Serena Allen:

Welcome to the Policy Paycheck. My name is Serena Allen. Thanks for tuning in. The Policy Paycheck was born from the idea that all people should have access to factual and relevant economic evidence about the most controversial policy topics we hear about every day. While our intended audience is American high school civics classes, even policy experts may learn something from each episode. Ideally, listeners like you will walk away better informed to not only discuss but also form your own opinions about the policies, as taxpayers, we already pay for.

In this episode, we have Dr. Richard Green with us to discuss how to secure housing and if buying or renting is the right choice for you. Dr. Green is Director of the USC Lusk Center for Real Estate and is a professor at the School of Public Policy and Marshall School of Business. He was recently President of the American Real Estate and Urban Economics Association. Welcome, Richard. Thank you so much for being on our show today. We really appreciate it.

Today we want to talk about housing. And right now we have a lot of listeners, young adults who are looking into housing for the first time, be it because they're going to university or they're moving out of their parents' home to work, or a variety of other circumstances. What is the difference in long-term versus short-term cost for buying instead of renting?

Dr. Richard Green:

In the short term, renting is almost always cheaper than buying. And the simple reason for that is there are costs involved in buying and costs involved in selling that you don't incur when you are a renter. There's a real estate commission that's paid when people buy or sell. Now, usually, the seller pays that, but it effectively gets built into the price. So the buyer and the seller are splitting that cost, and that's 3% on each side of the price of the house right there.

There are fees you're going to pay when you get a mortgage. And again, they could be rolled up into the mortgage, and so paid as interest. But one way or another, that's a cost you're going to have to bear. There are some states that have what are called transfer taxes. Sometimes the buyer pays them, sometimes the seller pays them. You have to get something called title insurance, which can be quite expensive depending on where you are. And again, it depends on where you live as to whether the buyer pays for it or the seller pays for it.

Whereas when you're a renter, you sign a contract. You may have to put down a deposit, but it should be refunded to you if you don't trash your place. And you pay your rent and that's it. And so, you don't have to what we call amortize those costs over a long period of time. And so, if you're going to live in a place for less than a couple of years, no matter where you are, you're almost always better off renting than buying.

Serena Allen:

Interesting. Personally, I've always lived in a rented place just besides when I live with my parents. Since I've come to college, I've rented just because you move every once in a while, and your home for the summers, and this and that. But if I was looking into buying a home, I mean, most of those things that you just said are just way over my head. And I'm sure, for many of our viewers, or many of our listeners, that it's also terms that they're rather unfamiliar with. So what kind of policies are in place to help people buy their first home to make this seem a little bit less daunting if they're interested?

Dr. Richard Green:

Yeah. What you're getting at is an issue called disclosure. How do you let people actually know what they're paying for something? And so, when you buy a large screen TV and you buy it with cash, you know what you're paying for it. If the price tag at Costco says $899, it's $899 plus sales tax and that's it, you're done. Whereas when you buy anything that involves financing, it becomes smart, complicated because inevitably there are costs to financing, and I listed some of those costs. And so, how do people know what they're really paying?

And so, I give the following advice. If you're going to buy a house and use mortgage to get it, go to at least two lenders, and preferably more than two, but a minimum of two, and ask them what is the interest rate that you are going to pay on a zero cost loan. Okay, which means that you don't pay anything upfront for buying the house. Okay. Now, if you do that, you're going to get charged a higher rate than if you pay for those costs upfront. You either pay it now or you pay it later. But that way you can make an apples to apples comparison.

You can go to bank A and bank B, and if you ask what does it cost me to get a zero cost loan at A versus B, you could compare the rates of those two loans, assuming they're both 30-year fixed-rate mortgages. And you know the one with the lower rate is the better deal. So that's one way you can navigate it. The other thing you could say, it's a similar sort of thing, is you look around at interest rates. It's easy to find online what mortgage interest rates are, but they vary a lot. You call up a bank and you say something like, "I want a mortgage with a three and a half percent rate. What's it going to cost me? What's the total upfront cost of doing that?" And again, you call more than one lender and you get that upfront cost.

You want them to hold the rate constant and find out what the upfront cost is going to be, and take the cheaper one. Alternatively, say, "I want no costs upfront," and take the lower rate. And that's really the only way you can do it and know you're getting the best deal. Now, that said, nobody actually knows exactly what their loan is going to cost because to some extent, it depends on how long you live in the house. Imagine you decide you want a lower rate and you'd rather pay costs upfront. So it costs you $4,000 to buy your house, and this is beyond the cost of the house. Okay. If you live in that house for two years and then sell it, that's $2,000 a year that's cost you.

But if you live in the house for 15 years, that's less than $300 a year it's cost you. So that impact on your cost varies a lot depending on how long you live in the place, which is why personally I always get zero cost loans because that way I really do know what everything is costing me. But there are people who say they have a lot of cash now, but they want to know that their payments are affordable. But for some people, let's say they got a gift from a relative, that can pay their upfront costs and they find that they are more comfortable with a lower payment, that's fine too. Although, to me actually, for a whole host of reasons, I would just always do the zero cost.

Get your best zero cost deal and go with that because nine times out of 10 it's going to cost you less money if you go that way than any other way that you go. I just can't promise it's 10 times out of 10 that that's true.

Serena Allen:

Right. Just fairly close. Interesting. So what are some of the real estate vocabulary words, if you will, that seem to make buying a home so daunting? What are the typical terms that we hear thrown out that people my age and high school students may not have any idea what they mean?

Dr. Richard Green:

The big ones are loan-to-value ratio, and that's just how big the loan is relative to the cost of the house you buy. So suppose you buy a house, let's leave California and go to the rest of the country for a second. Suppose you spend $200,000 on your first house, which if you leave California-

Serena Allen:

It's a great house.

Dr. Richard Green:

It's a good house, yeah. I mean, unless you get to DC, or Boston, or New York. But if you're basically anywhere between Vegas and Pittsburgh, 200,000 is plenty to spend on a house.

Serena Allen:

You're doing well.

Dr. Richard Green:

So if you get an 80% loan-to-value ratio loan, that means you're getting $160,000 mortgage and you need to have a $40,000 down payment. Okay? Now, the size of the down payment is important because it determines effectively the cost you're going to pay on the loan. If you have at least 20% down on your loan, you don't have to pay for something called mortgage insurance. There are two ways you can buy mortgage insurance. One is through the federal government through something called the FHA program. The other is through the private sector.

But either way, if you get mortgage insurance, you have to pay a premium, which, the way to think about it is money that you're spending on top of the cost of the mortgage. So if you have a three and a half percent mortgage, but you have a mortgage insurance premium of 85 basis points, and one basis point is one-one-hundredth of a percent, you're not really paying 3.5%, you're paying 4.35%. If you can get under 80%, you don't have to pay for that insurance. So that's why a 20% down payment will automatically make the loan cheaper than if you have a smaller down payment than that. So an LTV of 80% or less is a desirable thing to do.

Now, the thing is, while this is feasible for many people in most of the country, in California, in New York, in Seattle, it's very difficult for people to save that much money, so that's a separate issue. But the other thing is, as your LTV gets lower, the interest rate you're going to pay... You'll be done with mortgage insurance if you're under 80, but if you're at 70, you'll pay a lower mortgage rate than if you're at 80 because you're less risky. So if you want to get the best priced mortgage, you really want 25 to 30% down, which I know, again, is very daunting for people. But there is a price difference depending on LTV.

Second thing is FICO, and I'm sure you know what FICO is, and most of your listeners or many of them do. That's a score that's assigned to you to determine your credit worthiness.

Serena Allen:

Oh, okay.

Dr. Richard Green:

The way to think about it is, the maximum your score can be is 850. If you have a FICO of 780 or above, you're in the best quality credit category, which, again, means your credit is cheaper. You should be able to get the best price. And then, as that score falls, I mean, above 720, it's still good. You could still get a good deal. Below 720, now you're getting into a different category. Credit gets more expensive, considerably more expensive. Then below 680, it gets really, really more expensive. And below 580, basically, you're not going to get a mortgage. So knowing what your FICO score is is really important.

The key element of having a good FICO score is to actually have a credit card and pay it off every month. So show that you know how to manage credit well. You don't want to run a balance, but you also don't want to pay cash for everything because if you do that... And by the way, your ATM card is cash. If you do that, you're not establishing a history of managing credit well. And one could argue this is not the best way to manage credit worthiness. In fact, I make that argument, but that is the reality of the world right now.

Then the third thing is debt-to-income ratio. And what that is is about all of your long-term debts divided by your income. So it's things like what do you pay every month on your student loan, what do you pay every month on your car payment, what would you pay every month on your mortgage, and what is the ratio of that to your income? And generally, if your what's called DTI or debt-to-income ratio is below 43%, you can be eligible for a good loan. But if it goes above that, it becomes much more difficult.

Serena Allen:

So if you're then in the situation where your credit isn't high enough or your debt-to-income is... Would that be too high-

Dr. Richard Green:

Yeah, too high.

Serena Allen:

...is undesirable?

Dr. Richard Green:

Yeah.

Serena Allen:

Then would you then be forced to look into renting options instead while you better those?

Dr. Richard Green:

Pretty much. Yes.

Serena Allen:

Okay. Interesting. You also briefly mentioned an FHA loan. Could you touch a little bit on what that is?

Dr. Richard Green:

Yeah, so the FHA is a program that was created during the Great Depression to allow people to buy houses with lower down payments and to buy houses with fixed rate mortgages on them. Fixed rate mortgages were very unusual at the time. Now, 90% of loans are fixed rate so it's not just FHA. But I think what allowed for the development of that product at the time, it was a 15-year fixed-rate mortgage. And what FHA allows borrowers to do is get credit with down payments as low as 3%. And at the same time, the thing that makes FHA different from Fannie Mae and Freddie Mac loans, which is where the bulk of mortgage lending comes from, is that there's no price discrimination. So either you qualify for an FHA loan or you don't. If you get it, you get the same price for that loan as everybody else.

Whereas with Fannie and Freddie, it's what I was saying to you before. As your FICO goes down, your cost goes up. As your LTV goes up, your cost goes up. As your DTI goes up, your cost goes up. If you were to buy a condo with Fannie or Freddie, you're going to pay a higher rate than if you buy a single family house, etc. Whereas FHA, basically the price is the same for everyone. Now, the Trump administration has made noises about ending that. We'll see if that happens.

Serena Allen:

Oh, interesting. And for FHA, is that only for your first home purchase?

Dr. Richard Green:

That was how it was originally set up. But no, you can use FHA multiple times. You cannot own two houses.

Serena Allen:

Oh, okay. So it would be if you are transitioning to a new home or something, but not for buying both houses.

Dr. Richard Green:

Oh no, no. And you could sell an old house and buy a new house with FHA. That's a really good question, exactly how that transition works. The point is you can have only one FHA loan at a time.

Serena Allen:

Oh, okay. That makes sense.

Dr. Richard Green:

It's thought of as a first-time home buyer program because it's the way people can get in the market with a low down payment. The problem with FHA as well, as I said, the price is the same for everybody. They're still kind of expensive relative to the best credit. So if you can go in the other direction, you're going to go in the other direction. And one of the things we're seeing is, for borrowers with FICO scores of 680 or less, that's almost an all FHA market now because Fannie and Freddie have become so expensive in that market. But once you're above 680 and certainly above 720, you're going to prefer to do a Fannie, Freddie loan because it's cheaper.

Serena Allen:

Interesting. So really just depends on what your credit is.

Dr. Richard Green:

Right. Well and how big... The thing is, if you're buying a second house, usually you're taking equity from your first house, so you have a big down payment, which means that Fannie, Freddie are going to want your loan. They love, again, high down payment loans until it'll be cheaper.

Serena Allen:

Interesting. How might home ownership differ from state to state?

Dr. Richard Green:

Oh, it varies a lot. California and Hawaii have the lowest home ownership rates in the country.

Serena Allen:

Really?

Dr. Richard Green:

I believe West Virginia has the highest, and there are a couple of reasons for that. One obviously is cost. Housing is very expensive in California. The other thing in California is, once people buy a house, they never move because we have this law called proposition 13, which puts a cap on their property taxes so long as they don't move. And if they were to move, then their property taxes go up. And so, in California we have people saying, "You know what, if I want a bigger house, I'm just going to add an extra bedroom to it."

Then you do have to pay property taxes on the extra bedroom, but the rest of your house stays at that low property tax rate. Whereas if you sell one house and move to another, your property tax is going to go up quite a lot. And so, the amount of houses available for sale on the market in California is very low. And that's really problematic.

Serena Allen:

Definitely.

Dr. Richard Green:

It's one of several reasons why housing is so expensive here. Hawaii, again, very expensive state, and a very low-income state. West Virginia has high home ownership rate for a couple of reasons. One is it's very rural and it's hard to organize a rental sector in rural areas. Because think about it, if you're a landlord, if you want to be a good landlord, and as much as landlords get grief and some of them should, most actually want to do their jobs pretty well. And that means things like if you need a new toilet, you get a new toilet right away.

Where you have density, it's easier to have a property management team to take care of problems, whereas when stuff is really spread out, if the nearest plumber is 40 miles away, it's really hard to take care of your tenants’ problems. Even if you have the best intentions as a landlord, there isn't a plumber right nearby. There isn't an electrician right nearby. And so, we tend to see urban areas are more rental areas and rural areas are more home-owning areas.

The other thing about West Virginia is it's just very old demographically. And so, as people age, they tend to be homeowners. And basically, anyone who's young in West Virginia leaves West Virginia because there's no... I mean, I'm not trying to be snarky. There isn't economic opportunity there. And so, the bulk of your renters are young people. California is demographically a young state, which is another reason why we have a high rate of rental. Although, again, we have a lower ownership rate than we "should" given our demographic distribution. But part of it is just that.

Then the final thing in West Virginia is that people stay in these homes forever because the values are so low, they can't cash out. Let's not think about West Virginia because that's extreme, and let's not think about California because that's extreme. But suppose you've had a career in Dallas and you've done well in Dallas, and you have a house that’s worth 4 or 500,000, and you've paid off your mortgage. For retiring, what you may do is sell your house and move to a place in Florida that's even less expensive, and use that basically equity from your house to live at a higher standard of living somewhere else.

Whereas in Virginia, West Virginia where houses are worth 40, 50,000, you can't use it for that purpose. So you have this just very sort of stuck state with lots of homeowners there. An interesting thing, if you look at or did a scatterplot of unemployment, or income, or education levels, any measure of prosperity against home ownership rate, it wouldn't be what people would think, which is that richer places would have higher home ownership rates.

Serena Allen:

Interesting. I wasn't aware that there was such, well, one, such an emphasis in selling your home before retiring, and also that locking properties both in California with proposition 13, and in other more rural states with just not being able to cash out at the same level.

Dr. Richard Green:

Yeah. I mean, not that many people do it, but enough do it that it matters.

Serena Allen:

Definitely. I have heard a lot about I think what you were just touching on with more affluent areas, people would assume to have more home ownership. And a lot of people believe that there is some tie between home ownership and equity or systematic racism in general. I was wondering how you understand home ownership relates to concerns with equity and systematic racism?

Dr. Richard Green:

Yeah, I think it has been a key component of the inequity in wealth in the US. It may be the most important component of that. I talked about the FHA program before. The FHA program did many great things. It also did a really horrible thing in that it institutionalized red lining.

Serena Allen:

Can you define red lining for those that don't know-

Dr. Richard Green:

Yeah, I was going to get into that. When FHA underwriting standards were developed, and again, go back to the 1930s for this, there are always going to be underwriting standards. So lenders are only going to want to tolerate a certain amount of risk. Some risk is fine. If you're only making loans that never default, you're not doing your job well, actually. But you don't want to be seeing 20, 30, 40% of your loans go into default. That's bad for everyone. We saw that movie in fact, 12 years ago in 2008 with the subprime crisis. So there are absolutely legitimate reasons for underwriting.

But what happened in the 1930s was neighborhood was used as a proxy for risk. And the riskiness of a neighborhood was not determined by data or analytics, but by people's perception of racial composition. So Northern European neighborhoods, ethnically Northern European neighborhoods, were ranked as the best quality neighborhoods. And so, they saw credit flow to them quite easily. There were a series of categories. It was broken down finally enough that Northern Italian and Southern Italian were separate categories.

Serena Allen:

Wow.

Dr. Richard Green:

And Northern Italians were considered better underwriting risks than Southern Italians were. At the bottom of this perceived risk spectrum, now I want to remind listeners there was no analytics behind this, second from the bottom were African-American neighborhoods, and the bottom were Mexican neighborhoods. Effectively what that meant was that White folks could get credit, which allowed them to have what's called a levered investment, and I'll talk about that in a second, whereas black folks and Latino folks couldn't.

Go online. Google red lining map, St. Louis red lining map, Philadelphia, and you could see what these maps look like. And it's called red lining because the places that were shaded in red were, so like in St Louis, the Northwestern part of St. Louis was shaded in red. Okay, that's the place that was a no-go. And then there were places that were shaded in green. Those were places that lenders were encouraged to lend. And then yellow was sort of in between.

The benefit of leverage is extraordinary. So suppose you can borrow money at 4% a year, and you buy an asset that allows you to, one, not pay rent, and two, get some appreciation. Let's say that the rent payment that you would make if you weren't a homeowner would also be 4% a year, but your house appreciates 3% a year. So that's kind of modest. That's actually what houses do over the long run in places other than California. You're borrowing at four in order to make money at seven. So after a year, you've increased your wealth in that house by 3% having done nothing.

Actually better than that, you've increased your wealth more than that. So let's again go back to... Let's do an easy example. Suppose you buy $100,000 house with a $20,000 down payment. Okay. After a year, you've basically made 3%. Okay, but that's $3,000. But that's not on 100,000, that's on 20,000. You've invested 20, you've made three. That's a 15% return in one year.

Serena Allen:

Wow.

Dr. Richard Green:

Okay? Now do that over and over and over again. It allows people who had fairly small equity interests in their house to build a lot of wealth very quickly, even if their house just appreciated modestly. We're not talking about big changes. White folks got access to this, Black folks didn't, Latino folks didn't. And so, that all by itself, and remember this was government sanctioned discrimination in where credit went, all by itself explained an enormous amount of disparity in wealth between White folks and Black folks.

Serena Allen:

When did this go on till?

Dr. Richard Green:

We had fair lending laws come into existence in the 1960s.

Serena Allen:

Wow, okay.

Dr. Richard Green:

There were lawsuits going on well into the 1970s and 1980s. I think there is still certainly lending practices that result in disparate impact. We can talk about that if you want. Even to this day, it's clearly not as bad as it used to be, but it's still... I mean, it's not remotely as bad as it used to be. But you know what? It's still bad. Let's go back to the subprime crisis. What we know is people of color disproportionately, who are eligible for the best quality credit, so the cheapest loans available, were steered into subprime loans.

Serena Allen:

Oh, interesting.

Dr. Richard Green:

Let's go back to our example. Let's think about, you're eligible to get a 4% mortgage, but you wind up paying seven because somebody sells you into it. Seven isn't even the worst of them, but I'm just going to use seven. What's happened to your profit that I talked about before? It's disappeared, so you're not building wealth at all. You're maintaining what you had except that if house prices collapse, then you lose even that.

Serena Allen:

That was in the 2008...

Dr. Richard Green:

Yes. Yeah. And so, we saw this just tremendous elimination of wealth among African-Americans and Latinos in 2008/2009/2010-

Serena Allen:

Wow.

Dr. Richard Green:

In the aftermath of the subprime crisis.

Serena Allen:

I mean, it's just shocking that if you can make so much money off of home ownership that we see, we can just very clearly then I think link a lot of the problems that create this wealth gap, and the socioeconomic differences between different racial groups in America could easily, I feel like, be combated with different real estate policies.

Dr. Richard Green:

Yeah. I mean, so since I studied real estate and housing, maybe it's egoistic on my part to say it's the most important contributor to the disparity in wealth, but I think it is the most important contributor to disparity and wealth.

Serena Allen:

Right. Definitely. Actually, I'd have to agree with you on that. So let's go away from it a little bit for these concerns with equity that comes with real estate and disparities, and talk more about some of our listeners. Let's say that they're planning on moving out in a few months, maybe after high school graduations, what steps do they need to take in order to secure housing for themselves?

Dr. Richard Green:

Yeah, so, again, right now, we're in a world where well-managed buildings are underwriting tenants the way mortgage lenders underwrite borrowers. So you really want to have a clean credit history. So don't spend money you don't have. Because you're going to get a job, we hope if you graduate from USC, you're going to get a pretty good job. I don't know if people who are non USC people listen to this, but if you graduate from any of the colleges and universities around Southern California, in this economy, you should get a good job. You should get a job that's paying you 40, 50,000 dollars a year, something like that.

Can you afford an apartment by yourself? That's probably problematic because at 50K, you can afford like 1,250 a month. But if you find a roommate, okay, who's making the same amount, 2,500 a month, there are lots of two-bedroom apartments around Los Angeles for 2,500 a month. You want to find, in my view, a unit that is professionally managed as opposed to a mom and pop for a couple of simple reasons. First of all, that plumber, that electrician that you're inevitably going to need at some point, they just have better access to that. So getting your problems fixed quickly is more likely to happen.

And so, check the reputation, check the better business bureaus. But there really is a wide range of quality of landlords. Bad landlords are horrible. I mean, they will do everything to suck all the money out of you that they can without doing anything to make your place nice. Good landlords actually see the world as a repeated game and want you, when you leave your apartment, to say to a friend, "Yeah, you want to move in here." And so they'll actually take reasonably good care of you. It's not that they're cheap, they're not. But check out who the landlord is. I guess that's what I'm saying.

Go in with clean credit. Bring in your contract from your first job, and you should be good to go. But I'm not going to kid you. If you stay in California, it's going to be painful. It's going to take you a while. The deal right now is the new stuff in downtown LA because they built too much of it and it's too nice. So if you can find a roommate, again, two people with college graduate salaries should be able to swing that pretty well.

Serena Allen:

Let's say you're not somebody who graduated from college, what would your options be for...

Dr. Richard Green:

It becomes much harder. Yeah, the typical person in LA who makes a wage of about $22 an hour with a family, they don't have great options out there. Thinking about that $22 an hour person is, you're not even going to get on a section 8 waiting list, let alone... I mean, the programs out there to help people, section 8, low-income housing tax credit projects, you're not getting those. So the interesting thing is, if you look at housing for very low-income people, there are two categories. People who get subsidies, and they're actually okay, and those that don't and they're not.

But the thing is, in that lowest income category, only about half of people who are eligible for subsidies get it. Then you go from very low income to low income. Almost none of those people get it. And so, we're at this point where... I mean, everybody is, and you put it very well. I started with college students because that's who I thought you were asking me about. If you are making 30, 40,000 dollars a year in Los Angeles, it's really hard because you're probably not going to be able to get a subsidy and it's just too expensive here. So the alternative is, what, you live in Lancaster.

Serena Allen:

That’s where I’m from, woo!

Dr. Richard Green:

Where the rent is affordable, but you have a 60-mile commute to work. And what does that 60 mile commute mean? That means, cars cost about 50 cents a mile to run, so 120 miles round trip is 60 bucks a day, 300 bucks a week, that's 1,200 bucks a month. That's not helping you.

Serena Allen:

Right. It comes out to about the same cost.

Dr. Richard Green:

All that much. So I don't know what advice I would give people in that circumstance. It's just really tough. One thing I'm very hopeful about, and I don't want to be too optimistic, but one of the nice things in LA right now is people can build up to two auxiliary dwelling units on their parcels. So there have been issues with that, with getting permission from DWP in order to get electricity hookups and so on. But those are pretty easy, pretty inexpensive units to build. They're very feasible to rent to people for 1,000, 1,200 bucks a month. As I would hope, we'll be rolling out thousands and thousands of these in the next couple of years. And so, I would say to people, look for these places.

We've seen a big surge of permits for them. So those are not traditional apartments, but they are an affordable option. We don't have remotely enough of them yet. I hope, as I said, we have a lot more of them coming out in the next few years. But other than that, it's just, I wish I could give a better answer than-

Serena Allen:

Right. It's definitely a difficult market, in Los Angeles, especially. I mean, I think a lot of people that are looking into affordable housing are just leaving California flat out.

Dr. Richard Green:

Well, and we see that in data. The interesting thing about California is that there's been the story that all the rich people are going to flee because our taxes are so high. But we're actually seeing the opposite happen. High-income people are moving into California-

Serena Allen:

Interesting.

Dr. Richard Green:

And low-income people are moving out. That's absolutely happening. The most recent year we had data, California had a net loss of about 57,000 people.

Serena Allen:

Wow.

Dr. Richard Green:

But we had a net gamut of people who made a hundred thousand dollars a year in income or more.

Serena Allen:

Oh wow.

Dr. Richard Green:

And it's what you're saying, is if you could afford to live here, I mean, I don't want to live anywhere else. I'm lucky, I can afford to live here. It's awesome. Ocean, mountains, weather, food.

Serena Allen:

Ideal for most people.

Dr. Richard Green:

Wonderful.

Serena Allen:

Right. Yeah.

Dr. Richard Green:

Yeah. I don't slip on the ice, it's great. But it's becoming harder and harder for people to afford. And there are people who say, "Well, if you can't afford it here, move to Phoenix, move to Vegas. There are jobs there. The housing is cheap." And that's true. My issue with that is there are often very good reasons why people want to stay in a place, like they want to look out for their mom. They have networks. And I think to cavalier to at least say to people, "Give up all of the..." I mean, it's one thing for people to say, "I want to get out of this town. There's a place I want to go." I mean, I was once one of those people, and I think mobility is a great thing if you want to do it. But to say to people, "You can't live near your mom anymore," that really bothers me. And that basically is where we are as a state right now.

Serena Allen:

Right. That forced mobility that happens from almost a collapsing real estate market that's just unaffordable for the majority of people. I think that there's a good amount of people who are interested in eventually buying a house. I think for many Americans, that's part of the American dream, eventually owning a home for you and your family. And so, I want to turn to our question today from a high schooler. And this is coming from Olivia Moffitt from Bethesda Chevy Chase High School in Maryland. And she wants to know, since the state of the economy plays a key role in determining the state of the housing market, how are young buyers able to predict whether the market will stay a buyer's market rather than a sellers market, or simply when is it the right time to buy?

Dr. Richard Green:

So, Olivia, I know Bethesda well. I lived there for six years.

Serena Allen:

Oh wow.

Dr. Richard Green:

And it's an expensive housing market too. You never really know. I thought prices were too frothy here. Prices did, last year, increase starts to weaken, but they didn't decline. Actually, in the Bay Area, in a few places, they did. But now they've come roaring back again. So it's really hard to know. I mean, in general, what I would say is that if it costs a lot more money to own a house than to rent, then owning might not be the best idea. But if it's only a little more money, or they're more or less even, the cost of renting and owning... Now I'm not talking about those other costs. I'm not talking about the upfront costs. I'm talking about your monthly cost of owning versus your monthly cost of renting. If they're not that different from each other, it's almost always a good time to buy.

If it's a lot more expensive to make your monthly payments on a house, you pay your property tax, and so on to rent, that's probably a sign that it's better to rent. But here's the thing. I think people should look at houses, not as investments, having talked about their wealth building impact, and that's real, but more than anything else as a place to live. So here are the elements. If you like the house, if it's at a place you want to live, you're going to live there at least five years, and you can afford it, buy it. And don't worry about the ups and downs.

It's when you can't afford it that you have to worry about the ups and downs. Or if you don't like it and you want to move out. It doesn't make any sense to me to buy a house that you don't like. But if you could pass all four of those tests, then I say don't worry about it and buy it. And again, here is where California, and Washington DC, and New York, and Boston, and Seattle, which are, granted, really important places, but it's not the country. For two thirds of this country, people making 50, 60,000 dollars a year in income, can't afford a house.

Then the key is, do you like it? Do you like where it is? Are you going to live there five years? So the reason five years, and that's a bit of an arbitrary number, as I said earlier, if you're going to live there two years, there's almost no way you pay that cost of buying and selling in such a short period of time.

Serena Allen:

Interesting. I've heard some people say recently... I took a real estate class this past year, and I heard a couple people in the class say that it makes more sense... And I think this is just a theory of theirs. I'm just kind of curious about your opinion on it, that it makes more sense almost to use the tuition that you would pay for college to buy a house before coming to college. What are your thoughts on that?

Dr. Richard Green:

Well, of course, I'm going to say that USC tuition is a great deal. So let's leave USC out of it for a second. I think it depends a lot on the college and the housing market. I will say, if you go to a Cal State school, you're going to get a fabulous return on your investment. It's pretty inexpensive to go and you're going to get a good job. It's not that getting a job is the only reason to go to school. I actually don't think that. I think it's a really important reason, but I think there are others.

But if you go to CSUN, or you go to Cal Poly Pomona, or you go to Cal State LA, you're going to get a really good education at a really low cost, and it's going to be easy for you to pay that back. And the gap in your income as a result of doing that as opposed to not doing it. I can't see a scenario where buying a house is a better deal for you than that. I think if you go to schools that have great networks and great reputations like us, like Caltech, like Stanford, as expensive as they are, yeah, your return on that's going to still be better than buying a house.

If you're looking at a private college that most people haven't heard of, yeah, that's probably... And you're looking at a housing market that's not clearly overheated, there may be a point to that. But I'm going to say this. I think part of the bad rap college gets at the moment as a financial investment relates to the proprietary colleges that have opened. So if you look at people who go to a for-profit college, I won't name names, but we know what they are, and particularly those that don't finish, they wind up making incomes that are lower than had they not gone to that place at all.

Serena Allen:

Oh wow.

Dr. Richard Green:

If you look at where the student loan defaults come from, it's overwhelmingly from those sorts of institutions. And so, yeah, buying real estate is a much better idea than doing that.

Serena Allen:

It just depends on the individual situation, I guess-

Dr. Richard Green:

Yeah.

Serena Allen:

... then, and exactly what university you're looking at there. Interesting. I want to look back more at some of the budgeting and federally how this plays in. How much of the federal budget is dedicated to housing assistance, be it rental or mortgage assistance?

Dr. Richard Green:

Yeah. So the largest direct mortgage assistance program is section 8, and that's about a $20-billion-a-year program. We do a program called the Low Income Housing Tax Credit program that builds 100,000 units a year, a little over that, and they're spending like 300K a unit. That's like 30 billion if I got my zeros right. Yeah, that's about right. Yeah. Then we have the mortgage interest deduction, and it used to be the mortgage interest deduction would cost us in the neighborhood of 80 to 90 trillion dollars a year. Excuse me, billion dollars a year, not trillion.

But with the 2017 Tax Cut Job Act, basically, the vast majority of the benefit of the mortgage interest deduction went away. Now it's even more targeted to high-income people than before, so that's not great. But the total number is much lower. But what that is, I don't know yet. But my guess is it's in the neighborhood now of 20 to 30 billion instead of 80 billion. So you add all that up, it's somewhere in the neighborhood of a hundred billion. And then you have a little less than that.

Then you have this weird thing called non-taxation of imputed rent, which is... And figuring out this number is very difficult, but most people put it at over a hundred billion. The idea is this. When you own a house, you're basically renting a house to yourself and you're not paying tax on the rent. So let's say you and I own houses free and clear, so there are no mortgages involved, and you decide to rent my house and I decide to rent yours. We're in exactly the same situation but now I'm collecting rent from you. I have to pay income tax on it. You're collecting rent from me, you have to pay income tax on it. Whereas if we just stay in our own houses, we don't pay taxes. So that's called non taxation of imputed rent.

There are a couple of countries around the world. Israel was one. I think maybe Australia was one that tried to do it and it got people so upset, they didn't do it. But it really is a kind of income to you that you're not taxed on. And as I said, most people compute that's a hundred billion dollars. Okay. So that's a grand total of something under $200 billion. Much of it not particularly well directed. And then, the US economy is $20 trillion. So that means 1% of the US economy is spent on federal government assistance to housing. If you look at the share that's going to low-income people, it's about a quarter of 1% of the economy is going to help house poor people.

Serena Allen:

Interesting. That's much lower than-

Dr. Richard Green:

Well, people always think welfare programs are more expensive than they actually are, or social welfare programs.

Serena Allen:

So the other 75% of that 1% then, where is that from?

Dr. Richard Green:

That's the mortgage interest deduction which goes down almost entirely to people making six-figure incomes or above, and the non taxation of imputed rent. Okay. Some of that actually goes to lower income people, but that's going to still be a fairly small amount of that.

Serena Allen:

So the majority of the programs that is federally funded for housing goes towards upper income, upper-class citizens.

Dr. Richard Green:

Yes, that's correct.

Serena Allen:

Wow, that's very interesting. I had no idea that that even existed. I know that housing is... Although it's hotly debated in, and considering, I guess, a partisan issue, housing is at the moment of free market, how much does the government regulate housing prices, and what's the effect of that?

Dr. Richard Green:

Well, so far as I know, government doesn't regulate housing prices at all. It does regulate rent, but that's at the local level. Until recently, both Oregon and California have statewide rent control ordinances. In California, landlords can't raise rent more than the increase in the consumer price index plus 5%. So for all intents and purposes, that means about 8% a year right now, which in the vast majority of cases, doesn't even matter. And in Oregon, I think it's CPI plus seven. San Francisco, Oakland, Los Angeles, San Jose, Los Angeles County, Santa Monica, Beverly Hills, West Hollywood, I'm probably missing a couple of places, have local rent control that limits rent increases to considerably less than that for buildings that were built prior to, I believe it's 1978.

That's because of a set of California laws that limits what local governments can actually do to regulate rent. Berkeley is another place that has regulated rent. New York City has a very strict... It was just made much stricter rent control ordinance. I'm sure there are scattered other places in the country too, but those are the best known places with rent.

Serena Allen:

So places mostly where the rent is already very high-

Dr. Richard Green:

Yes.

Serena Allen:

... that we kind of talked about earlier, the government usually steps in and does some of the regulation there.

Dr. Richard Green:

Well, I wouldn't even say usually, but yes, it will step in.

Serena Allen:

It's started to.

Dr. Richard Green:

Yeah. Yeah. Yeah.

Serena Allen:

Okay. Interesting. So my final question here is something that we're ending the podcast on for every episode, but what is your opinion on how we could better approach citizens owning their homes from a non partisan lens to better allocate American tax dollars? And particularly keeping in mind the role that this has for equity and the wealth gap in our country.

Dr. Richard Green:

I think one of the real issues people have in this country is they fear multi-family housing. When they think of the multi-family housing, they think of high-rises, and they don't want high-rises in their neighborhood. And I understand that. I don't agree with it, but I understand it. I can live with high-rises, but that's fine. But multi-family doesn't have to mean big, tall buildings. If we could just have, say, along our boulevards in Los Angeles, six-story buildings, imagine Venice Boulevard becoming like a Parisian Boulevard, I think it could be quite lovely. We could substantially increase the amount of housing we have in a way that I don't think would be disruptive to neighborhood character.

I don't think increasing housing supply by itself solves the problem, but I don't think we could solve the problem if we don't increase housing supply. And so, just allaying fears, and in Minneapolis, they've done this. They've done away with single-family zoning in Minneapolis and I'm very impressed with that. Don't fear affordable housing. There's no evidence that it does harm. Don't fear a well-managed homeless shelter in your neighborhood. Keep being well managed. But still, it is such a cost saving thing to do to make sure people have a place to go at night. That we should all get on board with that. Again, I wouldn't ask any neighborhood to take five homeless shelters, but every neighborhood needs to do its part in this regard.

Serena Allen:

Definitely. I think, yeah, homelessness is a huge problem and we touch on that in another one of our episodes. Why do we find that so many Americans are so hesitant to buy homes? And particularly in our generation, they're still not wanting and not interested in... Or not that they're not interested, but not pursuing buying a home, if that makes sense.

Dr. Richard Green:

Marriage.

Serena Allen:

Really?

Dr. Richard Green:

The number one predictor of home buying is marriage. And I think the reason for that is, when you're not married, you want to be footloose. And as I said before, buying a house is making a commitment. It's a financial commitment that, again, is a costly one if you don't stick around for a while. In every OECD country, every rich country in the world, marriage rates have plummeted. And so, I think we are in an environment now where people stay single much longer. They may stay single forever. And that, by itself, has a very large negative impact on home ownership.

One of the interesting things to me, the other thing we see all around the world, is women are outstripping men in terms of education, and well-educated women are not interested in marrying men who are not well educated. And so, you have this basically mismatch in the marriage market right now that I think is driving a whole bunch of things. Amongst the most important is home owning.

Serena Allen:

Interesting. Do you think there's a way that the government could incentivize home ownership despite these changes in the potential buyers market?

Dr. Richard Green:

Yeah. I don't know that that's a good idea. I think we want to make sure that people who have shown themselves to be credit worthy, and this is a whole other conversation. But I think there are credit-worthy immigrants, credit-worthy people of color who, given current underwriting techniques are not shown to be credit worthy. And that's something I would really like to fix. And so, having the government make the lending market a fairer market is something that I think we need to do. But there's nothing wrong with renting, and as I said, if you want to move around a lot.

And as I said, just because people aren't getting married doesn't mean they don't want to get married. It's that they haven't found the right person. And so, let's say I'm somebody in Denver and I don't like that dating market, I might want the chance to move to Austin to check out that dating market. And if that's how I'm looking at the world, I really don't want to be a homeowner. And there's nothing wrong with that.

Serena Allen:

You just heard Dr. Richard Green and I discuss the differences of renting and buying. Thanks for listening. Dr. Green made great points about securing housing and how the implications of home ownership influence systematic inequality. In our conversation, we also mentioned how the cost of transportation from where you live affects your overall cost of living, as well as the importance of building good credit from a young age.

I want to inform listeners of two great resources I've linked on our website, bedrosian.usc.edu/paycheck under this episode. One is called the H+T index, which tells you by zip code the actual cost of where you live after factoring in transportation. The second is an award-winning USC-based startup called Credit Starter, which can help you start building your credit if your parents are not able to assist you in doing so.

At bedrosian.usc.edu/paycheck, you can also learn more about what Dr. Green does and provide feedback or request topics for future episodes. The policy paycheck is sponsored by the Bedrosian Center, an applied research center with the Sol Price School of Public Policy at the University of Southern California. A big thank you to Aubrey Hicks, Executive Director of the Bedrosian Center, Corey Hedden and his team at the Price Video Services, and Jordan Williams, the Designer of the Policy Paycheck logo.