

EconoFact Chats: The Rising Costs of Housing

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I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein

Homeownership is part of the traditional American dream. But is this becoming little more than a dream for those who would like to purchase their first home, with steep increase in home prices and borrowing costs? Renters in many places do not have it much better with the monthly cost of an apartment becoming an ever larger proportion of people's paychecks. How much have housing prices risen relative to the cost of other goods and services? And where have housing price increases been especially pronounced? What are the sources of these rising housing costs? And what could be done to reduce this important part of people's cost of living? To address these, and other, questions, I'm pleased to welcome Professor Jeff Zabel of Tufts University. Jeff is co-editor of the Journal of Housing Economics, and on the Editorial Board of Real Estate Economics and the Journal of Regional Science and Urban Economics. Jeff, welcome to EconoFact Chats and thanks for joining me today.

Jeffrey Zabel

Thanks, Michael.

Michael Klein

So, let's start out with the broadest view. Over the past decades, what has happened to house prices in the United States as compared to the cost of other goods and services?

Jeffrey Zabel

If we look at real U.S. house prices since about 2000 there's been a lot of variation. As we know, there was a boom and a bust. And if you look at five year periods, the highest growth rate was between 2000 and 2005 – about 10% annually. The lowest was between 2005 and 2010 which was about -5% annually. And what's interesting is that the annual growth rates between 2015 and 2020, and 2020 and 2025 were almost identical, around 4%.

Michael Klein

So the 2005 to 2010 period, of course, was the financial crash in September of 2008, and we saw a big drop in housing prices. But housing prices have been increasing, you know, relatively

strongly across the country. But this is not just the price of a house when people are thinking about it, there are other costs as well, right?

Jeffrey Zabel

I think one of the significant increases that has been talked about is due to climate change, and we see that in California, where there's been a significant increase in homeowner insurance premiums, and actual companies pulling out of California because it's not affordable for them to provide these for houses. Homeowners in California, for example. I'll have more to say about how federal immigration policy and tariffs have affected the housing market in a bit.

Michael Klein

So you mentioned California, I imagine the aggregate numbers that you cited a minute ago mask some pretty big differences across cities and regions. Is that true?

Jeffrey Zabel

That's certainly true, and if you look recently, what's interesting is that places that have seen large increases are not what you would expect, and this is partially due to the consequences of COVID and remote learning. So for example, if you look at the last basically year and a half to two years, places like Detroit, Michigan and Rochester, New York, have seen positive growth rates. Places like Austin and Sarasota, which saw big increases up to that point, have actually seen declines. So there's actually been places that have seen housing declines in the last couple of years.

Michael Klein

So along with that, we also know that incomes differ across regions, and that can be pretty dramatically different as well. But is it the case that the differences in housing prices far outstrip the differences in incomes?

Jeffrey Zabel

So if we look at the ratio of median household income to house prices, which is a common statistic to look at affordability, since about 1990 this actually peaked in 1997, declined till about 2006 which was the peak of the housing bubble then, and then, has fallen till 2012. And when the market started to turn around, this has gotten larger. So it's quite a bit higher now in 2024-2025, than even when it was in 2006.

Michael Klein

So with the median household income to house prices, if that number is smaller than that means that housing is less affordable, right?

Jeffrey Zabel

That's right. It's actually fallen recently, so it's particularly unaffordable now.

Michael Klein

And are there places where this is especially true?

Jeffrey Zabel

What's interesting is that the American Enterprise Institute has generated an Affordability Index for the 60 largest metro areas between 2013 and 2023. The most affordable places may not surprise you that are Pittsburgh, Cleveland and Oklahoma City. What's interesting though is that the typically least affordable places like San Jose, San Francisco, and Los Angeles were actually some of the top metros to increase in that 10 year period in terms of affordability. That's because house prices have actually fallen in those areas recently.

Michael Klein

But they're still very expensive, right?

Jeffrey Zabel

They're still very expensive, relatively speaking. They're not like Pittsburgh, Cleveland or Oklahoma City, that's for sure.

Michael Klein

So Jeff, you've established the facts about the increasing unaffordability of housing. What are some of the possible sources of this problem?

Jeffrey Zabel

I think it's a well known fact at this point that it's related to housing supply, and there's kind of two reasons for this. One is this mortgage lockout effect that's occurring because a lot of homeowners who purchased their houses prior to the run up in interest rates in 2022 to combat inflation, had particularly low interest rates, myself included 2-3%. And now they're reluctant to sell their houses, because if they bought another house, they would have to take on a mortgage at a much higher rate. And they're also kind of discouraged from selling their houses because they're concerned about finding another house because of the limited supply of housing. So that's one reason.

Michael Klein

And that's kind of feeding in on itself, right? People don't want to sell houses because people are not selling houses.

Jeffrey Zabel

Exactly. But really the biggest effect is just the lack of new housing supply. If you look at the number of new housing starts per 1000 households per month between 1960 and 1990, it averaged about 22 per month. Since then, it's down to 12, and since 2010 it's down to about 9.5

and there's estimates of the housing gap because of this that range between 3 to 5 million houses across the US.

Michael Klein

So that's really striking. So there are 3 to 5 million houses that are not available, could be sold if they were there, and so people are left not being able to find a house, right?

Jeffrey Zabel

Correct.

Michael Klein

So why is there this restriction to supply?

Jeffrey Zabel

I think we're all familiar now with this so-called NIMBY-ism syndrome that's going on. "Not In My Backyard." And the reason for this is that control over zoning is at the local jurisdictional level, and it means that homeowners have kind of been able to force their local officials to restrict housing supply as a way of maintaining or increasing the value of their house, which is their biggest asset, and this is particularly true for construction of multifamily housing in the US. So two restrictions that are quite significant in terms of reducing supply is the minimum lot size restriction. So for example, parts of towns may restrict houses to be on at least an acre to be built. And I've done some work with my co-author, Maurice Dalton, where we looked at this in the greater Boston area, and showed that increasing minimum lot size restrictions had a significant impact on increasing house prices in the area. One thing that's become apparent is what's happening in Minneapolis, Oregon, California, is an attempt to limit the supply of 'single family only' zoning areas. The problem with this, it sounds nice, but it would take a long, long time before it would have any significant effect, because it requires a single family home being sold, a developer buying it, and, you know, putting in two or more houses in that space, and that will take a long time to fully play out.

Michael Klein

So I guess that's true for the minimum lot size as well. You can imagine, you know, if it was halved, you could then put two houses there, but it'd take a while to build that. Is the minimum lot size, is it really sort of quite big compared to what one would expect. I'm not sure what one would expect, but you know, you can look at other houses in the area, or you know what's been happening. Is that really done in a way that you think is consciously an effort to limit housing?

Jeffrey Zabel

I think it's certainly done in a way to limit housing. There was a study based on the national longitudinal land use surveys from 1994, 2003, and 2019. And if we think of, kind of, eight lots per acre as being a reasonable kind of size in terms of building a reasonable amount of housing supply, upward to 20% of jurisdictions had their highest residential zone that was less than eight per acre. So a lot of jurisdictions have zones that I mentioned one and even two or higher units per acre, or units per two or five acres. So that's not untypical anymore.

Michael Klein

So are there policies at the state or federal level that could allow for more multi family housing or a smaller minimum lot size.

Jeffrey Zabel

Well, it's right that we have to have policies that circumvent the local jurisdictions at the state or the federal level, and here in Massachusetts, we actually have two of these that I think could be very effective. The first one that was implemented a number of years ago is the Massachusetts 40B law, which requires every city and town in Massachusetts to have at least 10% affordable housing. And if they don't, developers can kind of circumvent the typical red tape that's put up in front of developers to build multifamily housing, and this is really the only source of multi-family housing in the suburbs around Greater Boston. The recent one, which was actually implemented by the Charlie Baker administration, which is called the Massachusetts Bay Transportation Authority Communities Law requires about half the towns to actually increase density in areas near transportation stops in the area. This is just starting to play out, but this could have a big effect on increasing density, building more multifamily housing around transportation hubs, which is exactly where we would want to build new housing as well.

Michael Klein

And I guess it's worth mentioning, Charlie Baker was the Republican governor of Massachusetts.

Jeffrey Zabel

That's exactly right. Yes.

Michael Klein

So, Jeff, earlier you mentioned interest rates, and I imagine that this is a pretty important component of housing affordability.

Jeffrey Zabel

Certainly as interest rates are now rising, you know, to 7% and now maybe down to 6% that's the case. So if you take a house that was purchased for \$420,000 with a 5% down payment, using a 30 month fixed rate mortgage, your monthly payment would go up by around \$500 if you

obtained a 7% interest rate versus a 5% interest rate, or that's about 25% increase. So that's pretty significant.

Michael Klein

I'm not going to check your math, I'll take it that you're right with that. President Trump has been pressuring the Fed to lower interest rates as a way of reducing mortgage rates. Would this actually happen?

Jeffrey Zabel

Well, one thing to understand is the Fed controls the Federal Funds Rate, which is a short term rate. And, 30 year fixed rate interest rates are long term rates. They're more closely tied to the 10 year T-bill than they are to the short term Fed Funds Rate. And so it could have some effect, but it's limited.

Michael Klein

And you know, one concern that we've talked about in other podcasts is that if there's more political intervention in the Fed, that could raise people's expectations of inflation, which would raise, especially longer maturity interest rates, like the 10 year bond rate, so pressuring the Fed might actually work against lowering mortgage interest rates, right?

Jeffrey Zabel

That's right, and it's got to remember, this has to come along with increase in supply, otherwise, lowering rates will increase demand and could actually increase prices as well.

Michael Klein

Right, because it's a package. It's not just the mortgage interest rate, but it's the price of the house too. And it's a very good point you're making that you know, the two are linked to each other. So another thing that President Trump has tried to do is he's directed the government sponsored enterprises Fannie Mae and Freddie Mac to purchase \$200 billion in mortgage backed securities. If you increase the demand for mortgage backed securities, the price rises, which means the interest rate falls. Is this likely to be effective in making housing more affordable, or is it also sort of the same problem you just pointed out that if interest rates are lower, there'll be greater demand?

Jeffrey Zabel

Yes, that's true. And there's been a few estimates that this could actually reduce interest rates by a quarter to a half percentage point. But again, if it doesn't come along with more housing supply, it could end up raising housing prices.

Michael Klein

Well, we've been talking about supply, but there's also the issue of demand. At Davos, last week, President Trump also called for a law to ban large institutional investors from buying up houses. How important have institutional investors been for driving up housing prices, and what would be the likely effect if this law in fact passed?

Jeffrey Zabel

First of all, I think right now, it's not about driving up prices, it's about reducing the number of single family homes that can be purchased by individual families because they're kind of own to rent, where they've been buying up properties and renting them out, which has reduced the number of properties that can be owned by single family households. Even still, they make up about 2 to 3% of the overall market. So it's not a large portion to begin with. There are some cities like Miami, Phoenix, Las Vegas, Houston, where it could be up to 20% so maybe it could have some impact there, but overall, they make up a very small part of the market anyways.

Michael Klein

Jeff, earlier, you alluded to how immigration policy and tariff policy could be raising housing prices. What are the channels through which that would occur?

Jeffrey Zabel

The first thing to understand is that there are reasons, for example, why construction materials costs have gone up, which people have talked about. If you look at the Producer Price Index for construction materials regularly relative to the CPI, it gradually increased until about 2020 and then has dramatically increased by the middle of 2022 and this was really due to the disruption in supply chains because of COVID. It's actually decreased gradually since then. It's still about 33% higher than the CPI compared to 2000, so I think that dramatic increase we saw initially was really a supply chain disruption versus effective tariffs, which may have still maintained this relatively high construction costs.

Michael Klein

And immigration?

Jeffrey Zabel

One thing about immigration, I mean, I think that there's a concern that a lot of the construction workers are immigrants, and by restricting immigration, we would restrict the supply of workers. In fact, construction industry wages have gone up recently, so that may be partially a result of that impact on immigration enforcement.

Michael Klein

So the higher wages will feed through to higher house prices, I imagine.

Jeffrey Zabel

And yes, higher housing costs. And as we've seen, there has been this drop in the building of new houses, and the developers are saying that it's just the increasing costs overall that are driving that.

Michael Klein

So some of our listeners who might have been thinking of buying their first home after you know these 20 minutes may now be considering renting instead. But have rents risen as well?

Jeffrey Zabel

Rents have generally risen similarly to house prices, but if you look at the cost of renting versus the cost of owning a home, until about 2021, between 2015 and 2021, it was the cost of owning if you consider things like taxes, insurance, maintenance costs, down payment...they were less than renting. But since then, in fact, it's now about \$400 a month more to own a home than to rent, and in some cities, that's more by \$1,000 or more. So in fact, this was a piece from The Economist saying that you could be better off renting right now than owning at this point, anyways.

Michael Klein

Well, along with a place to live, purchasing a house is an important financial decision, and for many people, their house is their biggest financial asset, as you mentioned before. And so sometimes having a house is viewed as a form of forced savings, and you have, in fact, an EconoFact memo about that. What advice would you give people, Jeff, about buying versus renting? Does it depend upon where you are? Are there general rules? Or is it really something that's hard to give sort of one answer to this.

Jeffrey Zabel

I think that trying to time the housing market is a bad idea. What this comes down to is being right about the future trajectory of housing prices, and that's very hard to predict. My advice is one should buy when you're financially prepared to do so, and to also have a nest egg so that if you have a negative financial shock for whatever reason, you're not at risk of getting behind in your payments, and potentially getting foreclosed on. So it's really an individual level, in terms of being prepared and being ready financially to buy a home.

Michael Klein

In the introduction, I mentioned that owning your own home is often seen as part of the American dream, and George W. Bush in particular advocated home ownership because he said it also fostered better community involvement. If, in fact, it was a national goal to increase home ownership, what policies do you think would actually help achieve that?

Jeffrey Zabel

First, what's interesting is to put US home ownership in context, across countries, across the world. We're in the middle. There are places like Germany and Switzerland where the home ownership rate is below 50%, and it's around 90% in China and Singapore. And there's reasons for these differentials...partially cultural, but it's also related to the structure of the mortgage market and the government involvement in the housing market in each of these countries. The US, at a federal level, has been involved in the US housing market since the Great Depression. And in fact, one of the largest subsidies a lot of people don't know, for homeowners, is that there's no implicit tax on owning a home, whereas landlords have to pay taxes on rents they receive. I would argue that there's a natural home ownership rate, which is about 65% in the United States. And we had a failed experiment where we tried to raise this to about 70%...you know, 2005 and then along came the housing bust. And the way that we did this was by relaxing supply constraints and made it easier for low income homeowners to get a mortgage through the subprime market. And when that market went bust, a lot of these new homeowners ended up not being able to pay their mortgage payments and were foreclosed upon. And we're back down to about 65% as it is now. And that may be our natural rate where we should be.

Michael Klein

So those were the so called ninja loans, no income, no job, but people were still getting loans and able to borrow a very high proportion of the cost of the house right?

Jeffrey Zabel

At high interest rates too.

Michael Klein

Yeah. And then you have another EconoFact memo that I really liked, where you talked about the issue of whether or not home ownership is a good financial decision. And you kind of punctured that idea, by saying, well, you know, if you're foreclosed upon, it ends up being a really bad financial decision. And I guess this goes back to your advice earlier, that you should make sure that you're financially able. And you know, it's hard at that period, I suppose, because there's so many enticements and it looks so good, and housing prices had been increasing, but then 2008 rolls around.

Jeffrey Zabel

That's right, and I think there's a reason why 30% of households are renters. They're not financially ready to take on that longer term burden of owning a home, and it's not clear that we should encourage them to do so.

Michael Klein

Well Jeff, this is an issue that really is very central for a lot of people's lives, and it's good to have this very concrete, deep analysis of it. So I appreciate your coming on to the podcast and sharing your insights with us today.

Jeffrey Zabel

Thanks. I always love talking about housing Michael.

Michael Klein:

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