Janus Buys a House

Remarks presented to a panel discussion, “Tapping Emerging and Underserved Markets: Challenges and Opportunities” at the New Mexico Governor’s Housing Summit

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Fundamentally, there are only two ways of co-ordinating the economic activities of millions. One is central direction involving the use of coercion - the technique of the army and of the modern totalitarian state. The other is voluntary co-operation of individuals - the technique of the market place.

Milton Friedman¹

...the extension of the market organization in respect to genuine commodities was accompanied by its restriction in respect to fictitious ones. While on the one hand markets spread all over the face of the globe and the amounts of goods involved grew to unbelievable proportions, on the other hand a network of measures and policies was integrated into powerful institutions designed to check the action of the market relative to labor, land, and money. ... Society protected itself against the perils inherent in a self-regulating market system...

Karl Polanyi²

Janus, the most ancient of all the Roman deities, was the god of the doorway, which he guarded with his two faces, looking to the left and right, inside and outside, present and future. He was also the god of beginnings, but of course today we think of him as a symbol for things paradoxical or with two clearly distinguished aspects. I think Janus can tell us something about the extraordinary progress and the alarming crisis of American housing affordability in the last decade. The home has been steadily transformed into an ever more sophisticated instrument of debt, accumulation, and speculation. At the same time, carefully-crafted market institutions have been extended to a wide array of new markets of low-income households, racial and ethnic minorities, recent immigrants, and Native Americans.

But these markets aren’t new, except for those who didn’t see them before. They aren’t free, either.

Let’s get the bad news out of the way. Two-fifths of the nation’s renters live in housing that is not affordable, using the standard thirty percent of income threshold.³ More than five million unassisted low-income renters spend at least half their income on housing, or live in severely inadequate homes, qualifying them for the Congressional designation of “worst-case needs.”⁴ But only one of four households who are eligible for housing assistance get it. By the end of the 1990s, the average time on the waiting list for a Section

8 voucher was 28 months - but was more than ten years in Los Angeles, seven years in
Houston, five years in Memphis and Chicago. Between 1991 and 1999, the shortage of
housing affordable to low-income renters worsened considerably - falling from 52
affordable units for every 100 who need one, to 42 units. This depressing litany is sharply
racialized. The number of non-Hispanic Black renters with worst-case needs grew even in
the irrational exuberance economy of the late 1990s, and from the late 1970s to the late
1990s worst-case needs grew most rapidly among Asian Americans and Native Americans.

But there is good news, at least for those who are ready and willing to borrow money to
buy a house. In the last several years, David Listokin at Rutgers University led a team of
researchers on several studies documenting the remarkable transformation of American
housing finance. First, we conducted in-depth interviews and case studies of a cross-section
of institutions recognized as leaders in the underserved markets movement. We placed
mortgage processes in the context of changes in housing and capital markets, and we
analyzed the full cycle, from attracting applicants through qualification and underwriting
to post-purchase retention. This was like drinking from a firehose of information from
dedicated and sophisticated people working in national and regional lenders, smaller
community banks, lender partnerships, and nonprofits - and our modest summary of all
these efforts ran more than four hundred pages. If you want my concise summary, here it
is: mortgage markets don’t simply emerge like some natural, geologic formation. They are
actively made. It’s hard work for everyone involved - for people trying to buy their first
home, front-line loan officers, underwriters, and housing counselors meeting with
borrowers, branch managers and CRA representatives working in specific neighborhood
contexts, loud community activists protesting on the streets, wealthy Brooks Brothers
pinstripe CEOs contemplating the next merger, and it’s even a little bit of work for the
card-carrying members of the National Association of White Guys who periodically change
the rules of the game. In the last decade all of these people found themselves in an
unlikely alliance to transform mortgage markets, and in the process they changed the
landscape of all housing affordability.

In another study we put dollar signs on this transformation. We used the hedonic pricing
approach of George Galster and Susan Wachter, drawing on the Survey of Income and
Program Participation to model the choices made by renters who bought homes in the
mid-1990s. We then use this model to estimate the prices that all remaining renters might
reasonably be expected to pay if they were to buy homes. We then wrote synthetic

Tax Credit as a Housing Policy Instrument.” Housing Policy Debate 15(2), 203-260, citations on pp. 204-205.
7 HUD, Trends in Worst-Case Needs, p. xvi.
8 David Listokin, Elvin K. Wyly, Larry Keating, Kristopher M. Rengert, and Barbara Listokin, Making New
Mortgage Markets: Case Studies of Institutions, Home Buyers, and Communities. Washington, DC: Fannie Mae
Foundation, September 2000.
9 David Listokin, Elvin K. Wyly, Brian Schmitt, and Ioan Voicu, The Potential and Limitations of Mortgage
Innovation in Fostering Homeownership in the United States. Washington, DC: Fannie Mae Foundation, June
2002.
underwriting software for about a dozen specific contemporary mortgage instruments, comparing each of these to the traditional mortgage standards prevailing through the late 1980s. Bottom line: Mortgage innovation alone boosted total national home buying capacity for current renters from $314 billion to a range between $500 and $600 billion. We also examined the role of different instruments in reaching various groups of renters, and we measured several policy scenarios for expanded downpayment subsidies. In one scenario, 36 percent of all current renters could afford a modestly-priced house for a public subsidy that costs about the same as the mortgage interest tax deduction.

Housing affordability has been reshaped by the twin forces of public policy and the falling price of capital. The enduring bipartisan worship of homeownership, from FDR to Nixon, from Clinton’s “new markets” initiative to George W. Bush’s “ownership society,” is stronger than ever, and there is a steady proliferation of “American Dream” initiatives by scores of private companies. Homeownership is now the third rail of American politics. And yet two fundamental challenges remain. First, recent progress has not erased deeply entrenched inequalities of exclusion. Studies of HMDA continue to show troubling disparities in denial rates – and although these data have well-known problems, it is possible to enhance the information with an instrumental variable to account for lenders’ own evaluation of applicant credit history. Even when we look at the dynamic parts of the inner city where reinvestment and public policy should help underserved markets, we still find severe Black-White inequalities – with terrible disparities in Silicon Valley, Detroit, Minneapolis-St. Paul, Baltimore, St. Louis, and Dallas. Latinas and Latinos face especially severe exclusion in Cincinnati, the San Francisco Bay area, and Milwaukee.

The second major challenge, of course, is predatory lending. Let me be clear: subprime is not necessarily predatory. But we don’t need to devise a bulletproof definition of predation to know that underserved markets are now becoming ill-served markets of exploitation. In one study set in Essex County, New Jersey, Kathe Newman documents a close link between lis pendens pre-foreclosure actions and the dramatic rise of subprime lending over the last decade. On the left, the dark areas are neighborhoods that are more likely to be slotted into the subprime market even after controlling for a wide range of borrower characteristics. On the right, the dark areas have the highest preforeclosure rates. Gary King’s ecological inference technique provides strong evidence that the subprime boom was at least partly responsible for the wave of defaults in Newark and its distressed inner-ring suburbs.

Next month, Housing Policy Debate will present a special issue on predatory lending, with interdisciplinary contributions by legal scholars, practicing attorneys, economists, and geographers. Once again, drink from a firehose of evidence and pay special attention to just a few drops. First, predatory lending has become tightly woven into severe problems of information asymmetry, creating lucrative opportunities for a wide range of actors to profit at the expense of low-income families, elderly homeowners, racial and ethnic minorities, and underdeveloped regions and neighborhoods. Second, certain actors have found ways of making substantial profits from negative events, from delinquency to default to
foreclosure, violating the conventional wisdom as well as sacred assumptions of economic theory and public policy. Third, the limitations of public data cannot be used to dismiss concerns about predatory lending. Legal findings of fact, qualitative case studies of lenders and borrowers, and econometric analysis of Freddie Mac data, borrower surveys, and the subprime industry’s own loan performance data all reveal problems, what Jane Jacobs famously called “transactions of decline.”

What about New Mexico? I have the deepest reverence for the particularities of place, and so I want to be cautious when extrapolating from national trends or big-city problems. But there are reasons to be concerned, particularly when we consider the distinctive local circumstances of racial and ethnic inequality. Marge Turner’s recent update to the series of rigorous paired-testing audits in the Housing Discrimination Studies shows that Native American renters in metropolitan areas of New Mexico, Montana, and Minnesota face discrimination more than 28 percent of the time; Native Americans trying to buy homes in New Mexico metropolitan areas face discrimination 17 percent of the time.10 David Listokin’s research suggests that, at least in the ownership segment, this bias cannot be blamed on perceptions of risk. Section 184 loans and Fannie Mae’s Native American Conventional Lending Initiative have posted extremely low default and delinquency rates, outperforming FHA loans by a substantial margin. These disparities may have worsened in the recent turbulent economic climate. The number of Native American mortgage applicants in New Mexico metropolitan areas collapsed after 2000, although some of those who borrowed in prior years have been able to refinance.11 The market remains deeply divided. Even after we use a logistic regression model to account for income, estimated debt level, and an estimate of credit risk, Native Americans are substantially more likely to be rejected compared with otherwise identical Whites. They are almost ten times more likely to wind up at a subprime lender.

Conclusion

Homeownership is a property right that is valorized by exclusion: part of its benefit comes from the fact that not everyone has it. To expand homeownership, we must dilute its benefits, at least for some people, or we must extract more resources from renters. All signs indicate that both are happening. Our primary challenge, then, is to continue the

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hard work of reaching and truly serving the housing needs of new markets, even as we guard against the dangers of turning the home into a purely financial instrument. Almost twenty years ago, John S. Adams said this about the housing boom of the 1980s:

In the twilight of materialism, the meaning of housing will be simplified and clarified, with a renewed interest on shelter and neighborhood. The false hope that everyone can get rich from real estate investment will be laid to rest for another fifty years, or perhaps for all time.\footnote{John S. Adams, “Housing Markets in the Twilight of Materialism.” \textit{The Professional Geographer} 38(3), 1986, 233-237.}