Discussion of

“Run-up in the House Price-Rent Ratio: How Much Can Be Explained by Fundamentals”

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How to account for the recent run-up of the rent-price-ratio?
- Increased 40% between 2000 and 2006.
- Focus on fundamentals.
What They Did

1. Construct a rich general-equilibrium model where both the rent and the house price are endogenous.
   - Life-cycle model with uninsured idiosyncratic labor income shocks.
   - Rich model of housing (house size, tenure, landlord or not)
   - Fixed supply of housing (upperbound).

2. Use the model to measure the effect of exogenous changes on the price-rent ratio.

3. Steady state comparison (transition analysis = work-in-progress!).
   1. Lower downpayment requirement (20% → 15%)
   2. Lower interest rate (4% → 2%)
   3. Higher labor income (up by 10%)
   4. Combination of all three.

4. Clean exercise with a rich structural model of housing.
## What They Found

<table>
<thead>
<tr>
<th>Change</th>
<th>Price</th>
<th>Rent</th>
<th>P/R</th>
<th>HOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>↑</td>
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<tr>
<td>Lower downpayment</td>
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<td>↑</td>
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<td>↑</td>
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<tr>
<td>Lower interest</td>
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<td>↑</td>
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<td>Higher income</td>
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<td>All three</td>
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</tbody>
</table>
1. Very rich model!
   - Carefully calibrated.
   - Allows a variety of interesting experiments.

2. However, regarding the main question \((P/R)\) ratio, the answer is the same as the simple user cost - rent equivalence:
   - Lower downpayment requirement \(\rightarrow\) no effect on the \(P/R\) ratio
   - Lower interest rate \(\rightarrow\) higher \(P/R\) ratio
   - Higher income \(\rightarrow\) no effect on the \(P/R\) ratio

3. Why?
   - Easy transition/conversion between renting and owning.
   - Except for *rooms*, where only renting is available.
   - *Rooms* do not affect the aggregate house price much.
   - Therefore, a simple model of user cost - rent equivalence turns out to be a good approximation.
What could be added?

- New type of mortgages (Chambers et al.)
- Transition between steady states?
- (Expected) income growth (Kahn).
- Making rentals and owner-occupied properties more different.

Numerical robustness.

- How sensitive to the choice of $h$ grids?
- Especially, the 2nd smallest grid (smallest house for ownership). The jump from rooms to the smallest property for ownership generates a lot of action.

What is causing the recent run-down?

- Transition gets interesting.
- Mortgage rate (premium) increased?
- Expected income growth slowed?