

## Rearranging the Deck Chairs in the Housing Market

Edgar O. Olsen  
Department of Economics  
University of Virginia

January 30, 2009

That the housing market is in terrible shape is beyond dispute. Unfortunately, many proposed solutions won't help. These proposals are intended to promote the housing market's recovery by increasing the demand for owner-occupied housing. Proponents argue that their adoption would lead to higher home prices and fewer vacant units. The failure to consider their effects on the demand for rental housing has led to highly exaggerated claims about these effects. These proposals will simply rearrange the deck chairs in the housing market.

The markets for rental and owner-occupied housing are inextricably related. In each housing market during each time period, some units of each type are sold to buyers who intend to live in them and others to buyers who intend to rent them. To give one example, about 13 percent of all single family homes are rented each year. Since sellers want to get the highest price for their properties, these two types of buyers will not pay different prices for identical units. Why would sellers be willing to sell to buyers of one type for \$280,000 when buyers of the other type are paying \$300,000 for identical units? Therefore, identical dwelling units tend to sell for the same amount whether they are bought by people who intend to live in them or rent them. The market value of units of any type in a given housing market depends on the total demand for units of that type. The distribution of total demand for identical units between renters and owner-occupants does not affect their sales price.

The primary effect of many proposals directed at the housing market would be to decrease the demand for rental units by about the same amount as they would increase the demand for owner-occupied units. This would be the effect of the proposed tax credits or loans at below-market interest rates to new homebuyers. Almost none of the families that would receive a subsidy under these programs would be homeless in their absence. A few would be sharing housing with others, though not necessarily in crowded conditions or on a temporary basis. The overwhelming majority would be living in their own units. In many cases, these would be rental units. It is only to the extent that the recipients of the proposed subsidies would have been homeless or doubled up in the absence of the programs that the proposed programs would increase the total demand for dwelling units and hence increase their market prices. Ignoring the effect of the proposals on the demand for rental units leads to a gross overstatement of their effect on market prices.

The impact of preventing foreclosures on housing prices is overstated for the same reason. The overwhelming majority of families who default on their mortgages move to

another unit that they do not share with others. Therefore, preventing foreclosures would have little effect on the total demand for dwelling units and hence little overall effect on market prices.

Subprime mortgages did induce some people to buy houses beyond their means, and foreclosures would decrease the demand for the types of houses bought by these people. This would decrease the prices of similar houses. However, when they default on their mortgages, the families involved move to more modest houses or apartments, thereby increasing the demand for other types of units in other locations and the prices of units of these types. Preventing foreclosures would lead to higher prices for some properties and lower prices for others.

This is not to say that there is no social interest in preventing foreclosures. Foreclosures often lead to large reductions in exterior maintenance of properties that reduce neighborhood property values. Mortgage holders will not take this effect into account in renegotiating mortgage terms.

In assessing the current proposals to make homeownership more attractive, we should ask whether it is really desirable for the families involved to be homeowners. The uncritical pursuit of higher homeownership rates all was a major source of our current problems. We should not be swayed by overstated claims about the effects of proposals on housing prices.

We should also question the goal of higher housing prices. Higher prices hurt buyers of housing to the same extent as they help current owners. Is there any good reason to help one group at the expense of the other?

#####

Edgar O. Olsen is a professor of economics at the University of Virginia who specializes in housing policy.