

Not in Our Backyard: Plans, Planners, Regulators and the New Redlining

By OWEN BEITSCH, PH.D., CRE, AICP

WHILE SPECIFIC AND OPERATIONAL PROPOSALS BEYOND HUD's Neighborhood Stabilization Program (NSP) have yet to emerge, the federal government's commitment to maintain housing values in the context of rapidly declining residential demand prompts this discussion of the potential consequences—and missed opportunities.

Viscerally appealing, the NSP and similarly sympathetic strategies designed to support home values do not reconcile with *other* policy goals intended to make housing more affordable to larger numbers of families. By intervention, the failures of the market are not given a chance to correct themselves, leaving the impression that *higher* values are obviously the preferred public policy. Absent price supports provided through federal action, it should follow that a larger inventory of affordable housing units would become available. Thus, the apparent losses experienced in market values become societal gains as housing opportunities are broadened.

Instead, what federal intervention virtually assures are continued practices that limit affordable housing initiatives in almost every market. To be clear, the issues raised in this article are *not* about programmatically created affordable housing—that is, housing supported through federal subsidies or intended for targeted incomes—but about housing *affordability* without regard to specific income or means testing.

Despite broad claims to the contrary, there is little in either practice or policy that works to enhance affordable housing. Almost without exception, the rhetoric proclaiming the *need* for affordable housing is not supported by the *realities* of regulatory controls, financial practices, lending policy and in particular, the expressed wishes of housing consumers themselves. If housing affordability is a socially desirable end state, then programs, policies and capital should reinforce that goal. Instead, we have incubated a contemporary form of redlining with predictable consequences.

The social and economic influences that shape our housing preferences are not new phenomena and generally arise out of fear, expectations and cultural norms.

About the Author



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Approximately 65–70 percent of America's housing stock is owner-occupied with the balance renter-occupied. This results in a dominant population of households prejudicial to maintaining and advancing their own economic self interest. Policies that promote or assure increasingly high value homeownership are materially more attractive than those that don't. By extension, there is an implicit aversion to smaller homes, attached homes, condominiums, rental housing and the people who live there.

These observations are of course broadly generalized. Still, whatever exceptions there are to these biases, they are rarely sufficient to induce major restructuring or redirection of policy that has social and political as well as economic and physical dimensions. Despite ostensible trends toward diversity, land use policy and personal preference celebrate sameness in housing delivery and choice.

The institutional practices and personal preferences abiding in the residential market are not hard to understand. Unlike now discriminatory neighborhood redlining, they have little to do with perceived racial or income intolerances, although these social factors may be indirectly reinforced. Instead, these practices and preferences stem from the value embedded in the residential homestead which, in the United States, is the principal source of accumulated equity and wealth, certainly for the nation's group of homeowners.

Studies have suggested that 40 percent of the average family's wealth is attributed to the homestead, so asset preservation is a powerful force in shaping outlook as well as policy. Home equity has paid for college, new business startups, weddings, sabbaticals and retirement. When directed into the existing homestead through a remodeling effort, equity offers the prospect of even greater future accumulated wealth. The homestead stands not just for individual accomplishment. It is the single investment vehicle that has enabled almost every American household to achieve cross generational goals and social improvement.

Although new housing designs showcase the advantages of the smaller home, data collected over decades point to increasingly larger as well as increasingly more expensive homes. In 1950, the average new home contained about 850 square feet (SF) and included two bedrooms and a single bath. Astonishingly, the average family of about four people managed to function in this space. Today, the average new home is more than 2,000 SF and usually has

two or more bathrooms and three or more bedrooms. No less astonishing—this space supports a family of 2.25 people. How the added space gets used is something of a mystery ... today's new house provides almost the same space per person occupied by an entire family in 1950! All things equal, the average new home today would be more than twice as expensive as the basic single-family home constructed a generation ago, simply adjusting for size.

Personal choices drive personal demand. In the United States, the single family suburban home remains the standard by which alternative choices are evaluated. Despite swelling numbers of urban dwellers, the majority of buyers want larger single-family homes because they see opportunities for equity growth and appreciation.

Anything that compromises the single-family unit as a source of economic empowerment is grossly unappealing to America's homeowners. Few households are likely to surrender a belief system that has had generations to mature. Even if a home is of modest price, it is a highly prized investment. Though study after study works to dispel misplaced ideas regarding multi-family and mixed-use forms, poorly executed examples are as painfully visible as the successful alternatives, and these failures are a reminder to exercise caution.

The regulated environment in which America's homesteads are rooted is largely a product of property ownership, homage to this nation's commitment to rights based on English common law. The individuals active in the electorate are largely the families occupying and protecting their homestead interests. When they mobilize to create or influence land use policy, their perspectives are disturbingly, but understandably, narrow. Toiling to create a vision of the community commensurate with their own expectations, they lobby for lower density single-family neighborhoods where they preserve and enhance their homesteads.

An inherent resistance then emerges to land development regulations and policies that encourage smaller lots, higher density, and smaller housing units. Together, these approaches can push housing costs down. Declining *costs*, however, cast a shadow on housing *values* which, conventional thinking suggests, also will decline.

Occasionally, extraordinary design and marketing skills succeed in conveying a compelling landscape through mixed use, height and flexible forms. While the develop-

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ment may get initial approval by the local community, conflict often arises as plans progress. Resulting compromises often undermine the original intent of use and of design. Mixed use becomes defined as *specific* uses or activities without regard to the vagaries of the marketplace or the functional needs of the desired use or users. Height and bulk constraints make it difficult to execute the concept physically or financially. Residential units intended for rental may be discouraged overtly or discreetly through minimum size standards. Whatever planning and design goals may be accomplished within regulatory controls, they rarely *induce* more affordable housing.

To the contrary, there are many examples that suggest regulations have forced cost increases well beyond the benefits of individual or community concerns. In many cases, these controls can literally add thousands to the cost of a basic home. For consumers, these costs are a barrier to homeownership. But for existing residents, these costs reinforce a perceived community value that is realized in the pricing of the homestead.

A transfer of development rights (TDR) is often touted as one way for desired intensity or unit counts, sometimes of a specific configuration, to be achieved. The objective is conceptually intriguing in that it promotes the idea of encouraging specific building activity in targeted areas. These targeted areas have regulated maximum densities that can only be exceeded once rights from another area are acquired. Much oversimplified, the planning fiction associated with the TDR mechanism is that it allows lower cost units to be paired with higher value ones, ostensibly driving down costs overall, an apparent benefit to affordable housing. Viewed through this lens, it takes the appearance of an incentive. Only in the world of land use control can a series of tedious intermediate steps (identify neighborhood, negotiate transaction price for additional units, approve movements with regulators, reassign units to new area, price reallocated to units) be cast as an incentive.

If the goal of a specific policy is to promote density—making housing production more efficient and distributing greater land costs over the available unit count, thus enabling lower overall prices—then why is the policy directed to other considerations? The question, of course, is rhetorical but it focuses attention on the disconnects among stated objectives, community intentions, planning policies generally, zoning specifically,

subdivision regulations, building codes, and fundamental economics dictated by personal expectations and demands imposed by the market.

The homebuilder is something of an outsider in this dialectic that yields continuing changes to plans and concepts. Without specific incentives to bolster his business model, the builder of affordable housing must balance the needs of marginally qualified buyers, neighbors and regulators. Often viewed as a pariah within the community, the affordable builder is challenged along the entire continuum of the development process from zoning to capitalization. With the collapse of the mortgage market, this demand segment becomes difficult, if not impossible, to support.

The financial aspects of housing delivery present their own set of constraints to affordable housing. Like America's owner-occupied households, mortgage capital seeks a secure investment. Security takes the form of equity, mortgage insurance and expectations of rapidly increasing value so that the combination of equity and insurance enhance the lender's position. While the subprime nightmare suggests these guidelines were violated, more often than not the escalating value aligned the motives of both lender and borrower. That is, the borrower acquired an appreciating asset and the lender received substantial security in the loan.

In the mortgage industry, loans can be retained by the lender but it is considered prudent to package these loans and sell them on the secondary market. When retained, the security interest is dictated by the lender and the requirements are usually different from those imposed by the secondary market. Again, security takes the form of equity, private mortgage insurance and expectations about rapidly increasing value so that the combination of equity and insurance enhances the lender's position. Where the loan is held, the transaction costs will be high to reflect the risks involved. While these transactional costs are not central to the subject of affordable housing, this market segment is certainly not enhanced.

Condominiums, a source of much affordable housing, have proven especially vulnerable to the restrictions of the secondary market, which prefers to avoid mortgages on such products. Some private insurers are no longer providing coverage for this form of housing. The combination then, of transaction costs and standard underwriting behavior, is to favor conventional single-family loans. Because condominiums are usually constructed at

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higher densities consistent with allowable zoning, the financial markets work in concert with single-family homeowners to preclude affordable housing options.

HUD, FNMA, FHLMC and other functioning mortgage conduits share in steering people away from affordable housing conceptually; HUD through its historical lending and insuring processes, the latter groups because of the ways they package and evaluate loans suitable for the secondary markets. HUD—together with its predecessor agency FHA—has been implicated in and associated with redlining, suburban low-density settlement patterns, and the imposition of minimum development standards frequently in excess of accepted normal market requirements. While not to dispute the stability that HUD has injected into the market, the organization leaves a legacy that has contributed to expectations about the building industry and what consumers should demand in a housing product. Indeed, today's expectations about the conventional single family home can be traced to HUD and its directives after World War II. Other than benchmarking a specific mortgage limit deemed affordable, HUD's practices have not been that dissimilar to those of other lenders and individual consumers.

As for FNMA and FHLMC, they inject their own biases that drive housing costs upward and, like HUD, push consumers toward a large, conventional single-family product. Their behavior in the secondary market may have fashioned the practices that have dragged the securitized market downward and that now require federal assistance. Specific to condominiums, both FNMA and FHLMC have initiated stricter due diligence procedures that address legal documentation, adequacy of operating budgets, the age of association receivables, and the percentage of units owned by non-residents. Such changes are expected to protect borrowers and manage increasing levels of risk that the market suggests have not been confined to attached units only. Single family homes constructed in characterless tract communities—in this case something of a distinction with little difference—have some limitations, but not the severe restrictions imposed on condominium housing.

America's tax structure contributes to our housing excesses in other ways. Not only is an eligible household allowed deductions, but a gain on sale up to \$500,000 has no tax liability! This gain may be exercised every 24 months under the current tax code. Clearly, the largest and most expensive homes generate the greatest opportu-

nity to realize these tax-free gains. While available to all taxpayers, these tax provisions are an additional inducement to construct larger and more expensive housing. Effectively, our tax code pushes buyers to maximize their purchases. Seen in terms of earnings, what other form of activity in the United States literally assures a household an average of \$250,000 per year in tax-free income?

Americans have a cozy sentimentality about their homes, confounding the value as *shelter* and as *asset*. Although short-term positions are shaken, newspaper headlines have not fully extinguished the confident visions of American homeowners. Financial return from property ownership remains an expectation. Unless actively selling a home in today's market, the typical homeowner is in a state of denial regarding the value of his or her homestead and the threats to equity. Any proposal to aid troubled borrowers steadies that confidence.

It is with some irony that excess housing production—not price supports, interest rate modifications, controls and lowered underwriting standards—may be the greatest opportunity in a decade to significantly reduce the affordable housing gap. The housing market *may* be in need of price supports but such intervention is an explicit decision to promote *less* affordable housing supply.

The distinction between *value* and *price* is all but misunderstood. In economic terms, home prices are *sticky*. That is, the prices rise quickly but slip slowly because of many interacting variables. Among others, these variables include the resolute determination of the homeowner to hold a price regardless of the implications. With values falling around them, many homeowners still perceive *their* investments as stable or improving. A combination of hope, regulations and policy, it seems, will continue to protect equity and blur the price/value distinction despite societal costs.

So where does ad hoc and disjointed policy leave those who fervently support more affordable housing?

The answer is extraordinarily complex—players in the housing industry have had more than 50 years to codify and entrench their thinking—but a direction might begin with a relatively simple premise. In this construct, shelter has a commodity value as well as an investment value, but the former takes priority. Individuals would be free to select the housing product that serves a personal interest, real or perceived. Presumably, financial vehicles would be available as they are now in varying ways. Neither

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homeowners nor community officials would *ever* have the right to resist alternative housing plans that may be inconsistent with their personal value systems. Regulators would universally adopt form-based codes. In residential zones, minimum size standards for shelter would disappear, enabling development by right. These, and related ideas, lead to at least the following recommendations or considerations:

- It may be time to eliminate, certainly to restrict, use of the mortgage deduction which costs the U.S. treasury billions and encourages risky market behaviors. One consideration might be the size of the home to which it applies, rather than just the mortgage balance;
- While cumbersome, the tax code also may also need to be altered to remove the taxless gain on sale which benefits the most expensive homes and also encourages financial independence based on the equity of the homestead;
- Price supports for housing, as proposed by many sources, only delay normal pricing adjustment that should fall even lower. These supports—made possible by efforts such as the NSP—should be reevaluated. Some foreclosures are warranted and need to occur to clear the market of gross economic inefficiencies. Almost every strategy being advanced seems to ignore the difference between affordability and loss of equity. Many homes have unfavorable loan terms but the value of the home may have nothing to do with the owner's ability to continue to service debt;

- Smaller homes need to be encouraged through land use regulations as well as tax structure. Minimal building sizes need to be scrutinized for their alleged public health and safety benefits, with the narrowest of justifications permitted;
- Broad public policy considerations should involve a rethinking of the priority given to home ownership and other forms of housing. The state of the current market virtually demands that fundamental issues and deeply embedded assumptions be reevaluated.

The federal government and the states can play pivotal roles in supporting these practices. The feds would act by producing fair housing policies virtually impossible to circumvent through zoning and similar regulations. The Community Reinvestment Act took a strong position against redlining but discriminatory practices have emerged in a new form, and their effects are now experienced in ways that the lending crisis should make us understand.

Market corrections are painful and should be minimized if possible, but loss, in and of itself, should not be the single subject debated by policymakers. All costs and benefits need to be considered in the mix of strategy. The condition of the market opens the door to spark these discussions as part of an initiative to boost the economy, which needs every foundation poured to bring housing and financial stability. This door will close as soon as housing values suddenly are released from the constraints of the current slowdown. ■