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TO: Sean Edging (Department of Land Conservation and Development) and Megan Bolton (Oregon Housing and Community Services)
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SUBJECT: REVISED Review of California Regional Housing Needs Allocation critiques, relative to the emerging Oregon Housing Needs Analysis framework

In October of 2021, California’s Joint Legislative Audit Committee ordered an audit of California’s process for determining and accommodating regional housing needs (broadly: California’s *RHNA*, or *Regional Housing Needs Analysis, process*). In January of 2022, prominent housing experts Christopher Elmendorf, Nicholas Marantz, and Paavo Monkennen released a background paper to inform that audit.¹

This recently published background paper is well-timed to inform Oregon’s evolving system for housing need measurement and housing production. Oregon’s potential policy changes are currently under development, with recommendations to the legislature expected for the 2023 legislative session.² This memorandum reviews the critiques included in the audit background paper and applies them to Oregon’s currently proposed policies.

Measuring need

The background paper points out three mistakes in California’s system of measuring need (p 6), which it states amount to “a recipe for perpetuating California’s housing shortage while purporting to do something about it” (p 7):

1. The system assumes that a region’s need for new housing is the difference between projected units and the current number of units in the stock, where unit projections derive at least in part from past rates of household growth. The consequence is that cities that have restrictive land use controls and have therefore undersupplied housing will project this undersupply into the future in the form of low household growth rates. They are never asked to make up for past undersupply, and, worse, those rates of undersupply continue indefinitely into the future.
2. The system does not account for “the effect of new market rate housing (or its absence) on the availability and affordability of new housing.”
3. A California housing element provides an inventory of developable sites, quantifies how much “realistic” capacity exists on each site under current zoning, and then assumes that all of that capacity will actually develop in the eight-year planning period. A more

¹ Elmendorf, Marantz, and Monkennen. “A Review of California’s Process for Determining, and Accommodating, Regional Housing Needs.” January 4, 2022.

² This memorandum does not provide extensive background about California’s system, but instead assumes some base knowledge of the system and focuses on the critiques. For readers interested in learning more about California’s system, please see the following resources: About Housing Elements: <https://www.hcd.ca.gov/housing-elements-hcd> About California’s RHNA: <https://www.hcd.ca.gov/regional-housing-needs-allocation> [websites accessed June 2022]

appropriate assumption would be that only a portion of those sites will develop, which means that the sites themselves should be oversupplied in the inventory.

The paper's authors acknowledge that recent legislative changes in Senate Bill 828 and Assembly Bill 1771 (2018) began to address some of these concerns, if incompletely or inadequately. For example, the system now requires the addition of consideration of undersupply (or "present need") in calculations of housing need, but the paper's authors disagree with the method of calculating present need.³ Rules now direct regional governments to allocate housing targets in a way that increases lower-income households' access to exclusive (or "high opportunity") communities, but do not address the feasibility challenges of building affordable housing in high opportunity areas. And new laws give the state's Department of Housing and Community Development (HCD) the legal foundation to require cities to discount site capacity based on the likelihood of development, but leaves too much ambiguity about how this can be done (and therefore opportunity for cities to continue to "game the system"). The site capacity analyses, in the authors' opinion, continue to underestimate the available supply of land to accommodate housing need. The results it that overall, to a greater or lesser degree, each of these three main areas remain a concern.

Oregon's Housing Needs Assessment (OHNA) methodology and evolving recommendations on implementing that methodology collectively address these critiques as follows:

1. The methodology recognizes that it is critically important to start with the right top-line need number. If we are not planning for the correct amount of housing, we cannot overcome the underproduction that is driving rapid housing price increases. To derive that top-line need number:
 - a. The OHNA methodology assumes that more than one housing unit will be needed to accommodate each new regional household that is formed.⁴ This reflects the reality that a housing market needs additional units to allow for vacancy rates, demolitions, second/vacation homes, and price sorting.⁵
 - b. The methodology explicitly accounts for past rates of underproduction and for missing units for people experiencing homelessness, and includes those missing units in the total number of units needed.⁶

³ In brief: the methods rely on estimates of overcrowding and cost-burdening, without accounting for the fact that cost-burdened households may have left the region due to housing costs. As a result, this method could result in an underestimate of need. The authors suggest using prices and rents as a factor instead (p 16). In Oregon's proposed method, at least in part due to data availability in a largely rural state, we use the national ratio approach instead (described below).

⁴ A forthcoming ECONorthwest memorandum recommends changes to the OHNA pilot methodology to account for this cushion in future housing production.

⁵ "Price sorting" here refers to the concept that a housing unit that is too expensive for a given household's budget is functionally not available to that household, even if it is vacant and on the market. A housing market needs units available at a range of price points, so that the households that seek those units can "sort" into available units based on what they can afford.

⁶ The forthcoming ECONorthwest memorandum recommending changes to the OHNA pilot methodology will describe the suggested changes to calculating underproduction.

- c. The methodology suggests regional variations in calculating both past underproduction and future housing need based on the presence of second and vacation homes in each region.
2. If the currently-proposed method for setting local production targets becomes rule or law, the state will track progress toward housing production in two categories: (1) total units (inclusive of affordable units) and (2) units that are publicly-funded and available to those who earn below some threshold⁷ of median family income. By tracking progress toward total unit production, the system recognizes and encourages units of all types. Achieving these total production targets will help cities overcome past underproduction and increase the rate of downward price/rent filtering⁸ that the background paper describes as necessary. By tracking progress toward publicly-funded units for lower-income Oregonians, the system recognizes that the market, on its own, cannot meet all housing need. Even in a well-supplied market, these units will need public support, as market-rate units are unlikely to filter to these levels of affordability.
3. California’s system asks cities to identify sites for affordable housing development in areas that it determines to be “areas of opportunity”⁹ Oregon’s system provides a more flexible and nuanced approach. While we are still working through many of the details of how we might implement this approach, the OHNA allocation method provides the foundation. This method is based on regional (rather than local) incomes, which means that a city with higher incomes and a city with lower incomes will each plan for the same share of future housing to be affordable to lower income residents. Oregon’s system is not envisioned to have prescriptive requirements about precisely where within a city these units might be built, because this might place affordable units where the residents that might occupy those units do not want to live. In this way, Oregon’s system recognizes that *all neighborhoods* should be high opportunity neighborhoods. At the same time, we recognize that access to opportunity across neighborhoods is not currently equal, and that without intervention, some neighborhoods will face market pressures that will lead to involuntary displacement, and others will not see the production of needed affordable housing at all. As such, local housing production strategies must include policies and actions to support neighborhood stabilization and fair housing goals, and must engage citizens that are experiencing housing marginalization in the process of determining these and other housing development policies.
 - a. The background paper points out that the California requirement for affordable housing development in “high opportunity” neighborhood does not account for

⁷ The first round of OHNA methodology development used 50% as an income threshold. The team is currently working to revise that to 60%, to better align with affordable housing funding mechanisms and programs.

⁸ Filtering is the process by which housing ages and depreciates in value so that it becomes affordable to moderate- and low-income households over time. Filtering does not guarantee affordability for households with very low incomes, takes time (decades or even generations), and does not work in undersupplied housing markets.

⁹ The California Tax Credit Allocation Committee (CTCAC) and HCD charged the California Fair Housing Task Force with creating an opportunity map to identify “high opportunity areas” in every region of the state whose characteristics have been shown by research to support positive economic, educational, and health outcomes for low-income families—particularly long-term outcomes for children.

the higher cost of development in these (generally higher value) areas. Neither does Oregon's. To do so would require complicated, nuanced analysis of variables (incomes, land values, construction and labor costs, interest costs, access to competitive affordable housing funding and tax credits, etc.) that change on a sometimes-daily basis. Instead, Oregon's system recognizes that no affordable housing can be built without access to funding, regardless of where it is built. We are therefore working toward a legislative package that includes an explicit funding ask.

4. The background paper suggests that California's system should "account for" upward and downward filtering. Oregon's proposed methodology does not directly measure this effect. While technically possible, it would be extremely challenging to do so accurately given data availability (especially in more rural parts of the state) and would add a level of complexity that could become a source of challenge or confusion within the system. Further, in regions that have underproduced housing (which is most of Oregon's regions), filtering will have little to no near-term impact on overall market pricing. For these reasons, Oregon's outcome-focused and comprehensive housing production system is proposed to be implemented on a rolling basis, with new targets provided in each planning cycle. If a city is meeting need, and its rates of housing underproduction and cost burdening are declining, its future targets will change to reflect that progress.
5. The background paper's authors point out that HCD's methodology does not adjust for jobs-housing imbalances, nor consider how those who commute from one region to another might respond if more housing were available where they work. Oregon's method does not account for commuting between regions either. While this pattern certainly does exist (as in, people who live in Salem may commute to Portland for work), it is less common in Oregon than in California. The OHNA method does, however, account for intra-regional jobs / housing balance. In the process of allocating housing need from the region to local jurisdictions, one of the criteria used to weight the distribution is the number of jobs in a jurisdiction. In effect, the places with more jobs receive a higher allocation of housing need, and therefore would improve their jobs to housing balance (compared to the region) if they built to their allocated unit target.
6. Oregon's proposed system largely avoids the critique of site suitability and selection brought forward in the background paper. In an acknowledgement of the amount of uncertainty inherent in predicting precisely which sites might develop and at which densities and on what timeline, there is no proposed requirement for the OHNA to connect production targets to specific available sites in a city's Housing Production Strategy. Instead, Oregon communities will continue to be required to regularly complete "housing capacity analyses" that calculate the total available zoned capacity over a 20 year period to meet total housing need. If the available capacity is too limited, the city is required to adopt measures that increase the likelihood of higher density development and expand its urban growth boundary to allow for future growth. This system is far from perfect, and is also undergoing conversations about reform, with a goal of improving the boundary expansion process and addressing issues with the

system of measuring land availability.¹⁰ These reforms are important to addressing concerns that are related to (but different from) the critiques that the background paper raises.

Oregon's proposed reforms to local Housing Production Strategies instead focus community attention on *producing units* (the desired outcome), rather than meeting administrative planning requirements for site identification that may or may not result in production. As such, the proposed framework sets production targets that orient all partners toward common goals for market-rate and publicly-supported housing production. It then goes further, recognizing that targets by themselves do not achieve development outcomes, no matter how precisely they may be calculated. It recommends increased state-level housing funding, improves state-level coordination for administering a comprehensive housing system, and strengthens state-level accountability systems to ensure that improved housing production outcomes are achieved.

Setting targets

The background paper acknowledges that “setting housing targets requires a lot of guesswork. In doing this guesswork, the state shouldn't worry much about overshooting the optimal target, but it should be very concerned about setting the target too low” (page 4). The evolving system for doing this “guesswork” in Oregon begins with an acknowledgement that the targets are somewhat aspirational goals for housing production that would require a substantial increase in production to meet. The state should not expect cities to exactly hit their targets in each cycle, but if it is clear that a city is underperforming relative to its regional or market-based peers, there are likely locally-specific development barriers that need to be addressed. Oregon's system proposes using measurement of progress toward targets to identify these problem areas, and work proactively to address them (bringing state funding as a support). Recalcitrant cities may face enforcement orders,¹¹ reductions in state funding, or other accountability measures. This system also addresses the background paper authors' concerns that “cities aren't punished if they fail to meet their targets” (page 4).

Overall

Philosophically, Oregon's OHNA / Housing Production Strategy (HPS) system is headed in a different direction from California's. California's legislature is regularly tightening rules and adding local planning requirements, trying to force a connection between need and specific sites on the hypothesis that this additional planning work will lead to site development. The paper's authors double down on this approach, suggesting that further changes to the details of the methodology and the site capacity standards and requirements will create a better system. We

¹⁰ Information about this process is included on DLCD's webpage here: <https://www.oregon.gov/lcd/UP/Pages/Housing-Needs.aspx> under the section titled “Housing Capacity Workgroup.” [website accessed June 2022]

¹¹ ORS 197.320 through 197.335 - https://www.oregonlegislature.gov/bills_laws/ors/ors197.html

agree that this is true from a technical perspective. There are certainly better ways to measure need and capacity, and improved rules that limit the options for “gaming the system” may change some local behaviors. However, we see Oregon starting from a different place than California.

The goal of HB2003 (2019) was to shift attention from *planning* for housing to *building* housing. As such, the evolving OHNA/ HPS system is imagined as a flexible set of guiding principles for creating a housing production strategy (encompassing fair housing, community stabilization, and other housing-related goals) and a clearly-defined set of outcomes toward which cities must proactively make progress. It proposes accountability systems aimed at recalcitrant cities while recognizing that cities do not control all (or even many) of the levers that cause development to occur. As such, the OHNA / HPS framework points to solutions: more funding, targeted in the right places, common production targets that are transparently shared and measured, and administrative structures that have the staff skills and leadership needed to focus on building more units in a more equitable way.