**Renters, Homeowners & Investors: The Changing Profile of Communities**
**February 26, 2013**
**Renters, Homeowners & Investors: Governor Stein Introduction**

ANNA ALVAREZ BOYD: My name is Anna Alvarez Boyd for those of you that don't me, I'm a senior associate director here at the Board of Governors, working with the Division of Community and Consumer Affairs and on behalf of my Reserve Bank colleagues, both Theresa Singleton from Philadelphia and Paul Kaboth from Cleveland, I welcome you and thank you for joining us in today's event. So the -- as you walked in, I'm hoping that folks handed you a clicker because shortly, in the next hour or so, we'll be using those. If you don't have one, I'm sure someone will come out. We've got some folks in the back who can bring you one so please make sure in the next half an hour or so you have one of those in your hands. The housing crisis has profoundly changed how we view the housing sector. Many of us have revisited our underlying assumptions about how markets work, who the key players are, what consumers want, certainly what the role of government is and so on and so on. We're asking ourselves a lot of questions these days. We understand that the devastating effects that the crisis has had on communities and families and I know that many of you in this room are very profoundly interested in those topics. While there's signs that the housing market is turning around in some areas, there's markets that continue to struggle. Not all markets will change together. The Federal Reserve System has a longstanding commitment to this issue and we continue to work with local governments, community groups to target the resources and identify best practices, that's really the core work of the community development function here at the fed. One of the roles of the Federal Reserve system is ask difficult questions about these changing markets and today's forum is really the result of a series of conversations with many of you in this room, particularly with Eric Belsky and Eileen Fitzgerald, who you'll be hearing from shortly; about identifying the most daunting problems and finding a way forward and asking what is it that the Fed should continue to be doing in this space. So today we seek to really further those conversations with you; through the day, we'll be identifying tools and strategies that can help us move forward. And to that end as well, the panels are designed to really have maximum interaction so don't be shy, I know many of you in this room are not in the least bit shy. So we'll -- I think it will be a good conversation and a wonderful dialogue for the day. So I also -- before we to my primary task this morning which is really to introduce Governor Jeremy Stein, I want to bring to your attention that we also have a virtual audience today, this event is being live streamed and I believe captured for future consumption as well. So now let me get to my real task at hand; Jeremy Stein took office on May 30, 2012. He is essentially really our boss for the Division Community and Consumer Affairs; he's one of three governors that oversees the work of our division. Prior to his appointments here at the board, Dr. Stein was the Moise Y. Safra Professor of Economics at Harvard University. In 2009, Dr. Stein served as a senior advisor the Secretary of the Treasury and on the staff of a national economic council. Before joining the Harvard faculty in 2000, Dr. Stein taught finance at the Massachusetts Institute of Technologies, Sloan School of Management and was an assistant professor of finance at the Harvard Business School. He also served as a member of the Federal Reserve Bank of New York's Financial Advisory Roundtable. His research covers a range of topics, including behavioral finance and stock market efficiency, corporate investment and financing decisions, risk management, financial regulation and monetary policy. So without further ado, please join me in welcoming Governor Jeremy Stein.

[ Applause ]

GOVERNOR JEREMY STEIN: Well, thanks, Anna, thanks very much. And on behalf of the Federal Reserve, I'd just like to welcome all of you here and thank you for your participation in this importance conference. So as you all know, the housing market and the broader economy have been through some fairly wrenching events over the past few years and while on the one hand, the damage from the financial crisis and from the subsequent recession have been quite widespread, it's also important to remember that the impacts have been also fairly heterogeneous, in terms of falling home prices, foreclosures, unemployment, all that stuff have been especially pronounced in some geographic locales and among certain demographic groups. And of course this heterogeneity has been very, very closely tied to the housing market. I mean an amazing picture, set of pictures, if you like to make graphs for yourself, is if you plot the unemployment rate at the MSA level, at the city level basically, the first thing you can do is, you know, you can plot the unemployment rate in 2010 say, against the decline in house prices from 2007 to 2010, you won't be surprised to see that obviously the cities that had the biggest declines in house prices had dramatically more unemployment. A slightly more and to my mind, striking version of the graph is don't do house price declines, do house price run-ups from say 2002 to 2006 so now you're going to see the correlation flip; in other words, those cities that had the biggest run-ups in house prices in the early part of the decade, 2002 to 2006, have just again, very strikingly, it's a very, very striking relationship between that and the subsequent unemployment rate. So all the boom cities in the early part of the decade -- not all but, you know, there's a very strong association between boom cities in the early part of the decade and unemployment later so if you want to think of, you know, Stockton, Modesto, Vallejo, California, cities like that, those are really some of the top cities in terms of unemployment. Now there're some of the top cities in terms of house price appreciation, just to remind you that in spite of the fact that we'd like to think about in things in terms of macroeconomics and, you know, overall unemployment, this thing has been, I think, I would guess more so than some recessions, very heterogeneous and very housing related. And so obviously it's sort of really devastated individual communities in a lot of these places. And beyond the macroeconomic impacts, even in these cities, unemployment and so forth, what we're all about here today is the fact that the housing bubble's also put in play another set of forces that could have quite important and long lasting effects, more at the micro, household and community level. And in particular, I'm thinking of essentially the topic for today which is the conversion of some portion of the housing stock and interestingly, stand alone, single family homes from being traditionally own or occupied to investor owned rental properties. So, you know, at some level, you know, again, if you think of it kind of from a slightly more macro perspective, this is an inevitable and natural process of market equilibration, right? I mean think about it, think about, you know, a hundred families in a neighborhood or in a zip code area that have been foreclosed on and have been pushed out of their homes, okay? So what have you got? Now you've got a hundred families looking for a home and you've got a hundred homes on the market so somehow, you know, supply and demand have to come together. It's hard for them to come together in the normal way because precisely because those families presumably lost the wealth that they would need to put a down payment on a home, okay? So if they can't manifest that demand in any way, it's going to be very, very bad for the housing market because you're going to have a big excess of supply over demand, prices are going to fall. So how does the market clear, it sort of has to clear, it has to be the sense that the case that we get the wealth from elsewhere, the ability to make the down payment comes from places where there's bigger pools of capital and that's going to be the stabilizing mechanism. So those families will wind up back in houses in this example but they'll wind up back in them as renters rather than as owners. Should just note that the board, the Federal Reserve Board flagged this issue about a year in its housing white paper which describe exactly this kind of supply demand mismatch and I think however strongly you feel about home ownership and about the values of home ownership, I think one has to recognize that this is -- as I said, it's sort of an inexorable part of at least the short run adjustment mechanism and the alternative would have probably been more unattractive we hadn't had this kind of equilibrating mechanism we would have likely seen even bigger declines in house prices and a harder to arrest spiral. Nevertheless, necessary as it might have been or inevitable as it might have been, I think the shift raises a variety of issues that are going to require a fairly sustained and careful attention going forward. So, you know, one thing is I guess you could characterize it as there being a basic moral hazard problem in rental, in maintenance and upkeep. In other words, there's a good reason why, you know, you might ask yourself why is that apartment buildings you have often have rental and standalone houses, it's sort of less likely. Standalone houses tend to be more likely to be owner occupied; well, it's, you know, got to be in part because, you know, with standalone houses, maintenance, upkeep, all that stuff is both more important and harder to contract on in some fundamental sense. And with home ownership, the person who's doing the maintenance is also the person who owns it, who kind of is the residual claimant and incentives are aligned in an important way. When we're in a landlord mode, we can't take that incentive alignment for granted and one needs to sort of at least ask the question of how good a job is being done by the rental system in terms of all this. And, again, you know, a theme I just want to kind of keep stressing is the theme of heterogeneity which is to say, you know, it's very likely that this kind of moral hazard problem will play out differently according to the locale, according to the type of housing stock and so forth. So, you know, if an investor buys a hundred units in a single building and says ah, I'm going to leave 50 of those units empty for a year, probably not that big a deal, right? And I can tell you this firsthand so as Anna mentioned, I was in D.C. in 2009, I happened to rent a place on 24th and M; for some odd reason, no other units in the building were occupied. You know, Hyatt owned it, they hadn't decided what they were going to do, you know, so they'd like lent out a few places to some thing to corporate apartments, anyway so I was in this kind of odd, creepy thing where I was along in this building, a hundred units, maybe there was three or four other people, it wasn't a big deal, it wasn't a big deal. It didn't mess up my life, didn't mess up the other apartments. I think it might have been a very different case if this was, you know, a neighborhood block, right? And I was the one homeowner and all the other homes were empty, you can imagine it's a very, very different situation. So with that in mind, it's worth noting that we don't know or certainly I don't know nearly as much as you might want think about who are these investors. Now Eric Belsky was just telling me just before we started, that, you know, surprisingly, a small number of them are big sort of big, big institutional investors. In many cases, it's sort of mom and pop outfits that maybe just get five or six or whatever properties. So I think, you know, this is something that really needs to be understood who the investors are and then how do different types of investors behave in different sorts of situations. Is it the case that big investors behave well with apartment buildings, smaller investors are sort of better and need them on the ground versus smaller. We don't know, we don't know. You can imagine sort of various costs and benefits going different ways, these are really important things and it's just seems like an open and interesting and fertile issue for research. You know, that moral hazard thing is one example; I mean more broadly you can think of a variety of other channels through which a changing ratio of homeowners to renters could have additional consequences, you know, positive and negative for families and for communities. So, you know, in recent months, we've been hearing from housing experts, community leaders, many of you in the room today that these changes are sort of taking place and that they warrant attention and, you know, that the more we can learn about this, I think the better off that we'll be. Again, my gut instinct is that it's probably hard to make simple, sweeping, one size fits all answers and that's why it's sort of good to do research that, you know, this is a good thing or a bad thing. There's likely to be some nuance, as I suggested, it's going to probably -- I would hypothesize that it depends on the nature of the housing stock, the locale, urban versus suburban versus rural, it depends -- likely to depend on investor characteristics, big investor, small investor. Also just want to put in a plug for one of my favorite random ideas here, is, you know, we think about the benefits of home ownership and, you know, home ownership as a sort of investment is this a sort of useful way to promote savings and wealth creation and all that kind of stuff; it's got to depend in a really important way on the horizon of who's buying the property. Simple thing, imagine two families, both, you know, 35 years old, two kids, similar income, looking in a city and thinking should I rent or should I buy? You know, and is this a good investment? Family number one, kind of job situation where they expect to be living in the city for the next 20 years. Family number two, expect to be there for the next three years but after that, don't know. How do you think about housing as an investment for those two? Is it a risky investment, okay? The first family, sure, they have the risk of the house but in some sense, they have a pretty good hedge because they have an asset which is the house that moves around but they also have a liability which is they have to acquire housing in that city for the next 20 years. So in some sense, those two offset one another, house prices rise a lot, maybe actually maybe worse off not owning because they then have to rent at higher prices. House prices fall, they're in some sense hedged 'cause they're going to live there. Very, very different story for the family that's going to then, you know, live there for three years and then have to resell and move, they're much more of a short horizon investor. So hard to make sweeping statements about it's a good thing for kind of, you know, your household -- from a household finance perspective to be a buyer or seller. So, again, just one more plug for the idea, lots of heterogeneity, hard to make a sweeping statement. So with that and all these other complexities in mind, we're hosting this event today just to, you know, to bring you guys together, share information, discuss implications and all of that. You know, the Fed has been active in studying the stuff and we're trying to also do a little bit of convening. So, again, just like to thank all of you very, very much for your participation, look forward to a fun and enjoyable conference. Thanks again.

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