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Putting Tenants into Vacant Houses: Short and Long Term Effects on House Value and Ease-of-Sale, *Real Estate Notes*, No. 2, October 2011.

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The current U.S. housing market crisis is already exceptional in its breadth and duration. One consequence is that almost all metropolitan areas have unusually large numbers of vacant houses for sale. Most housing economists predict little relief soon. One way that owners of otherwise vacant houses can lower their holding costs is by renting them while they are on the market. What are the immediate and long term consequences of this strategy?

Tenant-occupied houses generally sell at a discount relative to owner-occupied properties, in part because they are not in move-in condition or simply do not show well. The tenant may have poor housekeeping habits or the owner might not be able to easily paint and refurbish or make aesthetic changes attractive to buyers with a tenant in place. The presence of a tenant also may restrict house showings to certain hours, especially during weekends or holidays. Or potential buyers may want to live in the house themselves, but may not want to deal with the hassle of evicting a tenant. These are short run or transitory effects that disappear in subsequent sales by owner-occupiers.

Tenant-occupied properties also sell at a discount because of rough use by tenants coupled with poor quality maintenance by landlords. If curable then the discount is transitory; if incurable, however, the discount will be reflected in future sales of the property even when subsequently owner-occupied. What this suggests is that a seller's decision to put a tenant into a house that would otherwise be vacant while on the market may have ramifications beyond the immediate gains or losses in value to the seller in this transaction.

A study by Geoffrey K. Turnbull (UCF) and Velma Zahirovic-Herbert (University of Georgia), recently published in the *Journal of Real Estate Finance and Economics*, addresses questions concerning how tenant-occupancy affects price and ease-of-sale.* They develop a method to empirically separate the short term and long term effects of tenant occupancy on house price and liquidity, while carefully controlling for how the mix of houses in the surrounding neighborhood (in terms of both size and occupancy) and how localized market conditions systematically affect selling prices and marketing time.

The presence of renters has two offsetting effects on price and selling time; through lower seller holding cost and lower buyer valuation of the property. Transactions data covering two decades in a medium size metropolitan area reveal significant negative short run or transitory effects of tenant-occupancy on price and ease-of-sale. There are no persistent long term price discounts from tenant overuse or poor owner maintenance; the excess physical depreciation associated with rental appears to be curable by subsequent owner occupiers. Instead, what could have been interpreted as long run tenant effects on value really arise from the house characteristics that make the property a feasible candidate for rent; put simply, high price-high quality houses are generally not economically feasible rental properties and this fact can inflate measured rental property discounts if not property addressed in the empirical model.

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* G. K. Turnbull and V. Zahirovic-Herbert, "The Transitory and Legacy Effects of the Rental Externality on House Price and Liquidity," *Journal of Real Estate Finance and Economics* (published on-line February 2010) doi: 10.1007/s11146-010-9235-6. Pre-print copies available on-line at http://www.springerlink.com/content/7u621513n76w1142/

Among other things, the analysis reveals that the immediate or short run effects of tenant occupancy are substantially greater than the long run effects associated with rental feasibility. The neighborhood composition also matters. Price discounts are significantly lower for tenant-occupied houses that are primarily surrounded by owner-occupied units than when surrounded by other rental properties. And it turns out that renter occupied houses take longer to sell and sell at a greater discount than if left vacant. Therefore, a seller's decision to put a tenant into a vacant house must weigh the benefits of lower holding costs from a rent-paying tenant against a lower ultimate selling price and a longer time to sell.

About the author: Geoffrey K. Turnbull is currently Professor and the Jim Heistand-NAIOP Eminent Scholar Chair in Real Estate at UCF. Previous academic appointments include Professor of Economics at Georgia State University and Professor of Economics and the C. J. Brown Distinguished Professor of Real Estate at Louisiana State University. His current research on real property markets focuses on housing and real estate brokerage, property rights issues in developed and developing countries, and the effects of taxation and regulation on urban land use and real estate markets. He has published extensively in scholarly journals on these and related topics and serves on the editorial boards of the *Journal of Urban Economics*, *Journal of Real Estate Finance and Economics*, *Journal of Housing Economics*, and *Review of Regional Studies*. Dr. Turnbull also advises local governments and firms in the business services, energy, and hospitality industries on a variety of issues.

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