Mea Culpa / Povera Me

- Sold my own home in 2012
- I thought it was the top of a cycle
- Turned out a little right short run
  - Intermediate run to date very wrong
- Tried to hedge Vancouver prices with Canadian stocks
  - Even “global” equities
- By arbitrage believed U.S. housing couldn’t be underpriced
- I still rationalize my failure with no arbitrage
- So take today’s talk with salt
Should I (continue to) own a home in Vancouver?

1. It’s ok not to own
2. There are good reasons to own
   ▶ Tax?
   ▶ Contracting frictions
   ▶ Lifecycle consumption smoothing?
3. Supply Elasticity and Housing Rents and Prices
   ▶ Theory
   ▶ Reality
4. Owning a home is risky
5. Owning a home is insurance
It’s ok not to own

▶ “I’m sick of paying the landlord . . .
▶ . . . I’d rather pay myself instead”
▶ No.

▶ Efficient, no tax, riskless market:

\[
\text{Rent + Capital Gain - Expenses} = \text{interest rate} \times \text{price}
\]

\[
\begin{align*}
\text{Return to owning} & \\
\text{Opportunity cost of capital} &
\end{align*}
\]
Mortgage payments

- PMT = interest + amortization
- Constant payment is common
  - Subject to interest adjustment
  - Early payments are mostly interest
  - Subsequent payments are mostly amortization
- Amortization is equivalent to buying a bond, so not a true cost
- But Equity in the home could be earning interest
- Interest is a cost much like rent
Owning and taxes

 Owners pay:

▶ Property tax (with a bit of a credit)
▶ Sometimes get credits for investment
▶ Rarely capital gains

Landlords pay:

▶ Property taxes
▶ Income tax on rent less:
  ▶ “Depreciation”
  ▶ Mortgage interest
  ▶ Property taxes
  ▶ Maintenance
▶ Capital gains when and if realized
▶ Net liability may be restricted to be positive

Depending on scenario, owners pay less

Frightening fact (corrected: “enlightening fact”):

▶ Rent to price ratio lower in Vancouver than Seattle
▶ Yet renting is relatively tax-friendly in Canada
  ▶ No mortgage interest deduction here
Owning vs renting: contracting frictions

- Landlord Releasing costs
  - Landlord worries you will move
  - Has to charge you for moving soon
  - Makes you want to move

- Your moving costs
  - You worry apartment won’t be available in the future

- Maintenance
  - Investment not your benefit
  - So you underinvest
  - Damage not your problem
  - So landlord charges accordingly
  - Typically see “1 building 1 owner”
  - So backyard, detached home unlikely rental

- Mortgages
  - Owning involves “schmuck insurance”, too.
  - Currently recently a giant problem in the US
  - But landlords can default, too…
Owning vs renting: lifecycle considerations

- Owning requires a downpayment ⇒ kids shouldn’t rent
- Selling a home is costly ⇒ kids and movers shouldn’t rent
Is it cheaper to own or rent?

- Rent versus “user cost”
  - Mortgage
  - Opportunity cost of equity
  - Property tax
  - Maintenance
  - Insurance
  - …
  - Less appreciation

- So we need to know appreciation rate
How much appreciation to break even?

- 4 BR North Shore home
  - Rent: 35000-55000/year ⇒ 3.2%-3%.
  - Price: 1.1M-1.8M (?)
  - Mortgage + equity return: ≈ 3%.
  - Maintenance: 10k ≈ 1.5%
  - Insurance, taxes, etc: 6k ≈ .3%
  - Selling costs: 4%/10 ≈ .4%
  - Total owner: 4.2%
  - Appreciation rate to break even ≈ 1.7-1.2%

- What’s missing?
  - Will 3% interest rates persist?
  - Will prices appreciate 1.7%?
  - Related questions!
    - Yield curve says “no” yes
    - History says “no” not sure

- Need a lot more than 1.2% on a detached home in Kits
  - Price double, rent similar, upzoning?
How much appreciation is reasonable?

- Giant real historical price appreciation in Vancouver
- Subject to this is the data we have (CMHC?)
  - Pink: price
  - Blue: rent
Phoenix: when prices rise, they will crash
Plotted: lat and lon of Starbucks in Phoenix
Dallas: when prices rise, they will crash
As in the 80s
New York: when prices rise, will they crash?
A bit in the late 80s, not much this time around
Vancouver is more like New York and will never be cheap
We know that “bubbles” are punished in “Flatland”
To a lesser extent in the “zoned zone?”
Some demand in Vancouver is driven by Chinese wealth
In the long run, nicest city in China is good
Short run risks of bubble collapse in China
Reasonable people disagree about magnitude of the risk
Returning to rational pricing

\[
\frac{\text{Rent} - \text{Expenses} + \text{Capital Gain}}{\text{Price}} = r
\]

net dividend rate = \(r - g\)

- We don’t know what \(g\) is
- When \(r\) is very small, easy to believe very high prices
- Hence I can’t say if we’re in a bubble or not
- Many are willing to declare bubble
- Easy to see downside risks
Owning a home is risky

- I don’t know value of my home today within 20%–50%
- Over 10 years range of outcomes huge
- Housing is most of most of our wealth
- We might want a high return to compensate for risk
- Luckily, our labor income doesn’t move with housing…
  - e.g. investment banker in New York
  - Oil people in Texas
- But our retirement income likely does
Owning a home is insurance

- Bad if prices fall, but there are options
  - Trade up
  - Don’t sell
    - Moving is a hassle at any age
- Good if prices rise
- In a perfect world, almost zero net exposure to housing costs
- Real world
  - Renting: negative exposure?
  - Owning: positive exposure?
Are owners long housing?

- Working backward, Grandma never sells
  - Unless she goes into a nursing home . . .
    - Does she then need the money?
    - Maybe this is why no LTCI market?
  - . . . Or lives a very long time
    - May be why no one buys life annuities
  - Bequest and housing risk??
- Trades up are more common than down
- Is Vancouver correlated in price with your next market?
- Do you have to move or want to move?
- Owning pre-tenure is risky
Are renters short housing?

- Yes, if rental consumption is fixed
- But it's not
- And renters (no kids) are a mobile population
- So those who are flexible do not need to insure against high rents
- Rent control helps with this . . .
- . . . But may increase starting rents
Comparisons to Coastal U.S. Make me (a) worry, (b) believe foreign $$$ is a crucial risk factor