THE EFFECTS OF GROWTH CONTROLS ON THE HOMEBUILDING INDUSTRY

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ABSTRACT

This thesis will investigate the impacts of residential growth controls on the homebuilding industry in southern Orange County, California.

As a result of rapid population growth, communities across the country and in California in particular, have implemented growth control plans in an effort to maintain the quality of life of the community as well as to minimize the impacts of rapid growth on both existing and future services and facilities. Growth controls have contributed to a more regulatory environment with a longer approvals process that exacts large impact and permit fees. These fees, in combination with the high cost of land, result in the highest median price for a single family home in the nation.

This thesis examines the types of homebuilders that can survive in this environment and the business strategies they use. Examples of the costs a homebuilder incurs when undertaking a project in a community that has implemented growth controls have been provided in addition to a discussion of the impacy that these costs have on the economic and social community at large.

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CHAPTER 1

A BRIEF HISTORY OF GROWTH MANAGEMENT

Growth management plans have been implemented in cities across the country as a means of controlling rapid growth and its associated negative impacts. These impacts are most often cited as: increased traffic congestion and commuting time; deterioration of air quality; the reduction of available services including water and sewer treatment, police and fire service, and schools; and the loss of open space through the development of land that is environmentally sensitive and not necessarily the best for development. Many of the communities which have implemented growth controls are primarily interested in maintaining the character and quality of life which contributed to its attractiveness while others wish to minimize the fiscal impacts of uncontrolled growth. The former have been variously described in the literature as elitist and the latter fiscally conservative.

Growth controls can be categorized into two broad areas: 1) Controls which allow for development at a reasonable, planned rate. These controls, sometimes referred to as "growth management," attempt to ensure that infrastructure is not overtaxed, neighboring land uses are compatible, etc. 2) Controls which attempt to slow or stop development as an end unto itself. These are sometimes justified as "preserving rural character," although the communities seldom qualify as "rural." This kind of growth control attempts to avoid the problems of growth in general and the influence of "land hungry" central cities by halting growth. Other mitigating measures are seldom invoked (California State Department of Housing and Community Development).

Burrows (1978) and Dowall (1981) further categorize growth controls as follows:

- limitations on the level of intensity of development permitted (subdivision control, zoning);
- stringent design and performance standards for lots and buildings (subdivision control, zoning);
- shifting costs from the public to the development project (adequate public facilities ordinances, exactions and impact fees, administrative fees for application review and processing);
- reductions in the supply of developable land and/or restrictions on the locations where development is permitted (zoning, urban limit lines, greenbelts, agricultural reserves);
- reductions in the amount of growth permitted, overall or per unit time (population caps, square footage or housing unit caps, annual permit caps).

Growth management plans have been controversial since they were first implemented in the 1970s in communities such as Petaluma, California, Boulder, Colorado and Ramapo, New York. Each of these cities sought to limit new housing to preserve their existing small town character and each withstood legal challenges from groups or individuals who felt their rights to develop would be unjustly limited. The plans have been accused of increasing the costs of housing, shifting the employment base out of the community and inhibiting the ability of low and moderate income people from residing in these communities. While supporters might hope that the plans improve or at least maintain their quality of life, in effect, these limitations often contribute to the further degradation of the environment by contributing to the sprawl of the metropolitan region in which the community is located. Growth limitations and restrictive land use controls implemented under the guise of protecting the surrounding environment are "hustles" (Frieden 1979) which elite communities use to exclude undesireable economic or social groups of people from the community while benefitting themselves by increasing the property values (Ellickson 1977).

THE IMPACTS OF GROWTH MANAGEMENT ON THE COST OF HOUSING

The most serious accusation directed towards growth management plans and the one that has been most studied is their impact on housing costs. Studies have consistently shown that California cities experience increased housing prices after implementation of a growth management plan in both direct and indirect ways. Dowall (1984) reported in his study of six California communities which implemented growth management plans that there are a number of ways which a community's local land use policies can affect the cost of housing: restrictions on the amount of land available for development; restricting the intensity of development of land (through zoning); increasing the fee requirements and approval times for subdivision plans; requiring the construction of both on-and off-site infrastructure improvements; and charging large permit and impact fees. All of these actions contribute to a need for greater capitalization on the part of the homebuilder who now must pay additional interest charges, taxes, and overhead costs as well as inflationary increases.

The indirect consequences of growth controls on housing costs as described by Dowall include restrictions on the developers ability to respond to demand when demand exceeds current supply. The supply of housing is restricted often as a result of insufficient amounts of residentially zoned land in the community. When this occurs, prices go up and in the long term, will increase demand for housing in neighboring communities (Dowall 1984). This "bottleneck" has occured in a number of Northern California communities where the many new electronics companies interested in locating in the Silicon Valley are forced to look elsewhere due to a lack of residentially zoned land to provide housing for employees. In Southern California, housing prices in Orange County are forcing employees of Orange County firms to purchase more affordable housing in neighboring Riverside County and to some degree, in northern San Diego County. This is the result of insufficient amounts of residential land and an increase in the cost of land in Orange County, both of which have contributed to increased sale prices.

Another contributing factor to increased housing prices is an overly burdensome approvals process which makes it difficult for new development firms to enter the market. This leaves the homebuilders who purchased the land for a price low enough to offset additional costs attributable to the approvals process, as the strong players in the market, for "they can afford the risks of operating in an environment of uncertainty"(Dowall). This makes it easier for these developers to control local land markets and the result is often "leapfrog development" where less fortunate developers "must move out to less centrally located and less expensive land. If local land use ordinances prohibit leapfrogging, the developers who control land can act as monopolists" (Dowall).

In addition to these restrictions, Dowall found that negotiated development with city staff and community groups can lead to higher housing costs when these groups demand lower density and more luxurious subdivision improvements. In response to these demands, the developer who initially proposed a large moderate-priced development is now faced with higher subdivision and per-unit land costs. In order to make-up for these costs, the developer often responds by reorienting the project to a higher-income market by adding amenities and features to the homes which become unaffordable to a more moderate income group. This reorientation is a common tact taken by homebuilders in markets controlled by growth management plans which will be discussed throughout this thesis.

This trend towards controlling the rate and pattern of development was contrary to the post World War II years of development which saw governments at all levels encouraging and often assisting land developers and merchant builders in their efforts to subdivide suburban property (Eichler 1982). This was most true in California which was one of the first states to establish government entities responsible for the creation and enforcement of development approval procedures such as plan review, public hearings, etc.

GROWTH CONTROL IN CALIFORNIA

In the 1960s, in response to rapid population growth, California experienced a movement towards limiting the amount and type of growth that could occur in its communities with the stated primary purpose of protection of the environment. This movement began by controlling coastal development, the development of agricultural lands and ensuring quality water for the state. It evolved into programs which concerned themselves with the effects of development upon all the services of a community (Eichler 1982).

By the mid-1970s, many California cities and counties had growth management policies and procedures in some form most often in the form of zoning restrictions. These procedures added more complex and timely reviews to the approval process by including an assessment of development proposals on their impact on public services, local government reviewed design, internal recreational facilities, unit size, planting, and other conceptual aspects of the building program. The result was a reduction in the total number of units permitted and added time and increased standards which dramatically increased development costs (Eichler).

From 1986 through 1989, 122 growth control measures were on the ballot in various cities throughout California. These initiatives had a 62% passage rate (California Association of Realtors, December 1989).

SELECTED GROWTH CONTROL PLANS

This thesis will investigate plans which are more correctly known as slow growth or residential development control systems that have been adopted as tools to implement the goals set forth in the General Plan of each city. Each community is primarily interested in the preservation of the existing quality of life or ambiance of the community by minimizing the impacts of new development on existing residential developments, surrounding environmental amenities, public services and the overall economic vitality of the community. The plans are normally implemented in response to a period of development which is threatening those qualities mentioned above and are often designed to limit the population of the community by limiting the number of residential building permits available each year with the ultimate goal of controlling the rate of growth over a number of years.

For example, the City of San Clemente, California implemented an ordinance to manage growth in response to "a period of intense residential development which is adversely affecting the capacity of the streets and local freeway system to meet traffic demands, the capacity of parking facilities in business, beach and other areas, the capacity of area schools to absorb children, the village by the sea character of the community, the quality of life prevalent in the city, its sphere of influence and the surrounding region, and the cost to households of some utilities and municipal services"(Ordinance No. 922, City of San Clemente, 1986). This ordinance was implemented in response to a citizen's initiative submitted at the special municipal election held in the City of San Clemente on February 25, 1986 and limits the number of dwelling units that can be constructed in the city to a maximum of 500 per year.

The City of San Juan Capistrano, California implemented a Residential Growth Management Plan in 1976. This plan was specifically designed to control the unprecedented growth the city had experienced between 1970 and 1976: a population growth of 3,781 to approximately 15,500. An average annual increase of 600 dwelling units occured between 1970 and 1975, with a high of 1,122 units in 1972 (San Juan Capistrano City Code). The plan set an annual growth rate of 400 units annually.

The growth experienced in San Juan Capistrano and San Clemente was not the result of any expansion of the local economy, but was due to an influx of people commuting to jobs in the employment centers of Orange County and retirees who were moving into a number of mobile home parks in the community. As a result, many long-time residents of the town consider it to now be "just a bedroom community" as opposed to the rural community to which they were accustomed (Dubbink 1984).

This thesis will investigate the impacts of Residential Growth Control Plans on the homebuilding industry in southern Orange County, California. It is believed that the implementation of these plans caused a certain number of homebuilders to cease doing business in these communities due to an inability to meet the up-front capital expenditure requirements that such plans dictate. If these homebuilders are not "forced" out of the market, the thesis will attempt to determine how they reorient their business to survive in the newly regulated environment. In addition, the thesis will provide a hypothetical example of the additional costs which a homebuilder incurs when undertaking a project in a community that has implemented growth control and will discuss what impact these costs have on the economic and social community at large. In particular, the thesis will discuss the impact on the developers desire and ability to build in such markets.

What impact do growth control plans have on the economic viability of the residential developer in these communities? Who are these homebuilders? This thesis will investigate the impacts of growth management plans which control the number of residential permits available on an annual basis, on the local homebuilding community.

THE NATURE OF THE HOMEBUILDING INDUSTRY

Before an analysis of the growth controls can be undertaken, it is necessary to review the history of the homebuilding industry in America in an effort to understand how this industry operates in Southern California. In 1982, Ned Eichler completed a study of "Merchant Builders" in an effort to identify the history and development of this unique American industry (Eichler, 1982). This study highlights the national trends and moods which created a market for the single family home.

The earliest examples of large-scale homebuilders in this country were according to Eichler's history, those early entrepreneurs who attempted to address the demand for hundreds of thousands of new homes for those families who emerged after World War II. Housing starts jumped from a level of 300,000 a year in the 1930's to 1 million in 1946 and 2 million by 1950. Responding to this demand, builders acquired the land in areas that would accommodate the development of mass produced, low-priced or low-rent housing. The location of land was critical for the success of the projects, as employment centers remained in the central cities at least initially. Inexpensive agricultural land at the edge of the city was thus subdivided for the development of housing. The physical characteristics of this agricultural land made development of these projects more feasible for the land was typically flat, dry, and less expensive than land in the city. In short, suburban development was a response to a desire to own one's own home in an area away from the dirt and noise, corruption, danger, and contamination of the city (Eichler). This movement was accelerated by the construction of highways and rail lines which made travel between these outlying areas and the central city more convenient.

In 1954, the Eisenhower administration drafted legislation to fund the interstate highway system which was proposed to have approximately 34,000 miles of freeways across the country. These freeways were originally intended to bypass the urban centers of the country, presumably to facilitate interstate commerce and the desires of those involved in the development of new suburban communities. Though the original plans were eventually altered in order provide urban interstate routes, the initial construction of the interstate highway system was probably the single most important factor in the development of America's suburban communities (Freiden and Sagalyn, 1989). New highways in combination with inexpensive and abundant gas, inexpensive automobiles and the rising incomes of postwar families in search of single family detached housing, contributed to the increased use of the automobile at the expense of urban transit systems and urban life in general.

Land was the most important ingredient for the success of the new suburban housing developments. The cost of this land was generally prohibitive to the new builder for few banks were legally prohibited in the 1940s to make loans on undeveloped land to builders without a proven track record (Eichler). Builders therefore arranged financing with the seller of the land (usually the farmer). These sales were made with purchase and sale agreements through which the seller (or a title company acting as the escrow agent) accepted a small deposit from the buyer to secure the transaction; this deposit was eventually applied to the purchase price. Land deals were made through the use of creative financing which would limit the amount of up-front capital required by the developer but which would also provide the seller with tax benefits, land deals were made. These deals, which were quite risky for the seller, provided the developer with the inexpensive land needed to undertake large housing subdivisions and were often the result of a strong, direct sales pitch from the builder (Eichler).

The important factor for the success of the merchant builder was the ability to select a site which was marketable and that could be obtained with the most favorable financial terms. This usually meant that the developer put up as little money as possible. It was, however, also necessary to select a site which had a minimum of engineering problems and was not subject to excessive government regulations both of which were costly and time consuming. The successful developers in the homebuilding industry were those who learned the political realties that were evolving around them and who could guide their projects through the process. Homebuilders represented the business fabric of America which respected the entrepreneurial spirit. This spirit was rewarded for many years as these companies expanded to newer and larger markets across the country. Eventually these builders would find the development environment more treacherous and less cooperative.

In the 1970s, several economic factors contributed to a more complex development environment for homebuilders: an increase in operating expenses, an oversupply of units, and a national recession. Up to this point, housing had been constructed at unprecedented levels. Once the combined realities of the factors mentioned above became evident, it was historically obvious that housing production had to decline. More specifically, Eichler points out the following signs of difficulty within the housing industry in the 1970's which led to a recession within the industry: withdrawl from housing by some acquirers (investors); apartment-operating costs increasing faster than rents; rising apartment vacancies; construction bottlenecks and costs increasing faster than the consumer price index; and declining contract sales in 1973 (Eichler).

These problems led to the demise or restructuring of many homebuilding firms who were ill-prepared to respond to these changes in the marketplace. Some of the premier homebuilders in the country such as Levitt, Larwin, Presley, McKeon, and Kaufman and Broad, suffered the most and were forced to either restructure or go out of business (Eichler). In the late 1970s, the amount of net savings and available mortgage funds swelled and interest rates declined. This combination contributed to a renewed boom in housing production which was somewhat tempered by an increase in residential debt. Various monetary policies of the government and actions taken by the financial institutions with regard to inexpensive interest rates contributed to record home sales. At the same time, however, restrictions on land development were becoming more commonplace, resulting in an increase in the value of land already approved. This contributed to an increase in the cost of housing that was offset by the increasing number of buyers willing to pay ever increasing prices. As house prices rose faster than the rate of inflation and total production increased, merchant builders were able to produce not only more units but to achieve higher gross margins (Eichler).

This strong new market supported some of the same large companies that had been in the homebuilding industry for years, while it saw the demise of others. In particular, many of the new entries to the industry in the 1970s experienced great success as they concentrated their land acquisition and development efforts on markets which they felt they understood and could to some degree control. New regulatory requirements in the form of growth controls would however have varying impacts on their success and business operations.

As previously discussed, most communities throughout the county which have enacted growth control plans have experienced an increase in the price of both land and housing. This is no less true in California, where housing prices have risen faster over the last fifteen years than in any other region of the country. This timeframe was characterized by intense shelter demand and frenetically speculative inflation in the California housing markets (Downs, 1989). During the period from the third quarter 1987 to the third quarter 1988, Orange County, California posted the fastest rate of increase in median home price in any metropolitan area at 32%. Partly because of this factor, Orange County has the highest home prices in the country. The county's strategic location in southern California between Los Angeles and San Diego counties is very attractive to people and firms who are attracted by its climate, beaches and strong, diversified economy. These factors make the county more desireable than such inland locations as Riverside and San Bernadino counties where overflow demand from Orange County is also driving up the cost of housing.

Over three hundred thousand people moved into Orange County between 1980 and 1988 resulting in 131,000 new households. Only 123,000 building permits were issued over roughly the same period however, reflecting a ratio of permits to new households of less than one housing unit permit per household (Downs). From the perspective of supply-side economic theory, areas that erect barriers to building new homes in the form of growth controls, would have lower such ratios than areas in which new building is encouraged. While the majority of communities in Orange County do not have formal growth control plans, less than one additional housing-unit permit per new household was granted between 1980 and 1987. This indicates a low supply-side response to increased population in the county. At the same time, the county experienced the highest home prices in the country (Downs, 1989). This reflects the large demand for housing in that area and provides an insight into the basis for the success of the homebuilding industry in the county.

CHAPTER 2

STRATEGIES UNDERTAKEN BY THE HOMEBUILDING INDUSTRY IN COMMUNITIES WITH GROWTH CONTROLS

The Orange County homebuilding industry has been dominated over the last two decades by a handful of very large landowners who either acquired or have been in ownership of parcels of land in excess of 10,000 acres. In fact, the Irvine Company continues to own in excess of 50,000 acres. Over the years, these companies have either developed the land themselves or have sold parcels of land to other merchant builders for development. It is estimated that these builders have over $10 Million in annual sales.

In addition to these large landholders, there are other owners of smaller tracts of land that was once used for agricultural purposes who are interested in either developing the land themselves or in selling the property to established developers. In both cases, the property owner wishes to take advantage of the significant economic appreciation of property no longer viable as agricultural land in this rapidly urbanizing area. For those involved in the development of residential projects, as in any other real estate investment, they must consider the potential risks versus the returns on their investments. This thesis will investigate the home building industry to determine the types of the builders who can operate in communities that have implemented growth control plans, how these builders respond to such plans and the impact of their responses on the development of housing in Orange County, California.

LONG-TERM LANDOWNERS AND DEVELOPERS

A majority of the large homebuilders in Orange County are land owners who bank land with the intention of developing it. These companies are generally diversified in product type and build in a number of communities in the county. The ability to develop the land is dependent on their ability both to successfully market a product in demand at that particular time and to understand and successfully navigate through the development approvals process including subdivision and zoning approvals, building permit allocations and building permit review. These processes each have associated costs associated which must be added to charges for infrastructure improvements and the fees attached to the development of property which are not related to the physical development of a particular piece of property. The latter might include school fees, or area-wide transportation and utility charges. These fees compound the cost of carrying the land over both the approvals period and construction period and are a significant cost of doing business. For example, a developer of one project in the City of San Juan Capistrano is estimated to have land carrying costs of $60,000 per week for this project alone.

The National Association of Homebuilders has determined that a homebuilder can expect financing expenses to range from three to five percent of operating expenses. At the same time, finished lot costs account for 23 percent of the costs of sales for homebuilders in the Pacific region,according to a NAHB 1988 Cost of Doing Business Survey. Finished lot costs are defined as the accumulated costs of finished lots that have been developed or purchased. Included are the cost of raw land, financing and interest, land planning, zoning, and other costs pertaining to the development of the land. Costs of sales are made-up of direct construction costs, indirect construction costs and finished lot costs which represent all costs associated with the units sold by the firm (NAHB, 1989).

Though it is difficult to know how much these figures may vary from state to state, it can be assumed that the cost of financing a project in today's more restrictive climate is a substantial part of doing business in California. To what degree or by what amount this affects the business will depend on how the project is financed. The recent restrictions placed on the savings and loan industry by the federal government make it impossible for an S&L to loan more than 10 percent of its total assets to real estate developers. This severely limits the amount of money available to developers and requires them to be more prudent about the projects that they develop.

SALE OF PROPERTY TO MERCHANT BUILDERS

If it is determined that it is not feasible for the company to develop a particular parcel of land themselves, this property may be sold to a smaller, merchant builder. For various business reasons, large homebuilders/landowners determine that there is profit to be made in selling the land to other developers without constructing the homes themselves. In this capacity, the landowner becomes a land developer who markets a parcel for which infrastructure has been provided and development approvals have been granted, making the property more valuable. The landowner may sell the land at a price that assumes an established return on investment for the purchaser and requires a participation in the profit that the purchaser experiences from each home. For example, a landowner sells property to a builder for $1,000,000. The landowner requires that each home in the project be sold for a minimum of $300,000. If the unit sells for more than this minimum amount, the landowner receives 50% of that amount which exceeds the minimum. In order for the builder to experience additional profit, a higher price must be charged for each unit which in turn largely depends on the market.

In some instances, this sale is contingent on the purchaser constructing the project under the rigorous design and construction standards set forth by the seller. This quality control is a necessary ingredient for the landowner because these standards are what has to a large degree, made the property valuable to begin with. The maintenance of strict design controls guarantees the profit to both parties. This motivates the smaller builder to enter into such an arrangement. It should be noted that the builder who purchases the land in such transactions is not always small (that is, a homebuilder who builds 100 units or less a year). In fact, some of these merchant builders are companies that have been in business as homebuilders for many years but who have been forced to discover and take advantage of a smaller niche in the marketplace.

In addition to the builders who purchase the land to develop it, there are those who acquired the property through bankruptcy or foreclosure proceedings at a reduced price. These purchasers are usually not homebuilders but investors who may hold the property long enough to receive preliminary development approvals, which makes the property more valuable, or they may gain the approvals and hold the land and contract a builder to construct homes on it for sale.

REPOSITIONING

Another business option which must be exercised by both the large homebuilder/landowner and the smaller merchant builder is the repositioning of their product within the market in an effort to remain competitive. This repositioning is necessary in a market where perhaps too much of a certain product has been brought on line and is presently not preferred by the buying public.

Several homebuilders interviewed for this thesis indicated that it takes from four to five years from the time the land is purchased to complete the application process for building permit allocation and construct a home on a parcel of ground in Orange County. Before the application for building permit allocations can begin, the homebuilder must have preliminary subdivision approval which provides a general outline of the proposed development. This preliminary approval will typically only be granted as a result of positive discussions with city planners responsible for the approval of development plans and others interested in the development process such as neighborhood groups. These discussions are designed to ensure that the proposed development will be physically and aesthetically compatible with the existing character of the area. The criteria established within the growth control ordinances are designed to ensure that the proposal will not overburden the existing infrastructure unless system improvements will be funded by the developer.

In order to begin discussions with the city, the homebuilder must have a proposed product type which is considered to be compatible with the surrounding area, consistent with the pattern of development of the city as outlined in the city's General Plan, and last but not least, marketable. The amount of time dedicated to the project to this point is considerable, making any changes very expensive and frustrating. The success of the homebuilder is not only dependent on his or her ability to efficiently process the development, but to be able to anticipate the demands of the market four or more years in advance. This process contributes significant risk to the development process.

NEW COMPANIES TO THE MARKET

All new entrants to the local market will experience the same development costs as the existing developers with the notable exception that they can expect higher land costs as a result of the appreciation of land values over the years. This is particularly true in communities which have enacted growth control plans which have limited the number of permits available or plans which have limited the amount of land available for development. They will also encounter those additional costs associated with development such as increased costs of materials and labor that other builders will experience. Small builders will actually incur higher costs because of the economies of scale which will not allow them to purchase materials at bulk discount.

Higher land costs, materials, and labor will result in a tendency of builders to upgrade the size and quality of units that they build in markets of "excess demand". When current demand exceeds current supply, home builders tend to contruct more expensive units because they can get more profit per lot and higher profit margins (Downs). In communities with growth controls this tendency to upgrade is an even more common occurence because larger units on larger lots are often exempt from the growth control plan. The construction of additional expensive homes contributes to a further reduction in the relative affordability of the community to those of more moderate means. The number of and demand for units of any particular type or price range for sale at any given time will also play a role in the decision to continue constructing large, expensive homes.

GROWTH CONTROL SPECIALISTS

In addition to identifying the types of developers who have experienced success in a variety of markets, the thesis will attempt to determine if there are those who choose to build in communities with growth controls because they have found a competitive advantage to doing business in those communities. These companies may in fact be the same large firms discussed throughout this thesis as the success of a firm in a community having growth controls is particularly dependent on its ability to obtain financing. As financing becomes more difficult to obtain from savings and loans who have historically been the principal source for working capital for home builders, the large firms may be the only companies left in the market.

CUSTOM BUILDERS

Custom builders represent a growing segment of the home building industry in communities that have implemented growth controls for as previously mentioned, they likewise build large, expensive units exempt from the ordinance and desireable to a greater segment of the homebuying population in Orange County. This demand is unique in light of a $40,000 1989 median income for the county (Downs).

Custom builders are described by the National Association of Homebuilders as those builders constructing one-of-a-kind units, generally on scattered lots and with a degree of craftsmanship indicating higher per-square-foot sales prices (NAHB). While there is no way to determine exactly how many custom builders there are in the county, it is noteworthy that the single most active price category in the first quarter of 1990 was the "over $450,000", which accounted for over 19 percent of all detached product sales with 108 units sold. This statistic while somewhat deceiving in a county having a median sales price for homes approaching $335,000, nonetheless represents a niche in the marketplace which can support custom homebuilders. Orange County, like many other expensive areas in the country consists of many households with two well-paid, full-time wage earners with average incomes exceeding the median who can qualify for the mortgages for these expensive homes.

The continued success of the builders of these homes will to some degree depend on the continued strength of the California economy in general but also on the ability to obtain financing. The smaller builder will experience problems because they rely more on the savings and loans for their financing than the large, master developer. With this source of funding becoming less and less viable, the small builder will have difficulty surviving in a market that has the high land prices found in Orange County.

The areas in southern California which are located close to the ocean are unique and desireable because they are in a metropolitan area that has an expanding total population and rising real incomes. These conditions create competition for the few best-quality sites amongst those with the highest incomes as the area grows. Since the absolute number and area of the land remains constant, the price of this 'best' land rises even faster than the population and incomes of the entire area (Downs). In addition, these areas are desireable because of the superior climate offered by the Pacific Ocean which provides cleaner air, cooler breezes and spectacular views unavailable inland.

Some custom builders believe that another major problem facing this segment of the industry is constraints on supply. For instance, in a February 1990 Los Angeles Times interview, when Richard L. Hall, president of the California Building Association and president of La Linda Homes, custom building firm was asked what he thought was the cause of a recent slowdown in housing starts, he responded by saying that:

> "there'll always be a demand for a good custom-home builder...It's the constraints on supply that are really slowing things up. One of the big problems we have in the industry is processing time. It's not unusual to find a project taking two to three years to get through the government hassles and bureaucratic red tape."

Others interviewed echoed this sentiment, complaining that the cities often look upon developers as unlimited sources of funds for the provision of infrastructure improvements or "deep pockets". Most of the developers felt that far too often, the planners and other city officials they must work with are inexperienced and ignorant of the realities of the financial aspects of the development process. These problems add considerable time and expense to the development firms ability to receive approvals. These costs will be passed on to the consumer in the asking price of the house.

CHAPTER 3

METHOD OF INVESTIGATION

The thesis investigates the impacts on the homebuilding industry of growth control plans that limit the number of residential building permits.I am particularly interested in how the various companies who do business in those environments survive the lengthy and costly regulatory process which is inherent in any growth control system. In pursuing investigating this topic, the fact that there are many different aspects to growth management became evident. There is a large amount of data regarding the impacts on growth management plans on the cost of housing but very little information on the direct financial impacts of these plans on the homebuilding firms who make-up the industry. This lack of information necessitated a compilation of existing facts regarding the history and operating characteristics of the homebuilding industry as well as a review of the literature on growth management in general. As became clear, existing literature does not directly address the question at hand.

To gather a broad impression of current trends, I conducted a series of interviews with people in the homebuilding industry; those who have studied the impacts of growth from an academic perspective; public officials; private consultants who are hired to assist developers with the processing and negotiations which are inherent to growth controls; and equity investors in housing projects (see sources). Many of my findings were necessarily qualitative not quantitative but a good deal of information was obtained from these interviews, as well as from the various market studies and profiles completed by the consulting firms interviewed. Additional data was obtained from the general literature documenting the impacts of growth controls on housing prices and their impacts on the communities which implemented such plans.

Many of the interviewees were as curious about the impacts of these plans on the industry as this writer yet many were prepared to take the simple way out and respond that they didn't know the answers. When pressed on the issue, they indicated that a single body of knowledge on the subject not only did not exist but would be difficult to quantify given the diversity of business plans and record keeping undertaken by the individual firms who make-up the homebuilding industry. This initial frustration on my part required a retrenchment in order to determine how to best approach the topic.

The danger in studying any topic related to growth management is being overwhelmed with the breadth of information on the subject. This information includes discussions about various state mandated plans, citizen initiatives in communities throughout the country, exclusionary zoning and other restrictive zoning policies. In addition to this problem, there is the danger of being absorbed in the growth phenomenon which is Orange County as opposed to the growth management plans implemented in two cities in the county and how these plans impacts homebuilders who operate in those communities. To avoid this problem, a strategy was created which insured that the focus of the thesis was not lost.

The focus of the thesis is to determine how policies which limit the number of residential building permits issued on an annual basis impact homebuilders. Do these plans affect the way which homebuilders do business and if so, how? I hypothesized that growth controls would create a more difficult and time consuming approvals process for homebuilders which would result in additional costs. These costs may be so burdensome that certain builders would not financially be able to continue to compete in these markets or the costs in combination with the additional expertise and energy required to operate within such markets would dissuade certain builders from doing business there.

Before this could be determined, it was necessary to identify the companies that make-up the homebuilding industry in growth control markets in Orange County, California. To determine which communities had growth controls as defined for this thesis, I contacted the Southern California Association of Governments and performed an article search of local newspapers which had published articles on the topic. Once I discovered that only two communities in the county had such plans, I proceeded to identify homebuilding firms who build there. I accomplished this by interviewing city planning staff members in those cities and requesting information on the plans and the most recent allocations. In one case, this information provided me the names of the homebuilders and characteristics about the projects. Since this information wasn't readily available in the other city, I requested the names of some of the homebuilders from the planners and inquired about that planner's professional experience with the builder.

As it is impossible within the constraints of this thesis to identify each and every type of company, I chose to create two major categories or types of companies to study: 1)companies which have held the land for years and 2) firms which are relatively new entrants to the market. Within these two broad categories, subcategories were created to describe the business choices that each of these types of companies may make in the face of growth controls. The two major categories seemed to be logical choices in an area of the country which is unique in terms of the presence of several large landholders and developers. The companies discussed in the first category have a significant influence over the patterns and style of development in Orange County, and should be distinguished from those relative newcomers in the market.

The primary sources of information for the thesis were personal interviews conducted with employees of firms who fit into each category. These interviews, while not sufficient in numbers to be used as a research sample, provided me with information about the business choices made by companies who build homes in the Orange County market and in those markets which have implemented growth controls in particular. In addition, I was able to gain an insight into how builders compete in those markets.

The developers of housing projects in a market which has a limitation on the number of permits issued each year are by nature of the allocation system, in competition with one another. This is because most plans are based on a point system which rates each project on its impact on local public facilities and services as well as on the more subjective aspects of the plan relating to site design and architectural quality.

Although in theory, one would expect that each project would be awarded permits on the basis of the points granted the project, this is not necessarily the case. Because each project is reviewed by the city planning staff and the planning board prior to receiving approvals from the city council, there are varying degrees of subjectivity associated with the process. Unfortunately, there also is the exercise of arbitrary and capricious behaviour on the part of the final decision-making body, normally the city council. In other words, the council in the jurisdictions investigated for this thesis, does not have to award the permits to the project(s) which received the highest number of points. They are only required by ordinance to issue the available permits to the projects which score a minimum number of points.

In a fair system, it would seem that the projects scoring the highest number of points would receive an equal share of the permits available. This is not always the case and the homebuilder who does not receive permits may or may not deserve to feel slighted, for each case seemed to have its own story. Based on the interviews conducted for this thesis, there are those homebuilders who feel that the system is in fact arbitrary and capricious. I would also venture to note that these same people are frustrated with the individual professionals with whom they must deal in the city development agencies. As one developer stated:

> "The planners are young, inexperienced, and naive about what it takes to develop a project...They see the developer as an open wallet".

It must be noted here that the planners have their side of the story as well:

> "Some of the developers are offended by the process. They feel that it is their god-given right to develop!"

Unfortunately, there is some justification for both opinions. There are many inexperienced planners hired by the cities who don't have experience in the development of projects. These planners are technicians carrying out a mandate from the city council. Innate knowledge about the financial realities of homebuilding would probably not influence the decisions they make in reviewing development projects. On the other hand, there are those developers who fail to appreciate that they must learn to interact positively with the city representatives and the process in general if they hope to be successful.

Besides the allocation awards, the homebuilders operate in a competitive marketplace where prices are determined by the demand for the product. This is particularly true in southern California and Orange County in particular. Until recently, there has been little competition amongst homebuilders in this area because of the enormous demand for homes. This situation is now changing as a result of an approximate twenty percent increase in the cost of housing over each of the last three years. This price rise in combination with increasing land costs due to the lack of available land, have resulted in a slowdown in the market due to the homebuyer's inability to obtain financing. The median priced single family home in Orange County, California as of April 1990 is estimated to cost $335,000 (The Meyers Group). Such a high median price makes it very difficult for first-time buyers to enter the market. As a result, densities have increased in the county as developers have begun to offer attached units to first-time buyers as an affordable alternative to detached units.

Increased sale prices have also caused the average size of homes to increase as it is now economically necessary to produce single-family detached units with higher densities. Single-family detached lots typically range from 4,500 to 8,000 square feet with most lots held by the largest or production builders ranging from 4,000 to 6,000 square feet with an average of 6,500 square feet (ULI,1990). Constructing larger, more expensive units on smaller lots provides the homebuilder with more profit per lot and higher profit margins. When only a limited number of units can be built, as in communities with growth controls, the units are often designed to include expensive amenities and features which maximize the builders' net income. This factor raises the average price and quality of units over time, shifting the mix toward larger and more luxurious units. Builders do not construct moderate-priced homes in markets with very strong demand or where there are severe governmental restrictions on how many units each builder can build each year (Salomon Brothers).

CHAPTER 4

INDUSTRY RESPONSES TO GROWTH CONTROLS

There are various business responses to growth controls taken by the homebuilding firms who operate in communities which have implemented limitations on the number of residential building permits which shall be issued on an annual basis. They include entering into joint ventures with equity partners, becoming more sophisticated in the development process and becoming land developers as opposed to just homebuilders.

Joint-Ventures and Land Developers

The ability to finance all real estate projects has become more difficult in response to a slowdown in the economy and the imposition of lending restrictions on the savings and loan industry. Homebuilding companies of all sizes have had to seek out new sources of equity financing for their projects. The primary sources of this equity are foreign investors, pension funds and insurance companies but also include large corporations such as General Electric and Weyerhauser. These groups have large amounts of capital to invest and are looking for long-term appreciation and participation in projects with strong local developers.

There are a number of large homebuilding firms who are themselves joint venturing. According to Richard Hall of the BIA:

> "The big builders, the master developers, a lot of them are joint venturing too. They'll buy thousands of acres of land at a time and invite other builders to come in and build"

Hall believes that while sources of capital may be shrinking, eventually leading to less competition in the building industry, this joint venturing by the master developers,

> "means there are more people participating in the industry. It enables a lot of the smaller builders to take advantage of the expertise of the master developer in things like marketing".

Many small and medium sized homebuilding firms who do not have large land holdings need alternative sources of financing in order to enter growth control communities. As these firms enter the market, they are faced with high land costs and high sales costs which will make the sale of their product more difficult (ULI). In order to purchase and develop land in a highly regulated market, they must take on a financial partner who is willing to and capable of sustaining the lengthy development process. This represents a substantial risk for any investor/partner which must be mitigated by the developer's ability to maximize the possibility of obtaining building permits and producing a saleable unit.

Joint venture partners can provide the needed capital for the acquisition of the land and the funding of any necessary off-site improvements. For example, a 1,000 acre project consisting of 2,200 total units in the City of San Clemente, California is being constructed by a joint venture between Centex Homes and Westinghouse Credit Corporation. Centex was successful in negotiating a favorable development agreement with the city after a nine month period in which all due diligence was completed. While the development agreement does not guarantee permits, it does provide Centex with some assurance that their project will be able to proceed and will receive certain improvements to be provided by the city so long as permits are available. As an equity investor, Westinghouse Credit provided $50 million for acquisition of the land and $36 million in required off-site improvements. Centex Homes has built in other California communities which have growth controls with far less success. They indicated that they would not have entered the San Clemente market which has a growth control plan had it not been able to obtain Westinghouse Credit as a partner, since the up-front costs and the resultant carrying costs would have been prohibitive.

Westinghouse entered into this arrangement because of the success of past deals they had successfully completed with Centex. They looked upon Centex as an experienced builder who has been in business in various markets across the country since the 1950s. In addition, they expect to receive a return on their investment in the range of twenty to thirty percent over a twenty year build-out.

In order to attract a joint venture partner, the developer must complete considerable amounts of information and planning. This planning includes the dimensions of the project, and a complete set of financial statements including the economic benefits to be expected. Without detailed information of this type, joint venture partners cannot know whether they ought to become involved in the deal. Once this information is provided, the developer will understand that the potential returns to the partner must be more than the returns that the developer could expect if there were no partnership. Without these higher returns, there would be no incentive for the partner to participate.

By contrast, large development companies which have been landowners for some time are not as reliant on these new sources of financing since they purchased the land for a price which resulted in a very low basis in the property. Thus, the overall escalation in the cost of land in the surrounding area has made their property that much more valuable. This valuable land in combination with a proven track record in the development industry has placed these companies in a very favorable position. Lots on properties owned by these large builders are presently valued from $80,000 to $100,000 per lot. If these companies continue to develop the properties themselves, they will experience substantial profits by building new single-family detached houses and townhouses which continue to be in demand (ULI). Some of these companies can also choose to sell the properties to merchant builders who must build to the standards of the large or master developer and must share the profits of their sales with these sellers.

The Legal Entitlement Process

Although these larger companies are presently well-positioned economically, they have no guarantees that they will receive building permits in communities which have implemented growth controls. And if they are unable to receive enough building permits and complete sales to make payments on land acquistion loans taken out for the property, they will face financial problems in the future. These companies must therefore be proficient in the legal entitilement or approval process in order to maximize their chances of receiving permits. This process involves the review of site and architectural plans, engineering plans and negotiations regarding public facilities and services to be provided by the developer.

As mentioned above, Westinghouse Credit agreed to enter into the financial arrangement with Centex because they were confident that Centex could successfully negotiate all of the necessary development approvals. Regardless of the size of the company, the successful firms in this process either have staff members assigned the responsibility of gaining city approvals or hire an outside consultant to perform this task. Both a thorough understanding of the residential allocation plan and the basis for its implementation will provide the firm with valuable insight into the city's goals for the residential allocation program. It is also necessary for firms to develop a rapport with those individuals within the city who are involved in the development process in order to be sure that the project being proposed is consistent with the development pattern and overall design goals and objectives of the city.

Chapter 5

AN EVALUATION OF INDUSTRY OPERATIONS IN GROWTH CONTROLLED COMMUNITIES

Up to this point this thesis has reviewed the literature written on the history of growth management and the growth control movement in California. It has also discussed the nature of the homebuilding industry and has identified some of the major types of homebuilding firms who operate in communities which have implemented growth control plans in Orange County, California. Finally it has described the strategies which these firms may utilize in an effort to survive the lengthy and critical approvals process associated with growth control plans.

A review of the various data gathered for this project, reveals a number of unique characteristics and trends regarding the economics of the homebuilding industry in Orange County, California. Demand for housing units in Orange County is great as the state continues to experience economic growth. The consumer is however finding it increasingly difficult to afford a home. The combination of high land costs and controls on the number of permits available for construction contribute to the development of larger homes on smaller lots.

This repositioning addresses the developer's need for larger profit margins in order to be successful. Rising land prices are a key element behind higher home prices in high-priced regions of the country such as Orange County. These higher land prices are the result of supply-side forces in an area which is economically prosperous. When an area prospers because of rising employment, population and income, stronger demand boosts housing prices. In order to staff its booming economy however, an area must be able to attract more people. This can only be done if there is an adequate supply of housing which these employees can afford to purchase (Downs).

In response to the rapid growth in Orange County, some of its communities have enacted policies restricting the amount of growth that can occur in a given timeframe. This thesis has looked specifically at communities which have limited the number of residential building permits available on an annual basis. These restrictions are designed to limit the impact on the services which the community must provide its residents and to maintain the quality of life and character which contributed to its desireabity. The maintenance of existing services is important to the continuing prosperity of the community. Perhaps ironically, these policies which restrict supply in the face of demand, force housing prices to ever higher levels making it difficult for not only newcomers to purchase homes but many long-time residents (e.g. those who grew up there) as well.

The homebuilding industry is forced to offer an expensively priced unit as a result of the high costs of land, construction, government fees and financing. These units may be either single family detached or attached units: the latter is relatively more affordable to the consumer and represents an increasing (43% as of April 1990) segment of the Orange County housing market. Government fees and permits are estimated to have increased 384% over the eight year period from 1981 to 1989. Land costs are estimated to have increased by 61% over the same period causing an increase in taxes of 3,672% These astronomical cost increases are major factors facing both the homebuilding industry and the consumer. It is estimated that these fees and permits add as much as $20,000 to the cost of a new 1,600 square foot home (Sunstrom, 1989).

Land price is established by first determining what buyers are willing to pay for finished homes (based on a number of factors including location, proximity to amenities, taxes, and design features) and then subtracting development and improvement costs and builder profit from the eventual selling price of the final product. The remaining value (or land residual) represents the price the builder is willing to pay based on the economic potential of the land. Exhibit 2 is based on recent pro formas used by some major home builders in Orange County and is included as an example of residual land costs in the county. These land costs alone contribute to the need for financial support at levels never before experienced. Government fees are based on the costs that cities attach to the construction and/or improvement of infrastructure and facilities and are often established as a factor of the community's desire to encourage development. They are often cited by the industry as another contributing factor to their inability to provide housing at affordable levels.

It is apparent that it is more difficult in general for real estate development firms to receive financing for their projects as the savings and loan crisis has forced the imposition of limitations on the amount of money that can be loaned to real estate ventures. This has severely reduced the primary source of funding, contributed to both an increase in interest rates and in the slowdown of real estate development across the country. Homebuilding firms are particularly impacted by these limitations because higher interest rates and housing prices have resulted in slower sales of units. These factors when added to a difficult development approvals process have made the homebuilding industry a more complicated and risky development environment.

Without exception, the homebuilding firms who were able and fortunate enough to purchase large tracts of land in the past and who were able to afford to develop the land over time as opposed to selling it, are the most successful. These firms have the advantage of a relatively low cost basis in the property coupled with the experience of building homes in the southern California marketplace. The larger homebuilding firms will continue to be able to raise capital through credit lines, commercial paper, and securities offerings (Eichler). The larger homebuilders who have developed a strong track record in the development industry over the years are not as severely impacted by the recent tightening of the capital markets and are able to continue to build as permits become available. This is primarily due to relationships that they have developed with the lending community over the years but is also the result of the development of a proven product which is acceptable to the lenders, the community and the buying public. This competitive advantage has not been a guarantee of success for inefficiently run companies in growth control communities, however. As mentioned earlier in the thesis, only those large firms which understand the importance of the development approvals process and which work closely with those who are responsible for administering the plans are successful in these markets. These same companies must also be successful in the marketing of their product.

There are, of course, exceptions to this in that some communities look upon the homebuilder as an "easy mark" from whom any number of exactions can be demanded. The cause of such behavior is difficult to ascertain. It may be driven by an anti-growth attitude that is pervasive throughout the city and that is directed towards all members of the development community, or it may be the result of an acrimonious relationship between employees of the city and the developer of any given project. In any event, arbitrary behavior can be expensive for both the developer and the city as it causes delays while the parties argue the merits of the exactions. These disagreements have also led to litigation which is expensive to all parties involved.

Some of the larger firms have an established presence in the marketplace that allows them to be able to maintain a significant influence over even local decision-makers. This influence is the result of the combination of the fact that the companies own large amounts of land, have constructed large amounts of product in the area and have involved themselves in the political fabric of the communities in which they operate. But of most significance is the success of the product which the company builds. If a company has successfully built and sold products which have been consistently attractive to the marketplace, a company has created a competitive advantage for itself. This competitive advantage makes it difficult for other firms to break into the market, for they are not as well positioned financially nor can they perform to the standards that are often created by the larger, established firms. There is no substitute for marketing prowess in a market where lengthy development approvals can take as long as four years. A homebuilder must be able to anticipate what product is most likely to be saleable by the time the project receives approvals and is actually constructed. This is an especially risky aspect of the development business. Several of the homebuilders interviewed for this thesis admitted that they probably should conduct additional economic analysis, but so far have not been forced to due to the high demand for housing in the county. As competition for scarce land increases, driving home prices even higher, homebuilders and major employers in the county will find it necessary to understand those economic forces which will impact the region's economy as a whole, particularly its ability to house its workers.

In general, the homebuilding industry responds to growth controls by becoming better capitalized, which provides the financial flexibility and staying power necessary in a lengthy development process. Since a company that owns the land will at best receive only a limited number of building permits each year, such companies must be able to financially withstand this extended development schedule. The small and middle-sized builders who in the past were able to raise money to buy land, install improvements, and build houses are no longer able to sustain this lengthy process in view of the limitation on the amount of capital available for construction loans from the savings and loans. They must therefore seek new sources of capital through joint ventures with either large homebuilders or other sources of capital such as off-shore investors, pension funds or insurance companies. In addition to the need to obtain new sources of income, the companies must learn to be successful in the development approvals process which has been described throughout this thesis, as time consuming and costly.

CHAPTER 6

GENERAL OBSERVATIONS AND CONCLUSIONS

As California continues to experience the economic and population growth of the last decade, it will also experience some degradation in its quality of life. Such things as traffic congestion, air pollution and shortages of water and sewer capacities will contribute to a clamoring for some form of growth management or controls. Because the homebuilding industry plays a significant role in the growth of any community and is directly affected by growth controls, it will have to be a major participant in future development plans. Richard Hall of the BIA claims:

> "we're going to be building coalitions between environmentalists, slow-growth people, builders--we're all going to have to work together. We're going to have to realize we all have the same concerns. It may not always appear that way because of the antagonism created by both sides".

Without this sort of coalition building, the homebuilding industry will continue to have a poor image amongst many Californians.

This thesis has investigated the impacts of growth management plans on the homebuilding industry. It has shown that in an increasingly regulated marketplace with limited sources of financing, the larger homebuilder who has banked the land is in the most advantageous position. But due to sharp increases in the costs associated with development, even large homebuilders are forced to seek out financial partners. They also may choose to become land developers who sell the land to merchant builders at a profit rather than developing it themselves. These "master developers" provide a business environment for smaller builders who otherwise would be excluded from the market. While these large and medium-sized builders are able to remain active in a market with extremely high land costs, smaller builders will have a difficult time surviving. The only exception to this would seem to be the small builder of expensive, custom homes. The thesis has also described the factors which make building difficult in communities which have implemented growth controls.

Even when homebuilders undertake the operational approaches described in the previous chapters of this thesis in their business, they will find it difficult to produce an affordable house that is within the grasp of most of the residents of Orange County. In a more typical economic environment where land costs are not as high as in Orange County, there is a broader price range of housing units available. This is becoming more and more difficult to achieve in California. Although no figures were available for Orange County specifically, it is estimated that only 17% of the families in Los Angeles, San Francisco and San Diego qualify for the median-priced home vs. about 45% who qualify on a national level (Barrons 1990). This leaves 83% of the families in a situation where home ownership may never be realized. The reality of this situation is that fewer communities are able to provide housing that is affordable to a wide range of people.

Affordability is obviously an even greater problem for those at the lowest end of the economic spectrum for fewer rental units and low-cost housing units will be constructed as builders escalate their prices and build more expensive units due to "excess demand". This is particularly true when local governments limit the number of housing units (Downs).

The facts described here and in legions of other writings indicate that growth controls are a contributing factor to the escalation of housing prices. This is particularly true in the highest-priced areas of the country where a high level of amenities and strong economic growth contribute to an influx of population. When an area is experiencing growth pressures as a result of economic growth across the metropolitan area as opposed to growth stimulated by strictly amenities (e.g. Hawaii), it will find it difficult to limit actual population growth. Governments must therefore consider reducing barriers to expanding the supply of available housing faster and permitting lower-cost housing to be built in more locations. These policies include zoning more land for multi-family housing, reducing minimum lot size and minimum housing-unit size requirements, speeding up processes for approving proposed residential subdivisions, and paying for more infrastructures through general government spending, rather than by imposing those costs on the new units served (Downs).

These suggestions are reasonable to a point, for there must be an effort mounted by local governments to ensure that affordable housing be made available for all of its residents. There is some irony to this situation however, because the many relatively wealthy...suburban communities also used their zoning laws to keep out unwanted minorities and the poor. Whether for racial or for economic motives--often for both--restrictive zoning served to harm the excluded and to raise the prices they paid for the leftover housing they were able to obtain (Popper, 1981). The relaxation of these policies would be contrary to the community's desire to control growth. Even if there is no conscious desire on the part of the community to exclude certain groups of people, the imposition of supply-side factors such as growth controls makes it difficult for people of a wide range of income levels to afford to live in these communities. In assessing high home prices states that "localities that seek to slow down growth--namely high-priced areas that are experiencing economic booms--usually reduce permissible housing densities, increase minimum lot-size and house-size requirements, place annual limits on the number of units that can be built, slow the permission process, and require developers to pay for their own infrastructure plus huge "impact fees" (Downs). I would agree "that all of these policies boost housing costs even higher".

In order to make housing more affordable, communities must work closely with the development community to create living environments that are designed to be more efficient, more dense and that are closer to employment nodes. This will not be an easy task in a suburban area where people still very much desire the single family detached home surrounded by private open space. The typical consumer in these areas of the country has not shown a desire for high density living although the attached housing unit is becoming more acceptable due to its affordability. The density of projects of these projects rarely exceed a density of more than 20 units to the acre. Homebuilders will need to encourage the design of more medium density projects which can provide many of the amenities of single family living while not taxing the infrastructure and services of the community. They must work closely with government agencies and local community groups to devise land use policies which will both protect the quality of life and allow for affordable housing.

City governments must devise and utilize alternative methods of funding improvements in an effort to remove some of the cost burden of infrastructure improvements required of the developer. These methods include the use of bond financing to equitably pay for the cost of new services. The issue of equity is important in this discussion because the fees that the homebuilder and ultimately the new homeowner pay to construct and purchase a home provides both the new and the exisiting homeowners with new services and facilities such as roads, fire stations and schools that the new homeowners did not have to pay for. An example of a bond financing program which serves as an effective means of equitable taxation for services is the Mello-Roos Community Facilities District Act which was passed by the California state Legislature in 1982. The Act establishes a method for cities, counties, special districts, school districts and other municipal corporations to form a seperate district to finance public facilities through the selling of bonds (Sundstrom). The taxing authority in a Mello-Roos

District can only levy a tax against the benefited property. With a general obligation bond, the taxing authority can levy against all taxpayers in the district (Sundstrom). This funding mechanism requires project coordination between government agencies and the developer or homebuilder and is an example of the cooperation that is necessary to improve the impacts of rapid development including the provision of affordable housing.

In addition to funding alternatives, cities must encourage projects that are more efficiently designed from a land-use perspective. This can be accomplished by zoning property to minimize the need for expensive infrastructure extensions such as roads and water and sewer lines and by creating zoning districts which allow higher density projects. This is not an easy task, for the land that remains available for development is land on the edges of the urban or metropolitan area. Ideally, cities could encourage the development of multi-use developments or urban villages where work and living environments overlap, but the demand for such projects has so far not been great. These types of projects may not be the entire solution, however; in sprawling suburban areas, they would result in the development of additional nodes which have certainly contributed to traffic congestion. Also, there are communities who would discourage these projects because of their higher densities and the stigma attached to these densities. Still, compromises must be made.

A reconsideration of the development review or approvals process is another opportunity for local governments to improve the services they provide the development community. The goal should be to make the system as efficient as possible without it being economically burdensome to the developer. This will require the establishment of a more professional work force who is able to work with the homebuilder to devise the best project for the community. Unfortunately, city government does not provide enough incentive for quality employees to continue employment long enough to establish credibility and consistency. Beyond personnel and procedural issues, cities must review the development fees which they have used as a special exaction levied on home builders and developers tied to new development of residential and commercial properties. These fees have become a popular way to fund everything from new roadways to fire stations. As mentioned earlier in the thesis, these fees have increased astronomically over the years.

As the various government entities in Orange County have come to realize, many of the problems caused by rapid population growth must be handled on a regional basis, for eliminating the problem in one community will more than likely only push it to a neighboring community. The county has established a growth management task force which will devise county-wide regulations regarding the conditions under which a developer may build as related to existing levels of service in the area of the proposed project. Efforts of this sort will be necessary to address the housing affordability issue in the county but short of additional federal government subsidies that would write-down the price of land or a long-term downturn in the economy which does not seem likely, housing prices will continue to rise.

The homebuilding industry will continue to thrive in these environments as demand for housing continues. The advantage that California has over other housing markets which have suffered serious declines over recent years, is the fact that its housing market is not overbuilt, it is simply overpriced. While there are various factors which contribute to these high prices, those who have been described here as having access to the land will be fortunate enough to continue to build, even in growth control communities. The majority of these companies will adapt to growth controls simply because they will not be able to afford not to build on what is very valuable land.

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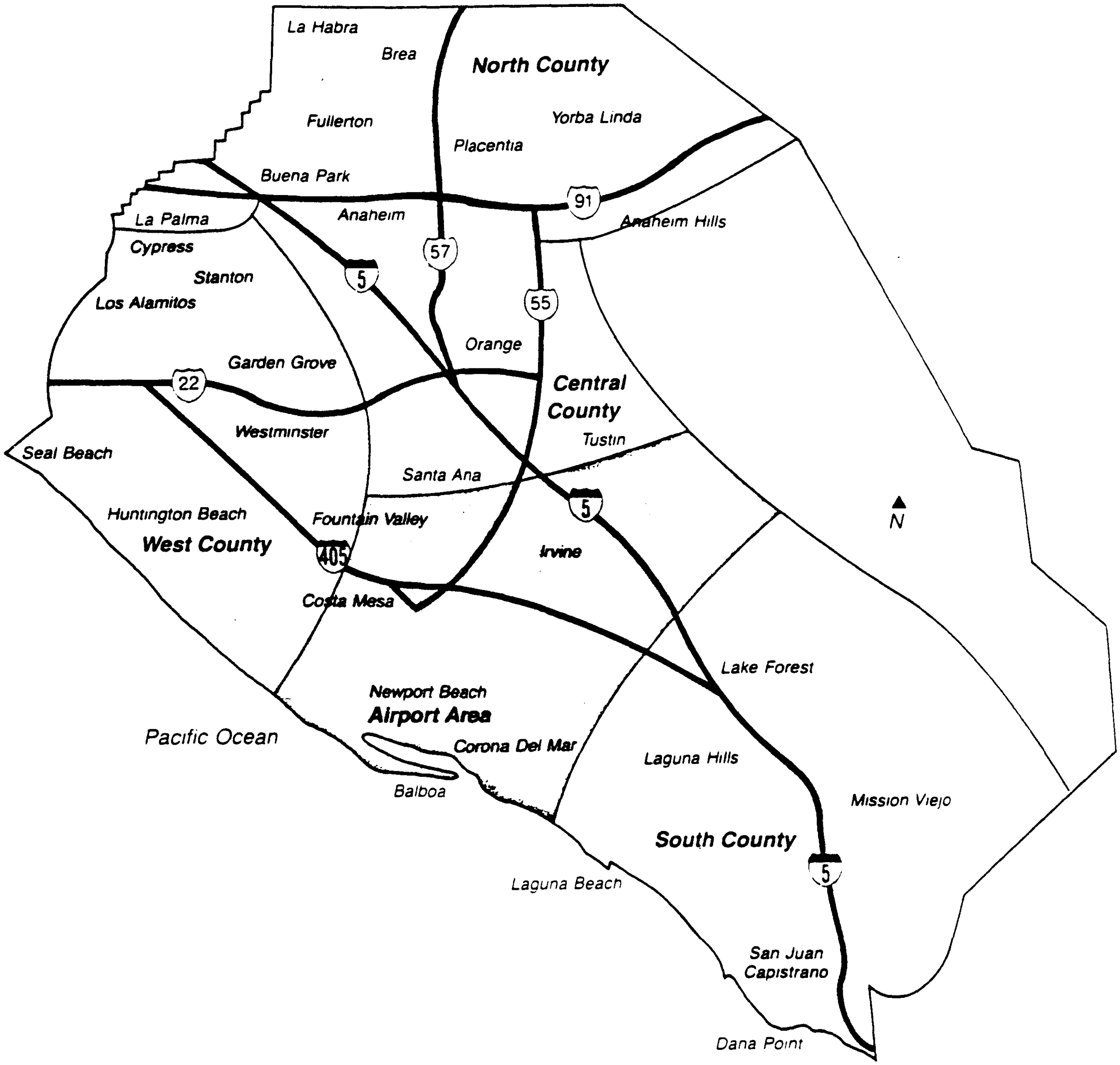
EXHIBIT 1



La Habra
Brea
North County
Fullerton
Yorba Linda
Placentia
Buena Park
91
Anaheim
Anaheim Hills
La Palma
Cypress
57
5
Stanton
55
Los Alamitos
Orange
Garden Grove
22
Central County
Westminster
Tustin
Seal Beach
Santa Ana
5
N
Huntington Beach
Fountain Valley
West County
405
Irvine
Costa Mesa
Lake Forest
Newport Beach
Airport Area
Pacific Ocean
Corona Del Mar
Laguna Hills
Balboa
Mission Viejo
South County
5
Laguna Beach
San Juan Capistrano
Dana Point

EXHIBIT 2

SINGLE FAMILY DETACHED
LAND RESIDUAL ANALYSIS

BASIC PROJECT ASSUMPTIONS

DWELLING UNITS:	120
GROSS ACRES:	23.00
NET ACRES:	15.00
DENSITY:	8.00
AVG. SELLING PRICE:	300,000
AVG. SQUARE FOOTAGE:	2,000
VALUE RATIO:	150.00
COST PER SQUARE FOOT:	45.00

REVENUES	PER UNIT	TOTAL	%
Sales price	300,000	36,000,000	100.00%
Lot Premium			
Total	300,000	36,000,000	100.00%
BUILDER DEVELOPMENT COSTS			
Direct construction	90,000	10,800,000	30.00%
Indirect construction	9,000	1,080,000	3.00%
Finance	27,000	3,240,000	9.00%
Marketing	15,000	1,800,000	5.00%
Overhead	9,000	1,080,000	3.00%
Warranty	2,250	270,000	0.75%
Transportation Corridor fee	1,500	180,000	0.50%
School and other governmental fees	9,000	1,080,000	3.00%
Other			
	162,750	19,530,000	54.25%
BUILDER IMPROVEMENT COSTS			
Lot improvements	25,000	3,000,000	8.33%
Rec common area	5,000	600,000	1.67%
	30,000	3,600,000	10.00%
Builder profit	30,000	3,600,000	10.00%
TOTAL BUILDER COSTS	222,750	26,730,000	74.25%
LAND RESIDUAL	77,250	9,270,000	25.75%
PER GROSS ACRE	403,043		
PER NET ACRE	618,000		