BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF RESEARCH AND STATISTICS

Date: January 8, 2016

To: Federal Open Market Committee

From: David Wilcox, Division of Research and Statistics

Subject: Housing Valuation

--- For Information Only ---

The two attached memos describe some recent analysis on housing valuation by Board staff.

- The first memo, prepared by Steve Laufer, describes a model of housing valuation that the staff has used for about the past ten years. The key variable in this model is the ratio of aggregate house prices to aggregate rents; in this model, discrepancies from "fair" valuation are identified as deviations of this ratio from its long-run trend.
- The second memo, prepared by Raven Molloy, describes a new methodology that uses Zillow data on price-rent ratios for individual properties (rather than constructing the price-rent ratio from aggregates). In this case, discrepancies from "fair" valuation are identified as deviations of the median Zillow price-rent ratio from historical medians that are calculated from 1960-2000 Census data.

Both approaches suggest that housing is not currently overvalued by a large amount, and therefore imply a low probability of a large house price decline in the near-to-medium term. We see these two approaches as complementing one another well, and therefore plan to follow both going forward. For further information about either methodology, please contact Steve Laufer or Raven Molloy of the Board staff.