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Is Housing Shelter or an Investment?

Securing shelter is a fundamental necessity for everyone. In Maslow's hierarchy of needs, the foundational level is rooted in the essentials of human existence. Basic life requirements include air, water, and food, in addition to the fundamentals of rest, clothing, and a place to shelter. When any of these essentials are absent, all other considerations naturally take a backseat as the immediate priority becomes obtaining these basic needs. It's not just a preference; it's a fundamental matter of survival.

The second level of Maslow's hierarchy is safety. Once a human's base needs have been met, it is natural to seek an increased level of security. Protection of oneself and one's property is urgent. There is also room here for things such as personal health, stable employment, and financial security.

A residence serves as more than just shelter; it enhances physical security and, under favorable circumstances, becomes a vehicle for accruing wealth and achieving financial stability. Homeownership often plays a pivotal role in ascending the initial rungs of Maslow's hierarchy.

The next step is love and belonging. The home plays a large role here as well. A home provides the place to raise a family and experience the intimacy of family life. Living in a place can provide a sense of connection to neighbors and a community.

Once a person has love and belonging, Maslow suggests the next level is esteem. Respect, status, and recognition are elements of esteem often reflected in a home. A housewarming party is a way to share good fortune with others. It's also a way to signal success.

At the pinnacle of Maslow's hierarchy is self-actualization, the pursuit of realizing one's full potential. While a home is not typically the catalyst for achieving self-actualization, the upkeep of a well-tended yard, engaging in occasional home improvement projects, or simply fulfilling mortgage payments can unexpectedly become avenues toward personal fulfillment.

The home is at the core of the American Dream because it is so many things to so many people. It's shelter. It's security. It's a store of wealth. It's a reflection of our status. It's where we live and experience life's most intimate moments. If we're lucky, it is the place we'll draw our final breath, surrounded by our loved ones, after a long life.

Housing serves us in so many dimensions, but what happens when these dimensions compete? When housing becomes a good investment for homeowners by reliably going up in value year after year, it impairs the ability of non-homeowners to purchase a home. When housing as a form of esteem or self-actualization leads homeowners to demand exclusionary zoning practices, it makes it difficult for needed housing to be built.

Economically, housing is an excludable good. If one person or family occupies a home, they can exclude others from making use of it. It is also considered a rival good. When a person or family occupies a home, that home is no longer available in the marketplace for someone else to occupy. This combination—excludable and rivalrous—makes housing what economists call a private good.

In theory, a free market will supply private goods in quantities and at price points to meet demand. Some essential private goods, such as food and clothing, the market provides in excess. The fact that some Americans go without food or clothing is not a function of supply breakdowns. There is ample food and clothing being produced, more than enough for everyone.

Housing is also an essential good, but it is not produced in excess like food and clothing. Quite the opposite; there is currently

a shortage of housing in North America. This wasn't always the case, but today an increasing number of cities do not have enough homes to satisfy local demand.

In a marketplace, a shortage in supply of a private good will make the price of that good go up. A hamburger is a private good that, once it is consumed, is not available to anyone else. If there is a shortage of hamburger, the price will go up and people will shift to eating other things. In theory, this should prompt the production of more hamburger, bringing the price back down to a point where the market demand is met.

When someone buys or rents a home, they occupy it temporarily. At some point—it may be months or decades—that home goes back on the market. It isn't consumed the way a hamburger is. For people who own a home, and for those who own rental property, rising prices are a feature, not a flaw. Scarcity makes the private good they own more valuable.

Today in North America, there are two different, mutually incoherent conversations about the housing market. One is conducted by “housing” people and the other among “finance” people.

“Housing” people are primarily concerned with housing's availability as shelter across the spectrum of incomes and needs. Rising prices are reflexively understood as a negative thing. “Finance” people are primarily concerned with the performance of housing as an investment asset class. They may recognize the struggles experienced by many in obtaining housing, but rising prices are often the implicit or explicit goal.

“The housing market” does not mean the same thing to the two camps. To housing people it means the stock of homes available for sale or rent and the participants in those exchanges. To finance people the phrase “the housing market” often means the mortgage market, including secondary markets in financial derivatives.

At the end of the day, housing is shelter. It is the most basic of human needs. One might be tempted to assert, on moral grounds, that concerns over housing's role as shelter should automatically supersede sensitivities over housing's role as an investment. That isn't wrong, but it is oversimplified.

That is because housing as a financial product is the foundation of the American economy. To a disproportionate extent, the ability of people to have a job, obtain food, support their family, pay their taxes, and so much more is dependent on elevated housing

prices. The converse is also true: falling home prices threaten the entire economy.

This is a tension that must be resolved, but there is no clear path to resolve it. There is a clear power imbalance, however, between those who benefit from high housing prices and those who are harmed by them.

Who Benefits from High Housing Prices?

Policy discussions about creating affordable housing often suffer from a fatal incoherence. The people having the conversation and the organizations they represent are generally harmed by a decrease in prices. The incoherence is that they want housing to become more affordable but without prices going down.

This is rarely stated openly, but it manifests in the policies put forth. Many of the least affordable cities have in place policies that aim to create a stock of dedicated affordable housing, albeit limited and inadequate, without disrupting the overall upward trajectory of prices. For example, inclusionary housing is the practice of requiring developers to include a percentage of below-market units as a condition of approving a development. In a sense, the more expensive units must be priced even higher to subsidize the below-market units. High prices are reinforced in the name of affordability.

To truly reduce prices through supply and demand mechanisms requires building a lot of new units. There is an institutional inertia against such an approach. That resistance needs to be acknowledged, not to shame but to understand why this challenge is so difficult. The list of those who benefit from high housing prices is long. It includes nearly everyone in a position to influence the production of new housing.

For example, local governments benefit from high housing prices. This is especially true for places that utilize the property tax. Cities often tout a declining tax rate as a sign of good fiscal management. When property values go up by a double-digit percentage, it allows local governments to raise more money at a lower tax rate. For taxpayers, there is less incentive to complain about local taxes going up \$200 in a year where the property being taxed goes up by \$20,000.

State and federal governments also benefit from high housing prices. States generally receive sales and income taxes. The federal government taxes income, both from the employee and the employer. As home values rise, it drives the kind of transactions that increase state and federal tax revenues. For the last couple of decades, this includes the cashing out of home equity for consumption spending.

Banks and insurance companies are obvious beneficiaries of rising home prices. Both hold mortgage-backed securities as part of their required reserves. When values are rising, those reserves become even more secure. If prices were to fall, it threatens their solvency in a way Treasury bills do not. An environment where home prices consistently rise increases the margin of error for financial institutions.

Developers and contractors are also routinely bailed out by appreciating home values. In fact, developers who mess up a project just need to wait for another year of appreciation to make up their lost margin. The fact that interest rates have been very low for the past two decades has made this kind of financial sloppiness more the rule than the exception.

In the broader market, pension funds and other conservative investors have placed trillions of dollars into housing. While they don't necessarily benefit from rising prices, falling prices do threaten their investments. These major financial institutions would be very resistant to policies that broadly lower home values.

As would the largest and most influential group: existing homeowners. It is obvious that it doesn't benefit someone to sell at a high price only to turn around and buy at a high price. Still, only a small percentage of homeowners move in any given year. The rest are generally content to have their net worth increase by thousands of dollars annually. They would be very cranky were the opposite to occur.

Line up all these constituencies on one side of the influence ledger. Who sits on the other side? Who doesn't benefit from appreciating home values? Renters; first-time homebuyers, especially young people and those without savings or equity to trade in; and the poor. It hardly needs to be said that these are less influential constituencies.

Even if we truly desire housing to become more affordable, we need to acknowledge that our personal incentives are mostly at odds with that goal. Put another way, individually, we have a vested interest in one approach (rising prices and growth), even though collectively

we may express a desire for the opposite (broader affordability and housing stability).

It is impossible for housing prices to climb annually at rates greater than inflation while simultaneously having housing become more affordable. More than even an economics problem, this is a cultural challenge.

Understanding the Housing Market

Almost everyone wears shoes. For all practical purposes, shoes are essential clothing for most humans alive today. Shoes come in seemingly as many varieties as there are feet. In fact, most Americans own multiple pairs. While some struggle to pay for shoes, there are many different price points and ways of acquiring them. Our economy produces shoes in such abundance that we never experience a shortage. There is no shoe crisis or shoeless problem.

Pretend for a moment that this isn't the case. Imagine a shoe market that produces only two kinds of shoes: a high-end loafer and an elite-brand tennis shoe. The high-end loafers are produced by a few companies such as Gucci and Louis Vuitton. The elite-brand tennis shoes are produced by companies such as Nike and Adidas. They are named after famous sports figures.

A century ago, there was a shoe crisis. Shoes were abundant but very poor in quality. A financial crisis then caused people to lose their shoes, through no fault of their own. The federal government stepped in and provided insurance and subsidies to get the shoe market moving again. New shoes were produced in abundance. Prices were broadly affordable. Quality went up significantly.

Through a broad cultural consensus, two styles of shoe begin to dominate the market: high-end loafer and elite-brand tennis shoe. Federal subsidies are set up to promulgate these two choices. Local regulations are put in place to reinforce this preference. Everyone from large banks to local shoe salesmen find it lucrative to support the emergence of these two options.

In this imaginary world, anyone who wants shoes can still buy them. There is a market, and that market has multiple competitors. Yet those competitors are competing at only two price points. Both price points are rather expensive.

People who can't afford shoes at high prices buy used shoes. New shoes filter down to be purchased by poorer people. Over time, the prices for new shoes climb. More and more people compete for the used shoes that are available. Now the price of used shoes climbs, as well.

The federal government steps in to assist people buying new shoes. They set up direct and indirect subsidies. They encourage banks to assist shoe manufacturers. Local governments, too, get in on the act and provide their own set of subsidies to shoe corporations. People can now pay more for their Gucci loafers and Air Jordans, so prices soar. So do profits.

Shoe corporations can sell both styles of shoes as fast as they can produce them, but there is a limit to how fast they can be produced. Local permitting restricts the number of shoes that can be made. Rising prices have bloated supply chains, making everything more expensive. The extensive web of public and private capital vested in producing high-end loafers and elite-brand tennis shoes stifles innovation.

Political factions arise that advocate for the production of more high-end loafers, with some fraction offered at subsidized prices. Opposing factions arise to object to these plans. A used and ratty pair of Air Jordans is selling for twice as much as a new pair cost a decade earlier.

Speculators now buy new Gucci loafers without any intention of wearing them. They simply want to capture the price appreciation. Shoe prices climb higher and higher. Lots of people who want shoes can't get them. They go barefoot. Those who can buy shoes feel financially squeezed. Price increases are normalized, even expected. Many people are desperate to get any pair of shoes.

This all feels bizarre. What kind of mass insanity would have to occur for it to become normal that only two types of shoes were available for purchase, and those produced by only a handful of suppliers? In this imaginary world, how long would this go on until someone did the obvious thing and began producing penny loafers? At what point in this self-created shoe shortage would people simply start making their own shoes?

We have an abundance of shoes today, and so this entire scenario seems absurd. It is absurd. Yet our present housing crisis, which seems normal to us, would be absurd to anyone living a century ago. In the context of millennia of human development, we are the first culture to find ourselves with a chronic shortage of housing. We have grown used to something that is deeply abnormal.

In a little less than a century, housing has gone from being abundant but low quality to relatively good quality but now an elite product. We wiped out the starter rung on the ladder. We need a housing market that produces penny loafers again.

Can Housing Prices Go Down?

Economists have long studied a phenomenon known as the resource trap. Sometimes called the “paradox of plenty,” the resource trap afflicts many countries that are rich in natural resources. For such places, having natural resources can be a blessing, but it can also be a curse.

The blessing comes from the jobs and opportunities the resources provide, such as opportunities to mine, drill, or log. The curse comes when the community becomes trapped in the resource economy, unable to grow beyond it.

This is easy for Americans to see in countries such as Venezuela or Saudi Arabia. Abundant oil has allowed their governments to persist, despite not meeting the needs of their people. Glitzy projects and occasional handouts have allowed them to limp along. High unemployment and low family wealth persists, despite the astounding riches extracted from the ground.

In a resource trap, quality of life becomes a cost to reduce. Jobs and wages are expenses to be trimmed. Opportunities for growth and investment are a distraction to the core goal of efficiency. In service of the resource being extracted, the economy becomes trapped in a predatory cycle, obsessively reducing society’s overall standard of living just to keep things going.

America has created its own resource trap. Instead of oil or some other commodity, the resource Americans have ready for extraction is their wealth. That wealth used to be tied up in a family’s home, an incidental savings plan capturing portions of a lifetime of labor. The home now is merely the drill bit used to gain access to that wealth.

The primary purpose of a house today isn’t to provide shelter. That is such an old-fashioned, quaint way to think about housing. No, the primary purpose of a house is to create a piece of mortgage paper, a financial instrument that can be brokered, transferred, bundled, securitized, hypothecated, traded, collateralized, and gambled with.

It is a piece of paper that represents the future earnings of each of us. The more Americans are squeezed financially, the more of that wealth they become willing to access. The more they can access, the more they are prepared to pay for the ability to be a homeowner. The more they will pay, the higher home prices go.

We are trapped. This is a cycle that can only go in one direction. Housing prices may correct a little, but they can never be allowed to fall to a level that would be considered affordable. Dramatically falling home prices would wreck too many things. We experienced that in 2008.

America's housing market is stuck in a trap. It is a financial trap, of course. We have placed housing at the core of the financial system. Home prices can't meaningfully decline without threatening the entire financial sector.

It is also a regulatory trap. We built a regulatory environment to quickly propagate a new pattern of development. It builds new homes and businesses quite well but, once built, locks them in regulatory amber. All change, any natural evolution of a place, can be fiercely resisted.

Finally, it is a cultural trap. We have common beliefs and practices that are part of the culture of housing in America. To escape this trap, we need to move beyond those beliefs and practices. We need to create a new culture around housing. What housing looks like, where it goes, how it is built, and who builds it all need to be on the table.

Housing is shelter. It is one of the most critical human needs. Housing is also the greatest store of wealth—in some cases, the only store of wealth—for American families.

To escape the housing trap, we must overcome the basic contradiction that housing can be both affordable and a good investment, more than just a store of wealth.

