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Housing Supply Elasticities

This writing will seek to review the market consensus of supply and demand and its impact on rent prices in the US. There are multiple determinants of supply elasticities and the effect of pricing during market bust and boom periods. Research suggests that changes in rents correspond to the balance of supply and demand factors measured through vacancy rates in local submarkets (Yun, 1999).

The interaction of supply and demand goes through market cycles in two phases, first the “two up-cycle” (recovery and expansion) when demand exceeds supply; and the second phase the “two down-cycle” (hyper-supply and recession) when supply exceeds demand. As a result, rental growth rates follow the physical cycle of market fluctuations. (Mueller, 1999). There is also interaction between supply elasticity and regional housing booms that play a role in rental increases or declines. Housing supply elasticity corresponds to an increase in development and potential building space or increase in supply. Housing supply inelasticity corresponds to a decline in development and limited potential building space leading to a restricted supply.

Housing supply elasticity in the US has declined, but those declines vary across regional areas and change over time due to regulation, demographics, and expectations of demand and pricing (Aastvei et al., 2020). Research of supply elasticity over the course of a boom-bust cycle suggests that supply-inelastic regions experience higher price booms than areas that have an elastic housing supply. There is a consensus of a nationwide decline in housing supply elasticities that indicate higher housing prices during demand shocks (Aastvei et al., 2020). Supply elasticities are declining due changes in land-use regulation, population density, construction wages, and unemployment rates (Aastvei et al., 2020). Along with these determinants, geographic barriers of supply elasticity exist like land scarcity that has its own impacts on pricing. The impacts of supply elasticities are different within the boom-and-bust periods. Areas with higher supply elasticity face greater construction rates and less appreciation during boom periods. During bust periods, high supply elastic areas have new construction, but the rate of price changes remain unaffected by whether supply elasticity is high or low\*\* (Ihlanfeldt and Mayock, 2014).

In conclusion, the impacts of housing supply elasticities on pricing are similar throughout the US in times of boom or bust cycles. Housing supply is increasingly becoming inelastic and causing higher pricing during times of large demand. This research is important to understand sub-market performance based on housing supply elasticities.