

The challenges will vary from place to place, so solutions must be tailored to local needs. Here are five promising approaches:

#### [Build on vacant urban land that cities have already zoned for multifamily development.](#)

California could prioritize infill development on vacant urban land that cities have already zoned for multifamily development. Multifamily infill projects can enliven cities, reduce the number of cars on the road, and raise economic productivity. Focusing on cities rather than “building outward” also preserves agricultural land and open space. In California cities with populations of more than 100,000 people, we conservatively estimate that there is capacity to build 103,000 to 225,000 housing units on vacant land that has already cleared the multifamily-zoning hurdle.

#### [Intensify the supply of housing around transit hubs.](#)

Given current land prices and allowable densities, cities such as Los Angeles, Sacramento, San Diego, and San Francisco cannot create enough housing within city limits. Transit-oriented development, which creates compact, mixed-use communities clustered around public transit hubs, is a solution. Locating housing on public-transit lines increases connectivity and convenience while reducing sprawl, highway gridlock, and greenhouse-gas emissions. State legislation from 2008 prioritized housing development within a half-mile radius of high-frequency public-transit terminals. San Jose has embraced these principles in its 2040 general plan, which channels housing growth into 70 mixed-use “urban villages” clustered around transit stations. By increasing housing density around transit, California could build 1.2 million to 3 million units within a half-mile radius of transit stations.

#### [Add units to existing single-family homes.](#)

In Los Angeles and San Francisco, 93 percent of the residential land area is dedicated to single-family housing. Many homeowners would like to create an additional unit on their property, such as a garage apartment, basement apartment, or backyard cottage. Through such “accessory dwelling units,” we estimate that California could add up to 790,000 housing units. Cities such as Berkeley, San Diego, and Santa Monica have a dearth of vacant parcels, but they have an abundant supply of private spaces that are fertile ground for microscale housing. Adding units inside existing units creates “invisible density.”

“Co-living” is another option. A co-living developer might obtain a 3,500-square-foot house previously occupied by a family of four and rent it to eight unrelated individuals who

commit to a culture of shared use. Co-living results in high-density, energy-efficient, and affordable housing without government subsidies. For owners, the business model in California yields cash-on-cash returns of 8 to 9 percent.

#### Add units to underutilized urban land zoned for multifamily development.

In Los Angeles, a single-story apartment building built in the 1930s might have four units, with most of the lot area dedicated to parking. But the lot may be zoned for ten units. To get a sense of the scale of the opportunity, we mapped every land parcel in two counties: San Francisco and Los Angeles. This geospatial analysis revealed that 31 percent of San Francisco's multifamily parcels are underutilized, which means the city could add 70,500 units under current zoning. In Los Angeles, the potential is for 306,000 more. Statewide, we conservatively estimate that there is capacity to build 580,000 to 990,000 units on underutilized multifamily parcels in the state's major cities over the next 30 years, and 200,000 in the next decade.

#### Develop affordable and adjacent single-family housing.

To meet market demand, a share of California's new housing supply must be built on land dedicated to nonresidential uses such as agriculture. To increase access to housing and reduce urban sprawl, greenfield development of single-family homes should be optimized for affordability and adjacency to existing development. We quantified the opportunity to build single-family homes in California in accordance with "smart growth" principles, such as small lot sizes and proximity to existing development, jobs, and transit. In three counties that fit these parameters—Contra Costa, Sacramento, and San Bernardino—our ground-level analysis identified more than 600,000 potential units.

### Turning ideas into homes

Capturing this opportunity requires leadership from government, engagement from citizens, and action from the private sector—including policy innovation, bringing new voices into local land-use decisions, and attracting social-impact investment. There is no single policy prescription to close the state's housing gap. California's statewide housing gap will only be closed at the local level.

Cities, towns and developers have the tools to act. For example, shortening the land-use approval process alone could reduce the cost of housing by more than \$12 billion through 2025. Reducing construction permitting times could cut another \$1.6 billion. Raising construction productivity and deploying modular construction techniques would improve efficiency substantially. Governments could reallocate \$10 billion a year in developer-impact fees to other forms of revenue generation in order to lower housing costs.

Attracting new sources of capital is also important. Policy tools such as inclusionary zoning, linkage fees, and tax-increment financing can capture some of the value

created through market-driven real-estate development and channel it into subsidized affordable housing.

There are opportunities to build. Based on rigorous and fact-based analysis, our report has identified how and where more than five million new housing units could be built. Our hope is that this research can help California to close its housing gap—a matter that is critical for improving social equality, enhancing quality of life, and boosting competitiveness. 🌐

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