

EXECUTIVE SUMMARY

Sustaining the Mass Economy: Housing Costs, Population Dynamics, and Employment¹

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***Housing and the Economy in Greater Boston:
Trends, Impacts and Potential Responses***

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Executive Summary

We now know a number of basic facts about the Massachusetts economy. Employment is down by over 160,000 since 2001; the population has fallen for the past two years in a row, mostly as a result of rapidly rising out-migration to places like New Hampshire, Arizona, and North Carolina; and the loss of population is disproportionately among young workers and their families. We also know that housing prices skyrocketed by 144 percent in Greater Boston between 1995 and 2004 so that the median single family home sold for \$376,000 at the end of this period. Meanwhile, Class A apartment rents in the Boston metro region were the most expensive in the country, save those in New York City. Price and rents have stabilized in the past two years, but they remain among the highest in the country.

There is also a great deal of conjecture and an increasingly amount of survey data that link these phenomena together. Housing costs, it is argued, have risen to the point where they are forcing young workers and their families out-of-state while firms are failing to invest in new jobs in Massachusetts because it is increasingly difficult to find workers and when they are located, the firms need to pay premium wages to cover the high costs of living in the region. When asked in a recent *Boston Globe* poll of randomly selected former Massachusetts residents why they left the state, the answer came back that lack of employment opportunity followed by housing costs were the top reasons for leaving.

This report attempts to use statistical methods to test whether or not this conjecture about the adverse economic development effects of housing costs is valid and whether the survey responses of former state residents represent a real trend.

To do this, we assembled a new data set combining data on the cost of living in 385 metropolitan areas across the country, internal net migration data (between 2000 and 2004) on 304 of these Metropolitan Statistical Areas (MSAs), and the change in employment levels during this period for 245 of these. Through regression analysis, we were able to test for the cross-section effect of housing prices on the change in employment and in net migration rates.

Major Findings

(1) The new cost of living data available from the Economic Policy Institute's "Family Budget Calculator" reveals that *Greater Boston is now the single highest cost of living Metropolitan Statistical Area (MSA) in the nation with housing, health, and child care costs contributing to this ranking* (along with the federal and state taxes associated with the income and spending needed to pay for these items.) Other Massachusetts communities including the older industrial areas of Lawrence, Worcester, Springfield, and Pittsfield may be considered "depressed," but nonetheless are in the top decile nationwide in cost of living.

(2) *Greater Boston experienced a 4.9 percent decline in employment* between 2000 and 2004, among the highest in the country.

(3) *Greater Boston experienced internal net out-migration of 5.2 percent* between 2000 and 2004, again among the highest in the country.

(4) The *Employment Growth* regression analysis reveals that housing costs play a consistent and statistically significant role in explaining job loss, confirming the hypothesis that high housing costs are detrimental to job growth. The relationship is "non-linear." Those metro areas with the highest housing costs have experienced little

job growth and in most cases job loss. Those with the lowest housing costs have also seen little job growth, as low housing costs reflect a weak local economy and decreased demand for housing. Metro areas in the middle of the housing cost distribution have enjoyed the fastest growth in employment.

(5) *Northeast region metro areas experience the strongest relationship between housing costs and employment growth in the nation.* Within the region, jobs are moving from high cost metro areas like Boston to lower cost communities in New Hampshire and Rhode Island.

(6) The *Internal Migration* regression reveals a non-linear pattern similar to that for employment growth. High housing cost metro areas are losing population along with the lowest cost regions. Metro areas in the middle of the distribution are experiencing net in-migration.

(7) *Housing prices have a large independent impact on migration,* after controlling for job growth in a region. If employment growth was 2.5 percent in a typical metro area in the Northeast, and housing cost averaged \$600 per month, the MSA would experience an expected net *in*-migration of 1.30 percent. With the same job creation, but housing costs at Greater Boston's \$1,266, there would be net *out*-migration of 1.74 percent.

Thus, we have found concrete and powerful evidence that housing costs are an important, independent factor in economic development. If home prices and rents continue to rise in Massachusetts, we can expect to see further job erosion, more out-migration, and a real challenge to the Commonwealth's prosperity.

We need more housing supply to moderate housing price appreciation and special provisions to provide housing that is affordable to younger working families if we are to reverse these trends

(8) But why should Massachusetts homeowners who have seen their home values appreciate rapidly from restricted housing supply encourage more housing to be built? The answer lies in the final analysis provided in the report. By statistically fitting the relationship between housing vacancy rates and housing price appreciation, we found another “non-linearity.” At very low vacancy rates, below 1.5 to 2 percent, housing prices accelerate rapidly. With few homes on the market, sellers have an edge over buyers. At higher vacancy rates, prices begin to moderate and may even fall slightly as buyers begin to gain some bargaining power.

But as vacancy rates for single family homes rise much above 4 percent, housing prices begin to plummet. The sellers’ market turns into a buyers’ market. This has occurred in a number of communities throughout the country (including Boston, Worcester, and Springfield between 1988 and 1995). In the worst case scenario, prices can fall by 20 percent or more and not recover to their peaks for twelve years or more.

Normally, these housing depressions occur because of industrial decline in such deindustrialized areas like Detroit and Gary, Indiana. Yet the regression analysis carried out on employment growth and migration points to the possibility that if housing prices do not moderate as a result of greater housing supply, the resulting decrease in employment and increase in out-migration could lead to a housing price roller-coaster with housing prices tumbling in the process.

Paradoxical as it may seem, this suggests that a modest increase in housing supply now, leading to a moderation in housing price appreciation, could help inoculate homeowners against a much larger loss in their property values in the future.