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A model for households' housing choices

Authors: **Ted Aranki, Nikita Koptyug and Alexandra Sundmark ***

Summary

Housing choices are influenced by a household's preferences and financial capacity, which in turn are impacted by their possibility for taking a loan.

In this FI Analysis, we develop an empirical model to study households' housing choices based on their preferences and loan possibilities. The model makes it possible to estimate the probability that new mortgagors will choose a particular dwelling as well as the utility they get from different options. The model enables us to analyse the probabilities associated with the dwellings new mortgagors choose, the size of the loan they will take, and how this choice will affect their loan-to-value ratio, loan-to-income ratio, and loan-service ratio. The model can then be used to simulate effects of changes in the conditions on the housing and mortgage market. The analysis is based on data from a sample of new mortgagors who purchased a tenant-owned apartment and the alternatives that were available at the time of the purchase decision.

As an illustration of how the model can be applied, we simulate the effects of a relaxation of the current borrower-based measures: the mortgage cap is raised from 85 to 90 per cent and the stricter amortisation requirement is removed. The model shows that milder mortgage rules lead households to demand more expensive dwellings and borrow more. At the same time, the average utility of homebuyers increases, but the development in housing prices plays a decisive role in whether the utility actually rises or even declines. How the amended mortgage rules impact housing prices is not captured by the model. However, the report shows several calculations of how households' utility would be affected if housing prices were to increase. The analysis covers only a subset of new mortgagors, and the model relies on a number of specific assumptions.

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