

Housing Tenure Choice and Risk in Spatial Equilibrium

Lorenz Küng

Recent decades have seen large changes in the wages, rents, and amenities in different locations. Using a spatial equilibrium model, we show that for a typical working-age household, the relative riskiness of owning versus renting housing depends crucially on the relative size of local productivity and amenity shocks, as well as the elasticity of supply of local housing. Guided by the model, we estimate risk processes underlying observed changes in wages and rents in different locations. Feeding these risk processes into a quantitative lifecycle model, we find that for households in locations with high housing supply elasticities, owning is safer than renting since owning hedges rent risk, consistent with Sinai and Souleles 2005. But for households in locations with low housing supply elasticities, renting is safer since rent risk hedges wage risk. Additional results based on the model imply that the welfare cost of sub-optimal housing tenure choices can be quite large. These results have important implications for government policies that affect housing tenure choices and the elasticity of supply of housing.