Discussion of

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

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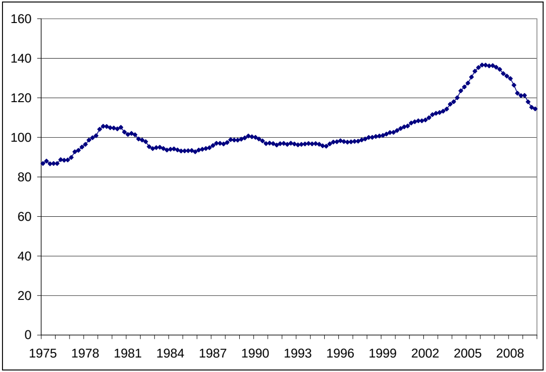
Motivation



- 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

Change	Price	Rent	P/R	HOR
U.S.	$\uparrow$	$\uparrow$	$\uparrow$	$\uparrow$
Lower downpayment	$\uparrow$	$\uparrow$	–	$\uparrow$
Lower interest	$\uparrow$	$\downarrow$	$\uparrow$	–
Higher income	$\uparrow$	$\uparrow$	–	–
All three	$\uparrow$	$\uparrow$	$\uparrow$	$\uparrow$

Comments - 1

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.

Comments - 2

1. 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*.
2. 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.
3. What is causing the recent run-down?
    - Transition gets interesting.
    - Mortgage rate (premium) increased?
    - Expected income growth slowed?