Some Thoughts on Housing Affordability

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Workshop on the Appropriate Government Role in U.S. Mortgage Markets
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Disclaimer
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• When I say “we”, I don’t mean Janet and me.
Recent Trends in House Prices

Rising Home Prices Raise Concerns of Overheating

Dearth of new construction and strong demand from buyers are pushing up prices.
Recent Trends in House Prices

- House prices have returned to peak
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- Relative to income,
  - Well below peak
  - High compared to 2000.
Recent Trends in House Prices

- House prices have returned to peak
- Relative to income,
  - Well below peak
  - High compared to 2000.
- Are priced overheating?
Price to rent ratio

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- Difficult to calculate
  - Properties are different
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- Use matched sample of property records and MLS
  - For income properties, MLS reports rental income
  - Property records record sale price if sale occurs
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- Great boom of 2000s was in P/R ratio
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- Use matched sample of property records and MLS
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- Great boom of 2000s was in P/R ratio
- Unlike $P$ or $P/Y$, $P/R$ returned to pre-crisis level

Paul Willen (Boston Fed) Affordability April 27-28, 2017
Affordability

- Increase in $P$ is due to
  1. Increase in income
  2. Increase in rent/income
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- But not in price/rent ratio.
Affordability

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  1. Increase in income
  2. Increase in rent/income
- But not in price/rent ratio.
- Rising rents are the issue.
Policy

- Households need a flow of housing services
- Efficiency gains from owning a stock of housing

Rent

Households need a flow of housing services

Efficiency gains from owning a stock of housing
Policy

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Rent

Own

Households need a flow of housing services

Efficiency gains from owning a stock of housing
Policy

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  - Efficiency gains from owning a stock of housing
- Housing finance:
  - Allows ownership of stock
  - Payment of flow

Rent vs. Own
Rent

Own

Policy

- Households need a flow of housing services
- Efficiency gains from owning a stock of housing
- Housing finance:
  - Allows ownership of stock
  - Payment of flow
- Gordon growth formula

\[
\frac{Price}{Rent} = r - g \Rightarrow Rent = (r - g) \times Price
\]
Rent Own

- Households need a flow of housing services
  - Efficiency gains from owning a stock of housing
- Housing finance:
  - Allows ownership of stock
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- Gordon growth formula
  \[
  \frac{Rent}{Price} = r - g \Rightarrow Rent = (r - g) \times Price
  \]
- Example of housing finance
  - 1970s – high inflation (high $g$)
  - Reduced amortization loans
Policy

- Housing finance can help here
Policy

• Housing finance can help here

• If high rents are the problem
Policy

- Housing finance can help here
- If high rents are the problem
- Housing finance cannot help much

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Policy

• Housing finance can help here

• If high rents are the problem
  • Housing finance cannot help much
  • Is this the solution?

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The slide you’ve all been waiting for...
The slide you’ve all been waiting for...

- The end.