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NATIONAL LOW INCOME HOUSING COALITION

The Cost of Maintaining Ownership in the Current Crisis

Comparisons in 20 Cities

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April 2008

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Acknowledgements

The authors would like to thank Alan Barber, Elizabeth Chimienti, and Meghan Morgavan for helpful comments on earlier drafts.

Executive Summary

The collapse of the bubble in the U.S. housing market is creating chaos in financial markets while throwing the economy into a recession. It is also threatening millions of homeowners and renters with the loss of their homes. In recognition of the problems in the housing market, Congress is considering measures that will alleviate the crisis. However, it is important that Congress recognize the full nature of the problem as it crafts legislation.

This paper compares ownership and rental costs in twenty major metropolitan areas. It shows that in many areas, ownership and rental costs are more or less in balance. This means that it might be practical and desirable to craft policies for these cities that are focused on keeping homeowners in their homes as owners.

However, the paper also shows that in many cities homeownership costs are greatly out of line with rental costs. These are cities, mostly on the two coasts, that have seen an extraordinary run-up in house sale prices over the last decade that have not been matched by any comparable increase in rents. In these markets, homeownership costs could easily be double, and even close to triple, the cost of renting comparable units. Paying these inflated ownership costs will take away money that might otherwise be used to pay for health care, child care or other necessary expenses. Similarly, a government that intervenes at these prices will have less money for other needs.

Furthermore, because prices are now falling rapidly in many of these markets, homeowners are unlikely to accumulate equity. In fact, it is likely that many homeowners will end up selling their homes for less than their outstanding mortgage, even if new mortgages are issued with substantial write-downs from the original mortgage. In these bubble markets, government efforts to support homeownership are likely to do little to help homeowners and could leave taxpayers with a substantial bill in cases where homeowners leave their houses with negative equity.

The paper notes that in these markets, a policy of ensuring suitable rental options is likely to be more helpful to many current homeowners. This policy can encourage the rapid conversion of vacant and abandoned units to rental properties, as well as policies that facilitate the conversion of ownership units to rental units for the same households.

In addition, the paper also notes that many of the properties facing foreclosure are already rental properties. In these cases, foreclosures often result in the displacement of the current tenants. Congress should recognize this problem and consider policies that provide greater security to tenants in such situations.

At this point, it is no longer possible to deny that there is a serious problem in the country's housing market. Over the last year houses prices have declined by 10.7 percent, and have been falling at a 23.2 percent annual rate over the last three months.[1] The housing bubble that developed over the last decade is now in the process of deflating.

This has led to the record rates of defaults and foreclosures that we are seeing across much of the country. The loss of housing wealth is pushing the economy into a recession, as it forces people to cut back on their consumption. It is also the basis of the financial crisis that has led the Federal

[1] These numbers refer to the Case-Shiller 20-city index for the period from January 2007 to January 2008. The annual rate over the last three month annualizes the rate of increase over the three months centered on January compared with the three moths centered on October (Case-Shiller, 2008).

Reserve Board to make unprecedented interventions in the economy. For this reason, there is a great interest in fixing the problems in the housing market that goes beyond the desire to help homeowners facing the loss of their home.

In spite of this urgency, it is important that policymakers have a clear understanding of the situation in the housing market before they rush forward with new legislation. Specifically, they must have a clear idea of the extent of the bubble in various markets. The fact that prices in some markets are still at bubble inflated levels, while others have settled to levels that are likely consistent with long-term trends, suggests that different policies may be appropriate for different parts of the country.

This paper evaluates the relative cost of homeownership and renting for 20 major metropolitan areas. It uses data on median house sales price from the 2006 American Community Survey[DP1] adjusting for the price change over the last year and FY2008 Fair Market Rents (FMRs).[2] The comparisons assume that an ownership unit that sells for 75 percent of the median price is roughly comparable to the median priced rental unit. (The **Appendix** provides a full explanation of the methodology.)

The analysis shows that for several cities with bubble inflated house prices such as Los Angeles, Boston, and Washington the cost of homeownership is likely to be two or even three times as high as the cost of renting a comparable unit. Furthermore, since house prices are likely to continue declining towards long-term trend levels, homeowners in these markets are unlikely to ever accumulate equity in their homes.

In these markets, encouraging people to remain as homeowners, even with substantial write-downs from their original mortgage terms, is likely to lead to situations in which they pay far more of their income in housing costs than necessary. The result could be that these families forego health care insurance for their kids or quality child care, since they will be forced to continue to make extra sacrifices to remain homeowners, with considerably less likelihood of a long term financial benefit relative to renting.

By contrast, in markets where house prices do not appear to be inflated, such as Atlanta, Cleveland, and Detroit, there is not a serious imbalance between the cost of renting and the cost of owning. In these markets, it is reasonable to implement policies that attempt to keep people in their houses as homeowners and stabilize house prices.

The 20 City Comparison

The basic comparison of ownership and rental costs is shown **Table 1** and **Figure 1**. These comparisons use calculations based on 75 percent of the median house sale price in a metropolitan for ownership costs and the FMRs for rental cost. The low, middle, and high cost scenarios assume 6 percent, 7 percent, and 8 percent thirty year fixed rate mortgages, respectively (see the **Appendix** for a full explanation).

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[2] FMRs are produced by the Department of Housing and Urban Development as "the amount that would be needed to pay the gross rent (shelter rent plus utilities) of privately owned, decent, and safe rental housing of a modest (nonluxury) nature with suitable amenities." (Notice of Final Fair Market Rents for Fiscal Year 2008. Full document available at www.huduser.org/ datasets/fmr/fmr2008f/FR_Preamble_FY2008F.pdf)
An important way this measure differs from other measures of typical rents is that it is based on the rents paid by recent movers. For more information on how FMRS are calculated, review the available documentation at http://www.huduser.org/datasets/fmr.html. This paper uses the two-bedroom Fair Market Rent.

As can be seen, even the low-cost ownership scenario is higher than the FMR in every metropolitan area, with the exception of Houston. However, in several of the cities there is not a large discrepancy between ownership costs and rental costs, even if the ownership costs are higher. For example, in Atlanta, ownership costs in the middle scenario are 37 percent higher than rental costs, in Cleveland the gap is 21 percent, 20 percent in Detroit. In Houston ownership costs in the middle scenario are 5 percent less than rental costs. In these markets, there appears to be a reasonable balance between sale and rental prices, the cost of ownership is less than 50 percent higher than the cost of renting a comparable unit. This can be seen as a reasonable cutoff for determining a bubble market.

By contrast, in cities where there has been a large run up in house sale prices, the gap between ownership costs and renting can be extraordinary. In New York, ownership costs in the middle scenario are 109 percent higher than rental costs. In San Diego, ownership costs are 133 percent higher than rental costs. In San Francisco, it costs 161 percent more to own than rent and, in Los Angeles, it costs 168 percent more. In these cities with bubble inflated house prices, families can expect to spend close to three times as large a share of their income on housing if they own as if they rent.

TABLE 1
20 City Comparison

City	Monthly ownership costs			Monthly rental costs
	Low	*Middle*	*High*	
Atlanta	$991	$1,131	$1,332	$824
Baltimore	$1,600	$1,826	$2,150	$1,013
Boston	$2,051	$2,340	$2,755	$1,353
Chicago	$1,335	$1,524	$1,794	$944
Cleveland	$767	$876	$1,031	$725
Denver	$1,274	$1,454	$1,712	$876
Detroit	$850	$970	$1,142	$805
Houston	$710	$810	$954	$852
Las Vegas	$1,575	$1,797	$2,116	$996
Los Angeles	$3,054	$3,485	$4,104	$1,300
Miami	$1,636	$1,867	$2,198	$1,035
New York	$2,415	$2,756	$3,245	$1,318
Philadelphia	$1,227	$1,400	$1,649	$932
Phoenix	$1,343	$1,532	$1,804	$862
Sacramento	$1,973	$2,251	$2,651	$982
San Diego	$2,771	$3,162	$3,724	$1,355
San Francisco	$3,637	$4,149	$4,887	$1,592
Seattle	$1,921	$2,192	$2,581	$942
Tampa	$1,008	$1,150	$1,354	$883
Washington	$2,303	$2,627	$3,094	$1,324

Source: Census Bureau, U.S. Department of Housing and Urban Development (HUD), and authors' calculations, see appendix. (**Bold** denotes a bubble market.)

FIGURE 1
Ownership and Rental Costs

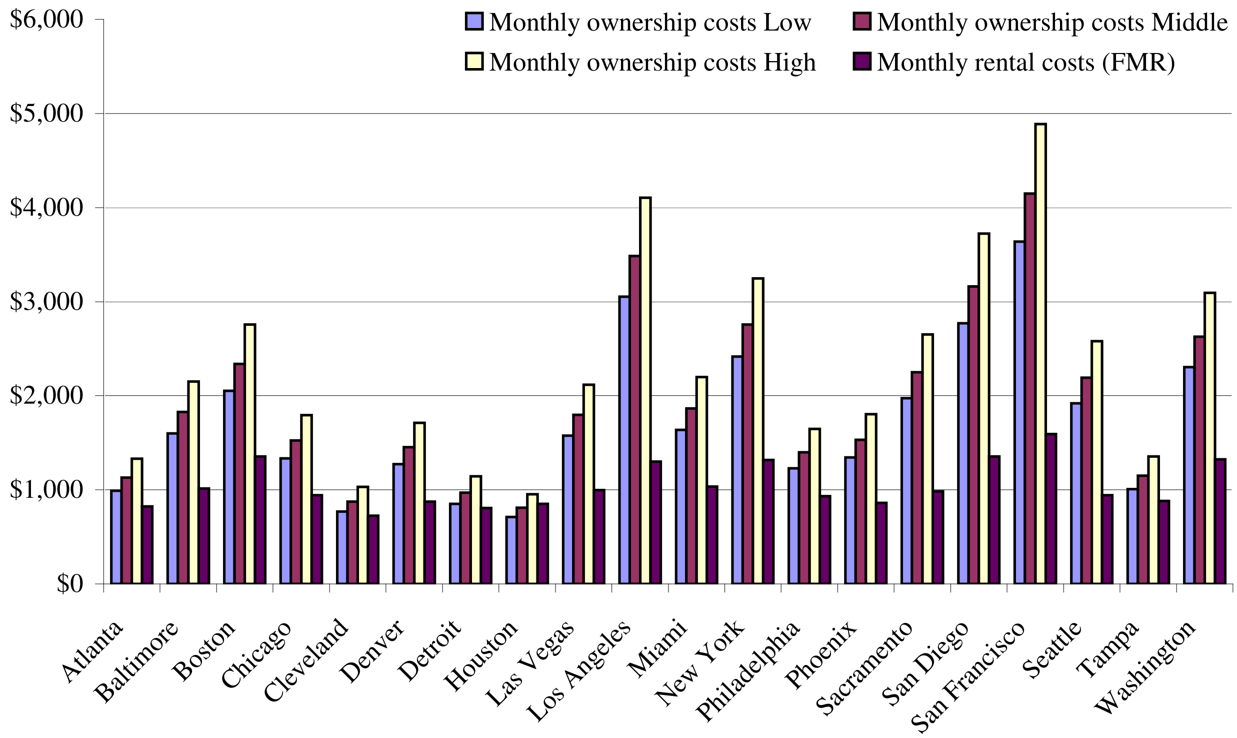
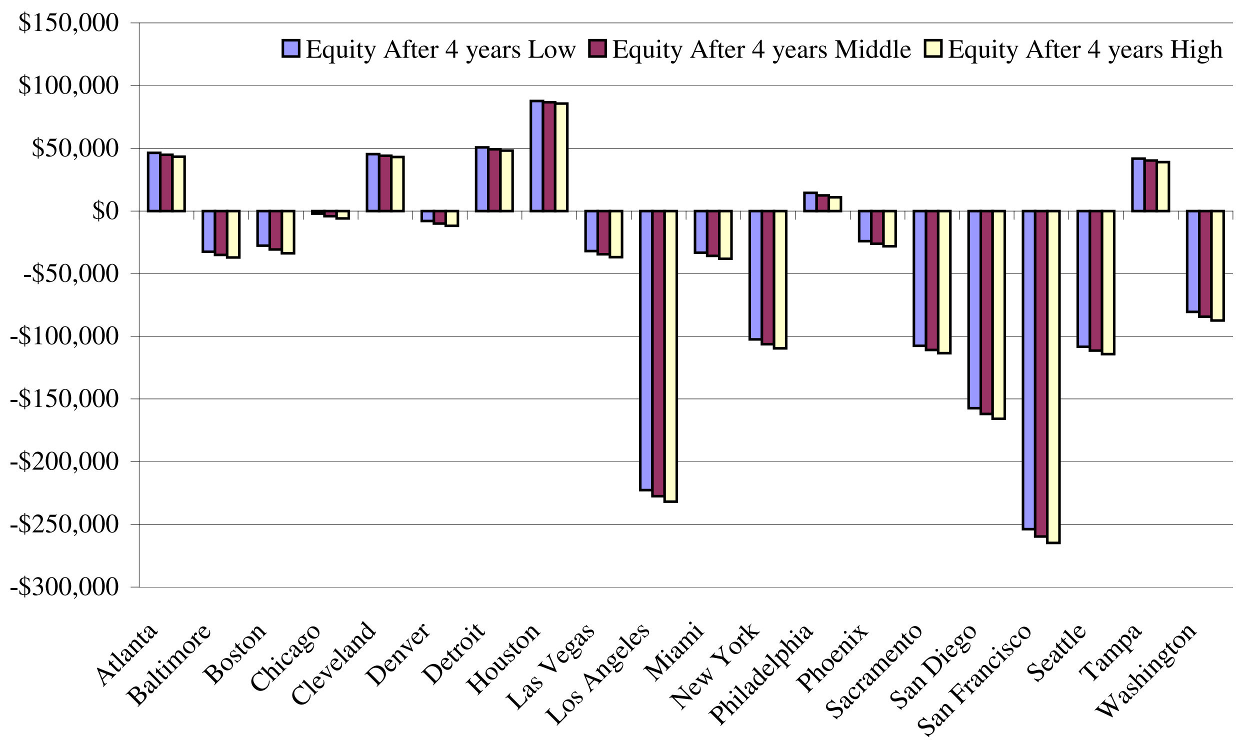


FIGURE 2
Home Equity Net of Sales Costs



What About Equity?

Of course some gap between ownership costs and the cost of renting is reasonable since owning can allow for the accumulation of equity. While the mortgage payment includes some payment toward equity, whether or not a homeowner ends up accumulating any equity will depend to a large extent on the movement in house prices and the point in time when the house is sold. At the moment, prices are falling sharply almost everywhere.

While it's not possible to know if these price declines will continue or will be reversed, it is possible to set an anchor from which to evaluate future prices. At an annual price to rent ratio of 15 to 1, the cost of owning and renting are approximately equal, so this would be reasonable to set as target to which house prices will adjust.

Table 2 calculates the equity that homeowners will accumulate in their home after four years assuming the set of housing costs in the low, middle and high cost scenarios in **Table 1**.[3] **Figure 2** shows the same information. (The calculations are explained in the **Appendix**.) The calculations also evaluate equity after deducting 6 percent of the projected sales price for realtor fees and other costs associated with selling a home.

TABLE 2
Equity after 4 Years

	Low	Middle	High
Atlanta	46,314	44,730	43,360
Baltimore	-32,409	-34,966	-37,178
Boston	-95,797	-99,073	-101,908
Chicago	-22,478	-24,612	-26,458
Cleveland	31,613	30,387	29,326
Denver	-23,974	-26,009	-27,770
Detroit	38,126	36,768	35,594
Houston	65,525	64,391	63,409
Las Vegas	-32,060	-34,576	-36,752
Los Angeles	-271,851	-276,730	-280,952
Miami	-31,319	-33,933	-36,194
New York	-175,616	-179,475	-182,813
Philadelphia	-358	-2,318	-4,014
Phoenix	-24,072	-26,217	-28,073
Sacramento	-107,621	-110,772	-113,499
San Diego	-203,803	-208,230	-212,061
San Francisco	-346,898	-352,708	-357,735
Seattle	-116,290	-119,358	-122,013
Tampa	38,751	37,141	35,748
Washington	-115,731	-119,410	-122,593

Source: Census Bureau, HUD, and authors' calculations. (**Bold** denotes a bubble market.)

[3] A recent study found that the median period of tenure for low and moderate income homebuyers in the 80s and 90s was four years Reid, C. 2004 "Achieving the American Dream? A Longitudinal Analysis of the Homeownership Experience of Low-Income Families," Department of Geography, University of Washington.

The difference between the projected equity accumulation across cities is substantial. In the cities without housing bubbles, like Cleveland, Detroit, and Houston, it is possible for homeowners to accumulate some equity in a relatively short period of time. However, the assumption that the market will continue to collapse in the bubble cities implies that homeowners will not be accumulating any equity. In Seattle, a homeowner will have $119,000 of negative equity after four years, if house prices follow the path predicted. In New York the shortfall would be $179,000, in Los Angeles $277,000 and in San Francisco, it will be $358,000. In such bubble inflated cities, homebuyers are taking a serious risk that their homes will plunge in value.

While the specific magnitude and timing of the equity problem in these cities will certainly be influenced by factors beyond the scope of such a simple projection, the pattern of lost equity in bubble markets now appears highly probable and the picture that **Table 2** illustrates is one that policy makers must seriously consider in structuring policy.

Implications for Policy

These data imply that there are enormous differences in the relationship between ownership costs and renting depending on the cities in question. In cities where there was no extraordinary price appreciation in the last decade, ownership costs and rental costs are reasonably closely aligned. In these cities, homeowners will not be forced to make substantial financial sacrifices to own a unit rather than rent a comparable unit. Furthermore, they stand a reasonably good chance of accumulating a modest amount of equity. In these cases, a housing policy that focuses on keeping homeowners in their homes as owners, using some form of government guaranteed mortgage, could help these homeowners to have affordable housing and the opportunity to accumulate equity.

In cities that have seen home price appreciation that has raced ahead of rental cost growth, however, it likely makes little sense to use public resources to encourage or subsidize severely troubled homeowners to maintain ownership. Similarly, it likely makes little policy sense to encourage or subsidize households to become homeowners in the near term as the market goes through a downward adjustment in prices. In these markets the transition of households and the housing stock to rental must be recognized as a significant policy challenge but also a policy opportunity.

With or without proactive policy, the transition to rental housing is already underway for many American families and communities as homeownership rates drop.[4] To some degree the increased demand for rental units in many of these cities is being met by the existing vacant rental stock (**Table 3**) and homeowner units converted to rental either by their current single family owners or by developers and speculative owners looking to cut their losses.

By contrast, units that are repossessed by lending institutions or those held on the market for sale may stay vacant for some time, without converting to rental. And local zoning, condo rules, and other restrictions may limit the ability of some units to easily and legally convert to rental. As **Table 3** shows, while rental markets have some slack, bubble markets have considerably less slack than non bubble markets, due in part to the conversion and replacement of existing rentals to ownership units during the boom.

[4] In 2007, for the first time since 2002, the homeownership rate fell below 68%. U.S. Census Bureau's Housing Vacancy Survey: Fourth Quarter 2007. Retrieved March 31, 2008, from www.census.gov/hhes/www/ housing/hvs/hvs.html

TABLE 3
Rental Vacancy Rate (%)

City	ACS[1] 2006
Atlanta	15.7
Baltimore	8.2
Boston	5.4
Chicago	9.6
Cleveland	14.4
Denver	8.3
Detroit	13.5
Houston	11.4
Las Vegas	9.3
Los Angeles	4.1
Miami	7.0
New York	3.7
Philadelphia	12.4
Phoenix	9.5
Sacramento	6.3
San Diego	4.7
San Francisco	5.7
Seattle	5.9
Tampa	5.0
Washington	6.0

Source: [1] 2006 Vacancy Rates come from the 2006 American Community Survey (ACS). (**Bold** denotes a bubble market.)

Due to this friction in the market, the rental market will most certainly grow tighter for the foreseeable future in these markets as demand increases and the conversion of the stock lags.[5]

Moreover, it is important to recognize the current foreclosure crisis is a housing market crisis not solely a "homeownership" crisis. Roughly, 40% of the recent foreclosures nationwide appear to be of non-owner occupied single family and multifamily rental homes.[6] In most cases renters in these units are threatened with eviction. A policy that does not encourage these units to quickly return to rental or only provides subsidy for them to be resold as owner occupied units will lead to tighter rental markets and an exclusion from assistance of a significant portion of the families affected by the crisis.

Finally, from a social policy perspective, facilitating the conversion of current ownership units to rental and the maintenance of current single family rental units as rentals post foreclosure will minimize the disruptions in neighborhoods and people's lives from foreclosure and eviction.

[5] An exception may be markets such as resort and second home markets where there was substantial over building of condo and other units easily converted by owners or developers to rentals for the more limited demand from residents.

[6] Preliminary NLIHC tabulations of Massachusetts data from the Warren Group find that only 42% of the bank repossessions in that state from January 1, 2007 to mid March 2008 were single family homes. Another 14% were condominiums. And fully, 42% were for buildings with two or more units. These type of results have been mirrored by other reports. For example, a recent report found that "38 percent of foreclosures now involve rental properties," affecting "at least 168,000 households nationwide," and that roughly half of the recent foreclosures in Nevada, Illinois and New York involved rental properties. CBS Evening News (2008, March 27). Foreclosure crisis causing crisis for renters. Transcript received from Lexis-Nexis March 28, 2008.

Families with children in particular will have difficulty finding appropriate-sized rental housing in their current communities, forcing a more distant move with a demonstrable negative impact on the schooling and health of their children.[7]

While there are many troubled homeowners who can be kept in their homes as homeowners with limited support from the government. There will also be many troubled homeowners who will reasonably make the decision to turn to renting, whose needs can be meet by the existing stock of rental market housing. However, in order to minimize the impact on current renters and to insure minimal social disruption, public resources should be committed to supplying additional rental housing by converting some of the foreclosed housing stock, and even perhaps allowing households to rent the homes they once owned.

Conclusion

To create effective policy to address the housing crisis unfolding as a result of the bursting of the housing bubble we must come face-to-face with the true dimensions of the problem. The simple analysis here provides a stark illustration that in the areas most affected by the steep increase in homeownership prices, homeownership will remain a costly and risky proposition for many households for some time to come. Policies that seek to help these homeowners remain in their homes as owners through subsidies and workouts will face long odds and steep costs. They also fail to help the significant proportion of renters experiencing eviction as a result of the current crisis. A preferable strategy is one that recognizes the rental market as part of the solution as well as part of the problem, and seeks to provide households, particularly low income households, with affordable rental options.

[7] See for example Crowley, S. (2003). "The Affordable Housing Crisis: Residential Mobility of Poor Families and School Mobility of Poor Children". *The Journal of Negro Education*, 23; U.S. General Accounting Office. (1994). "Elementary School Children: Many Change Schools Frequently Harming Their Education". Washington. DC: Author; and Scanlon, E. & Devine, K. (2001). Residential Mobility and Youth Well-Being: Research, Policy and Practice Issues. *Journal of Sociology and Social Welfare*, 28(1), 119-138. For a more recent study see Rhodes, V. (2005). "The Effects of Student Mobility on NCLB School Accountability Ratings". Penn GSE Perspectives on Urban Education, 3(3).

Appendix

The source for the median house sale prices is the Census Bureau's 2006 American Community Survey, data profile tables for metropolitan statistical areas, available at [http://factfinder.census.gov/servlet/ADPGeoSearchByListServlet?ds_name=ACS_2006_EST_G00_&_lang=en&_ts=224860494546]. The median sale price reported for 2006 was adjusted by the increase in the Office of Federal Housing Enterprise Oversight's (OFHEO) House Price Index for the metropolitan area from the fourth quarter of 2006 to the fourth quarter of 2007. These data appear in the OFHEO release of HPI data for the fourth quarter of 2007, available at [http://www.ofheo.gov/media/pdf/4q07hpi.pdf].

The calculations in the low, middle, and high cost scenarios use the monthly payment on a 30-year fixed rate mortgage at 6 percent, 7 percent, and 8 percent interest rates, respectively, for 75 percent of the median house price for each metropolitan area.

The scenarios assume alternatively property tax rates of 0.75 percent, 1.0 percent, and 1.5 percent. State and local property tax collections for fiscal year 2004-2005 (the most recent year for which data is available) were equal to approximately 1.2 percent of the combined value of residential real estate owned by households, and real estate owned by both non-financial non-farm corporate and non-corporate businesses. Data on property tax collections for 2004-2005 ($335.7 billion) can be found in the 2008 Economic Report of the President, Table B-86, available at [http://www.gpoaccess.gov/eop/tables08.html]. Data on the value of residential real estate at the end of 2004 ($16.7 billion) can be found in the Federal Reserve Board's Flow of Funds Accounts, Table B.100, Line 4, data on the value of the real estate held by non-farm non-financial corporate businesses ($5.9 trillion) is available in Table B.102, Line 3, and data for the value of the real estate held by non-farm non-financial non-corporate businesses ($5.6 trillion) is available in Table B.103, Line 3.

The low, middle, and high cost scenarios assume combined maintenance and insurance costs of 0.75 percent, 1.0 percent, and 1.5 percent of the sale price, respectively. Implicitly, the maintenance costs should also include some utilities to be fully comparable to the rental cost figure, since most market rents include the cost of at least some utilities.

The calculations for equity after four years assume that the house price adjusts over this period to a trend value that is pegged at 15 times the annual rent of the property. The annual rent is assumed to be 1.333 times the fair market rent as described in the text. This figure is further adjusted upward by a factor of 12.55 percent which would be the rent in four years, assuming an average annual rental inflation rate of 3.0 percent.

The calculation of net equity assumes that the seller incurs total sales cost equal to 6.0 percent of the sale price. This is subtracted from the sale price as calculated above. The net equity in the low, middle, and high scenario is then the difference between this amount and the balance outstanding on alternatively, a 6.0 percent, 7.0 percent, and 8.0 percent 30-year fixed rate mortgage.